



Distilled Spirits Industry
Council of Australia Inc.

Improving Australia's System of Alcohol Taxation – the first phase

**A Submission to Australia's
Future Tax System Review Panel**

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THE TREASURY

Who is DSICA?

The Distilled Spirits Industry Council of Australia Inc (DSICA) is the peak body representing the interests of distilled spirit manufacturers and importers in Australia. DSICA was formed in 1982, and the current member companies are:

- Bacardi Lion Pty Ltd
- Beam Global Spirits & Wine Inc
- Brown-Forman Australia
- Bundaberg Distilling Company
- Diageo Australia Ltd
- Maxxium Australia Pty Ltd
- Moet Hennessy Australia Pty Ltd
- Suntory (Australia) Pty Ltd
- William Grant & Sons International Ltd

DSICA's goals are:

- to create an informed political and social environment that recognises the benefits of moderate alcohol intake and to provide opportunities for balanced community discussion on alcohol issues; and
- to ensure public alcohol policies are soundly and objectively formed, that they include alcohol industry input, that they are based on the latest national and international scientific research and that they do not unfairly disadvantage the spirits sector.

DSICA members are committed to:

- responsible marketing and promotion of distilled spirits;
- supporting social programs aimed at reducing the harm associated with the excessive or inappropriate consumption of alcohol;
- supporting the current quasi-regulatory regime for alcohol advertising; and
- making a significant contribution to Australian industry through primary production, manufacturing, distribution and sales activities.

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Executive Summary

- DSICA is the peak industry body representing the interests of distilled spirit and ready-to-drink alcohol beverage ('RTDs') manufacturers and importers in Australia.

Alcohol taxation – challenges and problems

- It is widely acknowledged that the current alcohol tax system in Australia is complex and riddled with anomalies. This situation has arisen due to a long history of ad-hoc and incremental changes rather than embracing a holistic, comprehensive reform approach.
- The complexity of the system and the range of anomalies are outlined here:
 - **Tax systems:** *four tax systems* are operating – excise duty, customs duty, WET and GST;
 - **Types of tax:** *two styles* of tax are applicable to different products – *ad valorem tax* (wine, grape wine products and cider) and *volumetric tax* (beer, spirits and RTDs);
 - **Rates of tax:** at least *eight* different rates apply across different products – see *Graphic 8* in section 5 below;
 - **Indexation of tax rates:** *inconsistent* application of indexation – some rates are indexed and some are not;
 - **Tax-free thresholds and rebates:** *inconsistent* use of tax-free thresholds and rebates – some products qualify for tax free thresholds (eg beer) and rebates (wine) and other do not;
 - **Import Duty:** *inconsistent* application of import duty – only some products are subject to ad valorem import duty (spirits, RTDs, wine) while some are not (most notably, beer); Furthermore, within specific categories of alcohol beverage some products may be exempt from the ad valorem import duty depending on the product's country of origin (eg bourdon whiskey);
 - **Administering authorities:** *two different administering authorities* – both the Australian Taxation Office (ATO) and the Australian Customs Service (Customs) share responsibility for the administration of the taxation system on alcohol products.
- The unfortunate result is that there are significant distortions and inefficiencies in production and consumption decisions and less than optimal social and economic outcomes for Australia.

Australia's Future Tax System – a real opportunity to reform alcohol taxation

- In responding to these challenges and problems, DSICA has developed a series of **Guiding Principles** to underscore alcohol tax reform. These Guiding Principles are as follows:
 1. **Volumetric taxation:** Australia's future alcohol tax system should embrace volumetric taxation of **all** alcohol products including wine, grape wine products, cider and other products that currently pay the wine equalisation tax (WET).
 2. **Stepped taxation rates:** Australia's future alcohol tax system should apply stepped (or progressive) rates of volumetric excise taxation on alcohol products.

Products of the same alcohol content should be taxed at the same rate irrespective of the alcohol source of the product. For example, spirit-, wine- and beer-based pre-mixed alcohol products at 5% alcohol by volume (abv) should all pay an identical effective rate of taxation.

There should be a series of progressively increasing rates applying to products of higher alcohol content. For example, pre-mixed beverages at 5% abv should pay a lesser rate of taxation than the rate applying to full-strength bottled spirits.

3. Coordinated approach with health and social policy initiatives: Development of health and social policy initiatives in relation to alcohol use should be undertaken in recognition of, and in harmony with, the nature of the (reformed) alcohol tax system.

4. Administrative simplicity: Australia's future alcohol tax system should embrace administrative simplicity to the greatest extent possible.

This should include establishing the ATO as the single government agency responsible for the taxation administration of all alcohol products.

5. Transitional period: To the extent that changes in the system and rates of alcohol taxation will lead to changes in price (and therefore sales) of some alcohol products, the Government should consider specifying a transitional period over which there could be a gradual move to the new system.

6. No hypothecation of alcohol taxation revenues: Revenues collected on the consumption of alcohol products should NOT be hypothecated to alcohol education and treatment programs and services.

- DSICA will refer to these guiding principles in further developmental work that it will do in the coming months to bring together the detail of its recommendations for comprehensive alcohol tax reform.

1. Introduction

1.1 Alcohol tax policy in Australia

Taxation complexities result in poor social and economic outcomes

The current complexities in alcohol tax arrangements in Australia do not help achieve good social and health policy outcomes and distort decision making by business and consumers. The change to the tax rate for RTDs in April 2008 is the latest example of inappropriate taxation policy that has made the system worse.

DSICA believes that taxation of alcohol has an important role in achieving social and health policy outcomes, but it believes that the system should be designed in a way that will most effectively achieve those desired outcomes. As Treasury has noted in its discussion paper, *Architecture of Australia's tax and transfer system* (Treasury 2008a, p. 281 – referred to in this submission as 'the Architecture Paper'):

Addressing non-tax policy objectives with taxes on specific goods and services has complex effects. To the degree that there is some substitutability between different forms of consumption, non-uniform tax rates encourage the production and consumption of less taxed goods." (DSICA's emphasis).

The current alcohol tax system, because it imposes different types and rates of taxation on different products that are substitutes for one another, will not achieve positive social, health and economic outcomes. The recent increase in the excise tax on RTDs exacerbates this problem because it provides stronger incentives to produce and consume alternative (and cheaper) beverages.

Volumetric taxation for all alcohol products

Ultimately, DSICA supports a volumetric approach for the taxation of all alcohol.

Put simply – **alcohol is alcohol**, and on equity and simplicity grounds, all alcohol products should be subject to the same form of taxation irrespective of whether that alcohol base is beer, wine, or spirits.

Alcohol is a product that can be misused if consumed to excess. The economic theory of taxing a good to recover its external costs (its 'externalities') suggest that all alcohol products should be taxed on a volumetric basis according to their alcohol content, and not according to the source of the alcohol or the value of the product. Again, put simply, if you are consuming an alcohol product which contains a higher level of alcohol (or number of standard drinks), then the incidence of taxation should accordingly be higher.

1.2 Australia's Future Tax System – a systematic approach for comprehensive alcohol tax reform

DSICA is encouraged and welcomes this Review into Australia's Future Tax System (the Review).

DSICA is particularly encouraged as the Government has indicated that alcohol taxation will be an integral part of the Review. DSICA is also optimistic as the Review presents the first opportunity in many years to address the issue in a comprehensive, rather than piecemeal, way.

The approach that the Review Panel has taken in addressing this task is also heartening. DSICA is pleased that the Review is taking a systematic approach to assessing reform – the comprehensive nature of the Architecture paper, and the staged approach to the review process clearly indicate this.

DSICA's response to the reform opportunity

In line with this systematic approach, DSICA has in this submission canvassed at a broad level the key **challenges and problems** posed by the current system. In response, DSICA has referred to key system **features and guiding principles** for reform.

In the coming months, as DSICA work its way through later stages of the Review process, DSICA will be guided by these features and principles in developing comprehensive solutions for alcohol tax reform.

1.3 Structure of this Submission

This submission comprises seven sections in addition to its executive summary and bibliography.

The core sections of the submission – sections 3 to 6 – address the four '**framing questions**' the Review Panel has requested the community to respond to in preparing their submissions.

Before moving into responding to these questions, DSICA has outlined in Section 2 a brief overview of the current and historical status of the alcohol market in Australia.

From DSICA's perspective, the principal output from the submission to be carried forward into the next phase of the Review are the **six guiding principles for alcohol tax reform** contained in section 6 below.

2 The alcohol market in Australia – a summary

Section outline: In this section, DSICA outlines current alcohol consumption data and examine medium to long term trends in consumption of different types of alcohol beverages. This will help highlight some of the anomalies that exist in the current alcohol tax system.

2.1 Alcohol consumption in Australia is in long term decline

Despite common perceptions of Australia being a nation of heavy drinkers, per capita consumption of alcohol in comparable developed countries is higher than in Australia – especially in relation to spirits.

Recent data from the International Commission of Distilled Spirits on international drinking patterns, *World Drink Trends 2004* (PGVD 2004), shows that from 1999 to 2002 Australia's alcohol consumption ranking fell from 19th to 23rd in the world. In 2002, Australia ranked 36th in the world for spirits consumption, 9th for beer consumption and 17th for wine consumption (PVGD 2004, p 9).

Australia's alcohol consumption fell 12.6% during the 1990's, the greatest decline of consumption for any region in the world (PVGD 2004, p19). From an alcohol consumption peak in the early 1980's, current consumption rates have fallen to levels of consumption not seen since the 1960's.

Furthermore, alcohol consumption in Australia over the last 30 years has seen a significant decline (see next heading). Consumption in 2007-08 has fallen more than 20% from a peak reached in the early 1980's.

Comparison with the other nine OECD countries selected by the *International Comparison of Australia's Taxes* report (Warburton & Hendy 2006) further supports this conclusion. DSICA's analysis reveals that within these ten OECD countries, Australia has the lowest per capita consumption for spirituous beverages.

Stable trend in Australian adult per capita alcohol consumption

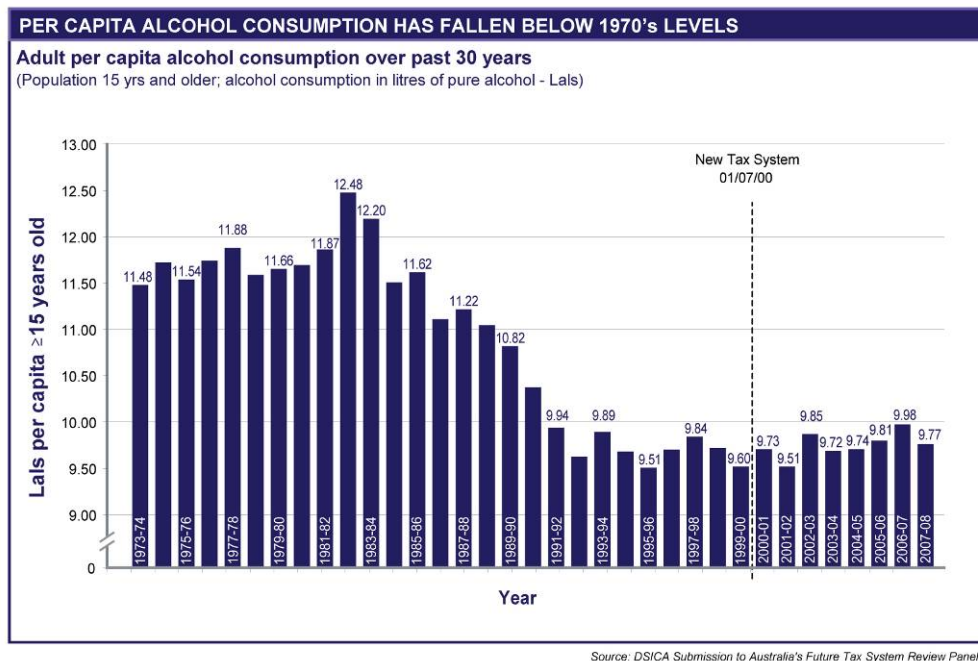
DSICA estimates alcohol consumption for 2007-08 in Australia at 9.77 litres of pure alcohol (Lals) adult per capita (population 15 years and over). This down on 9.98 Lals adult per capita in 2006-07.

The Australian Bureau of Statistics (ABS) figure for alcohol consumption in 2006-07 of 9.88 lals (ABS 2008b, p3) is very close to the DSICA figure provided above.

DSICA has summarised a number of key facts in relation to overall alcohol consumption trends. These trends are made clear by *Graphic 1*, which illustrates:

- adult per capita alcohol consumption has fallen below 1970's levels;
- there has been no significant increase in adult per capita alcohol consumption since the New Tax System (NTS) reforms of 1 July 2000; and
- while there appears to be a slight upward trend in recent years (although a decline in 2007-08 over 2006-07), when examined in a historical context, Australia's per capita consumption has been statistically flat over the past decade.

Graphic 1: Per capita alcohol consumption has fallen below 1970's levels



Adult per capita alcohol consumption has not increased significantly between 1999-00 (9.60 adult per capita Lals) and 2007-08 (9.77 adult per capita Lals).

2.2 Current composition of the Australian alcohol market

The alcohol market in 2007-08

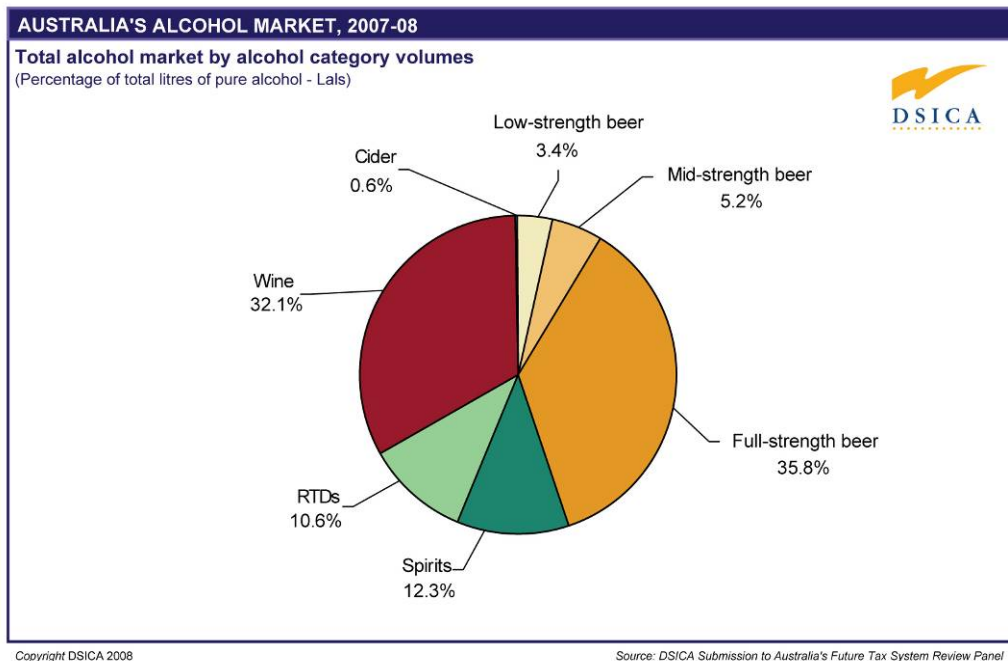
The breakdown of the alcohol market in Australia remained stable between 2006-07 and 2007-08.

According to DSICA estimates, in 2007-08:

- **beer comprised 44%** of the market (down 1% on 2006-07);
- **spirits (including RTDs) comprised 23%** (up 1%); and
- **wine comprised 33%** of the market (stable) (see *Graphic 2* below).

In April 2008, the 70% increase in the taxation of RTDs lead to a dramatic decline in RTD market volume for the last two months of the 2007-08 financial year. Data from various sources confirms a reduction in consumption (measured in lals) of greater than 40%. As the change was applicable from 27 April 2008, a full year impact of the change is yet to become apparent. However, this tax change has significantly influenced consumption patterns in the two final months of the 2007-08 financial year.

Graphic 2: Australia's alcohol market 2007-08



Revenue estimates for 2007-08

In compiling its revenue estimates, DSICA follows a rigorous methodology and sources information from both reputable industry sources and Government agencies (e.g. ABS).

The figures in the graphics below are the output from this process. The detailed historical data and forecasts in relation to these estimates can be found in more detailed analysis undertaken by DSICA. Further information can be provided on request.

For the 2007-08 year, DSICA estimates that the Government has received \$4,743 million in taxation revenue from the alcohol beverage sector (excluding GST revenue) as follows:

- \$1,232m in customs duty;
- \$2,813m in excise duty;
- \$699m in WET.

Graphic 3 below illustrates this and provides a detailed breakdown of these revenues.

Graphic 3: Non-GST revenue estimate 2007-08

NON-GST REVENUE ESTIMATE 2007-08 (\$ MILLIONS)					
Product category	Customs Duty	Excise Duty	WET	TOTAL	%
Low-strength Beer	-	\$83	-	\$83	1.7%
Mid-strength Beer	-	\$226	-	\$226	4.8%
Full-strength Beer	\$43	\$1,604	-	\$1,646	34.7%
Total Beer	\$43	\$1,913	-	\$1,956	41.2%
Spirits	\$1,185	\$172	-	\$1,357	28.6%
RTDs	\$4	\$728	-	\$732	15.4%
Total Spirits	\$1,189	\$900	-	\$2,089	44.0%
Wine	-	-	\$683	\$683	14.4%
Cider	-	-	\$16	\$16	0.3%
Grand Total	\$1,232	\$2,813	\$699	\$4,744	100.0%

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Source: DSICA Submission to Australia's Future Tax System Review Panel

Revenue forecasts for 2008-09 – impact of the RTD tax change

The effects of the 70% increase in the taxation of RTDs on the total alcohol market in 2008-09 are difficult to reliably estimate given the short time since the change. DSICA continues to examine reports of sales by manufacturers as they are released to identify long term trends.

The *Final Budget Outcome 2007-08* (Treasury 2008b), shows that Treasury overestimated the revenue on RTDs in 2007-08 by \$106m. This change on the 2007-08 Budget figure is over 14% of the actual revenue for RTDs reported in the *Final Budget Outcome* (\$744m).

DSICA believes that the substantial overestimation of 2007-08 RTD revenue in the 2008-09 Budget Paper (a year that includes only two full months at the increased excise and customs rates for RTDs) casts considerable doubt over the Treasury forward year projections published in the 2008-09 Budget.

2.3 People are changing their product preferences, but not increasing total consumption

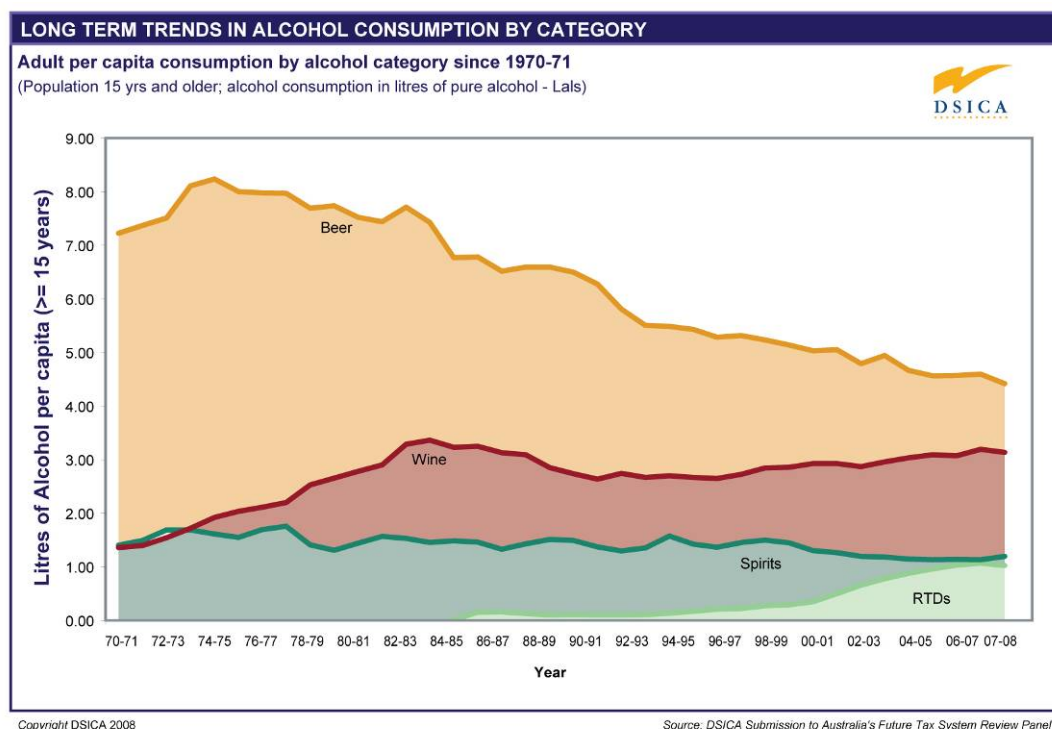
Trends in alcohol consumption by product category

In the last three decades, consecutive Australian Federal and State Governments have altered the taxation on individual categories of alcohol beverage.

As this has occurred, consumers have tended to shift consumption to those products with lower effective rates of taxation. **However, substitution from one alcohol category to another has not been a significant driver of changes in total consumption.**

Long-term trends in total consumption of alcohol have been for the most part driven by continuing decline in the beer category and at the same time increasing wine consumption. *Graphic 4* illustrates these effects by product category for the period 1970-71 to 2007-08.

Graphic 4: Long term trends in alcohol consumption by category



The spirits market

Full strength bottled spirits

Trends observed prior to the April 2008 tax change on RTDs revealed that the share of the market held by bottled spirits declined by 1.5% in the period 1999-00 to 2007-08. Full-strength bottled spirits (FSBS) currently comprise 12.3% of the total alcohol market (2007-08), down from 13.8% in 1999-00.

Long term analysis between the periods 1970-71 and 2006-07 reveals spirits consumption had only grown at an average annual rate of 1.4%. This conclusion, when read with the observations from *Graphic 1*, illustrates that a significant proportion of the growth in RTDs, particularly since the changes made under the NTS, has been at the expense of full-strength spirits.

Ready-to-Drink alcohol products (RTDs)

DSICA acknowledges that, prior to the April 2008 tax change, RTDs have experienced significant growth in recent years. However, DSICA stresses this growth be viewed in the context of other developments in the market – such as the decline in beer and full-strength spirits consumption.

In summary, it can be seen that the increase in the popularity of RTDs has been primarily in substitution for bottled full-strength spirits and full-strength beer, and is not due to an overall increase in consumption.

Discussions regarding the rapid growth in RTDs (over the period 2000 to 2007) also tend to ignore the following facts:

- the majority of RTDs are similar in alcohol content to full-strength beer (about 5% alcohol by volume (abv));

- RTDs comprise only 10.6% of the market (in 2007-08);
- 75% of RTDs are dark spirit-based, and are preferred by males 24 years and older; and
- growth in the RTD market has begun from a very low base of 3% of the total alcohol market in 1999-2000.

3 Alcohol Taxation – challenges facing Australia

Section outline: This section addresses the first' framing question' outlined by the Review Panel in its request for initial submissions, namely:

Framing Question #1: What major challenges facing Australia need to be addressed through the tax transfer system?

The particular challenges addressed in this section are, in the context of this submission, contained to challenges to be addressed in relation to alcohol taxation.

3.1 Introduction

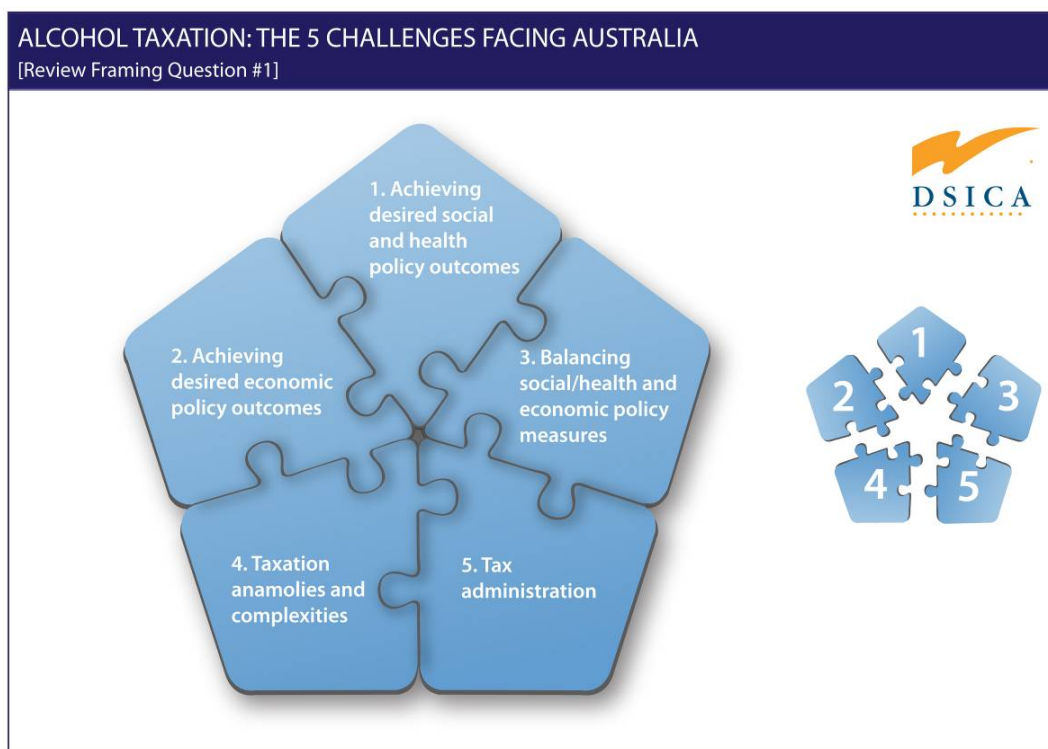
Within the context of its immediate issues of concern, in addressing Framing Question #1, DSICA will limit its comments and observations to the challenges facing Australia as they relate to alcohol taxation.

At a high level, DSICA considers that there are **five (5) challenges** facing Australia in terms of the design of an appropriate alcohol taxation system (*Graphic 5* below provides a pictorial illustration of these five challenges):

- 1 Achieving desired **social and health policy outcomes** for the Australian community;
- 2 Achieving desired **economic policy outcomes** for the Australian community;
- 3 Achieving the necessary and desired **balance between social/health policy tools and economic (tax) policy tools**.
- 4 **Removing anomalies and complexities** in the current alcohol system; and
- 5 **Improving the overall administration** of the current alcohol tax system.

In this section of the submission, DSICA addresses each of the 5 challenges outlined above.

Graphic 5: The 5 challenges facing Australia with alcohol taxation



3.2 Challenge #1: Achieving desired social and health policy outcomes

Recent research into social/health policy in relation to alcohol consumption

The Federal Government has sponsored a range of research and policy development activities in recent years regarding community expectations of social and health policy outcomes within the context of alcohol use and mis-use in Australia.

Two key recent documents which bring current thinking on this topic together are:

- *National Alcohol Strategy 2006-2009, Towards Safer Drinking Cultures*, Ministerial Council on Drug Strategy, 2006 (MCDS 2006); and
- *Australia: The Healthiest Country by 2020, a discussion paper prepared by the National Preventative Health Taskforce*, Commonwealth of Australia, 2008 (NPHT 2008a) (This paper was further supplemented by a technical paper on alcohol entitled *National Preventative Health Taskforce Technical Report No 3, Preventing Alcohol-related harm in Australia: a window of opportunity*, Commonwealth of Australia, 2008) (NPHT 2008b).

Current consensus on desired social/health policy outcomes

The key theme in both of these documents in terms of desired social and health policy outcomes is the need to *reduce the prevalence of harmful drinking by Australians*.

Both reports are also in agreement that **developing safer and healthier drinking cultures** in Australia is a key social and health policy objective.

Other related aims include (MCDS 2006, p.4):

- reduce the incidence of intoxication among drinkers;
- enhance public safety and amenity at times and in places where alcohol is consumed;
- improve health outcomes among individuals/communities affected by alcohol consumption; and
- facilitate safer and healthier drinking cultures by developing community understanding about alcohol and through regulation of its availability.

Addressing social and health policy outcomes

Both documents highlighted above outline a range of policy tools (or interventions) that the Government can use to achieve the stated goal of reducing harmful alcohol consumption.

Research has shown that using '**price related levers**' (such as **higher taxes**) can be effective in preventing and reducing alcohol-related harm (MCDS 2006, p. 29; NPHT 2008b, p. 37).

DSICA acknowledges that price and taxation have an appropriate place in achieving social and health policy outcomes. However, DSICA also believes, as do the policy makers, that the impact of taxation on the alcohol beverage and hospitality industries, as well as the community generally, needs to be considered in pursuing appropriate policies in this area (MCDS 2006, p. 29). For instance, it is suggested that higher taxation may need to aim for neutral impacts on industry in order to be accepted by industry and the community.

These complex issues need to be carefully considered in determining the appropriate style and mix of policies that are implemented to achieve the stated social/health policy objectives.

DSICA comment – need for accountability measures

DSICA supports the efforts of the Government in this area. For example, DSICA worked very constructively with the Government sponsored working group which developed the *National Alcohol Strategy 2006-09*.

It is essential that the Government continue to work with all stakeholders, including the alcohol industry, in developing policy responses to address health and social objectives to ensure that policies have the best chance of being accepted and being effective in the community.

However, to ensure that there is appropriate **accountability** and that outcomes are subject to assessment and review, DSICA strongly encourages the Government to develop and implement a series of **performance indicators** that are aimed at targeting and measuring policy outcomes.

DSICA notes that the discussion paper released by the National Preventative Health Taskforce has set a target of reducing the prevalence of harmful drinking for all Australians by 30% by 2020 (NPHT 2008b, p. 29). DSICA commends the Taskforce on setting this target, however DSICA believes that a series of more specific performance indicators needs to be developed as part of the National Preventative Health Strategy that will assist policy makers and stakeholders focus on achieving specified outcomes by a certain time. This will also assist in determining whether policy prescriptions are being effective or not.

DSICA would be pleased to work with Government to help develop these indicators. In this regard, DSICA refers policy makers to DSICA's "*Indicators of Alcohol Consumption Amongst Young People*" included as part of DSICA's *Pre-budget Submission 2008-09* (PBS 08-09, p. 28). DSICA notes that these Indicators are based on reliable and robust national survey data that is regularly updated. DSICA suggests that any indicators

developed in the context of the National Preventative Health Strategy also be based on and referable to soundly designed and collected data sets.



3.3 Challenge #2: Achieving desired economic policy outcomes

Australia's taxation system is an integral economic tool that is applied to achieve necessary and fundamental economic outcomes such as:

- **Public provision of goods and services** demanded by the Australian community (eg health and education services, defence and security, infrastructure and roads, etc.);
- Achieving a desired level of **income re-distribution** in society; and
- Achieving **aggregate economic outcomes** at the macro-economic level through the taxation system's role as an 'automatic stabiliser' on fluctuations in economic growth.

Taxation of goods, such as alcohol beverages, contributes significantly in helping the Government achieve these economic outcomes. The Architecture Paper outlines that alcohol products provide a significant percentage (almost 10%) of total revenue from taxes on goods and services in Australia (Treasury 2008a, p. 278).

Taxes effect decision making – and *distort* decision making

At the heart of the economic role of taxation design and implementation is the fact that all taxes will impact behaviour of individuals in some way.

Taxes affect the amount of money people have to spend and the incentives or disincentives they face to act in a certain way – for example, to purchase one type of product over another.

This was reinforced by Treasury in the Architecture Paper (Treasury 2008a, p. 281):

“To the degree that there is some substitutability between different forms of consumption, non-uniform tax rates encourage the production and consumption of less taxed goods.” (DSICA's emphasis).

DSICA comment

DSICA acknowledges and agrees that taxation of alcohol has a legitimate role in assisting the Government achieve its economic goals and objectives. Historically, excise taxation of alcohol has provided a defined and measurable base for taxation revenue. Furthermore, it is acknowledged that there are sound social and economic reasons for addressing the externalities associated with alcohol consumption through an appropriate level of taxation.

However, given that taxation inevitably alters decision making (see below), including decisions regarding what types of alcohol beverage might be consumed, DSICA strongly believes that the taxation system must be designed to ensure a neutral impact across all beverages so that one beverage is not favoured in its taxation treatment relative to another.

Distortions caused by inequitable taxation is very much at work in the context of the current system of alcohol taxation in Australia. Differing taxation burdens on different categories of beverage impact the respective levels of consumption of different beverages.

DSICA will demonstrate in this submission the significant taxation inequities that exist between different beverages. Two tools help us outline this in a very compelling way. **Firstly**, DSICA has compiled a league table of effective tax rates on different beverages (DSICA has determined a list comprising **at least 15 different rates**). **Secondly**, DSICA has also developed a table of taxation incidence on beverages by reference to a standard benchmark measure – the standard drink. Again, this tool will demonstrate the inequity of

and anomalies that exist – **tax per standard drink varies between 5 cents for low strength draught beer through to 87 cents for full strength spirits and RTDs.**

These tools demonstrate that there is a huge disparity in the incidence of taxation across different beverages. Accordingly, there are unnecessary distortions in production and consumption decisions.

As outlined in this submission, DSICA believes there is very considerable scope to reform the system of alcohol taxation to achieve a more equitable incidence of taxation across beverages and therefore to lead to less distortion in people's choices regarding alcohol production and consumption. This can be done without endangering the other important objectives of taxation outlined above.



3.4 Challenge #3: Achieving a balanced composition of social/health and economic policy tools

The sections above demonstrate that social/health policy tools and economic tools both comprise important elements to achieving desired outcomes for the community.

There is a significant challenge in bringing an appropriate level of both tools together such that they work co-operatively and productively together to achieve the best outcome(s).

This is particularly the case when looking at consumption taxes on goods like alcohol which may have negative health and other effects. It is commonly acknowledged that alcohol taxation often targets potential health issues and will address social policy objectives in relation to alcohol consumption.

The Architecture Paper clearly acknowledges that addressing non-tax policy objectives with taxes on relevant goods can have **complex effects** (Treasury 2008a, p. 281). The Architecture Paper gives the specific example of substitutability between different forms of beverage – and the fact that non-uniform rates will encourage the use of lower taxed goods.

DSICA believes that there is a significant challenge for policy makers, and for Australia more broadly, in ensuring that the appropriate level and mix of social and economic (tax) policy tools are brought together to address these issues. Significantly, DSICA wishes to ensure that policy development and implementation does not lead to unnecessary complexity and over-regulation that may result in less than optimal outcomes and unintended consequences.

As outlined below, where there are a range of non-tax policy measures applied to address desired health/social policy outcomes, there will be less of a need for taxation measures.

The Architecture Paper – taxation not the only way to achieve corrective action

The Architecture Paper acknowledges (Treasury 2008a, p. 278), and DSICA agrees that in the context of alcohol and certain other products there is a need to apply specific taxes to consumption of these products as they have some negative health or social impacts (or externalities).

Specifically, the Architecture Paper notes the commonly cited justification for taxation on externality grounds (Treasury 2008a, p. 280):

“Such a tax ensures that users or producers of the good take into account the negative effects they have on others when making production or consumption decisions.”

However, just as significantly, the Architecture Paper acknowledges that taxation is not the only way to achieve the necessary corrective action that is required to address an externality. Furthermore, the Architecture Paper emphasises (Treasury 2008a, p. 280):

“To the extent that the externality is addressed through non-tax means, there is a reduced need to apply a corrective tax.”.

DSICA comment – need for caution in the current reform climate

DSICA strongly supports the conclusion from the Architecture Paper above regarding alternative means to address externalities. DSICA also supports the inherent logic that if an externality is addressed through a non-tax measure, then there is less of a need to address the same externality through tax measures.

DSICA is keen to stress, particularly in the current environment of possible reform in both the taxation and (preventative) health areas, that the Government needs to be cautious in ensuring that:

- there is an **appropriate balance** between the two arms of policy; and
- **the Government does not, across the two areas, unnecessarily over-regulate**, which can lead to complexity, possible conflicts between the two areas of regulation, and unintended consequences.

DSICA welcomes the opportunity to work with all areas of Government to ensure that the right combination of measures is selected for implementation in this important area of policy making.



3.5 Challenge #4: Removing complexities and anomalies in the current alcohol tax system

DSICA believes that Australia's current alcohol tax system is outdated and desperately in need of reform. DSICA has for many years, primarily through its Pre-budget Submissions, outlined a series of anomalies in the system that cause inappropriate consumption decisions and add to system complexity and costs.

Summary of current complexities and anomalies in Australia's alcohol tax system

Section 5 below will outline in detail DSICA's concerns regarding the problems with the current system in terms of anomalies and complexities. However, to highlight the level of concern DSICA has regarding this issue, DSICA emphasises the following key points:

- **Four systems** of tax are operating – excise duty, customs duty, WET and GST;
- **Two styles of tax** are applicable to different products – ad valorem tax (wine, grape wine products and cider) and volumetric tax (beer, spirits and RTDs);
- At least **eight different rates** apply across different products – see *Graphic 8* in section 5 below;
- **Inconsistent application of indexation** – some rates are indexed and some are not;
- **Inconsistent use of tax-free thresholds and rebates** – some products qualify for tax free thresholds (eg beer) and rebates (wine) and some do not;
- **Inconsistent application of import duty** – only some products are subject to ad valorem import duty (spirits, RTDs, wine) while some are not (most notably, beer);
- **Two different administering authorities** – both the ATO and Customs share responsibility for the administration of the taxation system on alcohol products.

DSICA comment

DSICA believes that the extent of the anomalies and complexities outlined above demonstrates that Australia faces a very big challenge in terms of stripping these complexities and anomalies from the system.

However, DSICA is confident that the Review provides a very real opportunity to address these issues. DSICA looks forward to working closely with the Government to reform the system to remove the anomalies and to develop a system that is more in line with sound taxation policy principles (refer Section 4 below).



3.6 Challenge #5: Improving alcohol tax administration

The final major challenge that DSICA believes Australia faces in the context of alcohol tax reform is the need to replace the existing dual administration of alcohol taxation with a simpler system.

Dual administration – Australian Taxation Office and Australian Customs Service

The collection of excise duty on domestic production of alcohol is the responsibility of the ATO. Customs duties on imported 'excise equivalent' goods are collected and administered by Customs.

Accordingly, where a producer's product range includes both imported and locally produced goods, they will need to deal with both the ATO and Customs.

This dual administration causes excessive administration costs not just because of the need to report to two separate authorities, but also due to the complex set of administrative arrangements that exist around the issue of, administration and maintenance of licences to deal with excisable goods.

Where a producer has both imported and locally produced goods in their range, they will need to maintain licences (and be audited) under both ATO and Customs regimes. Accordingly, the dual Government requirements result in unnecessary duplication of systems and communications with both the ATO and Customs for clearance of goods.

DSICA comment

DSICA strongly believes that there should be a single administration with responsibility for tax administration of imported excise equivalent goods and domestically produced excisable goods. DSICA advocates a transfer of the revenue collection and administrative arrangements relating to imported goods from Customs to the ATO. There will be a saving in administration costs if this is implemented.

DSICA notes that the Productivity Commission in its recent research report *Annual Review of Regulatory Burdens on Business: Manufacturing and Distributive Trades* agreed with this recommendation (PC 2008, p. 197).

DSICA strongly urges the Government to address this challenge by taking up our recommendation, which has been supported by the Productivity Commission, to consolidate customs and excise duty administration within the ATO.



4 Alcohol Taxation – System Features

Section outline: This section addresses the second 'framing question' outlined by the Review Panel in its request for initial submissions, namely:

Framing Question #2: What features should the system have in order to respond to these challenges?

In responding to this question, DSICA has referred to the economic criteria of what constitutes good taxation design and also, in the context of excise taxation, the objectives of **excise** taxation.

4.1 Tax system features

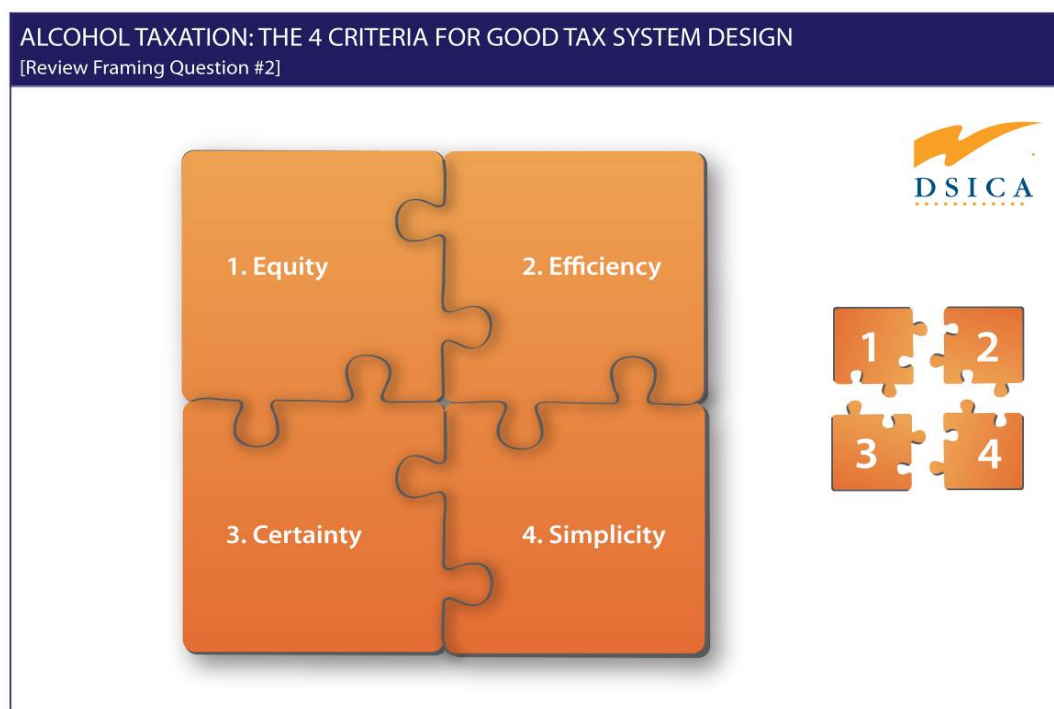
In order to make objective assessments about a tax system and to propose options for reform, it is important to consider the generally accepted features of a good tax system. In the case of fundamental reform of any form of taxation, DSICA believes it is prudent to assess reform against these criteria and that they be used as an essential guide for reform.

Economic theory has traditionally detailed four key features of a good tax system:

- **Equity** – or equality as between taxpayers (or products in the case of consumption taxes);
- **Efficiency** – that is, the economy of collection;
- **Certainty** – or transparency and predictability of the tax; and
- **Simplicity** – characterized by convenience of payment.

These features of a good tax system are outlined in pictorial form in *Graphic 6* below.

Graphic 6: The 4 criteria for good tax system design



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Each criteria is examined briefly below.

Equity



In relation to commodity taxation, tax regimes should ensure that commodities in similar circumstances should be taxed in similar ways (**horizontal equity or 'neutrality'**). A good tax system will fairly distribute the tax burden while also minimising disincentive or distortion effects.

While there is considerable international economic debate about what is 'fair', it is difficult to have a 'fair' tax system if the tax base is **narrow**. A 'narrow tax base' is generally characterised by a taxation system in which the incidence of taxation is borne by a limited sector of the economy; narrowness is typified when tax applies only to a limited number of individual taxpayers or, to be more relevant in the context of taxation of alcohol, to a limited range of goods. The fact that there is generally a narrow tax base in the context of alcohol taxation is often justified by the fact that there is a counterbalancing design benefit in the relative simplicity and certainty of excise taxation on a narrow base (see below).

Neutrality is a key principle to avoid discriminatory or distortionary taxation. The principle that similar circumstances should be taxed in similar ways is important to avoid unfair discrimination between taxpayers or between substitute goods. This principle is also important to prevent the tax system creating conditions that distort economic activity, or consumption.

The current alcohol taxation system does not satisfy this criteria. Refer to further discussion in section 3.5 above and sections 4.2 and 5 below.

We note that one potential way to measure inequity is through "**tax expenditures**". We note and commend the Treasury on their annual Tax Expenditure Statement publication. This publication documents all the concessions delivered through the tax system. A number of tax expenditures are noted in relation to alcohol products. These measure the degree to which taxation treatment of a product deviates from a stated "benchmark" rate. The extent of deviation is one way to show the degree of inequity between the taxation of various products.



Efficiency

Taxation systems should be efficient. Efficiency can be assessed by the effort required by governments to raise the required revenue. The lower the cost of administration by the government, the more efficient the system.

In general terms, efficiency can be characterised in the following ways:

- the lower the overall burden of taxation, the lower will be the distortions of taxation on economic activity;
- the broader the tax base and the more comprehensive the tax system, the greater the efficiency for any given tax level;
- high rates of taxation levied on a limited or narrow tax base provide greater incentives to make arrangements to minimise taxation, for example by moving from the production/consumption of higher taxed goods to lower taxed goods.

Again, DSICA would suggest that the current alcohol tax system does not score well against this criteria because:

- there is quite a high burden of taxation on some goods (for example, spirits and RTDs);
- the excise base is narrower than it could be through the exclusion of wine, grape wine products and cider from the excise base; and
- these two factors combine to encourage production and consumption of lower taxed goods rather than higher taxed goods (for example, production of wine-based or beer-based based RTDs and not spirits based RTDs).

In addition, another component to a tax's efficiency is the concept of **revenue adequacy or buoyancy**. Tax systems should ensure that adequate revenue is raised to finance government and societal needs. That revenue must not only be adequate but essentially be reliable in its expected collection. In addition to this basic requirement, where possible, taxation systems should aim for stability by minimising the impact that fluctuations in the level of activity in the economy will have on revenue. The tax system should also be able to meet the effects of market redefinition, substitute transactions and/or products, and new ways of doing business.

Given the relative inelastic demand for excisable goods, excise taxation tends to be quite buoyant irrespective of other factors in the economy.

Certainty and simplicity



Tax systems should be based upon **clear principles**, reflected in legislation.

Taxpayers should be able to **easily understand and comply** with their tax obligations. There should be certainty for taxpayers, with **uniformity and consistency in the application of the law**. The administrative costs of compliance should be minimised where possible.

It is interesting to note that there can often be a conflict between achieving a broad taxation base and achieving certainty and simplicity. For example, taxes levied on a narrow range of luxury goods might also satisfy the simplicity and certainty principles in their administration. However, a narrow tax base can encourage substitutes or evasion through product re-definition. These conflicts must be carefully considered and balanced as part of the overall taxation system design.

4.2 Applying tax policy principles to alcohol products

Having outlined above the key tax design principles, in this section DSICA applies these principles in the context of alcohol taxation design and comments on how each criteria should be broadly addressed in order to arrive at an appropriately designed taxation system for alcohol products.

Critical to the assessment of the tax features is the issue of market definition – what range of goods are being considered in assessing the applicability of the tax features. When assessing the taxation of alcohol against the features outlined here, DSICA believes it is essential that the alcohol market be viewed collectively as all alcohol products. This is critical as very often different alcohol products are substitutes for one another.

Equity

DSICA contends that alcohol taxation in Australia is presently characterised by a **significant lack of equity**.

For example, there are different tax regimes and different rates for the taxation of alcohol depending upon the product (this is further elaborated in a summary form in Section 3.5 above and in a more detailed way in Section 5 below).

The taxation of alcohol is by definition narrow, since it is imposed on a specific range of goods, but the key issues associated with the taxation of alcohol are those of equity and competitive neutrality.

Alcohol is not taxed equally between alcohol products due to a number of tax concessions – for example with beer (which has access to a 1.15% abv excise-free threshold) and with brandy (that has a rate below that applying to all other spirits).

The tax regime for alcohol products fails the test of good tax policy design because it lacks neutrality and clearly discriminates between taxpayers/consumers on the basis of the products purchased/consumed.

The anomalies in the regime have historically led to distortions in the market whereby products will be manufactured almost solely because of the concessional taxation arrangements. A clear example of this was evident in the 1990s (before the major tax reforms of 2000) when the tax base for so-called 'designer drinks' was manipulated away from spirits towards wine-based and beer-based products due to the lower taxation treatment accorded to these products.

Another way in which the current system can be assessed as inequitable is in relation to the range of other regulation that applies across alcohol. The alcohol market is governed by legislation and regulation that applies universally in matters such as licensing laws, minimum drinking age and road safety legislation (blood alcohol content rules). Policy-makers have therefore generally accepted that there is one alcohol market, rather than separate markets for beer, wine and spirits. This is an equitable approach to take.

Efficiency

On the one hand, excise is historically one of the most efficient sources of revenue in that administrative costs of collecting excise are quite low. With alcohol there are typically a small number of excise remitters, and under the self-assessment principles they calculate their own liabilities.

However, this is counterbalanced by high efficiency costs because taxing only a limited range of goods distorts production and consumption decisions.

These facts are acknowledged in the Architecture Paper (Treasury 2008a, p. 277):

“Although the administrative costs of collecting excise were quite low, their efficiency costs tend to be high in many cases. This is because taxing some goods and not others changes relative prices. This provides incentive for people to alter consumption from taxed goods to untaxed goods.”

The WET regime imposed on wine products is arguably less efficient, even though it too uses self-assessment arrangements. This inefficiency is due to the relatively larger number of WET remitters and the difficulties encountered by some producers in calculating their WET liabilities. The WET regime is complex and has a wide range of 'assessable dealings', wine definitions, producer rebates, credits and refunds.

The taxation of alcohol products is a relatively **buoyant** source of revenue over time, since it is not significantly impacted by economic cycles. The taxation of alcohol is relatively inelastic, but there is some substitution between different alcohol products depending upon price (influenced by the tax component) and there will be some shifting between products (ie substitution) as relative prices between products move. However, it should be noted that the ad valorem system that applies to wine can impact negatively on revenue buoyancy. Even in strong economic times that have been observed in recent years, there has been weaker WET revenue due to flat or even declining wholesale prices (ie the tax base for wine).

Certainty and simplicity

In respect of the excise regime, DSICA believes that there is significant room for improvement on this criteria – particularly on the point of having two Government agencies responsible for the collection of duties (see Section 3 above). The requirement for weekly remittances and the high compliance costs of maintaining licences and 'bonded' warehouses also creates a high level of administration and compliance cost for alcohol products.

The WET regime for wine alcohol products is imposed under separate legislation. The regime is complex. While major wine producers are more readily capable of estimating their WET

liabilities, this is less the case with the small to medium sized wine producers – see discussion above under 'Efficiency'.

4.3 The objectives of excise taxation

The discussion above has related to **general taxation features and design principles**.

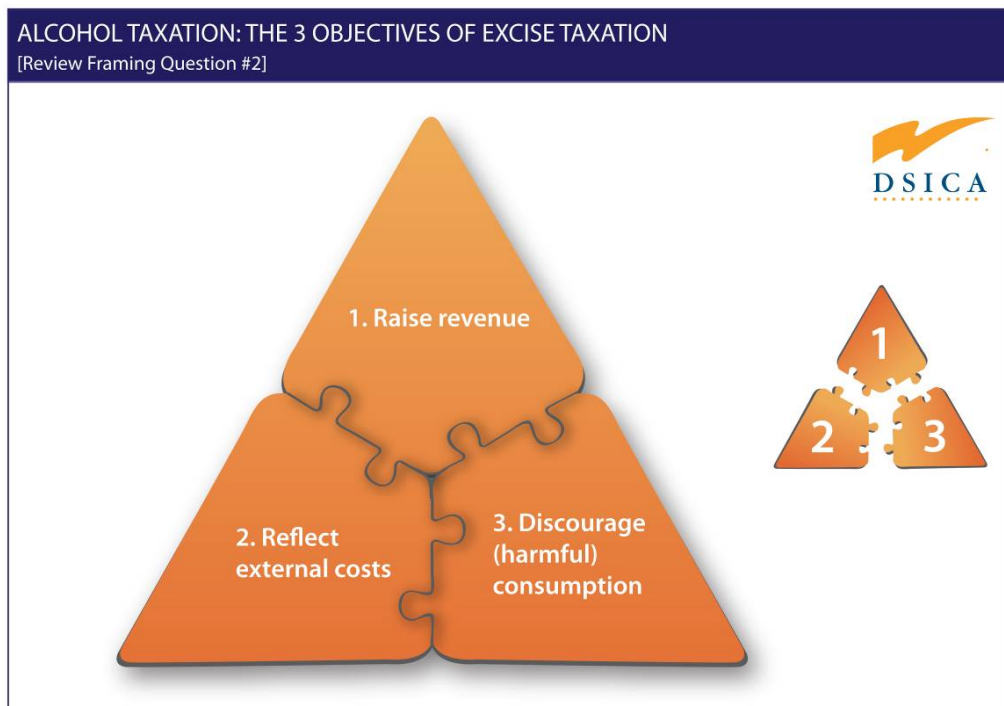
In this section, DSICA discusses the **specific objectives of excise taxation**.

The three commonly accepted objectives of excise taxation are:

- to raise revenue;
- to recapture some of the external costs of use/consumption; and
- to discourage (harmful) consumption.

These are presented graphically in *Graphic 7* below

Graphic 7: The 3 objectives of excise taxation



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Raising revenue - excise taxes are effective at raising revenue

Excise is applied to certain commodities, in addition to general consumption taxes, largely because it has the **capacity to raise a significant amount of revenue with little distorting effect**.

Excise usually requires limited administrative effort, has limited opportunities for evasion, large sales volumes, few producers, inelastic demand, easy definability and an absence of substitute products. .

DSICA believes that volumetric systems of taxation are more effective in raising revenue than ad valorem systems. This is because volumetric systems are not subject to variations associated with price movement (as it moves with the economic cycle). Also, with volumetric systems, there is less of an incentive and less scope to enter into tax minimisation and evasion around

valuation and “black market” issues. However, to clarify this point, DSICA believes it would be a worthwhile exercise for Australia to conduct an international analysis of which countries’ alcohol tax systems have been most efficient at collecting revenue.



External costs - excise taxes address externalities of use

Certain goods are typically perceived as appropriate for excise taxation on the basis of the **negative externalities associated with their use**.

These are often sumptuary or regulated goods that include alcohol, petroleum and tobacco. The excise imposed on these goods is intended to internalise at least some of the negative externalities associated with their consumption.

Demand inelasticity is an important characteristic of excisable goods, where the percentage change in consumption is smaller than the percentage change in the price of the goods through the imposition of excise. It is important to further note though that different cohorts of consumers will have different elasticities of demand.

A further point to note is that, in aggregate, products with relatively inelastic demand can also potentially have high rates of excise imposed that will result in **declining revenue**.



Consumption - excise taxes discourage harmful consumption

Over many years, Governments have used excise taxation as a means to restrain the consumption of products regarded as unhealthy. Accordingly, Governments often view that **public health objectives can be furthered through the imposition of excise taxes**.

Debate around the use of excise taxation for this purpose in the context of alcohol also needs to consider the related issues of:

- the need to take into consideration the various studies which have shown that a moderate intake of some alcohol can in fact have a **beneficial rather than detrimental health impact**; and
- the need to **balance taxation policy and non-taxation policy measures** which can both be directed at reducing harmful consumption (see Section 3 above).

An important point to be made in this discussion involves the patterns and trends of harmful consumption in Australia. As we have noted earlier, adult per capital alcohol consumption in Australia is stable. DSICA has sound evidence to suggest that patterns of *harmful* consumption amongst young people are not worsening (PBS 08-09, p. 28). To what extent could we therefore conclude that the current volumetric system is effective in discouraging harmful consumption? DSICA encourages the Department of Health and Ageing and the National Preventative Health Taskforce to investigate these patterns further across all age groups and, where possible, to extend this analysis internationally in terms of assessing against other tax systems.

4.4 Excise design issues

Targeting the use of excise taxation

The International Monetary Fund (IMF) typically recommends that excise be **limited** to a few principal groups.

In addition to alcohol, petroleum and tobacco, the IMF also recommends the inclusion of motor vehicles and their spare parts as excisable goods in transitional economies.

Use of specific rates

Specific rates of excise based on physical units such as volume or weight are typically preferred to **avoid the valuation issues inherent in an ad valorem based excise regimes**, particularly with the valuation of imported and domestically produced goods. Contributing authors to the IMF 'Tax Policy Handbook' noted that (McCarten & Stotsky 1995, p. 102):

“In addition, specific rates are the appropriate form of tax if the tax is intended to be externality correcting, that is an ounce of alcohol should be taxed the same whether it is contained in high-quality spirits or not.”

Correcting for externalities vs revenue raising

As outlined above, excise often fulfils two roles – correcting for negative externalities and raising revenue.

Imposing excise at extreme levels will reduce the negative externalities but beyond a revenue maximising point it will also lead to a decline in revenue yield.

Therefore if the policy objective is reducing or eliminating the negative externality, the revenue yield becomes less important. If the policy objective of the excise is revenue raising, the rate of excise will be limited by the revenue maximising point.

The tax policy principles underlying excise policy decisions are rarely transparent, with few governments outlining whether the policy intent is revenue yield or correcting for negative externalities. In many cases, excise policy may be driven by a combination of both policy objectives, since if addressing the negative externalities was the sole motivation, governments could theoretically eliminate them completely by banning the regulated products.

The 2006 'International Comparison of Australia's Taxes' report asserted that revenue yield was the priority in Australian excise policy (Warburton & Hendy 2006, p. 252).

*“The Excise duties are levied on products for a variety of reasons but are **primarily used to raise revenue**. The price effects of the imposition of excise duty can also influence consumer behaviour. For example, excise duty increases prices and broadly reduces the levels of tobacco and alcohol consumption, which is consistent with health policy.” (DSICA's emphasis).*

DSICA comment

DSICA does not dispute the long-held economic principles of excise taxation discussed above. It would, however, make the following comments (which will be further supplemented by discussion in Section 6 below):

- DSICA strongly supports the use of **specific/volumetric rates** in the context of excise taxation;
- DSICA would agree with the conclusions of Warburton & Hendy that excise taxation is primarily targeted at raising revenue. DSICA endorses the comments above regarding **revenue maximisation** from excise taxation and points to the recent increase in excise taxation on RTDs in Australia as a possible case of overshooting the revenue maximising rate for this category of beverage.
- DSICA again stresses the need to **balance the use of tax and non-tax policy measures** in terms of achieving health/social policy outcomes.



5 Alcohol Taxation – Problems with the current system

Section outline: This section addresses the third 'framing question' outlined by the Review Panel in its request for initial submissions, namely:

Framing Question 3: What are the problems with the current system?

The particular problems addressed in this section are, in the context of this submission, contained to problems with the current alcohol taxation system.

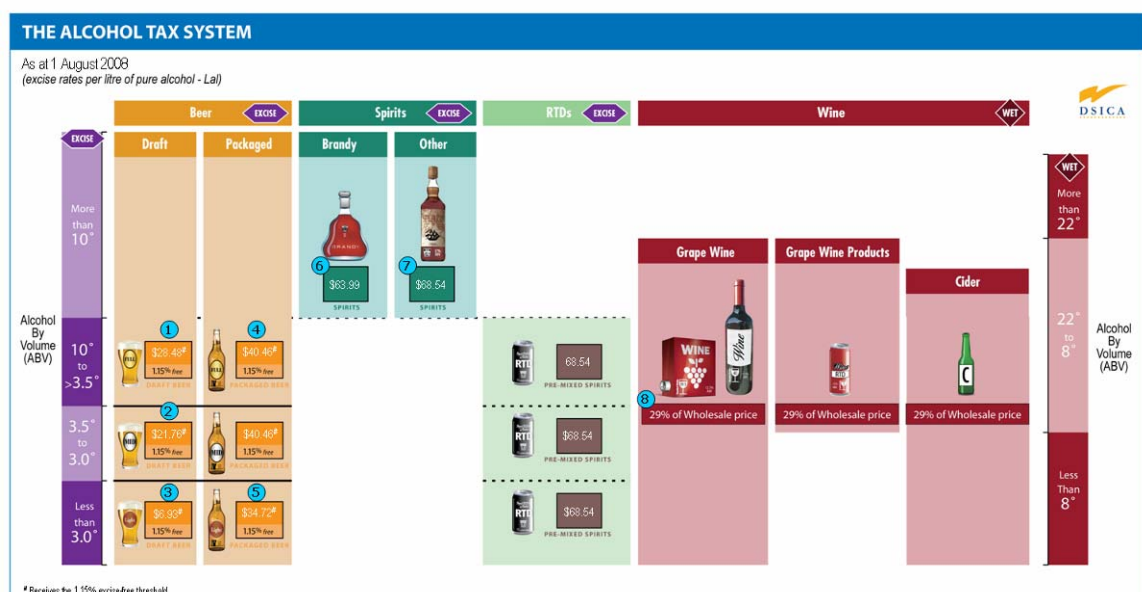
5.1 Introduction

The current alcohol taxation system fails to adequately satisfy any of the four key features of a good tax system: it does not help achieve good health policy outcomes; and inappropriately distorts the alcohol beverage market place by improperly influencing decision making regarding product manufacture and consumption.

The problems of the current taxation regime are demonstrated by:

- a mix of ad valorem (wine, grape wine products and cider) and volumetric taxation rates (beer, spirits and RTDs);
- a system of **eight different rates** – some of which are indexed and some not (see 8 below);
- some products (eg. spirits) have import duty at ad valorem rates indiscriminately applied;
- rebates and tax free thresholds available to some products (eg wine and beer) and not to others, and
- two different government departments administer different taxes for the same products.

Graphic 8: The complex alcohol tax system in Australia



Because the system does not treat all alcohol on the same basis (according to its alcohol content), there are distortions in production and consumption decisions that lead to inappropriate social, health and economic outcomes.

Effective taxation rates for alcohol

Care needs to be taken when referring to any nominal or dollar excise rates when seeking to compare the incidence of taxation on different products. **This is because beer products are subject to an excise-free threshold on the first 1.15% of alcohol. This has the effect of lowering the effective taxation rate applying to these products.**

This has many effects, including:

- exacerbating the inequitable and distortionary impacts as between beverages of similar alcohol content (see further discussion below); and
- an increase in the number of effective taxation rates applying across alcohol beverages.

DSICA has undertaken an analysis of the effective (non-GST) taxation rates applying to different alcohol products. The results are outlined in *Graphic 9* below.

Graphic 9: Effective taxation rates on alcohol products

EFFECTIVE TAXATION RATES ON ALCOHOL PRODUCTS (per litre of alcohol - lal)		
No.	Alcohol product	Effective tax rate per Lal
1	Draught beer – low strength	\$3.98
2	Cask wine (4 litre, \$12.99)	\$5.28
3	Port (\$14.99)	\$13.97
4	Draught beer – mid strength	\$14.61
5	Bottled wine (Semi Premium, \$13.99)	\$17.07
6	Packaged beer – low strength	\$19.93
7	Draught beer – full strength	\$21.36
8	Grape wine product (flavoured sparkling wine, \$4.25 per 200ml bottle)	\$26.72
9	Bottled wine (Premium, \$16.99)	\$26.72
10	Packaged beer – mid strength	\$27.17
11	Packaged beer – full strength	\$30.35
12	Flavoured malt baverage	\$31.15
13	Brandy	\$63.99
14	RTD (spirits based)	\$68.54
15	Spirits	\$68.54

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Source: DSICA and various Government and public sources

Some of the more notable conclusions illustrated by the above table are:

- With the exception only of low alcohol draught beer, cask wine pays the lowest effective rate at only \$5.28 per lal (when the abv is at least twice the abv of full strength beer or RTDs);
- Port (\$13.97 per lal) at 18% abv pays less than half the effective rate of full strength packaged beer (at 4.6%) of \$30.35;
- Mid-strength packaged RTDs (which pay the same effective rate as full strength packaged RTDs of \$68.54 per lal) are taxed at 250% the effective rate applying to mid-strength packaged beer (\$27.17 per lal);

- Full strength packaged RTDs (\$68.54 per lal) are taxed at 225% the effective rate applying to full strength packaged beer (\$30.35 per lal); and
- Full strength RTDs (at \$68.54 per lal) are taxed at 257% the effective rate applying to grape wine products (\$26.72 per lal) when their abv is typically double that of a full strength RTD.

As DSICA notes, the results of this analysis is stark and clearly highlight the lack of equity in the current taxation system. When confronted by this analysis, it is clear as to why production and consumption decisions are significantly distorted.

Non-GST tax per standard drink

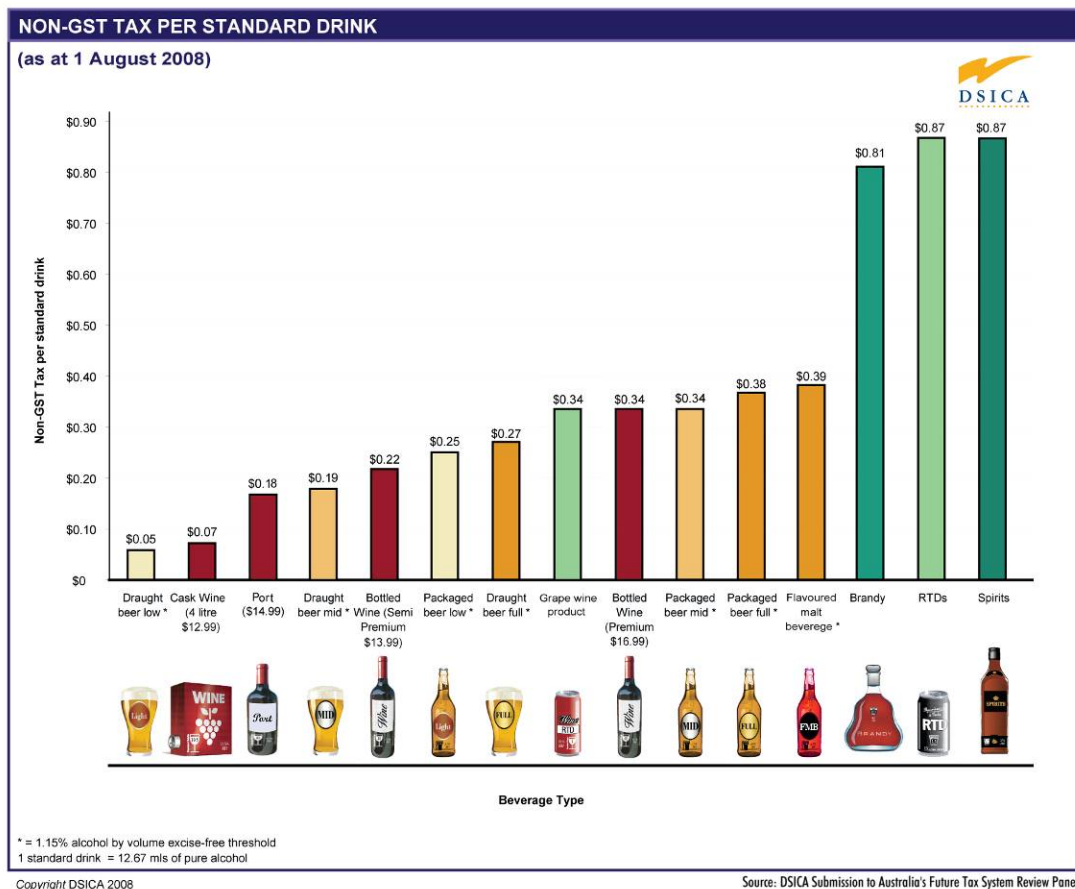
The complexity of the alcohol tax system is demonstrated in another way by observing the amount of tax different beverages pay on a 'per standard drink' basis – see *Graphic 10* below.

The concept of a standard drink allows a uniform means of comparison of the incidence of taxation on products of differing alcohol strength and retail price.

The spirits industry has invested heavily in promoting the standard drink concept through efforts such as including standard drink logos on container labels. This promotion, together with health agency promotion and education around standard drinks and alcohol consumption guidelines, has led to an increasing awareness of the standard drink concept amongst the general public. Accordingly, DSICA believes that consumers have an increasing appreciation of the need for taxation equity when measured on a 'tax per standard drink' basis.

The graphic below outlines tax per standard drink on the main alcohol beverages effective since the indexation of excise and customs duty rates on 1 August 2008.

Graphic 10: Non-GST tax per standard drink



Some of the inequitable outcomes that can be observed in the previous two graphics are:

1. The failure of the current tax system to maintain horizontal equity due to the different tax treatment of wine (on an ad valorem basis) compared to other alcohol beverages (on a volumetric basis).
2. The failure of the current tax system to maintain horizontal equity due to the arbitrary distinctions made under the excise and customs regimes, with **different effective rates** applying to products of the **same alcohol strength**. A number of tax concessions also unfairly apply to some categories of product and not others, despite common alcohol strengths.
3. The failure of the current tax system to maintain horizontal equity due to the application of an additional 5% protective tariff on **some** imported excise-equivalent alcohol products (spirits, RTDs and wine).

These three problems are explored in detail below.

5.2 Lack of taxation equity – comparison of the Excise/Customs and WET systems

Taxes on alcohol in Australia are raised under the following taxation regimes:

- Excise duty – volumetric excise duty applies to locally produced beer, spirits and RTDs;
- Customs duty – an valorem duty applies to imported wine, spirits and RTDs;

- Wine Equalisation Tax – an ad valorem tax applies at the wholesale level to locally produced and imported wine, grape wine products and cider; and
- GST – on all alcohol products sold in Australia.

Excise and customs duty

Specific excise or customs duties are applied to all beer, spirits and RTDs entered for home consumption in Australia. The duty rates for these products are outlined in the *Excise Tariff Act 1921* and the *Customs Tariff Act 1995*.

An ad valorem 5% protective tariff is imposed on imported wine, spirits and RTDs only (the 5% protective tariff is discussed in further detail below).

Wine equalisation tax (WET)

Since the NTS reform in 2000, wine has been taxed under the *A New Tax System (Wine Equalisation Tax) Act 2000*.

The Wine Equalisation Tax (WET) is an ad valorem tax applied at a rate of 29% of the notional wholesale selling price (s55 of the WET Act).

The very nature of an ungraduated, ad valorem alcohol tax system is contrary to the principles of taxation of alcohol outlined in Section 4 above - that is to recapture externalities and discourage harmful consumption. Rather, under the WET regime, increases in the tax liability of a product are proportional to the products value, creating the incentive for the production and consumption of low value, high alcohol wine and grape wine products (often sold in casks/soft-packs). These are unfortunate and undesirable outcomes.

The WET producer rebate, provided in the form of a wine tax credit, is made available on the first \$500,000 of a producer's WET liability. This rebate serves to further lower the effective tax rate applied on products falling under the WET regime. Wine producers will obtain a tax concession of an estimated \$195m (2008-09) as a result of the WET producer rebate (as measured in the Treasury's *Tax Expenditure Statement 2007* - Treasury 2007).

Australia is unique, as the only country in the 'OECD 10' (a grouping identified in the *International Comparison of Australia's Taxes* - Warburton and Hendy 2006) to apply an ad valorem taxation regime on wine. See *Graphic 11* below.

Graphic 11: OECD comparison: taxation systems for alcohol products

OECD COMPARISON: TAXATION SYSTEMS FOR ALCOHOL PRODUCTS			
OECD 10 countries	Beer	Wine	Spirits
Australia	S	AV	S
Ireland	S	U	S
Switzerland	S	U	S
UK	S	U	S
Canada	U	U	S
Netherlands	U	U	S
New Zealand	U	U	S
Spain	U	U	S
US	U	U	S
Japan	U	U	U

Key: S = specific (volumetric) rates
AV = ad valorem rates
U = unitary system



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Source: Warburton & Hendy 2006

In fact, almost all of the 30 OECD countries apply either a specific or a unitary rate of excise on all alcohol products (the other exceptions being Mexico, Korea and Turkey). Furthermore, the European Union (EU), Council Directive 92/84/EEC of the EU dated 19 October 1992 mandates that all members shall apply either a specific or unitary alcohol excise tax.

DSICA contends that there is no social or health policy justification for a separate taxation regime for wine, grape wine products and cider. Furthermore, international best practice amongst OECD and EU countries would suggest that there is no sound case for the ad valorem taxation of alcohol beverages.

Distinctions are drawn between beverages based on the ingredients and the form or manufacture that fail to maintain relevancy as alcohol beverage production and marketing become evermore sophisticated. Products of similar appearance – in packaging, colouring and texture – and of similar alcohol strength and taste may be taxed at considerably different rates. For example, DSICA would point to the vastly different tax per standard drink applying to wine based RTDs and spirit based RTDs as outlined in *Graphic 10* above.

5.3 Lack of taxation equity – market share vs revenue share for alcohol products

DSICA and its members continue to be astonished at the inequity in the current taxation system whereby the spirits sector (spirits and RTDs) can comprise only 23% of the market (in litres of alcohol), while being asked to pay close to half of total taxation revenue attributable to all alcohol products. The tax per standard drink graphic outlined earlier in this section tells a similar story.

Recent RTD tax change has exacerbated inequities and is creating distortions

The tax change to RTDs effective from 27 April 2008 has had the effect of exacerbating the inequity faced by the spirits sector in terms of the sector's share of the market compared to its contribution to alcohol tax revenue.

This discrimination is further heightened when the best available survey evidence demonstrates that the policy reason given by the Government for increasing the tax on RTDs has no substance or foundation. There is no reliable evidence to suggest that the growing popularity of RTDs has led to an increasing level of risky/high risk drinking by young people. To the contrary, in general terms and on most measures, harmful alcohol consumption patterns of young people are not changing (PBS 08-09, p. 28).

Increasing the rate of taxation of RTDs from that of similar strength products (eg beer) to products that are of an average of eight times the alcohol by volume (full strength spirits) has already lead to a return to the market of so-called 'designer drinks' based on beer and wine. These products attract an even greater relative tax advantage since the tax change. In addition, we have recently seen cider producers bring new products into the market to compete directly with RTDs. These products have a similar abv to RTDs (around 5%) and are being targeted at RTD drinkers in terms of their marketing and taste profiles. The tax advantage that cider has over spirit based RTDs will continue to aid the significant growth occurring in the cider market at the moment.

In the past, Treasury have recognised the problems a lack of tax neutrality would have on the manufacture of pre-mixed drinks:

"The vastly different rates of excise duties on alcohol beverages create competitive disadvantages. This means that spirits based drinks are at a competitive disadvantage compared to wine based pre-mixed drinks."
(Treasurer 1998, p. 73)

For this very reason, in 2000 the then Government – based on sound tax principles – reduced the excise and customs duty rates on RTDs from the same rate as full-strength bottled spirits to a similar rate to full-strength packaged beer. When reversed this year, the same market distortion cautioned by Treasury in 1998 was re-introduced into the alcohol market.

Therefore, far from closing a loophole with its recent decision to increase that tax on RTDs, the Government has actually re-opened an old one.

5.4 Lack of taxation equity – the Excise and Customs regimes

As illustrated in *Graphic 10*, further inequity in the current tax system is created by the following three abnormalities;

- Concessional rates applied to draught beer;
- The failure of the excise and customs system to provide incentives for the manufacture and consumption of low-and mid-strength RTDs as exists for draught and packaged beer; and
- The application of a 1.15% excise-free threshold applying exclusively to beer.

These abnormalities are discussed below.

Concessional rates applying to draught beer

Draught beer obtains a tax concession of \$170m (2008-09 estimate) as a result of lower nominal rates applicable to the product compared to the benchmark rate applying to full strength packaged beer (Treasury 2007). This reduced rate was implemented due to historical reasons in 2000 and 2001 and now distorts the market by:

- discriminating against packaged beer and RTDs that are taxed at higher rates; and
- discriminating against draught RTD products that are also taxed at a higher rate.

Other beer concessions - concessional rate applying to low-strength packaged beer and the 1.15% abv excise-free threshold applying to all beer products

DSICA believes that the current system of alcohol taxation needs to be fundamentally addressed as the system:

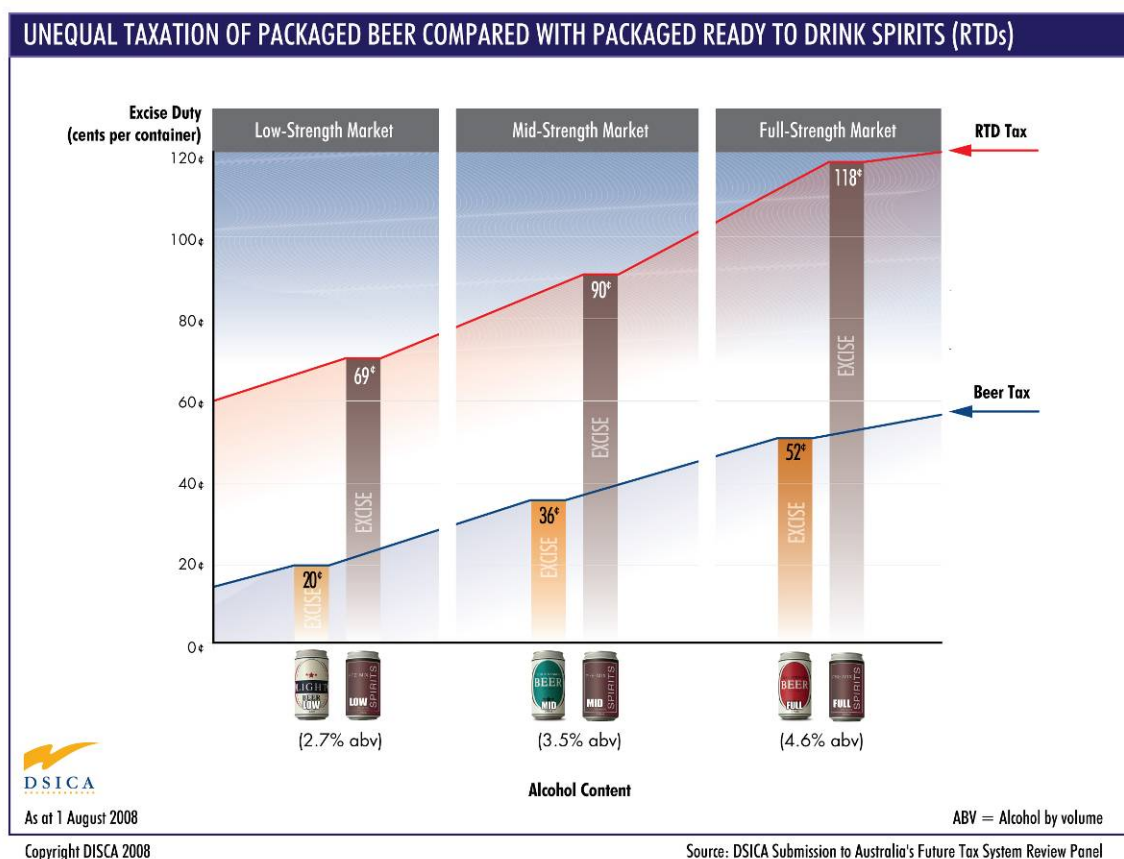
- fails to provide adequate incentives to encourage the production of lower alcohol products; and
- fails to provide adequate incentives for drinkers to choose those alcohol products that are least associated with harm.

It continues to be a major flaw in the current taxation structure that there is no incentive to produce low-strength and mid-strength RTDs as there is in the case of packaged beer (where a lower effective taxation rate applies). This situation has been further exacerbated by the recent 70% increase in the taxation of RTDs, which has had the consequence of increasing the tax liability of all RTDs regardless of alcohol content.

RTDs incur an even higher rate of effective taxation in comparison to beer as RTDs do not receive the 1.15% abv excise-free threshold. This is a failure against the fundamental equity principle of taxation and distorts production and consumption decisions.

DSICA has produced a unique excise tax graphic which demonstrates the amount of excise duty payable on a single can of RTDs and a beer product at the low alcohol and mid-strength content ranges (see *Graphic 12*).

Graphic 12: Unequal taxation of packaged beer compared with packaged ready to drink spirits (RTDs)



It can be seen that the amount of excise duty payable on a low-strength can of RTDs (69 cents) is greater than the amount of excise duty payable on a full-strength can of beer (52 cents).

Concessional rate applying to brandy

Brandy obtains a taxation concession of \$5m (estimate for 2008-09) as a result of lower nominal rates applicable to that product compared to the benchmark rate (for full strength bottled spirits) (Treasury 2007). This reduced rate discriminates against full strength bottled spirits of comparable alcohol strength that are taxed at a higher rate and again fails the test of taxation equity.

The 5% ad valorem protective tariff for imported spirits

There is no justifiable taxation or health policy rationale for the 5% customs duty on imported spirits, but no 5% customs duty on imported beer.

Further inequity arises as implementation of an increasing number of bi-lateral free trade agreements include agreements to remove the protective tariff for products of specific origin. For example, the Australia-US Free Trade Agreement allows whiskey (bourbon) from the United States (a significant component of the whiskey market in Australia) to be imported into Australia with no ad valorem duty component, while whisky of other origin (for example, from Scotland and Ireland – another significant component of the whisky market in Australia) is required to pay the 5% tariff.

Conclusion

The current Australian alcohol tax system clearly fails the fundamental taxation principle of equity.

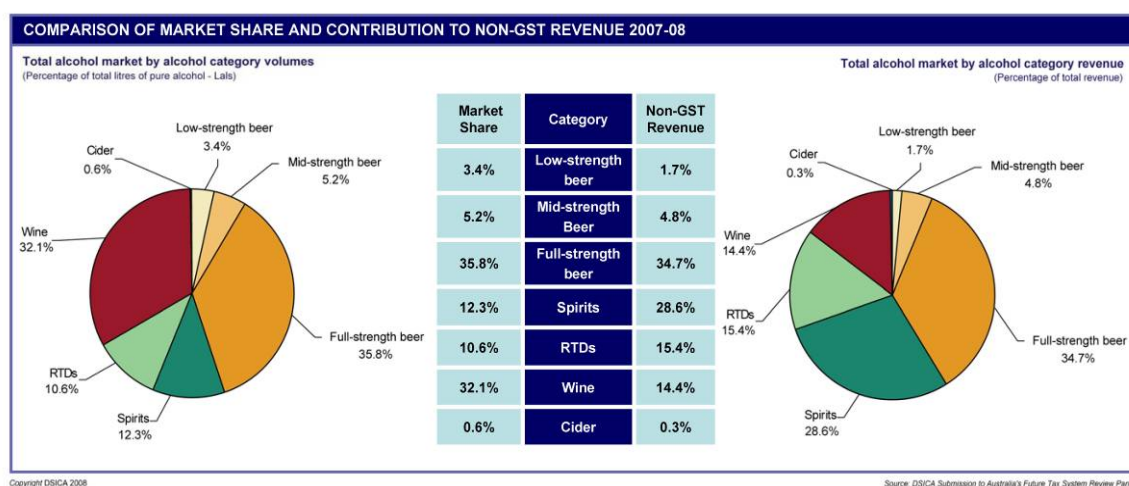
Inequity in the level of taxation applied to different product means that neutrality is not preserved.

DSICA estimates that in 2007-08, RTDs accounted for 10.6% of the total alcohol sold in Australia (in Lals). However, in that period RTDs accounted for 15.4% of total non-GST revenue on alcohol products.

Similarly, spirits accounted for 12.3% of the total alcohol sold in 2007-08 while contributing 28.6% to total non-GST revenue.

The impacts of the separate WET regime and the application of concessional rates of excise on beer products meant that in 2007-08 beer contributed 41.21% of total non-GST revenue on alcohol will making up 44.4% of the total market while wine contributed only 14.4% of total non-GST revenue despite making up 32.1% of the market. See *Graphic 13* below.

Graphic 13: comparison of market share and contribution to non-GST revenue 2007-08



The most stark outcome of this problem ridden system is the disincentive to manufacture and consume lower alcohol content spirits-based and wine-based products.

5.5 Efficiency

As described earlier in this submission, excise is historically one of the most efficient sources of revenue collection.

The WET regime imposed on wine products is arguably less efficient, even though it too uses self-assessment arrangements. This inefficiency is due to the relatively larger number of WET remitters and the difficulties encountered by some producers in calculating their WET liabilities. The WET regime is complex and has a wide range of 'assessable dealings', wine definitions, producer rebates, credits payments and refunds.

5.6 Certainty and simplicity

As described earlier in this submission, a problem with the current system arises due to the separate administration for the collection of excise and customs duties. This causes excessive administration not just because of the need to report to two separate authorities, but to do so when there are a complex set of administrative arrangements for the administration and maintenance of licences that deal with excisable and excise like goods.

6 Alcohol Taxation – Reforms needed

Section outline: This section of the submission addresses the fourth 'framing question' outlined by the Review Panel in its request for initial submissions, namely:

Framing Question #4: What reforms do we need to address these problems?

In responding to this question, DSICA has, in the context of this initial submission, outlined six 'guiding principles' that it believes should be followed to direct alcohol taxation reform. These principles will be used to develop detailed recommendations in future submissions to the Review Panel regarding specific reforms.

6.1 Introduction

Discussion in earlier sections of this submission clearly demonstrates that there is an urgent need for comprehensive reform of the alcohol taxation system in Australia.

The challenges facing Australia by way of alcohol use and mis-use (see Section 3) combined with the problems inherent in the current alcohol tax system (see Section 5 above), clearly present a strong case that fundamental reform of the system is urgently needed.

Given the health and social policy considerations and the extent of government revenue at stake from taxation of alcohol products, it is important that any reform is approached in a co-ordinated and considered way.

Guiding Principles for Alcohol Tax Reform

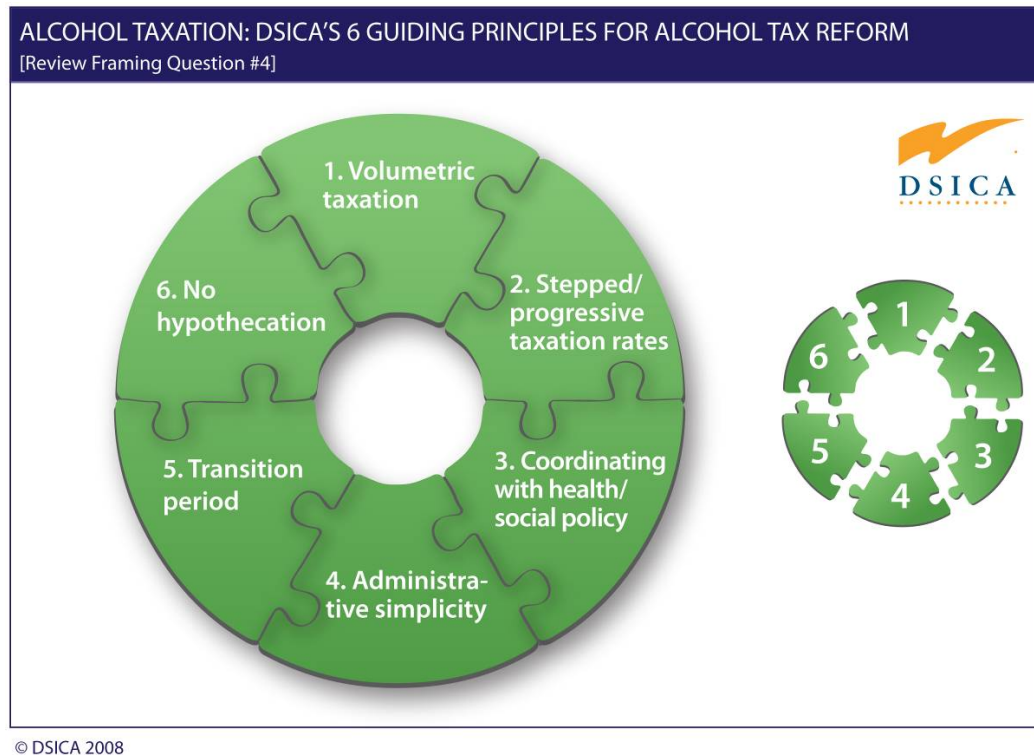
As a first step, to help guide the alcohol tax reform process, DSICA has developed a series of guiding principles that it will refer to in the coming months to develop more detailed positions on various aspects of the alcohol tax system. The guiding principles are as follows (and illustrated in *Graphic 14* below):

- 1. Volumetric taxation:** Australia's future alcohol tax system should embrace the volumetric taxation of *all* alcohol products.
- 2. Stepped taxation rates:** Australia's future alcohol tax system should apply stepped (or progressive) rates of volumetric excise taxation on alcohol products. There should be a series of progressively increasing rates applying to products of higher alcohol content. Products of the same alcohol content should be taxed at the same rate irrespective of the alcohol source of the product or the manner in which the alcohol is delivered (eg. poured from a keg or bottle).
- 3. Coordinated approach with health and social policy initiatives:** Development and implementation of health and social policy initiatives in relation to alcohol use should be undertaken in recognition of and in harmony with the nature of the (reformed) alcohol tax system.
- 4. Administrative simplicity:** Australia's future alcohol tax system should embrace administrative simplicity to the greatest extent possible.
- 5. Transitional period:** To the extent that changes in the system and rates of alcohol taxation will lead to changes in price (and therefore sales) of some alcohol products, the Government should consider specifying a transitional period over which there could be a gradual move to the new system.

6. No hypothecation of alcohol taxation revenues: Revenues collected on the consumption of alcohol products should **NOT** be hypothecated to particular purposes (such as alcohol education and treatment programs and services).

DSICA outlines these guiding principles in this section of the submission.

Graphic 14: DSICA's 6 Guiding Principles for alcohol taxation



6.2 Guiding Principle 1 – volumetric taxation

Australia's future alcohol tax system should embrace the volumetric taxation of all alcohol products.

DSICA believes that there is a very strong case for the application of volumetric excise taxation for alcohol – and, in particular, the need for it to be applied across **all** forms of alcohol.

The nature of volumetric taxation supports the common sense reality that alcohol is alcohol – and therefore that all beverages should be treated equitably on this basis.

Outlined below is a series of arguments that support the application of Guiding Principle 1:

- economic theory over many decades has supported the use of volumetric excise taxation for alcohol;
- international practice supports the use of volumetric excise taxation for alcohol;
- volumetric excise taxation, when applied appropriately, supports and complements the use of other policy measures to limit harmful alcohol consumption;
- volumetric excise taxation is an equitable mode of taxation that will encourage the production and consumption of lower alcohol content beverages;
- there is widespread support from health and social lobby groups for the use of volumetric excise taxation for all alcohol products; and

- the introduction of volumetric excise taxation across the board for all alcohol beverages would remove many of the anomalies and complexities in the current alcohol taxation system.



6.3 Guiding Principle 2 – stepped taxation rates

Australia's future alcohol tax system should apply stepped (or progressive) rates of volumetric excise taxation on alcohol products. There should be a series of progressively increasing rates applying to products of higher alcohol content. Products of the same alcohol content should be taxed at the same rate irrespective of the alcohol source of the product.

DSICA believes that there are sound economic and social policy arguments for a stepped progressive series of volumetric rates applying to all alcohol products.

Outlined below is a series of arguments that support the application of Guiding Principle 2:

- lower rates of taxation applying to lower alcohol content beverages will encourage the production and consumption of lower alcohol beverages (including beer, wine and RTD products);
- higher rates of taxation applying to higher alcohol content beverages is consistent with the economic and social policy arguments regarding the need to address the externalities associated with harmful consumption;
- there is widespread support from health and social lobby groups for lower rates of taxation to apply to lower alcohol content beverages; and
- the concept of tiered or stepped rates is already familiar to most alcohol product manufacturers and wholesalers in Australia.

During the next phase of consultations by the Future Tax System Review Panel, DSICA will develop and submit a detailed proposal on what the alternative rates could be and at what alcohol content levels they should apply.



6.4 Guiding Principle 3 – coordinated approach with health and social policy initiatives

Development and implementation of health and social policy initiatives in relation to alcohol use should be undertaken in recognition of, and in harmony with, the nature of the (reformed) alcohol tax system.

DSICA acknowledges the important place and role for various health and social policy initiatives in relation to alcohol use and mis-use. DSICA supports efforts in this regard through:

- its past involvement in major Government alcohol initiatives such as the *National Alcohol Strategy*;
- the support by all of its members for DrinkWise Australia – an organisation with the aim of promoting a more responsible drinking culture in Australia; and
- the efforts of its individual members to support community initiatives in the area of responsible alcohol consumption.

However, DSICA stresses the need for community alcohol initiatives to be developed in recognition of, and in harmony with, the alcohol tax system. As DSICA has indicated in this submission, drawing on work of the Treasury and other reputable economic sources, where there are non-tax measures in place to address the externalities of alcohol consumption, then there is less of a need for complementary tax measures.

This Guiding Principle is therefore underscored by the need to ensure the correct balance of measures is achieved.



6.5 Guiding Principle 4 – administrative simplicity

Australia's future alcohol tax system should embrace administrative simplicity to the greatest extent possible.

As this submission has outlined, excise systems of taxation lend themselves to administrative simplicity. DSICA believes that current administrative arrangements for the administration and collection of customs and excise duties are cumbersome, involve an unnecessary amount of duplication, and can be easily reformed into a much simpler system.

Outlined below is a series of arguments that support the application of Guiding Principle 3:

- economic and taxation theory have long suggested that excise taxation lends itself to administrative simplicity;
- there would be cost savings to the Government in moving to a simpler system of excise/customs duty administration (by removing the dual administration by the ATO and Customs);
- there would be efficiency savings to industry by having to deal with one administering tax authority rather than two; and
- there has been recent support from the Federal Government's Productivity Commission for adoption of a simpler approach to excise/customs duty administration.



6.6 Guiding Principle 5 – transitional period

To the extent that changes in the system and rates of alcohol taxation will lead to changes in price (and therefore sales) of some alcohol products, the Government should consider specifying a transitional period over which there could be a gradual move to the new system.

It is common practice in policy development and implementation that where a policy change could lead to major changes in behaviours (eg responding to price changes), that a period of time to transition to the new system be allowed.

Where the outcomes of the review of Australia's alcohol tax system result in adoption of new rates that will lead to significant changes in price and consumption, DSICA suggests that it would be equitable to allow a period of time for the industry and consumers to adjust to the new system. The length of the period could be set after consultation with the whole industry, with reference to the extent of change in the incidence of taxation on some beverages.



6.7 Guiding Principle 6 – no hypothecation of alcohol taxation revenues

Revenues collected on the consumption of alcohol products should NOT be hypothecated to alcohol treatment and education programs.

There are a range of policy and practical reasons why alcohol taxation collections should not be hypothecated to alcohol treatment and education programs:

- hypothecation distorts government funding priorities and leads to inflexibility;
- hypothecation reduces the level of accountability and scrutiny of funds in the budgetary cycle;
- hypothecation requires a high degree of monitoring and review;

- significant amounts of Federal Government revenue are already provided to the States/Territories (who have primary responsibility for the delivery of health treatment services) through the allocation of all GST revenues.



7 Conclusion

Australia currently has a very complex alcohol taxation system that fails in many elements to be optimal in delivering on the Government's various policy goals. As the system does not tax all products on a volumetric basis according to alcohol content, the system does not support the equitable principle that alcohol is alcohol.

This Review presents an ideal opportunity – an opportunity not to be missed - to reform the alcohol tax system in a way that produces better social and economic outcomes and removes the current complexity, anomalies and administrative burdens embedded in the current system.

DSICA is encouraged that there is a degree of consensus developing around various aspects of alcohol tax policy – for instance the need to have uniform volumetric taxation and the need to provide more incentive for production and consumption of lower strength alcohol products. This consensus provides a good foundation upon which to progress positive reform in the area.

DSICA believes that there is a sound economic basis for the propositions it has advanced in this submission. We have sought to bring these propositions together in the six 'Guiding Principles' outlined in section 6 that can direct reform.

DSICA looks forward to working with Government in the subsequent phases of the reform process with the aim of implementing a more equitable and efficient system that will produce better health, social and economic policy outcomes for Australia.

List of Abbreviations

ABS	Australian Bureau of Statistics
abv	alcohol by volume (ie alcohol content)
ACS	Australian Customs Service
ATO	Australian Taxation Office
DHA	Department of Health and Ageing
DSICA	The Distilled Spirits Industry Council of Australia Inc
FSBS	Full-strength bottled spirits
GST	Goods and Services Tax
Lals	Litres of alcohol
LMA	Liquor Merchants Association of Australia
MAT	Moving annual total
MCDS	Ministerial Council on Drug Strategy
NAS	National Alcohol Strategy
NDSHS	National Drug Strategy Household Survey
NHMRC	National Health and Medical Research Council
NTS	New Tax System (implemented from 1 July 2000)
RTDs	Ready-to-drink alcohol products
TES	Tax Expenditure Statement (Commonwealth Treasury)
WET	Wine Equalisation Tax
WHO	World Health Organisation

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