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Wine options of Australian tax reform

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Abstract

Australia's indirect tax policies for wine, the Wine Equalisation Tax (WET) and the WET rebate are very different to the policies of 'old world' wine countries and emerging competitors, and industry leaders have identified these tax policies as stymieing the industry. In light of these concerns and the current tax reform enquiry this paper critiques Australia's wine taxes and evaluates reform options. This paper supports the repeal of the WET. The WET (as well as the wine excise alternative) raise small amounts of tax revenue but damage economic efficiency, fail to target externalities (the wine abusers), appear inequitable and are too complex, particularly for the thousands of small wine producers. Without a WET, it follows that the WET rebate also needs to be repealed, as it is costly, inefficient and inequitable. Assistance would be needed to help those affected by the transition away from a WET.

Key words: Wine equalisation tax, Wine equalisation tax rebate, sales tax, tax policy, GST

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1. INTRODUCTION

From the 1980s to 2007 the Australian wine[4] industry experienced explosive growth built on exports, innovation and differentiation.[5] This came at the expense of 'old world' wine countries (such as France and Italy). Since 2007 the growth changed to a contraction with the value of domestic wine sales remaining flat and exports declining by 38 per cent between 2007–12.[6] The decline coincided with emerging new competitors from Chile, Argentina and South Africa and a more competitive old world wine industry.[7] Additionally, consumption habits in traditional and new wine consuming countries are converging, with premium wines gaining a considerable market share.[8]

Australia's indirect tax policies for wine, the Wine Equalisation Tax (WET) and the WET rebate are very different to the policies of old world wine countries and emerging competitors. In the wake of a persistent grape surplus industry and low profitability, industry leaders have identified these tax policies as stymieing the industry's ability to adapt to the increased competition.[9] However, the Australian wine market is fragmented[10] and thus other industry leaders and bodies argue for the status quo.[11] In light of these concerns the Commonwealth is currently proposing changes to wine taxation. In the 2016–17 Budget, the government announced that it will reduce the WET rebate cap from $500 000 to $350 000 on 1 July 2018 and tighten eligibility criteria. Additionally, producers who exceed the rebate cap can access a $100 000 per annum grant to encourage wine tourism.[12]

This paper seeks to critique Australia's supplementary indirect taxes on wine (hereinafter referred to as 'wine taxes'). The aim is to inform the process of setting an

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[4] This paper focuses on unfortified alcoholic grape wine.

[5] Emiliano Villanueva, 'The Anglo-Saxon New World Wine Producers' Paradigm Shift in Wine Business' (2015) 1 *Global Business & Economics Anthology* 45, 45 found that the competitive advantages were: a better approach to new consumers; an innovative operational and productive approach; simpler marketing and communications strategy; and a strong cohesive public and private support to exports.

[6] Centaurus Partners, 'Wine Industry Report for Wine Makers Federation of Australia — Expert Report on the Profitability and Dynamic of the Australian Wine Industry' (Report, August 2013) Appendix 2, 13 https://www.wfa.org.au/assets/noticeboard/Expert-Review-Report.pdf

[7] Ibid 5.

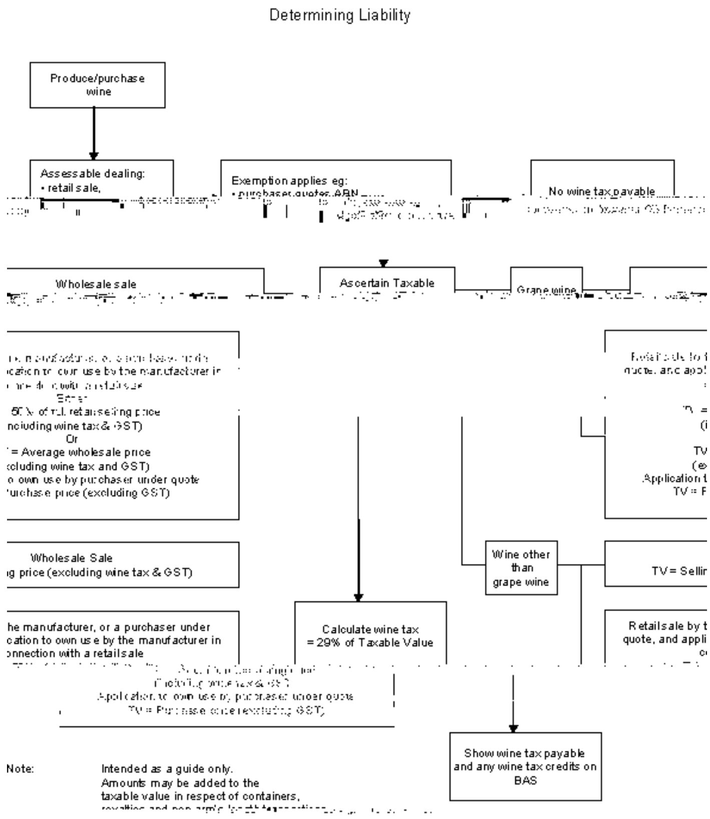
[8] Luigi Cembalao, Francessco Caraccciolo and Eugenio Pomarici, 'Drinking Cheaply: the Demand for Basic Wine in Italy' (2014) 58 *Australian Journal of Agricultural and Resource Economics* 374, 375. Non-premium wine now only comprises 1/7th of the value of global wine and half of the volume. There is greater homogeneity in non-premium wines since they have simple attributes, little quality complexity, and not much differentiation.

[9] Pernod Ricard Winemakers, Submission to the Tax White Paper Task Force, June 2015, 1–2 http://bettertax.gov.au/publications/discussion-paper/submissions/ ; Treasury Wine Emine (s)4.3 (dd [(c)k(L)7 (u)-10.70(e

3. AUSTRALIA'S WINE EQUALISATION TAX

The WET commenced on 1 July 2000 and was designed to replace the former wholesale sales tax[22] on wine.[23] The former wholesale sales tax was abolished on 30 June 2000 with the introduction of the GST and the WET. The WET imposes a wine

Figure 1: How the WET Works



As evident from the above diagram calculating the WET is complex, requiring taxpayers to consider factors such as the type of wine product, point of sale, exemption status and taxable value. The WET is payable by wine manufacturers, wine wholesalers and wine importers. Wine can be bought and sold numerous times and the WET is deferred and generally applied at the last wholesale sale of wine. Up until the last wholesale sale of wine, businesses quote their Australian Business Number (ABN) to gain exemption from WET (called 'quoting'). Quoting is also used for exports. In this way WET is passed on in the price of the wine to the end domestic consumer. Retailers of wine pay WET in the sense that their payments to suppliers for wine include a mark up for WET paid. WET is calculated at the rate of 29 per cent[33] of the taxable value of assessable dealings with wine in Australia.[34] The WET is calculated on the selling price of the wine excluding wine tax and GST. Where wine is not the subject of a wholesale sale, for example where it is sold at the cellar door or used for tastings or promotional activities the WET provides for the calculation of alternative values for the tax payable.[35]

[33] *A New Tax System (Wine Equalisation Tax Imposition — General) Act 1999* (Cth); *A New Tax System (Wine Equalisation Tax Imposition — Customs) Act 1999* (Cth); *A New Tax System (Wine Equalisation Tax Imposition — Excise) Act 1999* (Cth).

[34] *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 5-5.

[35] Ibid div 9.

low-alcohol threshold introduced for all products'.[58] The Henry Review asserted that the rate of alcohol tax should be based on evidence of the net marginal spillover cost of alcohol. However, no known compelling evidence has ever demonstrated that the externality costs associated with wine were at similar levels to other forms of alcohol such as beer and spirits. Not surprisingly, in view of the lack of evidence and concerns about the impact on the viability of the Australian wine industry such recommendations have never been adopted.[59]

In March 2015 as part of a wider Tax White Paper reform process, Treasury released the tax discussion paper 'Better Tax System Better Australia'.[60] This paper briefly noted issues with wine taxes that offered favourable tax treatment particularly for low-value wine compared with other forms of alcohol such as beer and spirits, and how this influences production and consumption decisions.[61] As part of this process the 'Wine Equalisation Tax Rebate Discussion Paper' was released in August 2015.[62] This paper sought to better inform discussion and analysis of the WET rebate.

The discussion paper noted the many differences of

Industry participants also raised concerns to the Tax White Paper review about the adverse impact of the WET rebate.[69] The paper found a number of ways the WET rebate could be reformed to ensure the sustainability of the wine industry:

1. abolishing the WET rebate;

2. phasing out the rebate with a grant to existing recipients;

3. restricting eligibility for the WET rebate by excluding bulk, unpackaged and unbranded wine;

4.

industry.[74] Murray Valley Winegrowers pleaded that a volumetric tax on wine at a time when the industry is at its lowest would be catastrophic.[75] Wine Tasmania also argued that the WET be retained[76] as increasing wine tax would severely impact the industry.[77] The Winemakers' Federation of Australia sought a differentiated tax rate on wine but (not surprisingly) did not have a position on the preferred structure of the wine tax due to the different business models of its members.[78]

Health and health-related bodies advocated replacing the WET with a volumetric tax. The National Alliance for Action on Alcohol argued for a volumetric tax since increasing the price of alcohol was one of the most effective policy interventions to reduce consumption and harm.[79] The Foundation for Alcohol Research and Education argued that the high number of health problems provided a sound rationale for such reform.[80] The Cancer Council, noting that alcohol is a risk factor for cancer as well as an important cause of illness, injury and death, [81] called for a volumetric tax as the most cost effective way of reducing alcohol consumption and alcohol-related health harm.[82] On the other hand the Australian Liquor Stores Association asserted that the majority of the population (80.7 per cent) consume alcohol in moderation so there is no reason to increase alcohol taxes.[83]

There was considerable consensus for reforming the WET rebate. Most submissions advocated removing bulk, unbranded wine and foreign producers from eligibility for the rebate.[84]

required under the Australia–New Zealand Closer Economic Relations Trade Agreement and thus asserted that the WET rebate should be preserved.[86]

The Commonwealth government established the WET Rebate Consultative Group[87] to examine the submissions and provide advice to the government on options for reform. In the next step in the tax reform process a Green Paper was proposed in the second half of 2015. Following further community consultation on possible reforms a White Paper was expected to be published in 2016.[88] With the change of the Prime Minister and Treasurer in November 2015 this process appears to have been rescheduled.[89] Additionally, the Senate referred certain matters on the Australian grape and wine industry to be reviewed by the Senate Rural and Regional Affairs and Transport References Committee, and this included the impact and application of the WET rebate on grape and wine industry supply chains.[90] The WET was found to work against the profitability of the wine industry and was subject to unlawful claims or rorting. The Committee recommended that the WET rebate be phased out over five years, with the savings to assist the industry and include an annual grant to genuine cellar door operators to support their continued operation.[91] Also, the Committee urged the government to undertake a comprehensive reform of wine taxation.[92]

6. POLICY PERSPECTIVES FOR WINE TAX

A partial policy analysis is undertaken with a view to gaining an understanding of the wine tax options for Australia. This analysis is undertaken from the perspective of four well accepted tax policy criteria: fiscal adequacy; economic efficiency; equity; and simplicity. These criteria have been used by optimal tax theorists who seek to maximise social welfare[93] and have become prominent in certain tax reform processes.

[86] New Zealand government, Submission to the Tax White Paper Task Force, 28 May 2015, 4 <http://bettertax.gov.au/publications/discussion-paper/submissions/>.

[87] The Consultative Group members are: Mr Russell Campbell — General Manager, Small Business Tax Division, The Treasury (Chair); Mr Tony D'Aloisio AM — President, Winemakers' Federation of Australia; Mr Darren De Bortoli — Managing Director, De Bortoli Wines (NSW); Ms Rebecca Duffy — Winemaker, Holm Oak Vineyards (Tas); Nigel Gallop — Owner, Fraser Gallop Estate (WA); Mr Tom Harvey — Chairman, McLaren Vale Group Wine and Tourism Association (SA); Mr Robert Hill-Smith — Chairman, Yalumba (SA); Mr Larry Jorgensen — CEO, Wines of Western Australia (WA); Mr Anthony Murphy — Managing Director, Trentham Estate Wines (Vic); Mr Roger Sharp — Director, Group Corporate Affairs, Treasury Wine Estates (Vic); and Mr Lawrie Stanford — Executive Director, Wine Grape Growers Australia (SA).

[88] Commonwealth Treasury, 'Re:Think Tax Discussion Paper, Better Tax System Better Australia', above n 51.

[89] In September 2015 the former Prime Minister Tony Abbott was replaced by Malcolm Turnbull.

[90] Senate Rural and Regional Affairs and Transport References Committee, Parliament of Australia, *Australian Grape and Wine Industry* (2016) <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry>.

[91] Ibid 34.

[92] Ibid.

[93] An optimal tax balances these often conflicting tax policy objectives. James Alm, 'What is an "Optimal" Tax?' (1996) 49(1) *National Tax Journal* 117, stated: 'A central issue in public economics is the appropriate design of a tax system. Such a system is usually viewed as balancing the various desirable attributes of taxation: taxes must be raised (revenue-yield) in a way that treats individuals fairly (equity), that minimizes interference in economic decisions (efficiency), and that does not impose undue costs on taxpayers or tax administrators (simplicity)'. Bruno Frey, 'Excise Taxes: Economics, Politics and Psychology' in Sijbren Cnossen (ed), *Theory and Practice of Excise Taxation* (Oxford

For example, in Australia these four tax policy criteria were central to policy formulation in recent tax reform processes, the 1999 Ralph Review and the 2010–11 Henry Review.[94] Limitations of this study are acknowledged, since policy settings are also the result of other factors such as political, social, cultural and historical, which are beyond the scope of this paper. Additionally, this paper refers to a number of international studies on alcohol taxes and it is noted that much caution must be exercised in comparing or applying such research between countries. Further, a number of minor levies and other imposts also apply to wine[95] but these are also beyond the limits of this paper.

6.1 Fiscal adequacy

Fiscal adequacy[96] appears to be one of the primary reasons cited for specific alcohol taxes. For example, in respect of wine taxation, the Australian government provided revenue raising as its rationale for significant increases in the wholesale sales tax on wine in 1993 and 1997.[97] However, comparatively ihlll (hl)--2 (o)2 (u)2 (n)2 (t)-2.7 (e o)2 (f)-

goundsr strongyed. tisrge d(t)-4.6 (h)10.8 (a)-1.6 dthigr txe91.2 (s)-2.3 x

ine rejustifie d(s)8.6 (i)-4.7 nuc92.3 (e)-1.7 (l)6.3 (he)-1.7 (y)10.9 (br)-4 (oa)-1.6 eus the hig extnal co alcohol consumption. It is also argued that wine has an inelastic demand and therefore, there are minimal distortions with taxes levied at a higher rate. Additionally, alcohol is seen as a complement to leisure and thus should be taxed at a higher rate. Further, it is argued that such taxes correct information failure. On the other hand, it is contended that wine should be taxed at the same rate as other goods to minimise economic distortions that impede the competitiveness of an important industry. There may also be adverse unintended consequences associated with wine taxation. Externalities should be addressed by corrective taxation that targets alcohol abusers.

6.3 Arguments for wine taxes

6.3.1 Corrects externalities

The externality costs generated from abusive alcohol consumption provide a seemingly sound rationale for supplementary taxes on alcohol. These costs are not included in the market price of the goods. External costs include the direct costs of abusive drinkers' car accidents, property damage and violence[101] and the indirect costs of government-funded hospitals and health services for alcohol abuse and other government expenditures such as police.[102] The costs to the individual alcohol consumer, though, from poor health and loss of work are not considered to be external costs.[103]

other people.

Australia's WET is based on wholesale values and thus even less effectively targets the external costs associated with wine consumption. Additionally, alcohol tax may not greatly affect external costs. For example, people do not stop drinking alcohol because of a higher wine tax, since alcohol is addictive. Whilst price elasticities vary with consumption levels for heavy drinkers, the response to price is small compared to light and moderate drinkers.[114] Measuring the externalities presents another problem in designing an alcohol tax.

6.5 Estimating the external costs of alcohol

Collins and Lapsley estimated that the tangible costs of alcohol in Australia were between 0.9–1.0 per cent of GDP. Crime, health cost and lost production amounted to $11 billion[115] and further intangible costs asn9 7f(s an)12fc9 (o)1yt(e)8(bl)-4.63 ((s) ai)-4.6 (bl)- (rJ 0 comprises the impact on economic output.[122] Whether this constitutes external costs depends on the extent to which alcohol affects worker productivity as seen in wages.[123] The costs of lower wages are costs to the individual and are not considered to be external costs. Research in the United Kingdom has actually linked a moderate level of alcohol consumption with higher wages than light or heavy drinkers.[124]

6.6 Estimating the external costs of wine

External costs associated with bottled wine consumption appear to be significantly lower than with beer and spirits. The New Zealand Tax Review 2001 similarly found that whilst a wine excise could be justified on externality grounds, such a tax should be well below the excises currently imposed.[125]

The consumption of wine is generally not abusive.[126] An Australian Institute of Health and Wellbeing survey found that wine is consumed in 9.24t6ow Td [(f)-4 i33.4 (n)(40.9 (a)h)1

Pigouvian tax on alcohol can be different especially since wine, spirits and beer generate different levels of external costs. As discussed above, in Australia the external costs of wine appear to be significantly lower than of beer and spirits. On this basis, low levels of supplementary alcohol tax should apply to wine in Australia. It appears unlikely that premium wine would be the choice of abusive drinkers. A Pigouvian tax would result in a very low tax on expensively priced wine. As discussed above, increasing wine tax revenue, though, will have a substantial negative impact on the wine industry.[144]

6.8 Limitations of alcohol tax

Why only target the external costs of alcohol and a few other products with a supplementary tax, why not target all of the numerous goods and services that involve externalities?[145] For example, a supplementary tax on all sports that cause serious injury and on all food that contribute to obesity given the associated expensive health costs. The rationale for supplementary taxes that only address the difficult to measure externalities from wine and which do not target a minority of wine abusers is weak.

6.8.1 Inelastic demand

It is argued that wine taxes provide minimal distortion to economic decisions. Ramsey found that goods with inelastic demand should be taxed more heavily as such a tax minimises consumption distortions.[146] Alcohol is considered to have a highly inelastic demand schedule as it has few substitutes, and is addictive and indispensable. Consumption is minimally affected by a small increase in price.

However, Doran et al found that abolishing the WET and replacing it with a higher volumetric tax would reduce total alcohol consumption by 1.3 per cent, indicating the elastic nature of wine.[147] As noted above, Italy and France have zero/minimal supplementary wine taxes yet these countries face a downward trend in domestic wine consumption.[148] Wine consumption in these countries appears to be relatively elastic.

Leung and Phelps reviewed studies of price elasticity of alcohol in the United States and found elasticities of -0.3 for beer, -1.0 for wine and -1.5 for spirits.[149] Price elasticities vary with consumption levels; heavy drinkers are not very responsive to price, but light and moderate drinkers are.[150] The New Zealand Tax Review 2001 found that the demand for wine is often more elastic than the demand for petrol, tobacco and beer.[151]

Ramsey inverse elasticity rule.[152] Having regard to these studiers there appears to be no strong argument for wine taxes due to inelastic demand.

6.8.2 Alcohol as a leisure complement

Some consider that goods that are complementary with leisure should be taxed higher as this provides a proxy for a missing tax on leisure. A United Kingdom study by Crawford, Keen and Smith found that utility is not weakly separable between consumption and leisure, and that changes in the relative price of goods do impact on labour.[153] Therefore, goods complementary with leisure should be taxed at a relatively higher tax rate and goods complementary with work should be taxed at a relatively lower tax rate.[154]

It is inconclusive, though, whether alcohol is complementary with leisure.[155] On comp( )d [(e)-1.6

6.9 Arguments against wine taxes

6.9.1 Minimises distortions

The significant size of the Australian wine industry and its export orientation in a globalised wine world necessitates a competitive industry. As discussed above, concerns have been raised with the WET in harming the industry. F beap 56FonTd [(o)1m.7 (t)y3ac wine grape production[168] and small wine producers. Consequently, as noted previously, the wine tax reform debate is balanced between the interests of the premium wine industry, small wine producers and the non-premium wine industry.

Premium Australian winemakers have supported a move to excise taxation as long as the overall level of wine taxation revenue does not increase. Wine industry leaders note that the WET and the rebate are significant factors in preventing the industry from restructuring.[169] Treasury Wine Estates argues the current wine taxes are

> threatening the wine industry's sustainability in Australia whilst simultaneously eroding its premium positioning globally. Continuing with the current tax arrangements will mean more of the same, consigning the Australian wine industry to an unprofitable and oversupplied market.[170]

Pernod Ricard Winemakers concludes:

> The current structure of

6.10 Equity

Indirect taxes such as wine taxes may have a regressive impact since such taxes are not based on one's ability to pay.[183] The following Australian Bureau of Statistics survey compares household expenditure on alcohol for five (low to high) gross income quintiles: [184]

Table 2: Australian Bureau of Statistics Household Expenditure and Characteristics, By Equivalised Disposable Household Income Quintile Groups 2009–10

	Gross Income Quintiles				
	1	2	3	4	5
Expenditure relative to Income:					
Alcoholic Beverages	1.9%	2.3%	2.9%	2.9%	2.7%

The above table shows that high income earners spend about 50 per cent more of their income on alcohol as people in the lowest income quintile. However, there is no data on the household expenditures of wine so it is not clear whether the WET has a regressive or progressive impact in Australia. There is a progressive element to the

Studies of distributional affects in the United States have found alcohol taxes to be regressive.[190] The finding of the studies varied according to the time line of the analysis; the longer the time line the less regressive.[191] Using lifetime shares of

146 paragraphs. WET provides a complex second regime for alcohol taxation that sits uneasily with the excise system that applies to beer and spirits. The WET is very regressive for the thousands of small wine producers that need to claim the WET rebate.

A different set of difficulties arise under an excise as noted in the submissions to the Tax White Paper Task Force[200] Complexity would arise from costly bonded warehouses, inspections and permissions to move wine.[201] It would also be very regressive for the thousands of small wine producers affected. Significant transitional costs would arise in moving from the WET to an excise.

Ideally, from a s(t)-4.6d .6 (i)-283o63 (i)-2.9f i(n)2 (e6 (l)-4.tb8i0 -1.6 (En)2 (e6 ec (n m)9.2 -ogbe)