



Distilled Spirits Industry Council of Australia Inc

Improving Australia's System of Alcohol Taxation - the second instalment

Second submission to Australia's Future Tax System (AFTS)

Review Panel

Response to the AFTS Consultation Paper



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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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List of Abbreviations

ABS	Australian Bureau of Statistics
abv	alcohol by volume (ie alcohol content)
ACS	Australian Customs Service
AFTS	Australia's Future Tax System
ATO	Australian Taxation Office
BAS	Business Activity Statement
DSICA	The Distilled Spirits Industry Council of Australia Inc
GST	Goods and Services Tax
IAC	Industry Assistance Commission
IDC	Inter-Departmental Committee
IMF	International Monetary Fund
Lals	Litres of alcohol
MCDS	Ministerial Council on Drug Strategy
MP	Member of Parliament
NGOs	Non-Government Organisations
NTA	National Tourism Alliance
NTS	New Tax System
RHS	Right Hand Scale (in graphs)
RTDs	Ready-to-drink alcohol products
WET	Wine Equalisation Tax

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Executive Summary

Who is DSICA?

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

An urgent need to reform alcohol taxation

- DSICA's first submission (the 'First Submission') to Australia's Future Tax System (AFTS) Review Panel (the Review Panel) outlined the complexities and anomalies that exist with the current alcohol tax system in Australia. The system causes significant distortions and inefficiencies in production and consumption decisions, and less than optimal social and economic outcomes.
- We noted that the current inefficient system is the result of a history of ad-hoc and incremental changes, rather than through an all-embracing, principle-driven, comprehensive development or reform process.
- There is an ongoing need to effectively address harmful alcohol consumption. The fact that the current alcohol system does not optimise desirable consumption outcomes means that there is an urgent need to reform Australia's current alcohol tax system.

DSICA tax reform proposal

- DSICA has developed a comprehensive, principle driven, proposal for alcohol tax reform that is more equitable between beverage categories, and that provides incentives to produce and consume lower alcohol content beverages.
- As highlighted in the First Submission, DSICA has adopted a series of 'guiding principles' to assist it develop its tax reform proposal. The guiding principles provide a foundation and framework to arrive at a proposal which will help address economic, health and social policy objectives.
- At DSICA's request, KPMG has conducted an independent economic analysis of DSICA's reform proposal and has estimated the price, consumption and government revenue impacts of the proposal using its econometric model for the market for alcohol beverages.
- The findings of the econometric modelling indicate that under DSICA's reform proposal, overall alcohol consumption would fall and government revenues would increase relative to the pre-2008 alcohol tax system. (Note, while KPMG has modelled the impact of the DSICA reform proposal, KPMG does not have an opinion on alcohol tax policy).
- These outcomes can be achieved by a combination of incentives to consume lower alcohol content beverages, the removal of some existing concessions and application of higher rates to some beverage categories.

Addressing the Review Panel consultation questions

- DSICA notes that the Review Panel has raised three consultation questions specifically related to taxes on alcohol – refer to consultation questions Q11.1, Q11.2 and Q11.4 of the Discussion Paper.

- In framing its response to the two primary questions (questions Q11.1 and Q11.2), DSICA has referred to the guiding principles outlined in its First Submission. With the assistance and support of the guiding principles, DSICA has concluded:
 - **Consultation Question Q11.1:** It is appropriate to use tax on alcohol to influence consumption decisions, so long as the taxation is neutral and non-discriminatory across alcohol types. The guiding principles assist in determining the structure and rates.
 - **Consultation Question Q11.2:** The competing potential objectives of revenue raising, health policy and industry assistance can be resolved. This involves ensuring an equitable tax system design which is complemented by a range of non-tax measures.
- In relation to Consultation Question Q11.4, there are sound policy and administrative reasons to maintain the duty free concessions on the arriving passenger importation of alcohol.

Longer term reform

- DSICA's primary aim in relation to alcohol tax reform is to ensure that a more equitable, efficient and sustainable system is adopted as soon as possible. Our recommendations for this system are outlined in this submission.
- In the longer term, DSICA believes that further reforms can be made to achieve an even more equitable system. In this regard, DSICA has outlined a series of concepts for consideration as part of a longer term alcohol tax reform agenda. These do not necessarily represent current DSICA policy, rather they are points for further discussion.

1. Introduction

1.1 Urgent need for alcohol tax reform

The AFTS Review has provided yet another opportunity to highlight the complexity of the current alcohol tax system. Submissions to the Review Panel and the Panel's Consultation Paper have both identified the many anomalies and shortcomings of the existing system.

DSICA's First Submission outlined the challenges Australia faces in alcohol policy, the problems with the current system and most importantly documented six guiding principles for alcohol tax reform.

In DSICA's view, it is indisputable that Australia urgently requires alcohol tax reform to address the many distortions and the sub-optimal economic and social outcomes that are presently occurring.

1.2 DSICA's alcohol tax reform proposal

In this submission, DSICA builds on the guiding principles by outlining an alcohol tax reform proposal that adheres to the guiding principles and will help achieve better economic and social outcomes.

DSICA strongly supports and advocates a volumetric approach for all alcohol products. Simply put – **alcohol is alcohol** and all products irrespective of their alcohol base should be subject to the same form of taxation. DSICA's tax reform proposal embraces this approach.

DSICA also supports stepped, or progressive, rates of taxation for alcohol products whereby a progressively higher rate of taxation applies to products of higher alcohol strength. Products containing higher alcohol levels will pay more tax under a volumetric approach. In addition, it has been a longstanding practice to tax products with a higher alcohol content at higher nominal rates. DSICA accepts this approach and this concept is firmly embedded in DSICA's tax reform proposal. As a corollary, DSICA also considers that products that are low alcohol within their category should be subject to a lower nominal rate.

As part of developing the tax proposal, DSICA commissioned KPMG to conduct an independent economic analysis of DSICA's reform proposal and estimate the price, consumption and government revenue impacts of the proposal using its econometric model for the market for alcohol beverages. In summary, while the reform proposal will result in some changes in price relativities for products, it will importantly result in lower overall alcohol consumption but a higher amount of revenue collected. These results are outlined in this submission.

1.3 Structure of this submission

This submission contains four sections in addition to its executive summary, introduction and conclusion.

In addition to recapping DSICA's six guiding principles of tax reform (Chapter 3) and outlining its reform proposal (Chapter 4), the submission also documents DSICA's response to the three consultation questions outlined in section 11 of the Discussion Paper which deal with the taxation of alcohol.

From DSICA's perspective, the principal output of this submission for consideration by the Review Panel is the tax reform proposal outlined in Chapter 4.

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2 Objectives of alcohol taxation

Chapter overview: In this section, DSICA outlines how it is possible to reconcile the competing potential objectives of alcohol taxation as outlined in the Discussion Paper of revenue raising, health policy and industry assistance [Consultation Question Q11.2]

2.1 Excise as an appropriate form of tax for alcohol

Consultation Question Q11.2 considers the important issue of how to reconcile the often perceived conflicting policy objectives of revenue raising, health policy and industry assistance.

Consultation Question

Consultation Question Q11.2: Can the competing potential objectives of alcohol taxation, including revenue raising, health policy and industry assistance, be resolved? What does this mean for the decision to tax alcohol more than some commodities?

DSICA believes that these objectives can be effectively reconciled, providing an appropriate system of alcohol taxation is implemented and an appropriate perspective is taken on the role of alcohol taxation in the health policy and industry assistance contexts.

Revenue raising objectives

For centuries it has been accepted that certain types of goods, including alcohol, lend themselves appropriately to be subject to excise taxation. The relative demand inelasticity of these goods (and therefore their **revenue “buoyancy”**), combined with the inbuilt mechanism to **‘internalise’ the negative externalities** associated with their use, have rendered them as ideal candidates for excise taxation. Based on evidence in the Australian context, DSICA is of the view that the primary objective of alcohol taxation is to raise revenue.

Health policy objectives

At the same time, health advocates highlight another objective of excise taxation – to **discourage harmful consumption**. While it is true that higher taxation of alcohol, through its effect on price, will broadly reduce consumption – it may not effectively target and reduce *harmful* consumption within particular groups in the community.

Accordingly, the ‘blunt’ effect of taxation on all alcohol consumption (whether harmful or not) means that the majority of drinkers who drink responsibly are penalised while those who drink at harmful levels may not be assisted to change or moderate their behaviours. It is necessary therefore for more targeted and specific interventions to assist those at higher risk.

DSICA therefore recommends that a moderated, neutral, consistent tax regime which provides the incentive to produce and consume lower alcohol content beverages is the appropriate taxation approach for alcohol. Specific health objectives beyond this should be pursued through targeted (non-tax) health measures and programs funded from Government health portfolio budgets and the various (Government and industry funded) non-Government organisations (NGOs). Furthermore, other Federal and State/Territory regulation has a role in this area – with such things as liquor licensing and drink-driving laws.

Industry assistance policy objectives

DSICA believes that it is not appropriate to pursue industry assistance policy objectives for selected industry sectors through the tax system. The potential for distortion and the added complexities that would arise which may interfere with the desired economic and health policy outcomes is best avoided by not seeking to deliver industry assistance through the tax regime.

If the Government wishes to deliver assistance to a particular sector of the alcohol industry, this would be better pursued through direct assistance from budget outlays. Assistance delivered in this way is also more transparent and subject to a greater level of review and accountability.

Reconciliation of policy objectives

In response to the Review Panel's Consultation Question Q11.2, DSICA believes that it is possible to resolve the potentially competing revenue raising, health policy and industry assistance objectives PROVIDED THAT:

- There is an equitable, tax neutral approach to all alcohol products – ie all products of similar alcohol content are subject to the same form and rate of taxation.
- The tax system provides an emphasis or incentive to produce and consume lower alcohol content beverages.
- Attempts to address particular harmful or risky consumption behaviours are NOT addressed through the taxation system. Rather, these should be addressed through targeted policies and interventions funded from government outlays.
- The tax system does not attempt to achieve industry assistance objectives, which should be addressed through other mechanisms (eg Government outlays/assistance).

Is it appropriate to tax alcohol more than other commodities?

The second part of Consultation Question Q11.2 asks whether and how, based on the response to the first part of the question, this impacts on the decision to tax alcohol more than other commodities.

As outlined in the First Submission, DSICA accepts that taxation of alcohol has a legitimate role in assisting government achieve its revenue targets and economic objectives. Furthermore, we accept that there are social and economic reasons to address the externalities associated with harmful alcohol consumption.

Alcohol is a commodity that Australian society has decided can be legally consumed. However, DSICA acknowledges and accepts the societal norm that certain private consumption goods be taxed at a higher rate than other consumption goods.

Accordingly, based on our analysis above regarding revenue raising and health policy objectives, DSICA concludes:

- It is appropriate to tax alcohol at a higher level than other commodities.
- Given that the primary objective of excise taxation is to raise revenue, care must be taken to ensure that rates of taxation are not set at a level higher than that which yields the maximum possible revenue (there is some evidence that this has occurred with the recent tax increase on RTDs).
- Tax should be levied equitably and consistently across all beverage types of similar alcohol content to minimise distortions and harmful consumption effects.

2.2 Objectives of excise taxation

In the First Submission, DSICA discussed the three specific objectives of excise taxation (DSICA 2008, p 23).

DSICA believes that these commonly accepted objectives explicitly assist in addressing Consultation Question Q11.2 in that they help frame evidence and informed debate around the revenue raising and health policy questions raised in Consultation Question 11.2.

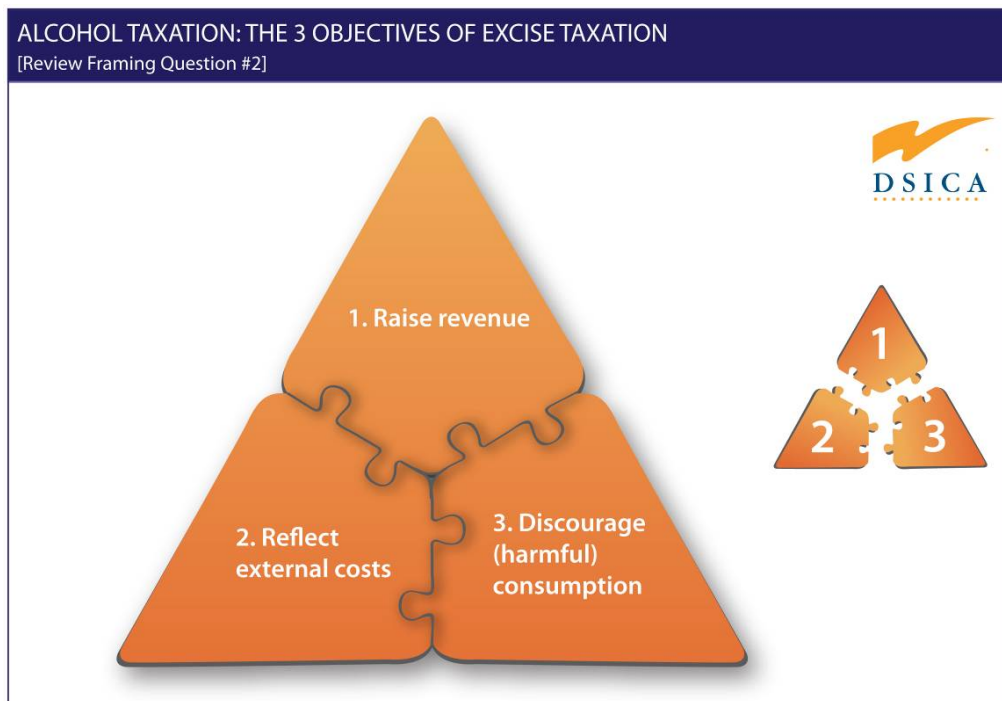
Three objectives of excise taxation

The three commonly accepted objectives of excise taxation are:

- to raise revenue;
- to recapture some of the external costs of use/consumption; and
- to reduce consumption from a level that would otherwise be the case including discouraging excessive and harmful consumption.

These objectives were represented diagrammatically in the First Submission as in Graphic 1 below.

Graphic 1: The 3 objectives of excise taxation



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Excise taxes are effective at raising revenue


The economic rationale underlying the effectiveness of excise taxation on certain goods (such as alcohol, tobacco and fuel) in raising revenue is related to the absence of close substitutes for these products and that private consumption can be targeted. The absence of substitutes means that demand for them is *inelastic* (although in the case of alcohol, demand for some products (eg

beer) is less elastic than others (eg spirits)). This means that tax rates can be set at higher rates with relatively smaller effects on consumption. In economic terms, it is said that distortions are minimised when taxation is applied to goods for which demand is less elastic.

Products generally subject to excise are characterised by the fact that they are easy to identify, sales volume is high and there is generally a small number of producers (Cnossen 2005, p 3). This has meant that, in practice, excise taxes have tended to be levied primarily for revenue raising purposes. The *2006 International Comparison of Australia's Taxes* asserted that revenue yield was the priority in Australian excise policy (Warburton & Hendy 2006, p 252).

DSICA accepts both the economic theory and the realistic practice that taxation of alcohol has a legitimate role in assisting the Government achieve certain revenue targets in order to deliver services to the community. However, to minimise distortions and impacts on decision making, DSICA stresses the need for the alcohol tax system to be neutral across all beverages so that one beverage is not favoured in its taxation treatment relative to another. In simple terms, inequitable taxation between products leads to a reduction in consumer benefit as consumers are priced away from their preferred choice.

Excise taxes help recapture some of the external costs of consumption

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Excise taxation on certain goods is also often justified on the basis that it acts as a charge for the external cost that consumers or producers of excisable products impose on others (Cnossen 2005, p 3). That is, where there are physical, financial or other costs imposed on others as a result of production/consumption of excisable goods, then this should be accounted for in the price if this is not separately recouped or charged for. The economic or physical costs imposed on others is often referred to as 'negative externalities' of consumption.

As we noted in the First Submission (DSICA 2008, p 25), a conflict between the revenue raising objective and the correcting for externality objective exists which needs to be balanced. As noted above, DSICA believes that in Australia excise taxation is primarily targeted at raising revenue.


In relation to the external costs of alcohol consumption, DSICA notes a study in this area was released last year that sought to quantify the avoidable costs of alcohol abuse in Australia. The study – *The avoidable costs of alcohol abuse in Australia and the potential benefits of effective policies to reduce social costs of alcohol* (Collins & Lapsley, 2008) – received a significant amount of media and academic attention due to the rare quantification of an actual dollar amount that the authors attributed to alcohol abuse, namely \$15.3b.

DSICA commissioned Access Economics to review the methodology, assumptions and conclusions of the study. The Access Economics report (Access Economics 2008) found:

- The costing analysis displayed a paucity of supporting evidence, incomplete references, lack of transparency and poor methodology and data use;
- The methods selected for the study were not appropriate to the primary research question; and
- The methods used to select interventions were problematic and out of line with standard practice.

Overall, Access Economics concluded that there were fundamental flaws in the methods used by Collins and Lapsley, and hence its recommendations. Accordingly, DSICA cautions against any use or reliance on this study to help shape alcohol related policy.

Excise taxes discourage harmful consumption



It is quite common for Governments to use excise taxation as a means to reduce harmful consumption of relevant goods. Accordingly, we observe Governments seeking to further public health objectives through increases in the rates of excise taxation.

As we noted in the First Submission (DSICA 2008, p 24), it is important to consider the following, specifically in relation to the excise taxation of alcohol:

- Various studies have shown that a moderate intake of some alcohol can have a beneficial rather than detrimental health impact (ie there is a level of alcohol consumption that could be considered not harmful).
- There is a need to balance taxation policy and non-taxation policy measures which can both be directed at reducing harmful consumption.

DSICA believes that there is potential to reconcile the objectives outlined in Consultation Question 11.2.

2.3 Achieving desired health policy outcomes

It is widely accepted by health regulators, health professionals, academics and the industry that the key health policy objective in relation to alcohol consumption is to reduce the prevalence of harmful drinking by Australians (NPHT 2008a; MCDS 2006)). Developing safer and healthier drinking cultures is an important related objective.

DSICA acknowledges that price and taxation have a role in the overall suite of policy measures aimed at achieving health policy outcomes. However, as the Treasury has cautioned, addressing non-tax policy objectives with taxes on relevant goods can have complex effects (Treasury 2008a, p 281). In this regard, DSICA makes two comments:

- As acknowledged by Treasury (Treasury 2008a, p 280), if an externality is addressed through a non-tax measure, then there is less of a need to apply a corrective tax.
- It is critical that the balance and interaction of tax and non-tax measures is carefully assessed to ensure the best chance of obtaining optimal outcomes.

DSICA believes that an appropriate outcome taking into consideration the above is to:

- implement an equitable and neutral alcohol tax system to help meet the economic and social objectives outlined above (refer DSICA recommendations in Chapter 4);
- ensure that the alcohol tax model incorporates an incentive for the production and consumption of lower strength alcohol products; and
- address harmful consumption issues in the community through targeted policies and interventions that have been shown to be effective.

Non-tax measures have been and continue to be assessed, implemented and reviewed through important initiatives such as the *National Alcohol Strategy* and the National Preventative Health Taskforce. DSICA urges relevant bodies to take into consideration the important policy framing parameters outlined above.

2.4 Industry assistance measures

Governments have on occasion sought to deliver industry development assistance through the taxation system. For example, the Wine Equalisation Tax (WET) wine producer rebate

effectively exempts small wine producers from WET to help build and sustain the industry, which is concentrated in rural and regional areas. Another example is the excise concession for microbreweries that refunds excise up to a certain limit.

DSICA believes that it is not appropriate to deliver industry assistance via the alcohol tax regime. Tax concessions or exemptions will distort producer and consumer behaviours and cause inefficiencies. This would include, in the context of the WET rebate, over-investment in wine production activities that would not be viable without this concession. One can also argue that the ad valorem WET system for wine also confers a broad assistance measure to the wine industry as it results in a much lower tax incidence than would be achieved under a volumetric excise at a similar rate for products of similar alcohol content. This has an obvious distortionary impact on price and therefore consumption and production decisions.

Furthermore, given the important interaction between health and tax policy objectives outlined above, introducing a third objective into the range of framing parameters for alcohol taxation will complicate and possibly hinder the achievement of the priority objectives of revenue raising and positive health outcomes.

DSICA strongly recommends that any assistance for sectors of the alcohol industry that can be demonstrated to be beneficial should be delivered through outlays (eg direct grants) which are subject to greater budget scrutiny, rather than through the taxation system.

3 Alcohol tax principles

Chapter overview: This chapter recaps on the guiding principles for alcohol tax reform DSICA outlined in its First Submission. It also addresses Consultation Question Q11.1 regarding the use of tax to influence consumption choices and where relevant relates each principle to DSICA's response to this question.

3.1 Using the taxation system to influence consumption

Consultation Question Q11.1 poses the question, whether and how the tax system may be used to influence individual consumption choices.

Consultation Question

Consultation Question Q11.1: Is it appropriate to use taxes on specific goods or services to influence individual consumption choices, and if so, what principles can be applied in designing the structure and rates of such taxes?

DSICA believes that:

- The excise taxation of alcohol is primarily targeted at raising revenue (DSICA 2008; Warburton & Hendy 2006, p. 252);
- Using the taxation of alcohol to influence individual consumption and/or address externalities of use is an important, but a secondary consideration to this main purpose;
- Taxation is a 'blunt instrument' when used to influence consumption and accordingly can be used as a general measure to discourage harmful/over consumption but should **not** be manipulated to try to achieve specific consumption outcomes with regard to particular products or classes of consumer;
- Non-tax measures should be used to address harmful consumption;
- A number of changes to the current tax structure would not only reduce distortion but would also encourage the consumption of lower alcohol products; and
- DSICA's 'Guiding Principles' for alcohol tax reform outlined in the First Submission (DSICA 2008, p 37) provide a framework for designing the appropriate alcohol tax structure, including the rates of taxation applicable.

3.2 Tax measures vs non-tax measures to influence alcohol consumption

Taxation is a blunt policy instrument

While it is true that higher taxation of alcohol, through its effect on price, will broadly reduce consumption – it is unlikely to effectively target *harmful* consumption by particular groups of consumers.

The 'blunt' effect that taxation has on all consumption and consumers means that the majority of drinkers who drink responsibly are likely to moderate their consumption because of the price effect while those who drink at harmful levels may not change or moderate their behaviours. It

is necessary therefore for more targeted and specific interventions to assist those drinking at higher risk levels.

Therefore, a moderated, neutral tax regime which contains incentives to produce and consume lower alcohol content beverages is the appropriate taxation approach. To achieve specific health objectives, Governments should implement appropriately researched and designed, targeted (non-tax) health measures and programs.

High price can cause perverse responses

Seeking to achieve health policy outcomes by relying primarily on price (through taxation) may result in unwanted and unintended consequences.

Artificially inflating the price of alcohol beyond a certain point may lead consumers to access illicit substances (which are untaxed) for “intoxication like” effects. This is not a desirable health outcome and will reduce revenues.

Also, it is relatively easy and has been relatively common for individuals to turn to “home production” of alcohol if commercial product is too expensive – that is, driving production “underground”. These practices also will have undesirable effects in that the quality of the product may be sub-standard and/or dangerous to health and government revenue is avoided.

These two examples serve to illustrate that relying too much on price (ie tax) to regulate consumption can result in behaviour that is totally contrary to that which the tax policy is setting out to achieve. A moderate and neutral tax regime, complemented by a range of non-tax measures, is therefore likely to result in more optimal social, health and economic outcomes.

3.3 Guiding Principles for Alcohol Tax Reform

Achieving tax neutrality and encouraging consumption of lower alcohol beverages

DSICA’s first submission to the Review Panel outlined a series of six guiding principles to direct the design of a tax system that is neutral and non-discriminatory across alcohol types. These principles were developed on the basis of the conclusion outlined above, ie that a taxation regime for alcohol is best framed around the objectives of tax neutrality and encouraging the consumption of lower alcohol beverages. The six principles were explored in greater depth in the 2009-10 DSICA Pre-Budget Submission.

A secondary benefit of a number of these guiding principles is that they have an impact on consumer choice, by reducing distortions that encourage consumers to substitute to products that are cheaper than they would otherwise be because they enjoy a tax advantage.

DSICA summarises the six guiding principles below. Please refer to the First Submission and DSICA’s 2009-10 Pre-Budget Submission for further details.

Outlined below is a consideration of each guiding principle with reference to providing a response to Consultation Question Q11.1.

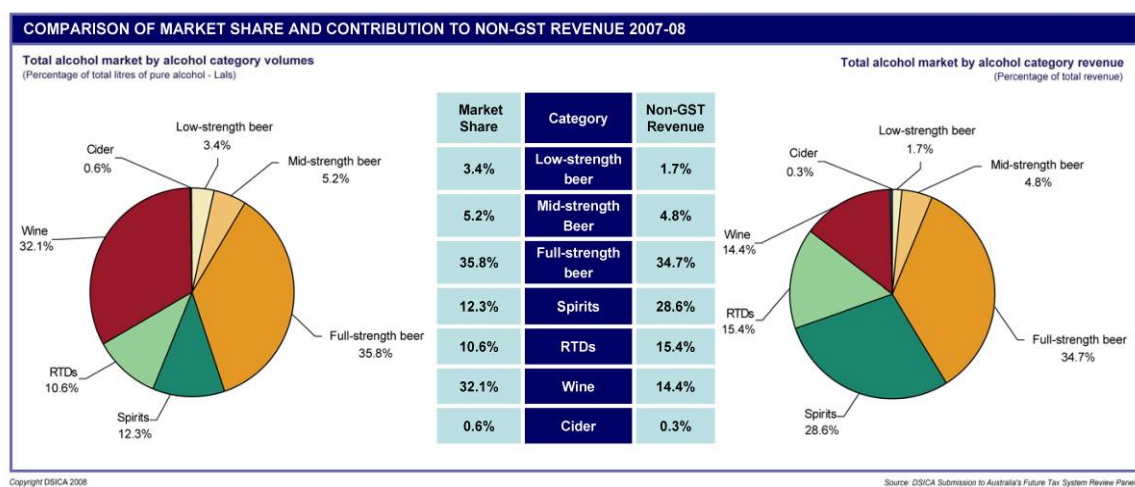
3.4 Guiding Principle 1 – volumetric taxation

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

Under the current alcohol tax system, wine is the only beverage category to not be taxed on a volumetric basis (ie based on the litres of pure alcohol contained in the product).

Since the NTS reform in 2000, wine has been taxed on an ad-valorem basis under the *A New Tax System (Wine Equalisation Tax) Act 2000*. The WET is applied at 29% of the notional wholesale selling price. The low effective tax rate per litre of pure alcohol that the WET system (and the associated WET producer rebate scheme) imposes means that in 2007-08 wine contributed only 14.4% of total non-GST revenue despite making up 32.1% of the market (measured in litres of alcohol) (See *Graphic 2*). By comparison, bottled spirits contributed 28.6% of non-GST revenue but represented only 12.3% of the alcohol market. These figures highlight the current inequity and imbalance in the system.

Graphic 2: Comparison of market share and contribution to non-GST revenue 2007-08



DSICA believes that there is a very strong case for the application of volumetric taxation to all alcohol, including wine. The First Submission outlined this case. Guiding principle 1 is the key feature of DSICA's preferred alcohol tax system embracing the concept of tax equity and neutrality.

Revenue effects

A further benefit of volumetric tax systems is that they are not subject to revenue fluctuations associated with price variations as prices of products move with the economic cycle. Furthermore, with a volumetric system, there is less incentive and less scope to enter into tax minimisation through artificial valuations.

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 regime**, 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."

In the Australian context, recently, the Commissioner of Taxation issued a press release (ATO Media Release 2009/24) which foreshadowed that the ATO would be seeking to deal with arrangements that attempt to reduce the amount of WET paid, or to improperly seek to claim the WET producer rebate. In both cases, the issues arise out of the point in the supply chain at which WET is assessable and the value-based nature of the tax.

Health policy impacts

Volumetric excise taxation, when applied appropriately, can also support and complement the use of other policy measures to limit harmful alcohol consumption.

Currently, the ad valorem nature of the WET regime provides no incentive to produce lower alcohol wine products. Rather, increases in the tax liability of a product are proportional to the product's 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 very nature of a volumetric tax means that products with a higher alcohol content pay a greater tax than similar products with lower alcohol content. Consequently, volumetric excise taxation is an equitable mode of taxation that will encourage the production and consumption of lower alcohol content beverages. In addition, it provides an opportunity to tax lower strength products within a category on a disproportionately lower basis, for example the current taxation arrangements for low strength beer. This principle has not currently been extended to lower strength RTDs.

The volumetric taxation of all alcohol products is widely supported by health and social lobby groups.

3.5 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.

This guiding principle supports DSICA's conceptual view that the taxation system should provide incentives to produce and consume lower alcohol products. It also supports the first principle which seeks to achieve equity and neutrality.

Revenue effects

DSICA believes that alcohol is alcohol – and therefore all alcohol beverages, no matter the form of production, should be taxed equitably on this basis. That is, products within a similar band of alcohol content (such as beer and RTDs) should be taxed at the same rate.

The basic economic premise of taxation is that taxes impose an economic cost and lead to a reduction in welfare. This is because taxes change the behaviour of consumers and producers from how they would have behaved in the absence of taxation. Policy makers should therefore lean to a tax structure that minimises these economic costs.

Taxing one discrete part of a commodity group on the basis that the commodity group as a whole is unresponsive to change will not be efficient if other products in the group are not taxed on an equal basis.

The current alcohol tax system lacks horizontal equity, and therefore substitution into products that are of similar strength but are subject to lower tax distorts the market and imposes a welfare cost.

The principle of aligning the excise rates across all beverage categories would act to improve efficiency gains and reduce the welfare cost.

Health policy impacts

Inconsistencies in the application of taxation rates across products with higher degrees of substitutability leads to a substantial distortion of alcohol production and consumer behaviour, generally towards higher consumption of products at lower effective tax rates. This can often involve substitution to other beverage types of a higher alcohol content (for example with the lower effective rate applying to wine which has a higher alcohol content than beer and RTDs).

The effectiveness of stepped rates of volumetric excise on beer has already been shown in Australia, with low- and mid-strength beer in 2008-09 estimated to account for 8.8% of total alcohol consumption and 19% of total beer consumption, when measured in lals (DSICA 2009).

Disproportionately lower rates of taxation applying to all lower alcohol content beverages will further encourage the production and consumption of beverages that are of a lower strength within their beverage class (including beer, wine and RTD products).

3.6 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.

This principle expresses DSICA's view that as tax cannot effectively address harmful consumption behaviours, it is necessary and desirable to implement a range of non-tax measures.

Health policy impacts

The nature of alcohol excise, applying to all alcohol beverages, without regard to the nature of the consumer's consumption patterns or environment, means that taxation can only act as a 'blunt instrument' to implement policy.

DSICA therefore stresses the need for targeted, community-based alcohol initiatives to be developed in recognition of, and in harmony with, the alcohol tax system (See Section 3.2 of this submission for further comments).

3.7 Guiding Principle 4 – administrative simplicity

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

Meaningful tax reform should be supported and enhanced by simple and efficient administrative arrangements.

DSICA strongly believes that there should be a single administering agency with responsibility for tax administration of imported excise equivalent goods and domestically produced excisable goods.

This concept should be carried forward into future tax reform.

DSICA recommends that the single agency should be the Australian Taxation Office (ATO). This will involve a transfer of the revenue collection and administrative arrangements relating to imported excise equivalent goods from Customs to the ATO. There will be a saving in administration costs if this is implemented.

DSICA notes the Government response to the Productivity Commission recommendation along these lines in its research report *Annual Review of Regulatory Burdens on Business: Manufacturing and Distributive Trades* (PC 2008, p. 197).

DSICA commends the Government for its response (Government 2009), which stated that “the Australian Taxation Office (ATO) and the Australian Customs and Border Protection Service (Customs) will jointly develop and report on options to further reduce the duplication of revenue administration for excise and excise equivalent goods in order to reduce the regulatory costs associated with the collection of these revenues.”

DSICA is being consulted in the current ATO/Customs review, and will continue to recommend the consolidation of customs and excise duty administration of excise equivalent goods within the ATO.

3.8 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.

DSICA recognises that given the current extremely low effective taxation for bulk low value wine, a move to a volumetric system will likely lead to a substantial repricing of products such as cask wine.

In order to allow producers of cask wine to transition to the new alcohol tax system, the Government should consider specifying a transitional period over which there could be a gradual move to the new system. Over a period of years, the Government could gradually increase the tax rate on cask wine product to the full rate which is proposed. Alternatively, to remove the distinction in the proposal between bottled and cask wine, a series of phased rates for **all** wine could be introduced with the initial rate set at a level that would achieve revenue neutrality from wine in the first year (assuming removal of the wine producer rebate).

3.9 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.

DSICA continues its long held position that revenues collected on the consumption of alcohol products should not be hypothecated to particular purposes (such as alcohol education and treatment programs and services). See the First Submission for further discussion regarding DSICA's policy in this area (DSICA 2008, p 40).

The next chapter describes DSICA's tax proposal based on the above principles.

4 DSICA tax proposal

Chapter overview: *In this chapter, we outline an alcohol tax reform proposal that meets the reform criteria laid out in the First Submission and Chapter 3 of this submission. The proposal will make a huge step forward in tax equity and will provide incentives for the production and consumption of lower alcohol content beverages.*

4.1 Need for alcohol tax reform

The poor design of the alcohol tax system, together with the ongoing need to effectively address harmful alcohol consumption, means that there is an urgent need to reform Australia's current alcohol tax system.

DSICA has applied its 'guiding principles' to assist in the development of its tax reform proposal. DSICA acknowledges that this is not the optimal taxation structure, but believes that the proposal is a strong step towards a long-term objective of total equity and simplicity in the tax system. It is also necessary to be pragmatic by acknowledging that a theoretically optimal taxation structure is unlikely to be implemented in practice in the short term.

The guiding principles have been employed as a foundation and framework to arrive at a proposal which effectively addresses economic, health and social policy objectives, while recognising the timeline that will be required for more radical reform.

At DSICA's request, KPMG has conducted an independent economic analysis of DSICA's reform proposal and has estimated the price, consumption and government revenue impacts of the proposal using its econometric model for the market for alcohol beverages. The results of this analysis are outlined in section 4.5 below.

4.2 The DSICA recommended alcohol tax proposal – a summary

The DSICA alcohol tax proposal includes the following key features:

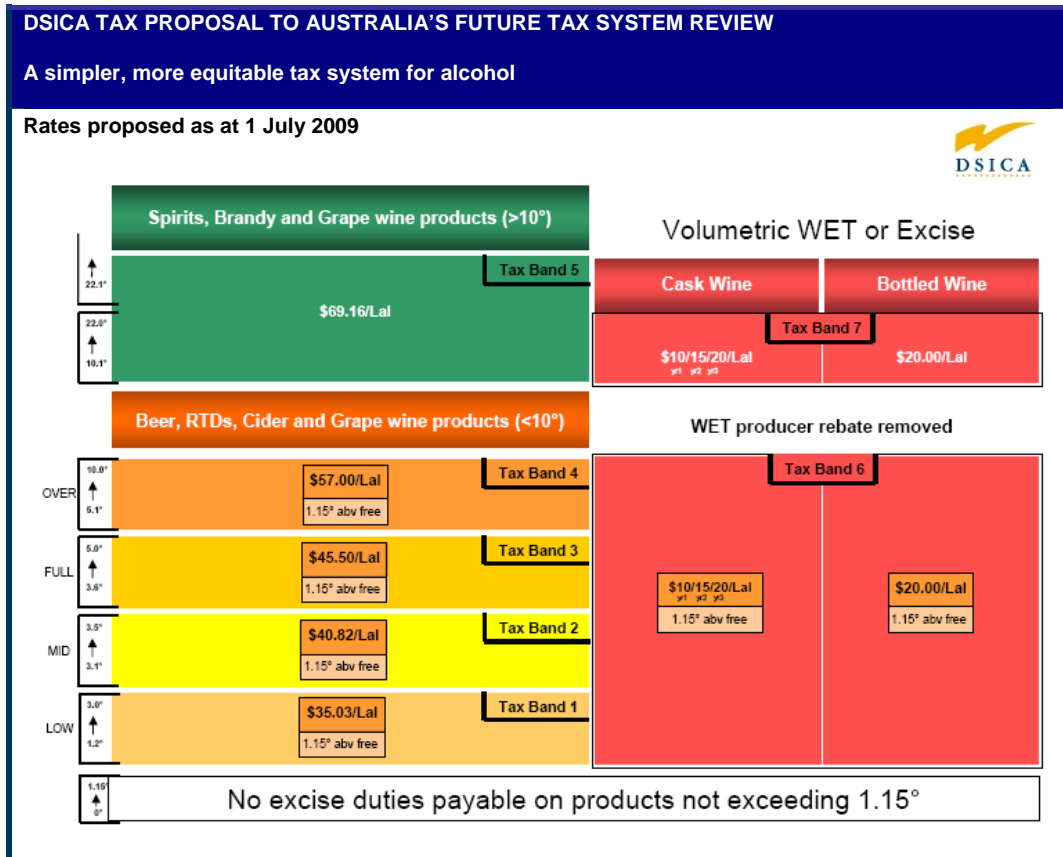
- The volumetric taxation of wine, grape wine products and cider;
- Graduated tax rates applying to all beer (packaged and draught with no tax distinction between the forms of delivery), RTDs (packaged and draught with no tax distinction between the forms of delivery), cider, grape wine products and full-strength spirits; and
- Application of the 1.15% abv excise-free threshold to all alcohol products not exceeding 10% abv.

The DSICA tax proposal is illustrated in *Graphic 3* below.

For the purposes of comparison, KPMG modelling uses as a baseline comparison the alcohol tax system that applied prior to the RTD tax increase that took effect on 27 April 2008 (the 'baseline case') (this is because the RTD tax increase still has not been legislated by amendments to the *Excise Tariff Act* and the DSICA proposal reverses the tax increase).

More details on the proposal are outlined in section 4.4 below.

Graphic 3: DSICA Tax Proposal



4.3 Impacts of the DSICA tax reform proposal – a summary

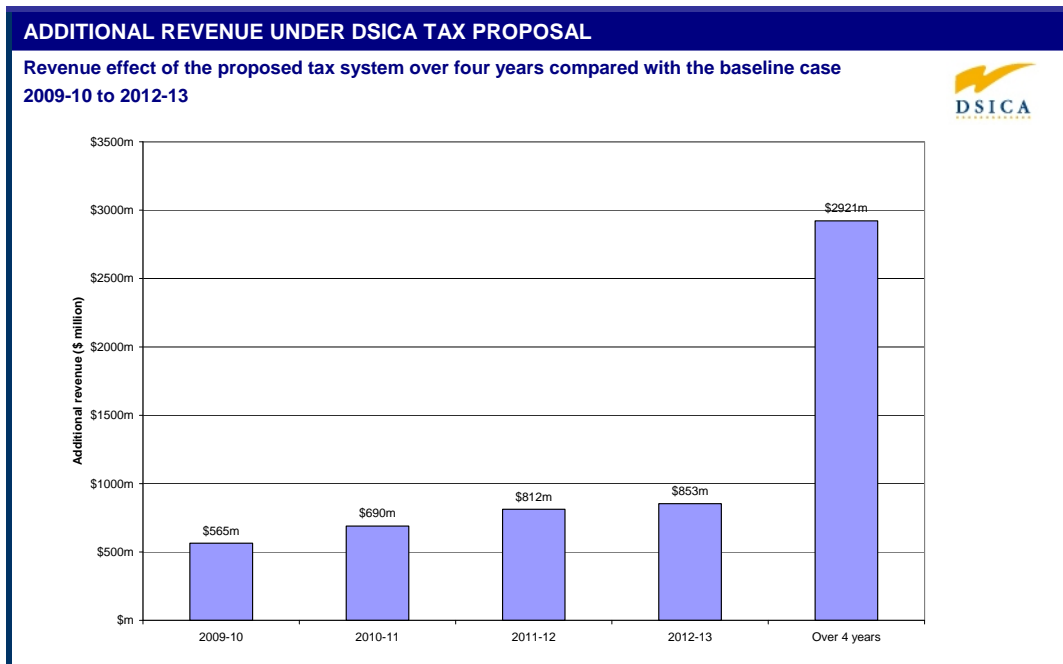
KPMG modelling of the DSICA proposal shows:

- Consumption:** A **reduction** in overall alcohol consumption of 14.1m lals, or approximately a 2% decline, over a 4 year period. This reduction occurs due to the redirection of consumption away from products that have a high alcohol content, towards products which have a lower alcohol content as a result of the progressive rates applying to most products less than 10% abv.
- Revenue:** An **increase** in revenue of \$2.9b from all alcohol products over four years compared to that currently collected from all alcohol products under the baseline model. See *Graphic 4* below.
- Market impact:** Market share under the proposal **changes only slightly**, with an estimated 2% loss in the market share of cask wine redistributed to all other categories. See *Graphic 5* below.

Note that while KPMG has modelled the impact of the DSICA reform proposal, KPMG does not have an opinion on alcohol tax policy.

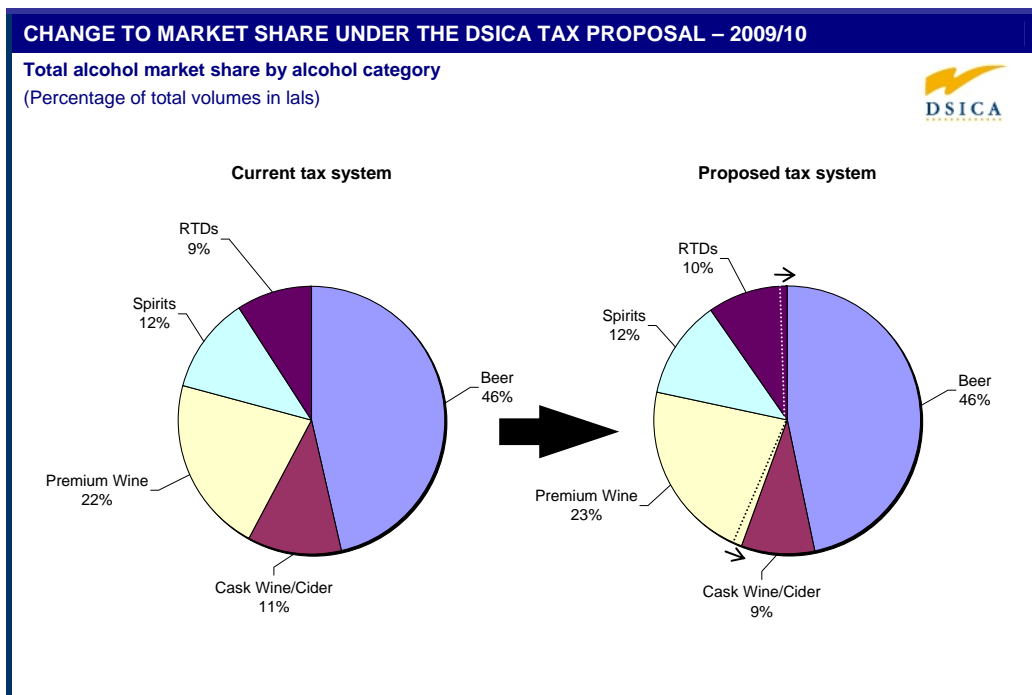
[Note: the baseline case modelled by KPMG uses a tax rate for RTDs that is the same as the nominal rate applied to full-strength packaged beer; ie. the tax system that existed prior to 27 April 2008.]

Graphic 4: Additional revenue from DSICA tax proposal vs baseline case



Copyright DSICA 2009

Graphic 5: Change to market share under DSICA tax proposal – 2009/10 vs baseline case



Copyright DSICA 2009

4.4 Key elements of the DSICA recommended alcohol tax proposal

1. Volumetric system for all alcohol (refer Guiding Principle 1)

In DSICA's tax proposal, all alcohol beverages, including wine, are subject to a volumetric taxation regime.

Changes to the current system include changing the taxation of cask and bottled wine from the existing ad-valorem WET rate of 29% of the nominal wholesale value, to a volumetric rate in 2009-10 of \$20 per lal (phased in over three years for cask wine).

The \$20 per lal excise on wine was chosen to ensure that the price of a semi-premium bottle of wine (\$10-\$13 price range), manufactured by a large wine producer, would remain unchanged in 2009-10.

We acknowledge that policy makers may find the distinction created between cask and bottled wine in the first three years as undesirable. An alternative to the proposed phasing in arrangements for cask wine that would remove the necessity to distinguish between cask and bottled wine would be to introduce a series of phased rates for all wine, with the initial rate to be set at a level that would ensure revenue neutrality (assuming removal of the wine producer rebate) from wine in the first year.

The implementation of a volumetric system for wine also includes the abolition of the WET producer rebate. As explained in Chapter 2 of this submission, DSICA believes that it is not appropriate to pursue industry assistance policy objectives for the alcohol and related industries through the tax system. If the Government wishes to deliver assistance to a particular sector of the alcohol industry, this would be better pursued through direct assistance from budget outlays.

2. Stepped taxation rates – 7 tax bands (refer Guiding Principle 2)

Application of stepped taxation rates across product categories means that products with similar alcohol content will face comparable taxation burdens, reducing inequities in effective taxation rates and (non-GST) tax per standard drink across categories.

The DSICA tax proposal comprises 7 tax bands which encompass different alcohol products. The tax bands and suggested rates are outlined in *Graphic 6* below.

DSICA has formulated four tax bands that cover beer, RTDs, cider, and grape wine products not exceeding 10% abv (tax bands 1 – 4). Two tax bands have been established to cover wine, one for wine not exceeding 10% abv (tax band 6) and one to cover wine greater than 10% abv (tax band 7). Finally, there is one band to cover sprits (including brandy) and grape wine products above 10% abv (tax band 5).

Tax bands 1 to 4 are broadly structured on the alcohol content levels currently used for the taxation of beer. In addition, for these products, DSICA has added an additional tax band to cover beer, RTD, cider and grape wine products exceeding 5%, but not exceeding 10%. DSICA believes that this additional tax band will re-enforce the incentive to manufacture and consume lower alcohol products. The reduction in alcohol strength in a number of Australian produced beers over the last few years demonstrates that industry participants will reduce the alcohol content of their products in order to reduce their excise tax burden.


Note that a point of distinction between the 10% abv and under categories and the over 10% abv categories across all products is that the 1.15% abv threshold only applies to the 10% abv and under category. This provides further incentives to produce and consume lower alcohol content beverages. Further detail on the seven tax bands is outlined below.

Graphic 6: 7 tax bands of the DSICA tax proposal

7 TAX BANDS OF THE DSICA TAX PROPOSAL		
Tax Band	Alcohol Product(s)/abv content	Tax Rate(\$/lal)
1	Low-strength product (1.2% abv – 3.0% abv) including packaged and draught beer, packaged and draught RTDs and cider.	\$35.03 ^{1,2}
2	Mid-strength product (3.1% abv – 3.5% abv) including packaged and draught beer, packaged and draught RTDs and cider.	\$40.82 ^{1,2}
3	Full-strength product (3.6% abv – 5.0% abv) including packaged and draught beer, packaged and draught RTDs and cider.	\$45.50 ^{2,3}
4	Over-strength product (5.1% abv – 10.0% abv) including packaged and draught beer, packaged and draught RTDs, cider and grape wine products.	\$57.00 ^{2,4}
5	Spirits: Spirits and liqueurs (above 10% abv) including spirits, liqueurs and grape wine products.	\$69.16 ⁵
6	Wine not exceeding 10% abv (Note: Eligible for 1.15% excise-free threshold)	\$20.00 ^{2,6}
7	Wine exceeding 10% abv (Note: Not eligible for 1.15% excise-free threshold)	\$20.00 ⁶

Notes:

- Adopted from current excise regime for like packaged beer product.
- Eligible for 1.15% abv excise-free threshold.
- Rate greater than current full-strength packaged beer rate to generate additional revenue.
- Rate set at the approximate mid point between tax band 3 and tax band 5.
- Adopted from current excise regime for spirits > 10% abv.
- A three year transitional period would be implemented for cask wine to ease immediate pricing impact. Year 1 rate = \$10/lal; Year 2 rate = \$15/lal; Year 3 rate = \$20/lal.



Copyright DSICA 2009

Tax Band 1 – Low-strength products

DSICA has identified the following products for Tax Band 1 that would share a high degree of substitutability:

- low-strength beer;
- low-strength RTDs; and
- low-strength cider.

Consistent with current excise taxation arrangements, DSICA has identified *'low-strength'* as those products **exceeding 1.15%** abv but **not exceeding 3.0%** abv.

DSICA believes that production and consumption of products in this tax band should be promoted, and therefore proposes the lowest of the stepped rates for this band.

Proposed Duty Rate: DSICA proposes that products falling into this tax band pay the same excise/customs duty rate currently applied to low-strength packaged beer (\$35.03 per lal). The 1.15% abv excise-free threshold should also apply to provide a further incentive to produce lower strength product within the relevant tax bands.

Tax Band 2 – Mid-strength products

DSICA has identified the following products for Tax Band 2 that share a high degree of substitutability:

- mid-strength beer;
- mid-strength RTDs; and
- mid-strength cider.

Consistent with current excise taxation arrangements, DSICA has identified '*mid-strength*' as those products **exceeding 3.0%** abv but **not exceeding 3.5%** abv.

Proposed Duty Rate: DSICA proposes that products falling into this tax band pay the same excise/customs duty rate currently applied to mid-strength packaged beer (\$40.82 per lal). The 1.15% abv excise-free threshold should also apply to all products in this tax band.

Tax Band 3 – Full-strength products

The term '*full-strength*' has commonly referred to alcohol products exceeding 3.5% abv but not exceeding 10% abv.

DSICA believes that this range of alcohol strength is too broad to be covered by one single tax band.

Consequently, DSICA believes that the definition of full-strength should be restricted to include those alcohol products **exceeding 3.5%** abv but **not exceeding 5%** abv.

Tax Band 3 includes the following full-strength products which share a high degree of substitutability. These are:

- full-strength beer;
- full-strength RTDs; and
- full-strength cider.

Proposed Duty Rate: DSICA proposes that products falling into this tax band pay the same excise/customs duty at a rate of \$45.50 per lal. The 1.15% abv excise-free threshold should also apply to all products in this tax band.

This tax rate has been chosen to include a premium over the current excise rate applied to full-strength packaged beer to:

- create an incentive for the production of alcohol with lower alcohol content;
- to increase the revenue potential of the DSICA tax proposal; and
- minimise the extent of price variations on all products, while still achieving the objectives above.

Tax Band 4 – Over-strength products

DSICA has developed the new term of '*over-strength*' for those beverages **exceeding 5.0%** abv but **not exceeding 10%** abv. These beverages are more commonly sold in a ready to drink format.

Tax Band 4 includes the following over-strength products which share a high degree of substitutability. These are:

- over-strength beer;
- over-strength RTDs;
- over-strength cider; and
- over-strength 'grape wine products'.

'Grape wine products' by definition (s31 of the *WET Act*) must be of an alcohol content of between 8% abv and 22% abv. Those not exceeding 10% abv can often be found in the form of piccolo bottled products (200ml to 250ml) that are close substitutes for beer and RTDs.

Proposed Duty Rate: A tax rate of \$57.00 per lal has been chosen for this category as the mid-point between the rates set for tax band 3 and tax band 5 (see below). The 1.15% abv excise-free threshold should also apply to all products in this tax band.

This rate again acts to create an incentive for the production of alcohol with lower alcohol content while also maximising the revenue potential of the DSICA tax proposal.

Tax Band 5 – Full-Strength Spirits and other higher alcohol products

DSICA believes that the following products **exceeding 10%** abv are closely substitutable and should be included in a single tax band - Tax Band 5:

- full-strength bottled spirits;
- liqueurs;
- brandy; and
- grape wine products exceeding 10% abv.

Grape wine products exceeding 10% abv often take the form of imitation liqueurs and are therefore substitutable with the other products nominated for this tax band. DSICA supports the amendments that are proposed in *Excise Tariff Amendment (2009 Measures No. 1) Bill 2009* which would have resulted in a grape wine product that has added to it a spirit flavour (eg rum) no longer being taxed as wine, but as an RTD.

Proposed Duty Rate: DSICA proposes that products falling into this tax band pay the same excise/customs duty rate currently applied to full-strength spirits (\$69.16 per lal).

The 1.15% abv excise-free threshold is not applied to products in this tax band.

Tax Band 6 – Lower strength cask and bottled wine

Proposed Duty Rate: DSICA proposes that cask and bottled wine, not exceeding 10% abv, should be liable to a volumetric tax at the rate of \$20 per lal.

Similar to other alcohol products at the same alcohol content, products in this category should also receive the 1.15% abv excise-free threshold.

DSICA understands that, due to the current low rate of effective taxation for cask wine, a change to a volumetric tax at this rate will likely lead to a substantial repricing of cask wine.

To allow producers of cask wine to transition to the new alcohol tax system, the Government could implement a three year transitional period to allow a gradual move to the new system. DSICA's proposal is for a 3 year period over which the tax rate on cask wine is increased from \$10 per lal in year 1, \$15 per lal in year 2 and then to \$20 per lal (ie the same as that proposed for bottled wine) in year 3, indexed for CPI. Alternatively, to remove the distinction in the proposal between bottled and cask wine, a series of phased rates for **all** wine could be

introduced with the initial rate set at a level that would achieve revenue neutrality from wine in the first year (assuming removal of the wine producer rebate).

Tax Band 7 – Higher strength cask and bottled wine

Proposed Duty Rate: DSICA proposes that cask and bottled wine exceeding 10% abv should be liable to the same volumetric tax rate as lower strength wine (\$20 per lal) but should not receive the 1.15% abv tax-free threshold.

DSICA's proposal for tax band 7, like tax band 6, includes a 3 year period over which the tax rate on cask wine is increased from a base of \$10 per lal to \$20 per lal (ie equivalent rate for bottled wine). The same alternative could be applied here as outlined above, namely that the distinction in the proposal between bottled and cask wine could be removed with a series of phased rates for **all** wine with the initial rate set to achieve revenue neutrality from wine in the first year (assuming removal of the wine producer rebate).

4.5 The DSICA recommended alcohol tax proposal – detailed estimates

At DSICA's request, KPMG has conducted an independent economic analysis of DSICA's reform proposal and has estimated the price, consumption and government revenue impacts of the proposal using its econometric model for the market for alcohol beverages.

Baseline comparison benchmark

For the purposes of comparison, KPMG modelling uses as a 'baseline' the alcohol tax system that applied prior to the RTD tax increase that took effect on 27 April 2008 (the 'baseline case') (this is because the RTD tax increase still has not been legislated and the DSICA proposal reverses the tax increase). Pricing and tax rates were indexed by actual and estimated measures to compare the DSICA tax proposal to this baseline system in the years 2009-10 to 2012-13.

Impact on alcohol consumption

KPMG estimates that under the DSICA proposal, alcohol consumption would fall by 14.1m lals for the 4 years from 2009-10 to 2012-13 – see *Graphic 7* below.

The yearly reduction is in the order of 3-4 million lals, or approximately a 2% reduction on current alcohol consumption.

The reduction in consumption is explained by redirection of consumption away from products that have a high alcohol content, towards products which have a lower alcohol content.

Graphic 7: DSICA tax proposal - consumption impact vs baseline case

Change (million Lals)	2009/10	2010/11	2011/12	2012/13	Total
Beer	-0.9	-0.7	-0.6	-0.8	-2.8
Cask Wine/cider	-4.8	-5.4	-5.9	-6.2	-22.4
Premium Wine	1.6	1.6	1.5	1.5	6.2
Spirits	0.2	0.3	0.4	0.4	1.3
RTDs	0.8	0.9	1.0	1.0	3.7
Total	-3.1	-3.3	-3.6	-4.1	-14.1

Source: KPMG, *Economic Impacts of possible alcohol tax policy changes, April 2009*

Impact on alcohol tax revenue

KPMG estimates that the DSICA proposal would generate, over the 4 years from 2009-10 to 2012-13, an additional \$2.9b in excise and customs duty revenue over that currently raised from all alcohol products under the baseline case – see *Graphic 8*.

Nearly 70% of the net increase in revenue collections would come from beer. Beer would generate 18% more revenue for the four year period than it would under the baseline case if it were to continue.

Wine/cider would generate 32% more revenue than under the baseline case. This arises due to the move to the volumetric rate and removal of the wine producer rebate.

RTDs would generate \$169m less in revenue, or 20% less, than under the baseline case. This reflects that RTDs are more highly taxed under the baseline case than say beer of the same alcohol strength. This is due mainly to the fact that RTDs do not attract the 1.15% abv excise free threshold under the baseline case – see *Graphic 8*.

Graphic 8: DSICA tax proposal – revenue impact vs baseline case

Change (\$ million)	2009/10	2010/11	2011/12	2012/13	Total
Beer	444	474	512	543	1973
Cask Wine/cider	152	177	202	217	748
Premium Wine	-3	59	111	110	277
Spirits	14	22	28	28	92
RTDs	-42	-41	-41	-45	-169
Total	565	690	812	853	2921

Source: KPMG, *Economic Impacts of possible alcohol tax policy changes, April 2009*

Impact on alcohol beverage pricing

KPMG modelling shows that there would be minimal impact on the price of beer, with no more than an around a 5% increase. Likewise, premium wine has only a marginal price increase.

As expected, the most dramatic impact on prices occurs with cask wine/cider (up to 36% increase) and low and mid-strength RTDs (up to nearly 9% reduction for mid-strength RTDs).

The price of full strength beer is predicted to increase by around 5% (note that this would be a composite increase for both packaged and draught beer) – see *Graphic 9*.

Graphic 9: DSICA tax proposal – pricing impact vs baseline case

Price Effects	2009/10	2010/11	2011/12	2012/13
Beer low	2.3%	2.3%	2.4%	2.3%
Beer mid	1.2%	1.2%	1.3%	1.2%
Beer full/high	5.2%	5.2%	5.3%	5.2%
Cask Wine/cider	29.8%	33.9%	36.8%	36.4%
Premium Wine (a)	-0.6%	0.5%	1.4%	1.2%
Spirits	0.0%	0.0%	0.0%	0.0%
RTDs low	-10.7%	-10.7%	-10.9%	-10.8%
RTDs mid	-8.4%	-8.5%	-8.6%	-8.5%
RTDs full/high	-2.2%	-2.2%	-2.2%	-2.2%

The price of premium wine is based on large producer retail prices and so no allowance is made for the wine producer rebate

Source: KPMG, *Economic Impacts of possible alcohol tax policy changes, April 2009*

Graphic 10 below summarises preliminary estimates for the price impact for RTDs including full and high strength RTDs as separate product categories. Again, it should be noted that these estimates are a comparison against the pre-April 2008 tax structure.

Graphic 10: DSICA tax proposal - pricing impact for RTDs vs baseline case

Price Effects	2009/10
RTDs low	-10.7%
RTDs mid	-8.4%
RTDs full	-3.7%
RTDs high	3.7%

Source: KPMG, *Economic Impacts of possible alcohol tax policy changes, April 2009*

4.6 Comparison to Treasury estimates

The Treasury publication, *Tax Expenditure Statement 2008* (TES), provides estimates for the tax expenditures arising from a number of tax concessions that are addressed in the DSICA tax proposal, namely:

- the concessional rate of excise levied on brandy (tax expenditure of \$5m in 2009-10);
- the concessional rate of excise levied on draught beer (tax expenditure of \$135m in 2009-10, based on the revenue gain method); and
- the wine equalisation tax producer rebate (tax expenditure of \$260m in 2009-10).

The TES estimates for the brandy and WET concessions use the revenue forgone approach that does not account for behavioural changes as a result of the removal of the tax concession.

In the case of the removal of the concessional rate of excise levied on draught beer, the TES provides a revenue gain estimate of \$135m (2009-10) which factors in a behavioural response.

While these three tax concessions do not reflect all of the changes under the DSICA tax proposal, the scale of the related tax expenditures (that sum to \$400m in 2009-10 – when using the revenue gain estimate for the draught beer concession) is comparable to the \$565m in additional revenue that is estimated to occur under the DSICA tax proposal for 2009-10.

4.7 Conclusion

The DSICA tax proposal provides very positive outcomes for Government and the community.

- It applies good tax design principles.
- It raises more revenue than the current alcohol tax system.
- It leads to a reduction in overall alcohol consumption compared to the current tax system.

5 Longer term alcohol tax reform

5.1 Introduction

In this chapter, DSICA takes the opportunity to highlight some **propositions** for longer term reform of the alcohol tax system. We stress that these propositions are ‘for discussion’ and do not necessarily reflect firm views of DSICA and its members – rather they act as concepts for further consideration.

It is important to note that the matters outlined below for consideration do not detract from or impinge upon the imperative to adopt the reform proposals in the short term outlined earlier in this submission. Any implementation of the concepts outlined in this chapter would be longer term.

5.2 Should there be a separate tax on alcohol?

A necessary starting point for a conceptual discussion regarding taxation of alcohol is: should there be a separate and distinct tax on alcohol? The Discussion Paper poses this question more generally as Consultation Question Q11.1:

“Is it appropriate to use taxes on specific goods or services to influence individual consumption choices, and if so, what principles can be applied to designing the structure and rates of such taxes?”

The Goods and Services Tax

Since 1 July 2000, a broad based consumption - the Goods and Services Tax (GST) - has been in place in Australia.

While generally described as broad based, there are a significant number of exemptions in the GST legislation. Some arise for technical design reasons, for example the domestic leg of international voyages is not subject to GST. Others arise because of policy decisions of the Government in designing the GST or political or parliamentary factors in the implementation. These discretionary exemptions include certain food, medical and health services, hospital treatment, drugs and medicinal preparations, education and religious and charitable activities.

We note that the Terms of Reference of the review reflect the Government's policy not to increase the rate or broaden the base of the GST. Notwithstanding the effect of this exception, DSICA observes that in a situation where a broad based consumption tax designed for revenue raising is in place but is not maximising its revenue potential, there should be strong and sustainable arguments to maximise the revenue stream from the GST before other discretionary taxes are imposed on specific products.

Taxes on alcohol and tobacco

Taxes on alcohol and tobacco have some conceptual similarities. Both are pharmacologically active substances that it is legal to consume, with certain restrictions, in Australia although there is a significant difference between the two products. DSICA notes and endorses the Discussion Paper's observation that Australian survey data shows an association between daily

consumption of small amounts of alcohol and high reported levels of wellbeing. By way of contrast, it is generally accepted that all tobacco consumption leads to harm.

The existing customs and excise duty systems are designed to target the incidence of taxation of alcohol to alcoholic beverages, that is where the product is consumed with a resultant pharmacological effect rather than for other purposes. The concessional spirits scheme provides alcohol free of duty for certain defined industrial, educational, medical, veterinary, scientific or other purposes. Although generally the concessional spirits scheme is not of direct relevance to members whose activities are directed to the alcoholic beverages market, DSICA supports this outcome. That said, DSICA notes that the existing arrangements are administratively intrusive and involve specific decision making by the administering authority, the Australian Taxation Office.

The production cost of many forms of alcohol is relatively low. Without a tax on alcoholic beverages, it could be argued that on a society wide basis the overall level of consumption would be higher than is considered optimal. Within this outcome, levels of harmful consumption may be higher than the outcome that may occur under a higher price. The effect of tax is to broadly raise the price of alcoholic beverages, although because of competition between producers and different forms of alcoholic beverages, the full extent of the tax may not be passed onto consumers. Nevertheless, there will be a higher market price than there would be in the absence of the tax and hence broadly lower consumption than that which would otherwise occur. There may be some diminution of harmful consumption as part of this reduction but DSICA cautions that increasing levels of tax on alcohol broadly or on particular products does not provide a solution to the issue of controlling and reducing harmful consumption.

Whether this broadly lower level of consumption is more optimal than that which would occur if alcohol were untaxed is open to question and is probably an issue on which a societal consensus will never be reached. While DSICA believes there are sustainable arguments not to have a separate tax on alcohol, we note that society has long accepted arrangements where a separate tax is in place (irrespective of the reasons for which that tax has been implemented).

The discussion in this chapter is predicated on the above view and proceeds on the basis that there will continue to be a specific tax on alcohol. In relation to alcohol consumption, DSICA is strongly opposed to any consideration of the alternative approach that society has taken to certain pharmacologically active substances, namely banning their production and/or consumption.

Alcohol tax propositions

DSICA has considered propositions for longer term reform under the following broad headings:

- **Tax base** – how should the tax base for ‘alcohol’ be defined?
- **Tax rate** – how many rates should apply to alcohol products?
- **Taxing point** – at what point should tax be applied to the tax base?
- **Tax administration** – what are the most efficient tax collection mechanisms?

5.3 Tax base

DSICA proposition: One defined base for taxation purposes.

The alcohol tax base could be simply defined and should not distinguish between different beverage types or sources of alcohol.

A single tax base and definition would have efficiency and administration advantages. In particular, it would remove the major subsidy that the wine industry is currently receiving through the tax system, with significant costs to economic efficiency through over-investment in wine grape growing activities that may not otherwise be viable.

DSICA's alcohol tax proposal outlined in Chapter 4 above is a step towards this outcome. Moving wine and cider to a volumetric system, which applies to all other alcohol, removes a major barrier to implementing an all encompassing definition of alcohol for taxation purposes.

DSICA notes that there is significant common ground with the health sector in relation to volumetric tax. For example, the Medical Journal of Australia recently published an editorial by Dr Steven J Skov on behalf of the Royal Australasian College of Physicians Alcohol Advisory Group that advocated "taxing beverages on the basis of their alcohol content – a volumetric system" (Skov 2009). DSICA agrees.

5.4 Tax rate

DSICA proposition: One uniform volumetric taxation rate.

One volumetric rate applied uniformly across all alcohol would help achieve a simple and efficient taxation system. Such a system would remove arbitrary tax distinctions and would discourage production (and therefore consumption) decisions dictated by taxation.

A volumetric system has the advantage of an in-built externality capture mechanism whereby higher alcohol content beverages pay a higher amount of tax. This means there is less of a necessity for progressive rates.

This proposition is also supported by the IMF view that a specific rate tax avoids the potential for disputes over valuation that may be associated with ad valorem taxes. Specific rates based on physical units are also considered the appropriate form of taxation if the excise is intended to be externality correcting. That is, alcohol should be taxed the same whether it is contained in high quality spirits or not. (McCarten & Stotsky 1995)

To encourage consumption of lower alcohol content beverages, a single volumetric rate could be enhanced through an excise free threshold which could be set at a higher level than the current level of 1.15% abv.

No "penalty" rates for particular beverages

DSICA note that the editorial cited above (Skov 2009) advocates "additional taxation based on evidence of harm associated with particular beverage types". DSICA strongly opposes this concept as it is not the case that one single product or product category can be singled out as the only or predominant contributor to risky or high risk drinking levels.

The 2007 National Drug Strategy Household Survey results demonstrate that the product category most commonly consumed by risky and high risk drinkers varies according to gender and age group. Based on long-term risk status, results from the 2007 NDSHS show that:

- **Risky or high risk male drinkers of all ages** mostly consumed regular strength beer;
- **Risky or high risk female drinkers aged 14 to 29** mostly consumed regular bottled spirits and liqueurs; and
- **Risky or high risk female drinkers aged above 29** mostly consumed bottled wine.

Other factors will also contribute to variation in product preferences amongst more specific at-risk groups, for example the indigenous Australians, different socio-economic groups and/or residents in particular geographic regions.

Implementation of additional taxation based on evidence of harm associated with particular beverage types as advocated by some health sector members would lead to a contradictory outcome that all alcoholic beverages would face an additional impost, which defeats the underlying purpose and benefits of a move to a volumetric system. DSICA believes that both in the short-term and the long-term, the best approach to address harmful consumption is to implement a range of non-tax measures.

5.5 Taxing point

DSICA proposition: Tax at point of sale.

Currently, the taxing point within the excise system is broadly framed around 'manufacture' and the rather archaic concept of an 'entry for home consumption'. This is compared to the WET system, and most other consumption taxes, which have their taxing points framed around a particular assessable dealing that creates the tax liability (generally the last wholesale sale for non-cascading sales taxes).

Moving to a (final) taxing point at the last wholesale sale would bring efficiency and compliance benefits. These would arise from removing the customs and excise based 'permissions' and 'entry' compliance regime and replacing it with a selling point regime similar to the regimes for other taxation (eg GST) and contractual (supplier-purchaser) purposes.

A move to this style of taxing point would also simplify compliance activities by the revenue authorities in that they would only have to administer one style of regime. Also, as the system would apply equally to imported or locally manufactured product, this proposal would remove the issue of the 'dual administration' by the ATO and Customs (refer section 3.7 above).

Research in the applied theory of optimal taxation suggests that indirect taxes, including excises, should be imposed as close as possible to the final point of sale because of the potential for excises to have unexpected distributional and efficiency effects when imposed on intermediate goods (Ahmad & Stern 1989 as referenced by McCarten & Stotsky 1995, p 102).

Taxes imposed at the point of manufacture also severely penalise a manufacturer's cash flow because tax is typically payable well before the manufacturer can recoup it from the customer.

DSICA acknowledges that the historical principle underlying tax on manufacture for beer and spirits has been the need to 'control' product for revenue protection purposes. These concerns could be mitigated by lower tax exposures on typically high taxed products (achieved through the uniform rate proposed above) complemented by a 'tax instalment' system. In particular, DSICA notes that unlike excise and customs duty on alcoholic beverages other than wine which is paid on a weekly basis under specific arrangements, WET is payable on the Business Activity Statement (BAS) in the normal cycle under which a particular entity is required to make payments.

5.6 Tax administration

DSICA proposition: Tax administration consolidated with existing reporting obligations

DSICA's long held recommendation for a 'single administration' for excise and customs duties on excise equivalent goods is one step towards consolidating tax compliance obligations. DSICA suggests that there are further consolidation and simplification opportunities over the longer term.

In line with the tax withholding system outlined above, the tax compliance regime for alcohol could be 'rolled into' existing tax reporting requirements, such as those reported under the existing BAS reporting regime (ie GST, Pay-As-You-Go, Fringe Benefits Tax etc). Consolidating tax remittance and reporting in this way should bring significant simplification and compliance cost savings for both taxpayers and revenue authorities.

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6 Other issues – passenger duty free concessions

Chapter overview: *In this chapter we examine Consultation Question Q11.4 which concerns the duty free concession for passenger importation of alcohol. DSICA believes this concession should be maintained.*

6.1 Consultation Question

Consultation Question Q11.4 asks interested parties to consider whether the existing duty free concessions for passenger importation of alcohol and tobacco should be retained.

Consultation Question

Consultation Question Q11.4: If health and other social costs represent the principal rationale for specific taxes on alcohol and tobacco, is any purpose served in retaining duty free concessions for passenger importation of these items?

Context of consultation question

In the first instance, DSICA would dispute the opening statement, and therefore the context, of the consultation question. As outlined in previous chapters of this submission, DSICA believes that the principal reason for specific taxes on alcohol is revenue raising. Economic theory and recent evidence of changes to rates within the excise system in Australia supports this conclusion (see Chapter 2 above). While taxation of alcohol certainly has some role to play in health and social policy, it is not the “principal rationale” for specific taxes. This conclusion therefore places the consultation question in a different context and ‘dilutes’, or at least modifies, the significance and consideration of the question. DSICA has therefore prepared its response to the question in that context.

6.2 Current passenger duty free concessions

The *Customs Tariff Act 1995* (the *Customs Tariff*) contains a range of duty exemptions and concessions (the concessions) for goods imported by arriving passengers and members of the crew of ships and aircraft.

Policy rationale for passenger duty free concessions

DSICA believes that there are important, non-taxation policy reasons for the retention of these concessions.

There are significant passenger facilitation and administrative issues that dictate the need for passenger concessions. Furthermore, Australia needs to remain competitive with other countries in the region in terms of attracting tourism shopping patronage. These issues were considered extensively in the 2000 Customs led review of the concessions that resulted in an increase in the concessions effective from 1 February 2005.

Given the nature of DSICA’s membership, we will concentrate in this chapter only on the duty free concession for alcohol.

Relevant legislation

Item 15 of Schedule 4 to the *Customs Tariff* provides for a free rate of duty for certain goods, as prescribed by by-law, that are imported by passengers or members of the crew of ships or aircraft, or have been purchased at an inwards duty free shop by a person who has arrived on an “international flight” as defined.

Application to alcohol

Subject to the other requirements of the *Customs Tariff* and its by-laws, Item 15 of Schedule 4 to the Customs Tariff allows for duty free entry into Australia of alcohol beverages up to **2.25 litres** by each adult arriving international passenger. (Note that above this limit, duty and tax is payable on all of the goods, not only the goods exceeding the concession limit. This limit was increased from a limit of 1.125 litres that applied prior to 1 February 2005 but with a waiver of collection of revenue below \$50).

Review of passenger duty free concessions

In 2000, Customs commenced an Inter-Departmental Committee (IDC) review of the passenger and crew duty free concessions. The review was commissioned partly in recognition of the fact that the concessions had not been reviewed since 1994 and that the concession levels had not been altered since 1986.

At the time, the tourism and duty free industries were very concerned that the concessions had not been lifted for nearly 15 years and Australia was increasingly uncompetitive with other countries in the region.

In 2003, the Government announced that it would increase the concession levels – which included lifting the alcohol concession from 1.125 litres to 2.25 litres.

Given that the report of the IDC was not made public, we do not know to what extent health policy issues entered into the decision to change the duty concession for alcohol. However, we can only assume that it was considered and factored into the final recommendations and Government decision.

6.3 Purpose of passenger duty free concessions

Industry Assistance Commission report on the passenger concessions

The 1985 Industry Assistance Commission (IAC) report on the concessions (IAC 1985) assists us understand the policy rationale for the existence of the passenger duty free concessions.

In reviewing the concessions and making its recommendations in 1985, the IAC nominated four criteria to be applied in setting the levels of the concessions (IAC 2005, p 93).

- *Passenger facilitation*: the concessions must allow a larger proportion of passengers to pass through Customs without paying small amounts of duty.
- *Simplicity*: the concessions must be simple for passengers to understand.
- *Ease of administration*: the concessions must be simple for Customs to administer.
- *International obligations*: the concessions must allow Australia to fulfil its international treaty obligations.

DSICA believes that these criteria represent very strong arguments for maintaining the duty free concession for the passenger importation of alcohol. In particular, the need to allow for an efficient passenger flow at busy international airports (22.7 million international arrivals in Australia in 2007-08), the need to ease duty collection obligations on customs officers and the requirement for Australia to adhere to international obligations regarding the free and timely flow of passengers provide strong arguments to support the retention of the duty free concessions on alcohol.

In relation to passenger facilitation, the combination of long term growth in passenger numbers combined with an increasing focus on security related border control measures means that there is ongoing pressure on border agencies to meet standard passenger processing times. Removing passenger duty free concessions would be counter-productive to these efforts.

International obligations

The Protocol of amendment to the World Customs Organisation International Convention on the simplification and harmonization of Customs procedures (commonly known as the Revised Kyoto Convention) (WCO 1999) contains certain obligations for ratifying countries regarding certain customs procedures. Australia ratified this agreement in October 2000.

Recommended practice 16 in Chapter 1 of Annex J of the Revised Kyoto Protocol provides that Customs should permit not less than 2 litres of wine or 1 litre of spirits to be imported free of import duties and taxes by travellers.

Australia's ratification was made subject to a number of reservations, including a reservation to Recommended practice 16. The reason given by the Australian Government for this reservation was that the recommended practice was inconsistent with Australia's allowance (at that time) for 1.125 litres of alcoholic beverages.

Australia has since increased the allowance of alcohol that may be imported free of import duties and taxes to 2.25 litres and is now in accordance with recommended practice 16.

Should the passenger duty free concessions be removed Australia would be in breach of the recommended practice set out in the Revised Kyoto Convention.

The Convention on International Civil Aviation (also known as Chicago Convention), which Australia ratified on 1 March 1947 also requires contracting states to adopt all practicable measures to prevent unnecessary delays to aircraft, crews, passengers and cargo and specifically refers to the administration of customs clearances, amongst other laws. The significant denigration of the facilitation rate that would occur if the passenger duty free concession was removed emphasises the importance of this concession remaining in order to meet Australia's obligations under this Convention.

Maintaining competitiveness of Australia's tourist shopping regime

In addition to the policy motivations outlined above, there is also the requirement to maintain the competitiveness of Australia's tourism shopping industry. A key component of this competitiveness is the existence of passenger duty free concessions on goods like alcohol.

In a recent Australian Government review of the tourism shopping regime in Australia, key tourism industry participants (such as the National Tourism Alliance) pointed to the critical need to maintain a competitive tourism shopping regime in Australia (NTA 2005).

Shopping is one of the most popular activities undertaken by visiting tourists and with the increasing level of international travel, tourists generally have a good understanding of the various tourism regimes across different countries. Accordingly, it is imperative that Australia

retain duty free concessions to remain competitive (in tourism shopping terms) with other countries in the region. This is particularly the case due to the busy trans-Tasman route with New Zealand. As New Zealand already has more favourable alcohol duty free concessions than Australia, removing them altogether would result in a transfer of purchases from Australia to New Zealand.

6.4 Conclusion

DSICA recommends that the passenger duty free concession for alcohol be retained and be regularly reviewed to ensure it is meeting its policy objectives and maintaining competitiveness with other countries in our region.

7 Conclusion

DSICA continues to be encouraged by the opportunity the AFTS Review offers to fundamentally reform Australia's inequitable alcohol tax system. We commend the Government on its bold reform agenda and the systematic approach to reform it is taking.

DSICA too has taken a systematic approach to developing its alcohol tax reform proposal. Based on guiding principles outlined in the First Submission, DSICA has developed an equitable and socially responsible tax proposal that will lead to improved economic and social outcomes.

In this submission, DSICA has provided its response to the applicable consultation questions posed by the Review Panel in its Consultation Paper. Our responses to these questions are in agreement and consistent with our tax reform proposal.

Addressing both economic (taxation) and social (health) issues through the taxation system involves a complex interplay and balancing of policy measures. The AFTS Review provides a critical opportunity to assess these inputs in order to get the balance and outcomes right.

DSICA looks forward to working with Government in subsequent phases of the reform process to ensure that Australia can benefit from a more equitable and efficient alcohol tax system that will produce better health, social and economic outcomes.

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