



Distilled Spirits
Industry Council
of Australia Inc.

Pre-budget Submission 2012-13

January 2012

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 Australia Pty Ltd;
- Brown-Forman Australia;
- Bundaberg Distilling Company Pty Ltd;
- Diageo Australia Limited;
- Mast-Jägermeister AG;
- Moët Hennessy Australia Pty Ltd;
- Rémy Cointreau International Pte Ltd;
- Suntory (Australia) Pty Ltd; and
- 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 co-regulatory regime for alcohol advertising; and
- making a significant contribution to Australian industry through primary production, manufacturing, distribution and sales activities.

Preface

DSICA appreciates the opportunity to prepare and present a Pre-Budget Submission to the Federal Treasurer.

This 2012-13 document continues a long DSICA tradition of compiling industry and revenue data in a comprehensive and detailed manner not readily available elsewhere.

Many of the issues we raise are long standing, such as the discriminatory tax regime borne by the spirit drinker.

More recent data has allowed us to evaluate and demonstrate that the Ready-to-Drink product (RTD) tax hike was a failure from both a health and revenue perspective.

And of a more contemporary nature is the emerging groundswell of calls from diverse sources for a move to a volumetric tax regime as so eloquently proposed in the Henry Review.

The explosion of the cider market is examined and tax opportunities identified.

DSICA remains realistic in its proposals, recognising that the current imperfect tax regime has grown over decades as a consequence of changing consumption patterns, production methods and political expediencies. It cannot be changed overnight but the road to alcohol tax reform must commence and this document contains a number of recommendations that can facilitate a start.

In a departure from previous submissions, this year DSICA has not included social commentary on aspects of alcohol consumption having, in late 2011, published a new book *Alcohol in Context*.

As always, comments or queries regarding this Pre-Budget Submission are welcome.

A handwritten signature in blue ink, reading 'Gordon Broderick', with a horizontal line underneath.

Gordon J Broderick
Executive Director

Table of contents

Summary of recommendations	3
1 The Australian alcohol market and DSICA revenue estimates for 2012-13	6
2 Alcohol consumption patterns in Australia and initiatives to reduce harmful consumption behaviours	10
Budget priorities 2012-13	
3 Reform of traditional cider taxation	26
4 Tightening of Wine Producer Rebate provisions	30
5 Removal of the five per cent nuisance customs duty on imported spirits and Ready-to-Drink products	34
6 Tax equivalence for low- and mid-strength Ready-to-Drink products	38
7 Proposed offsetting of the Consumer Price Index impacts of the carbon price from automatic indexation of excise duty rates applying to spirits and Ready-to-Drink products	42
Long-term reform objectives	
8 Reform of the wine taxation regime	50
9 Conclusion	68
A Appendix – The Australian alcohol market	70
Table of figures	81
List of abbreviations	82
References	84

Summary of recommendations

Budget 2012-13 priorities

Traditional cider taxation

Recommendation 1: Taxation of traditional cider products at the Ready-to-Drink product excise duty rate

That the taxation of traditional cider¹ products be amended from the current Wine Equalisation Tax (WET) arrangement to a volumetric tax at the same rate as RTDs.

Estimated revenue impact: \$496 million in additional revenue over the forward estimates

Introduction of Wine Producer Rebate anti-avoidance amendments

Recommendation 2: Introduce Wine Producer Rebate anti-avoidance amendments

That the Government make all necessary legislative amendments to the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) (and Wine Producer Rebate provisions) to prevent the current abuses.

Estimated revenue impact: \$237 million in additional revenue over the forward estimates

Removal of the five per cent ad valorem customs duty on imported spirits and Ready-to-Drink products

Recommendation 3: Removal of five per cent ad valorem customs duty

That the Government immediately remove the five per cent nuisance customs duty on imported spirits and RTDs in order to remove structural complexity from the current alcohol taxation regime.

Estimated revenue impact: \$80 million cost over the forward estimates

Tax equivalence for low- and mid-strength Ready-to-Drink products

Recommendation 4: Tax equivalence for low- and mid-strength Ready-to-Drink products

That the Government introduce taxation equivalence between low- and mid-strength packaged RTDs and packaged beer of similar alcohol content by applying the same volumetric rates as well as applying the 1.15 per cent alcohol by volume (abv) excise-free threshold.

Estimated revenue impact: \$20 million cost over the forward estimates

Proposed offsetting of the Consumer Price Index impacts of the carbon price

Recommendation 5: Offset second-round Consumer Price Index effects of the carbon price on automatic indexation of excise duty rates

That the Government eliminate the unintended second round effects that the introduction of the carbon price will have on the automatic indexation of excise and excise-equivalent customs duty rates applying to spirits, RTDs and beer. Consumer Price Index (CPI) indexation of excise and excise-equivalent customs duty rates applying to these products on 1 February 2013 should be discounted to remove the estimated contribution of the carbon pricing package to CPI indexation in the second half of 2012.

¹ A 'traditional cider' product is a beverage that is the product of the complete or partial fermentation of the juice or must of apples. It is contrasted with a 'flavoured cider' product which has had added ethyl alcohol or any liquor or substance (other than water or the juice or must of apples or pears) that gives colour or flavour.

Long-term reform objectives

Recommendation 6: Government acknowledgement of the end of the ‘wine glut’

That the Government note that the ‘wine glut’ is likely to end within the next 12 to 24 months and therefore commence considering alcohol taxation reform options to ensure that they can be implemented in a timely manner following the end of the wine glut.

Recommendation 7: Reform of the Wine Equalisation Tax to a volumetric taxation regime

That the Government pursue wine taxation reform using the four-step process devised by DSICA as a transition step to achieving the long-term goal of a fully volumetric taxation regime for all alcohol beverages. Introduction of a volumetric alcohol taxation regime will provide an effective minimum floor price.

Recommendation 8: Freezing of statutory indexation of excise duty rates to facilitate transition to a wholly volumetric alcohol taxation regime

That the Government commit to freeze automatic (statutory) indexation of the spirits and RTD excise duty rates as a means of facilitating the transition to a single volumetric rate for all alcohol products, as recommended by the Henry Review.

1 The Australian alcohol market and DSICA revenue estimates for 2012-13

1.1 Introduction

In this Chapter, DSICA provides a brief overview of the Australian alcohol taxation system, the latest data on the composition of Australia's alcohol market and estimates of government revenue from alcohol products in 2012-13. A full technical explanation of each of these considerations is set out in Appendix A. Readers who are unfamiliar with Australia's alcohol taxation regime are recommended to read Appendix A before proceeding.

1.2 Alcohol taxation in Australia

Revenue authorities around the world apply two main methods in taxing alcohol products:

- tax on the basis of the volume of alcohol in the beverage (a 'volumetric', or specific rate method); and
- tax on the basis of the value of the product (an 'ad valorem' method).

Australia uses a combination of both methods, depending on the beverage type as follows:

- beer, spirits, Ready-to-Drink alcohol products (RTDs) and flavoured cider are subject to excise duty on a volumetric litre of pure alcohol (LPA) basis; and
- wine, wine products and traditional cider are subject to the ad valorem Wine Equalisation Tax (WET) at 29 per cent of the product's wholesale sales value.

1.3 The Australian alcohol market in 2010-11 and revenue estimates for 2012-13

DSICA estimates that of the alcohol market in 2010-11 (when measured in LPAs):

- beer comprised 42 per cent;
- spirits overall (including RTDs and flavoured cider) comprised 20 per cent;
- wine (and grape wine products) comprised 37 per cent; and
- traditional cider comprised one per cent of the market, but was the fastest growing market segment.

DSICA estimates that the Federal Government will collect approximately \$7.7 billion in taxation revenue from the production and consumption of alcohol beverages in the 2012-13 financial year. This revenue will comprise:

- \$1.9 billion in customs duty;
- \$3.3 billion in excise duty;
- \$775 million in WET.

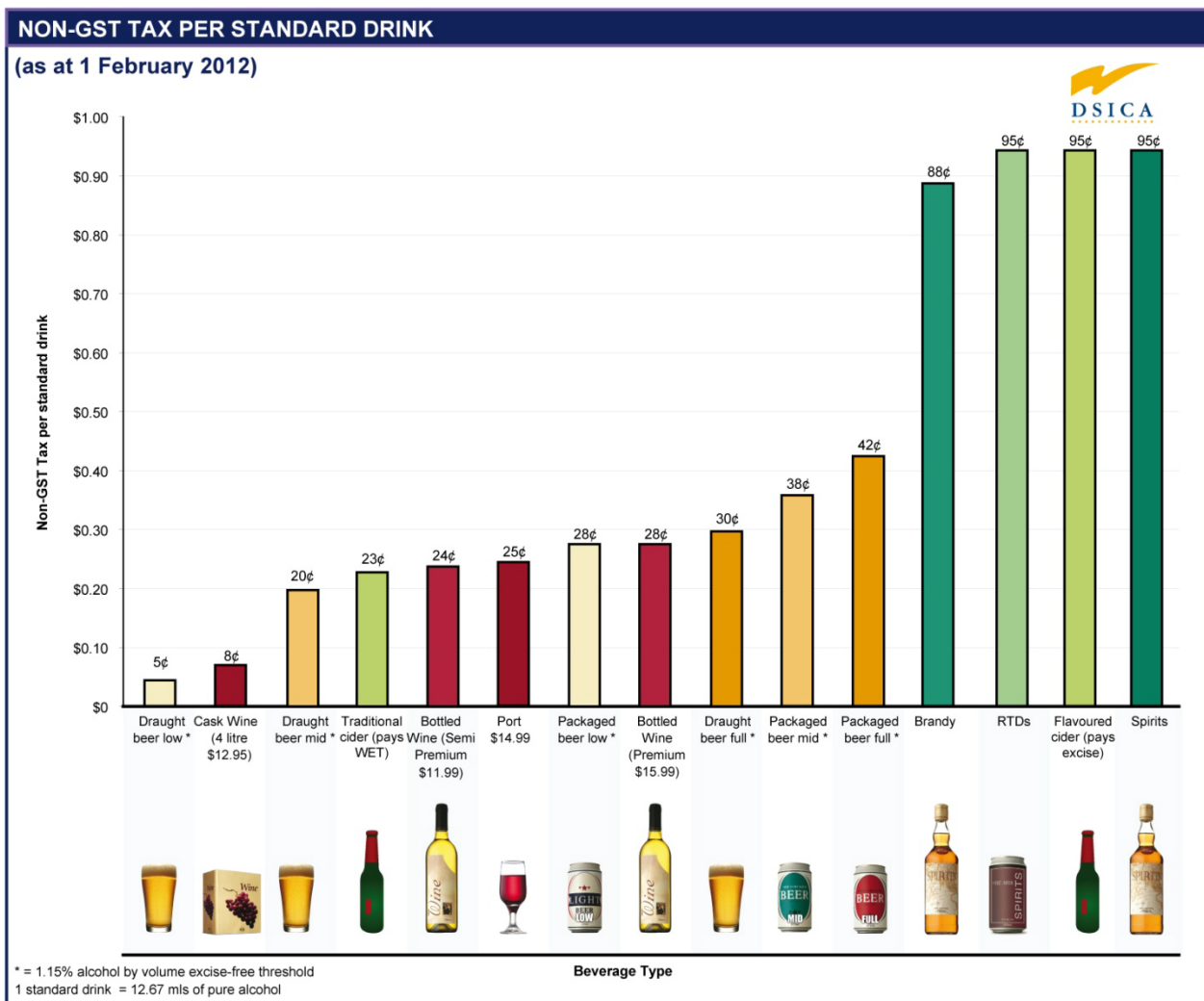
Resulting in \$6.0 billion in non-Goods and Services Tax (GST) revenue, and \$1.8 billion in GST revenue (see Appendix A for further details).

1.4 Non-GST (alcohol) taxes per standard drink

Using the concept of a standard drink allows for a uniform comparison of the incidence of taxation on products of differing alcohol strength and retail price, shown in Figure 1.1. The graphic highlights some of the issues and complexities inherent in the current tax system.

DSICA believes that consumers have an increasing appreciation of the need for taxation equity when tax incidence can be compared on a ‘per standard drink’ basis.

Figure 1.1: Non-GST alcohol tax per standard drink as at 1 February 2012



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Source: DSICA Pre-Budget Submission 2012-13

The inconsistency in the tax treatment of different beverages becomes particularly clear when one considers that:

- cask wine (typically with an alcohol by volume [abv] of 11 to 13 per cent) pays only 8 cents per standard drink;
- full-strength RTDs (which are less than half the abv of most cask wines) pay 95 cents per standard drink (12 times that paid by cask wine);
- full-strength packaged beer (at about the same abv as full-strength RTDs) only pays 42 cents per standard drink, less than half that paid by RTDs of equivalent alcohol content; and

- traditional cider only pays 23 cent per standard drink, less than a quarter of that paid by flavoured cider.

1.5 The ideal alcohol taxation system

The Henry Review outlined a recommendation pertaining to the design of an ideal alcohol taxation system as follows:

Recommendation 71:

All alcoholic beverages should be taxed on a volumetric basis, which, over time, should converge to a single rate, with a low-alcohol threshold introduced for all products. The rate of alcohol tax should be based on evidence of the net marginal spillover cost of alcohol.

Taken from Commonwealth of Australia, Australia's Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis, 2010, p. 442

DSICA strongly supports this recommendation. DSICA also notes that the use of a single volumetric rate for all alcohol products should be supported, as it:

- does not distort production and consumption decisions;
- facilitates desired health and social policy objectives as it enables consumers to make responsible consumption decisions based on the alcohol content of product (this is in contrast to the current tax regime in which some higher-strength products may enjoy a cheaper retail price due to favourable taxation structures [e.g. cask wine]); and
- better addresses social harm arising from risky and high-risk alcohol consumption through closer targeting of social costs (as facilitated through the introduction of a single volumetric rate based on evidence of the net marginal spillover cost of alcohol).

1.6 Reform of the Australian alcohol taxation system

DSICA acknowledges that reform to a single volumetric rate is a long-term goal. However, in the interim there are a number of incremental reforms which can be undertaken to assist in reforming the anomalies and distortions prevalent in the existing taxation regime. As such, DSICA's Pre-Budget Submission is structured in a manner which discusses each of these incremental reforms as follows:

- **Chapter 2:** alcohol consumption patterns in Australia and the effectiveness of initiatives designed to reduce harmful consumption behaviours
- **Chapters 3-7:** outline DSICA's 2012-13 Budget reform priorities and incremental reform opportunities, including:
 - ⇒ **Chapter 3:** taxation of traditional cider products at the RTD excise duty rate, rather than under the WET
 - ⇒ **Chapter 4:** tightening of Wine Producer Rebate provisions in the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) to address issues of tax avoidance and 'double dipping'
 - ⇒ **Chapter 5:** removal of the five percent ad valorem customs duty on imported spirits and RTDs
 - ⇒ **Chapter 6:** tax equivalence for low- and mid-strength RTDs with packaged beer

- ⇒ **Chapter 7:** offsetting of the Consumer Price Index (CPI) impacts of the carbon price from automatic indexation of excise duty rates applying to spirits and RTDs
- **Chapter 8:** outlines DSICA’s long-term vision for reform of the Australian alcohol tax regime, namely reform of the WET from an ad valorem tax to a volumetric tax and then gradual transition to a single volumetric excise duty rate for all alcohol beverages.

DSICA acknowledges that in this tight fiscal environment, all reform proposals must be fully-funded.² To this end, the revenue gains to be realised through taxation of traditional cider products at the RTD excise duty rate and reform of the Wine Producer Rebate may be used to fund the proposals outlined in Chapters 5-7.

² Australian Government, *Tax Forum Discussion Paper: Tax Reform – Next Steps for Australia*, 2011, p. vi.

2 Alcohol consumption patterns in Australia and initiatives to reduce harmful consumption behaviours

2.1 Introduction

DSICA supports the Government's commitment to changing Australia's drinking culture and addressing alcohol misuse. DSICA considers that policy development and program implementation aimed at achieving targets to reduce harmful alcohol consumption must be based on the best available evidence.³ To this end, it is imperative that stakeholders have access to accurate and timely data which assesses changing levels and patterns of alcohol consumption to enable them to measure the effectiveness of Government policies and initiatives.

Despite the Government's claims of increased levels of 'binge drinking' and 'alcohol abuse', recent academic studies and DSICA analysis of data relating to alcohol consumption patterns, behaviours and trends indicate that:

- there is a stable trend in Australian adult per capita alcohol consumption;
- the majority of Australians drink responsibly, at levels below the risk of long-term harm;
- the April 2008 RTD tax increase has had no substantive effect on total alcohol consumption levels, instead resulting in substitution out of RTDs and into other alcohol beverage categories; and
- current proposals exploring the concept of minimum floor pricing as a means of reducing alcohol misuse are unnecessary and unlikely to result in any significant changes to alcohol consumption patterns.

This Chapter discusses recent trends in Australian alcohol consumption patterns and outlines evidence demonstrating the failure of the RTD tax increase of April 2008. This Chapter also outlines how current proposals relating to the introduction of a minimum floor price are unnecessary and unlikely to achieve the Government's desired health and social policy outcomes.

2.2 Stable trend in Australian adult per capita alcohol consumption

DSICA estimates adult per capita (population 15 years and over) alcohol consumption for 2010-11 in Australia at 10.05 LPAs. This is down from 10.35 LPAs adult per capita consumption in 2009-10. These figures are primarily derived from the Australian Bureau of Statistics' (ABS) *Apparent Consumption of Alcohol, Australia* series and supplemented from industry sources on traditional cider (as traditional cider is not included in the ABS data collection).

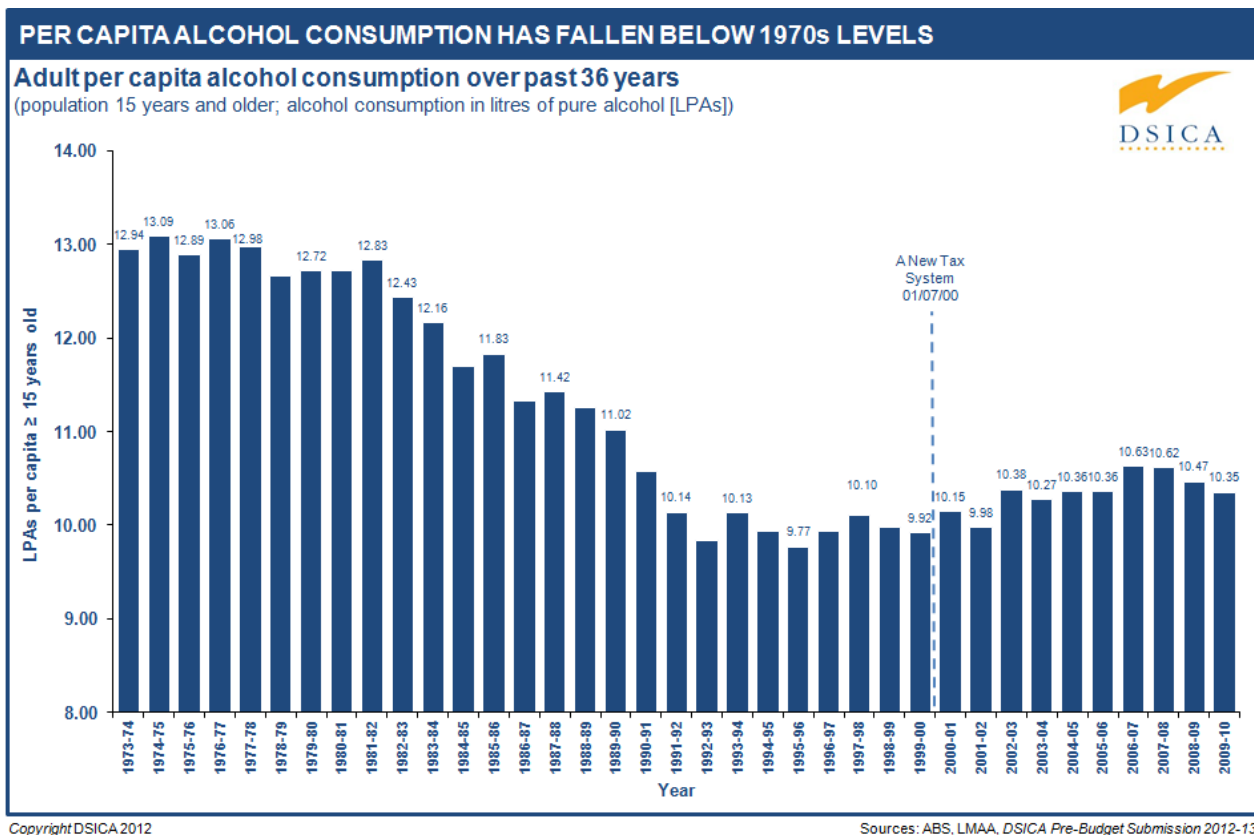
A time series of adult per capita alcohol consumption from 1973-74 to 2009-10 is provided at Figure 2.1. DSICA highlights the following observations and insights in relation to this time series:

- current adult per capita consumption has fallen below levels in the 1970s and is now more than 20 per cent below its 30-year high reached in 1974-75;
- there has been no significant increase in adult per capita consumption since the *A New Tax System* reforms of 1 July 2000, which included a reduction in the tax rate applied to RTDs; and

³ Australian Government, *Taking Preventative Action – A Response to Australia: The Healthiest Country by 2020*, 2010, p. 11.

- while the reduction in RTD volumes after the RTD tax increase on 27 April 2008 was entirely offset by substitution to full-strength bottled spirits, beer and traditional cider, growth in alcohol volumes has been outpaced by population growth. As a result, per capita consumption declined in both 2007-08 and 2008-09.

Figure 2.1: Adult per capita alcohol consumption in Australia (1973-74 to 2009-10)



This stable trend in per capita alcohol consumption is supported by the Australian Institute of Health and Welfare, which notes:

‘Between 1993 and 2007, the daily drinking patterns of people in Australia aged 14 years or older remained largely unchanged, at around 8 per cent. However, in 2010, there was a statistically significant decrease (since 2007) in the proportion of people drinking daily.’⁴

This reinforces DSICA’s view that there has not been a dramatic change in overall alcohol consumption trends in the last ten to 15 years that would justify the term ‘binge drinking epidemic’.

2.3 The majority of Australians drink responsibly

Alcohol is widely enjoyed throughout Australian society and is broadly accepted as a way of relaxing and socialising. It is important to note that the majority of Australians drink in a responsible manner without harm to themselves or others. Indeed, the Preventative Health Taskforce acknowledged the role of alcohol in Australian society and the fact that the majority of Australians drink responsibly:

⁴ Australian Institute of Health and Welfare, 2010 National Drug Strategy Household Survey Report, 2011, p. 46.

‘The majority of Australians who regularly drink, do so in moderation. Around three quarters (72.6 per cent) of Australians drink below levels for long-term risk of harm.’⁵

In 2010 over 58 per cent of the Australian population (aged 12 years and older) drank alcohol at low-risk levels,⁶ while approximately 21 per cent were recorded as ‘abstainers’ (i.e. those who had not consumed alcohol in the previous 12 months). Therefore, if low-risk drinkers are combined with abstainers, almost 80 per cent of the population consume alcohol in a way that does not put them at risk of harm from alcohol-related disease or injury over their lifetime.⁷

Australia’s comparative alcohol consumption

Despite common perceptions of Australia being a nation of heavy drinkers compared with other countries, adult per capita consumption of alcohol in comparable developed countries is higher than in Australia. A comparison between the Organisation for Economic Co-operation and Development (OECD) countries for which per capita consumption data is available (see Figure 2.2) reveals that Australia ranks only equal eighth (along with Denmark and Switzerland) out of a total of 22 countries.⁸

Figure 2.2: Australia’s comparative alcohol consumption (2009)

AUSTRALIA DOES NOT HAVE A HIGH LEVEL OF PER CAPITA ALCOHOL CONSUMPTION COMPARED WITH OTHER OECD COUNTRIES					
Ranking	Country	LPAs per capita	Ranking	Country	LPAs per capita
1	Austria	12.2	13	Netherlands	9.4
2	Czech Republic	12.1	14	New Zealand	9.3
3	Estonia	12.0	15	Slovak Republic	9.0
4	Slovenia	11.5	16	Korea	8.9
5	Ireland	11.3	17	Chile	8.6
6	Poland	10.2	18	Canada	8.2
(equal ranking)	United Kingdom	10.2	19	Japan	7.4
8	Australia	10.1	(equal ranking)	Sweden	7.4
(equal ranking)	Denmark	10.1	21	Norway	6.7
	Switzerland	10.1	22	Turkey	1.5
11	Finland	10.0			
12	Germany	9.7			

Statistics taken from the 2009 *Non-Medical Determinants of Health: Alcohol Consumption* dataset series. Note that statistics relating to alcohol consumption collected by the OECD and DSICA differ, however only OECD statistics have been used in this comparison to ensure consistency across all countries.

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Source: OECD

A further comparison with nine selected OECD countries in the *International Comparison of Australia’s Taxes* report further supports this conclusion.⁹ DSICA’s analysis reveals that within these ten OECD countries (referred to as the ‘OECD-10’), Australia has the second lowest per capita consumption of alcohol beverages.

The World Health Organization ranks Australia as 44th out of 188 countries in terms of per capita alcohol consumption.¹⁰ DSICA cautions readers about such large international comparisons due to cultural and religious factors in some other countries. Accordingly, DSICA believes it is

⁵ Preventative Health Taskforce, *Australia: The Healthiest Country by 2020, National Preventative Health Strategy – The Roadmap for Action*, 2009, p. 23.

⁶ I.e. low-risk levels of alcohol-related harm over a lifetime.

⁷ Australian Institute of Health and Welfare, *2010 National Drug Strategy Household Survey*, 2011, p. 53.

⁸ Organisation for Economic Co-Operation and Development, *Non-Medical Determinants of Health: Alcohol Consumption*, 2009.

⁹ Ibid.; Warburton, R. and Hendy, P., *International Comparison of Australia’s Taxes*, 2006, p. 268.

¹⁰ World Health Organization, *Global Status Report on Alcohol and Health 2011*, 2011, pp. 273-277.

appropriate to compare Australia’s consumption only against similar Western countries – as in the OECD comparisons above.

2.4 Failure of the Ready-to-Drink product tax increase

Despite a stable trend in alcohol consumption and acknowledgement that the majority of Australians consume alcohol in a responsible manner, the Australian Government raised the excise duty payable on RTDs from \$39.36 per LPA (the excise duty rate applying to full-strength packaged beer products) to \$66.67 per LPA (the excise duty rate applying to full-strength bottled spirits products) on 27 April 2008 – an increase of 70 per cent. This policy measure was designed as a means of reducing the harm to young people arising from excessive drinking. Indeed, the Government stated that ‘binge drinking’ is a ‘community-wide problem and requires a comprehensive, community-wide response’.¹¹

It should be noted that the pre-April 2008 tax differential between RTDs and spirits was neither an anomaly nor an unintended feature of the alcohol tax system. This differential resulted from a deliberate policy decision, implemented in July 2000, to tax RTDs at a similar rate as packaged beer. The policy rationale was that beer and RTDs are of similar strengths, are marketed to consumers in similar ways, and are substitutes, competing for the same consumer demographic.

The Government’s decision was implemented on 27 April 2008, despite the fact that there was no reliable evidence demonstrating that RTDs are disproportionately linked with risky and high-risk drinking behaviours. Further, in the time that has elapsed since the tax increase, evidence demonstrates that the RTD tax increase has not been effective in reducing harmful drinking levels.

No evidence that Ready-to-Drink products are disproportionately linked with risk and high-risk drinking behaviours

There is no reliable evidence that RTDs are disproportionately associated with, or have caused a rise in, risky and high-risk drinking by young people.

In justifying the RTD tax increase, the Government stated that it was responding to purported evidence that RTDs were responsible for causing a dramatic rise in ‘binge’ (or risky/high-risk) drinking amongst young people. Contrary to this, neither the Henry Review nor the *National Drug Strategy Household Survey* indicate that there is any reliable evidence demonstrating that this is the case.

The Henry Review finds no evidence

The Henry Review concluded that there is currently no credible evidence demonstrating that RTDs are disproportionately linked with risky or high-risk drinking behaviours.¹²

The National Drug Strategy Household Survey provides no evidence

Australia’s most reliable longitudinal survey series demonstrates that there is no relationship between risky and high-risk drinking patterns and RTD consumption levels.

Evidence from the *National Drug Strategy Household Survey* confirms that there is no link between the growth in RTD consumption and an increase in risky and high-risk drinking patterns. Indeed, the evidence demonstrates that, prior to 2008, there had been a reduction in

¹¹ Hansard, *House of Representatives (Nicola Roxon)*, 13 May 2008, p. 2613.

¹² Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis*, 2010, p. 435.

the proportion of 14-19 year olds (both male and female) drinking at levels of long-term harm. While risky and high-risk drinking levels amongst 14-19 year olds are still unacceptably high, DSICA notes that the decline in these behaviours is a welcoming trend, and analysis of this data in the period following the RTD tax change indicates that this trend has generally continued.¹³ The most notable trends are outlined in Figure 2.3 below.

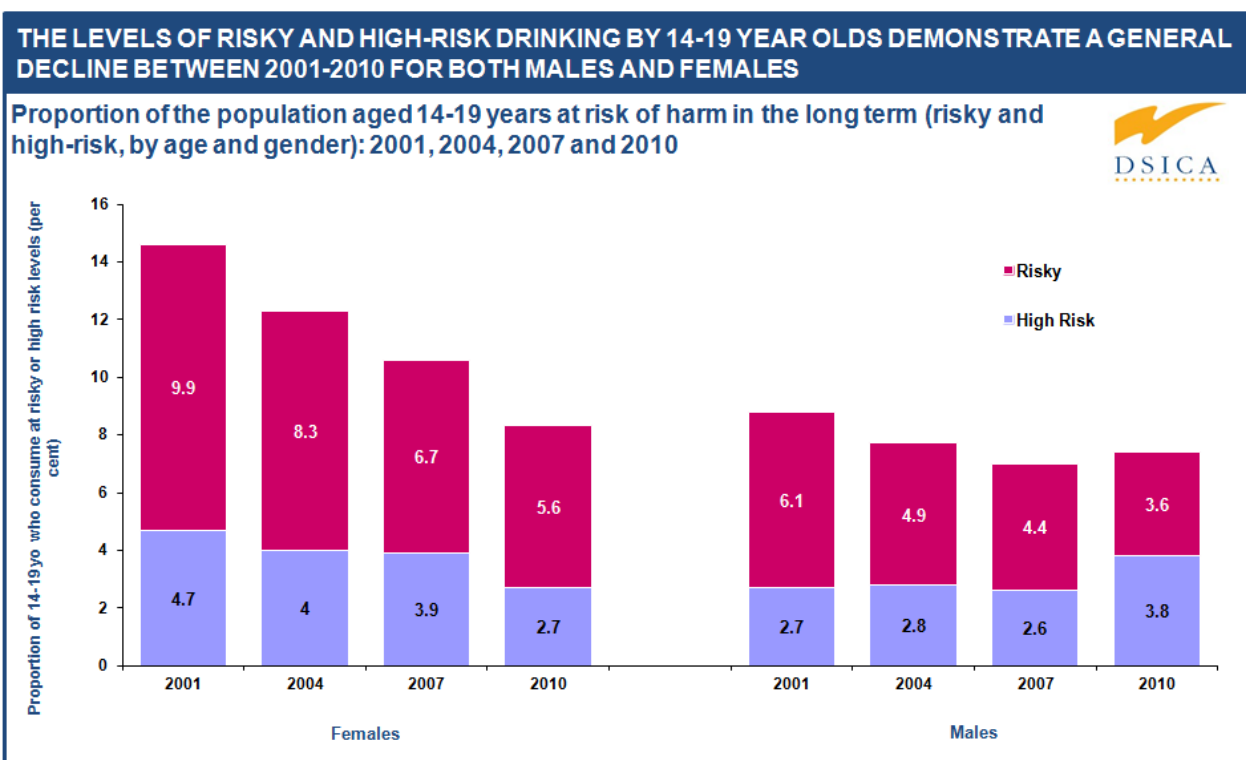
Figure 2.3: Risk of long-term harm from alcohol consumption (risky and high-risk drinking behaviours, males and females 14-19 years, 2001-2010)

Risk of harm in the long-term		
Females (14-19 years)	Proportion who consume alcohol at risky and high-risk levels fell from 14.6 per cent in 2001 to 8.3 per cent in 2010	Reduction of 43 per cent between 2001 and 2010
Males (14-19 years)	Proportion who consume alcohol at risky and high-risk levels fell from 8.8 per cent in 2001 to 7.4 per cent in 2010	Reduction of 16 per cent between 2001 and 2010

Sources: 2001, 2004, 2007 and 2010 National Drug Strategy Household Survey: First Results

These findings are illustrated in Figure 2.4 below.

Figure 2.4: Long-term levels of risky and high-risk drinking by 14-19 year olds (males and females, 2001-2010)



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Sources: 2001, 2004 2007 and 2010 National Drug Strategy Household Survey: First Results

There has been a slight increase in the number of 14-19 year old males drinking at high-risk levels between 2007 and 2010. However, the *National Drug Strategy Household Survey 2010*

¹³ Note, however, that there has been a slight increase in the proportion of 14-19 year old males drinking at high-risk levels of harm in the long term between 2007 and 2010, and a slight increase in the proportion of 14-19 year old females drinking at levels which present a risk of harm in the short-term on a monthly basis between 2007 and 2010. The proportion of 14-19 year old males drinking at risk of short-term harm on a weekly basis has fluctuated throughout 2001 to 2010.

indicates that spirits and RTDs are not the preferred beverages of this demographic group. In fact, 34.4 per cent of this demographic group indicate that full-strength beer is their preferred beverage.¹⁴

Evidence also demonstrates that prior to 2008, there had been a continued reduction in the proportion of 14-19 year olds (both male and female) consuming alcohol on a weekly or monthly basis which presents a risk of short-term harm. This trend has continued following the RTD tax change. The most notable trends are outlined in Figure 2.5 below.

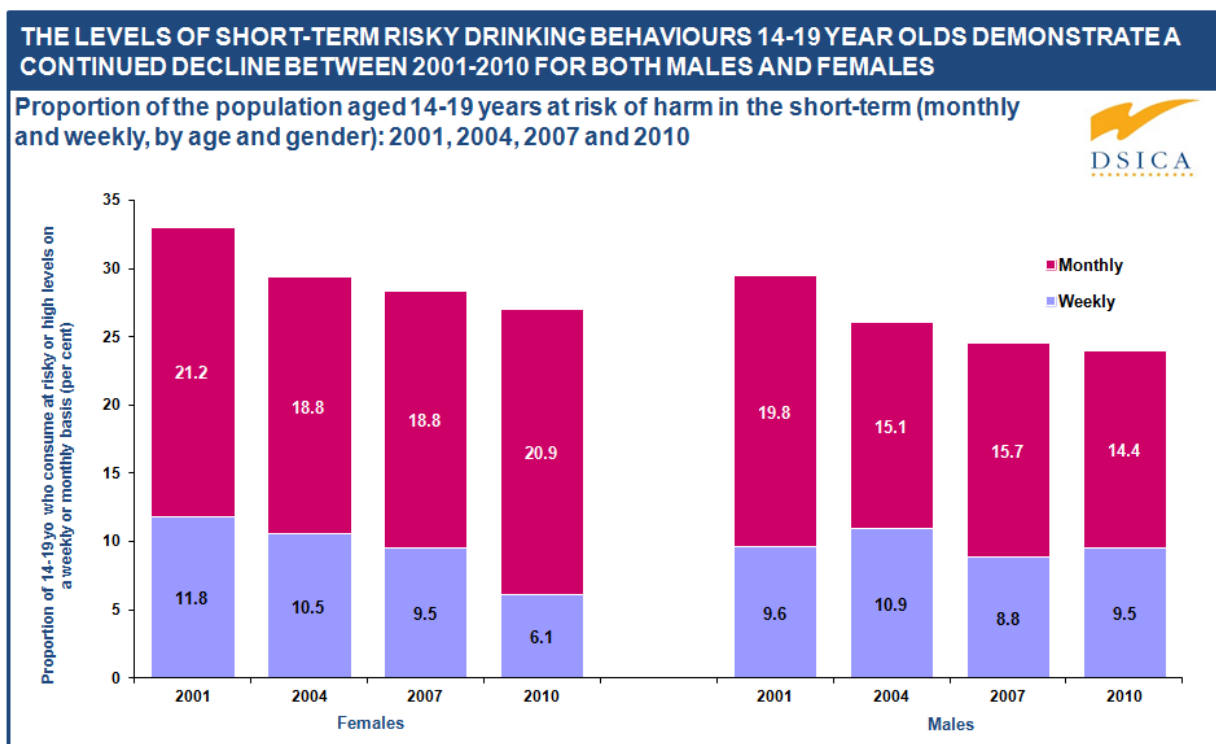
Figure 2.5: Risk of short-term harm from alcohol consumption (weekly and monthly, males and females 14-19 years, 2001-2010)

Risk of harm in the short-term		
Females (14-19 years)	Proportion who consume alcohol at levels presenting a risk of short-term harm on a weekly or monthly basis fell from a combined total of 33.0 per cent in 2001 to 27.0 per cent in 2010.	Reduction of 18 per cent between 2001 and 2010
Males (14-19 years)	Proportion who consume alcohol at levels presenting a risk of short-term harm on a weekly or monthly basis fell from a combined total of 29.4 per cent in 2001 to 23.9 per cent in 2010.	Reduction of 19 per cent between 2001 and 2010

Sources: 2001, 2004, 2007 and 2010 National Drug Strategy Household Survey: First Results

These findings are illustrated in Figure 2.6 below.

Figure 2.6: Short-term risky drinking behaviours by 14-19 year olds (monthly and weekly, males and females, 2001-2010)



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Sources: 2001, 2004 2007 and 2010 National Drug Strategy Household Survey: First Results

¹⁴ Australian Institute of Health and Welfare, 2010 National Drug Strategy Household Survey Report, 2011, p. 77.

DSICA notes that the *National Drug Strategy Household Survey* findings indicate that the decline in risky and high-risk drinking behaviours was evident *prior* to the introduction of the tax increase on RTDs, and does not appear to have arisen as a result of this tax change. It is therefore presumptuous to demonstrate that this welcoming trend has arisen as a direct result of the RTD tax change.

The Ready-to-Drink product tax increase has failed to reduce total alcohol consumption

The best available evidence confirms that the 2008 RTD tax increase failed to reduce overall alcohol consumption in Australia.

Australian Bureau of Statistics data released in January 2011 confirmed that the dramatic decrease in consumption of RTDs seen in the 2008-09 financial year (following the RTD tax increase) has been more than offset by an increase in the consumption of full-strength bottled spirits, beer, wine and traditional cider products.¹⁵

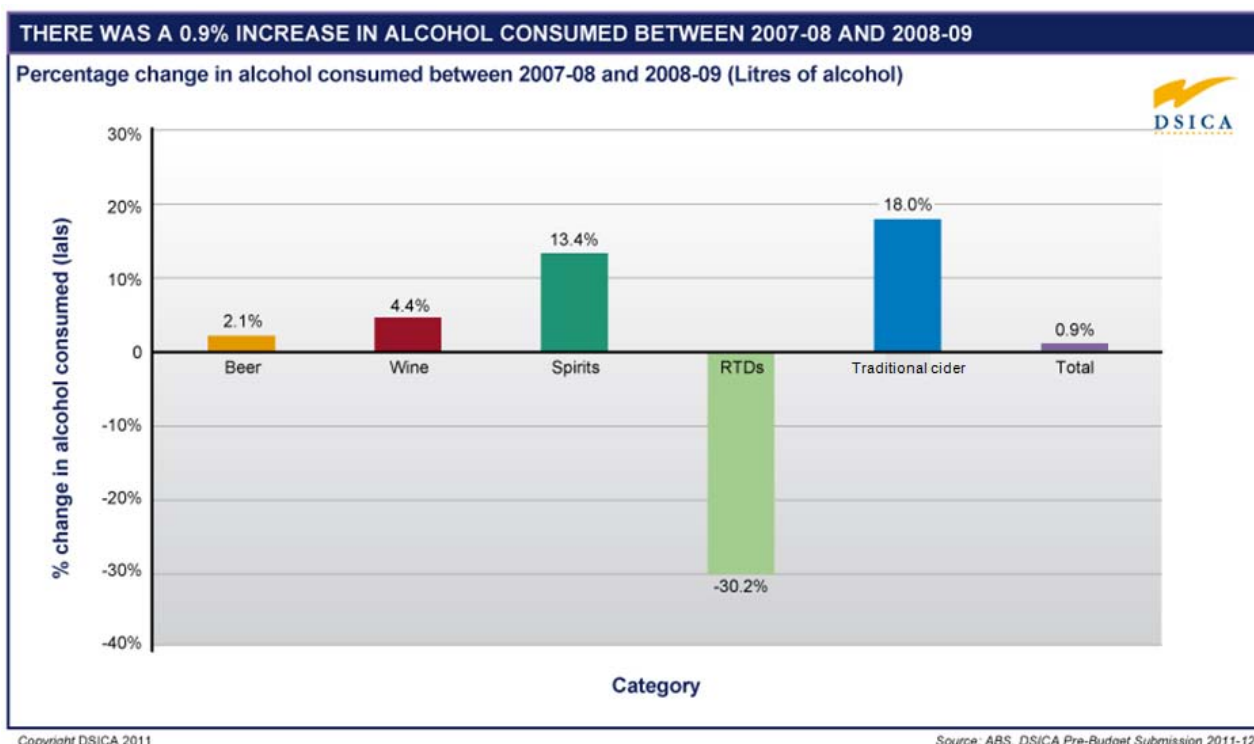
The ABS data series *Apparent Consumption of Alcohol, Australia*, records the levels of alcohol consumption by beverage category – beer, full-strength bottled spirits, RTDs and wine. However, the series does not include traditional cider consumption, the fastest-growing segment of the Australian alcohol market (and a direct competitor of RTDs). Factoring in industry data regarding sales in the cider market, *total* alcohol consumption has increased by 0.9 per cent between 2007-08 and 2008-09.¹⁶ This demonstrates that while the RTD tax increase has altered consumption of RTDs, it has not reduced total alcohol consumption. Instead, consumers have moved to consuming full-strength bottled spirits, beer, wine and traditional cider in substitution for RTDs.

Figure 2.7 overleaf demonstrates that despite there being a significant reduction in the consumption of RTDs following the tax change (down by 30.2 per cent), this has been more than offset by increases in full-strength bottled spirits, wine, beer and traditional cider consumption.

¹⁵ Australian Bureau of Statistics, *Apparent Consumption of Alcohol, Australia: Extended Time Series, 1944-1945 to 2008-09* (Cat. No. 4307.0.55.002), 2011.

¹⁶ While *total* alcohol consumption increased between 2007-08 and 2008-09, alcohol consumption on a *per capita* basis declined due to faster population growth during this period.

Figure 2.7: Consumption of beer, wine spirits, Ready-to-Drink and cider products (2007-08 and 2008-09)

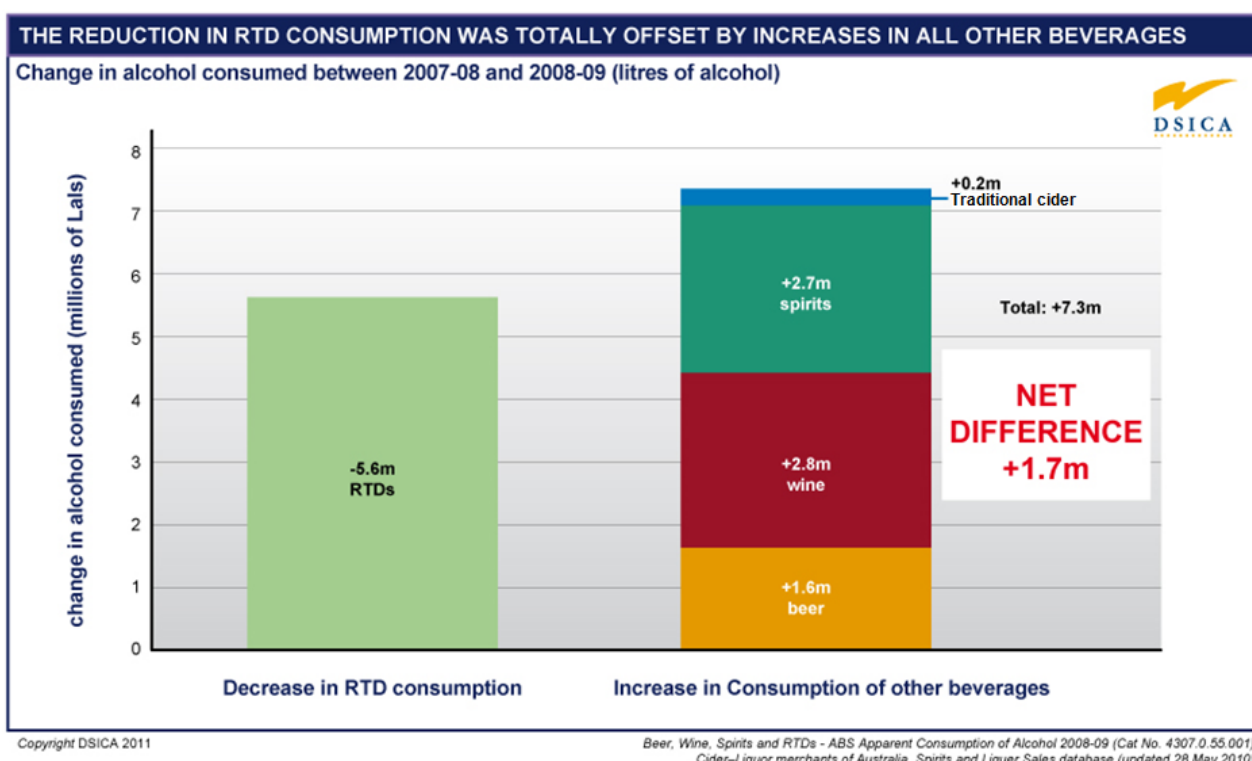


In summary, ABS and industry market data confirms the following:

- **total alcohol consumption increased by 0.9 per cent** (or 1.7 million LPAs) in 2008-09 compared to 2007-08;
- **RTD consumption fell** by 5.6 million LPAs (down by **30.2 per cent**);
- **full-strength bottled spirits** consumption increased by 2.7 million LPAs (up by **13.4 per cent**);
- **beer** consumption increased by 1.6 million LPAs (up by **2.1 per cent**);
- **wine** consumption increased by 2.7 million LPAs (up by **4.4 per cent**); and
- **traditional cider** consumption increased by an estimated 210,000 LPAs (up by **18.0 per cent**).

Figure 2.8 overleaf provides a diagrammatic representation of how the decrease in RTD consumption was totally offset by the increase in consumption of all other alcohol beverage categories.

Figure 2.8: Substitution of Ready-to-Drink product consumption into other alcohol beverage categories (2007-08 and 2008-09)



These findings support academic literature which questions the efficacy of taxation initiatives which target single beverage categories as a means of reducing harmful alcohol consumption. Indeed, Christopher Doran of the National Drug and Alcohol Research Centre notes that ‘policies for preventing alcohol-related problems should focus on reducing total alcohol consumption instead of focusing on single beverage types’.¹⁷ To this end, DSICA notes that while the RTD tax increase prima facie appears to have been successful in reducing consumption of RTDs, the overall increase in total alcohol consumption due to substitution into other alcohol beverage categories mitigates the purported benefits of the tax change.

The Ready-to-Drink product tax increase has failed to reduce levels of alcohol-related harm

There is no evidence that the 2008 RTD tax increase was effective in reducing alcohol-related hospitalisations.

A recent longitudinal study of alcohol-related hospitalisations and Emergency Department presentations by the University of Queensland/Griffith Health Institute has concluded that alcohol-related hospitalisations and presentations have not declined since the RTD tax increase. This study confirms that the RTD tax increase has not been effective in reducing the incidence of alcohol-related harm.

The University of Queensland and Griffith Health Institute at Griffith University collaborated with a range of Queensland-based institutions and the Gold Coast Hospital to study alcohol-related presentations at the Gold Coast Hospital between 2005 and 2010. The study found that the proportion of alcohol-related Emergency Department presentations for 15 to 29 year olds on

¹⁷ Doran, C. and Digiusto, E., ‘Using taxes to curb drinking: A report card on the Australian government’s alcopops tax’, *Drug and Alcohol Review*, 2011, p. 4.

the Gold Coast did not significantly fall after the introduction of the RTD tax increase when compared with alcohol-related presentations in an older age group, or with non-alcohol-related presentations in the same age group.¹⁸ These findings prompted the authors to propose the following hypotheses on the effectiveness of the RTD tax increase:

- price influences average consumption of all drinks, but not risky consumption on a single occasion;¹⁹ and
- raising the price of just one type of drink may not reduce alcohol-related harms. This has prompted the authors to note that, if true, this may raise questions about generalising from the effects of *overall* increases in alcohol tax to initiatives that target one type of drink.²⁰

The findings of this study not only demonstrate that the RTD tax increase has not resulted in a reduction of alcohol-related harms, but also that a more comprehensive approach (rather than fiscal changes alone) is required to reduce the incidence of risky and high-risk drinking behaviours.

Conclusion

The 2008 RTD tax increase has failed to achieve its desired health and social policy objectives, instead resulting in substitution into other alcohol beverage categories, leading to a net overall increase in alcohol consumption between 2007-08 and 2008-09. The views expressed in academic literature and analysis of alcohol consumption trends demonstrate the Government's weakness in developing workable, evidence-based alcohol health policies, necessitating ongoing and intensive scrutiny in this area.

2.5 Introduction of a minimum floor price

DSICA strongly opposes the introduction of a minimum floor price mechanism for alcohol products.

DSICA acknowledges that there is a current policy and media focus on minimum floor pricing on alcohol products. In particular, the Australian National Preventative Health Agency (ANPHA) has been tasked with the development of a minimum floor price concept. It is understood that the potential introduction of a minimum floor price is a likely response to claims of misuse of cheap wine products, particularly in Indigenous communities.

DSICA strongly opposes the introduction of a minimum floor price on a number of grounds, including:

- the fact that there is a lack of economic evidence confirming the effectiveness of minimum floor pricing in reducing risky and high-risk drinking behaviours;
- a minimum floor price will negatively impact the population at large (particularly responsible consumers and those of lower socio-economic backgrounds), rather than targeting at-risk drinkers and those who are determined to misuse alcohol; and
- international experience demonstrates the difficulties associated with implementing a minimum floor price which delivers desired health and social policy objectives.

DSICA believes that a rationalised tax system based on a tiered volumetric tax across all wine products would remove the need for minimum floor pricing. To this end, DSICA proposes reform of the ad valorem WET to a tiered volumetric taxation structure, as this would provide an

¹⁸ Kisely, S. et. al., 'Effect of the increase in 'alcopops' tax on alcohol-related harms in young people: a controlled interrupted time series', *Medical Journal of Australia*, 195: 5 December 2011-19 December 2011, 2011, p. 692.

¹⁹ Ibid.

²⁰ Ibid.

effective minimum floor price on alcohol and alleviate concerns regarding the low taxation rate paid by low-value wine products.²¹

What is a minimum floor price?

Definition

A minimum floor price for alcohol means that a standard drink or unit of alcohol has a minimum (retail) price attached to it by means of legislation (i.e. a statutory mechanism).²²

How does it work?

The number of units in a particular alcohol purchase depends on the volume of the product and the alcohol strength, measured as the percentage abv. The attachment of a minimum price to each unit of alcohol means that it cannot be sold by retailers to consumers for less than the minimum price. The more standard drinks an alcohol product contains, the more expensive it will be.

It is extremely unclear what methodology would be applied to determine the appropriate minimum floor price for Australia. There is no internationally accepted method for undertaking such an analysis, and the issue has proved seriously problematic in several overseas countries (see further discussion below). This would be a very contentious issue, which would almost certainly be the subject of vigorous public debate and likely dissent.

A statutory minimum floor price is not a tax and the extra margin resulting from the imposition of a minimum price structure will be collected by retailers, wholesalers and manufacturers in the supply chain, not the government. The distribution of the additional margins will most likely occur as a direct result of the relative bargaining powers of the key players in the supply chain. This is likely to be the major retailers. In light of the negotiating position and leverage that the two major retailers have in Australia, it is unlikely that the additional margins produced by a statutory minimum floor price will flow through to manufacturers and wholesalers. DSICA believes that it would not be a desirable policy outcome to create a situation in which major retailers may have a further opportunity to increase their margins at the expense of other stakeholders in the supply chain.

Minimum floor pricing in the Australian context

Recent calls for the introduction of a minimum floor price in Australia have largely been made in the context of abuse of cheap wine products (especially cask and cleanskin wine), particularly in indigenous communities.²³

Analysis of the non-GST tax paid per standard drink in Australia (shown in Figure 1.1) indicates that:

- cask wine is cheaply taxed at 8 cents per standard drink; and
- spirits and RTDs are heavily taxed at 95 cents per standard drink.

DSICA notes these anomalies in the Australian alcohol taxation system, but contends that the introduction of a minimum floor price will fail to adequately address these issues, as it:

- lacks economic credibility as a means of reducing the incidence of risky and high-risk drinking behaviours; and

²¹ DSICA's proposal for reform of the WET is outlined in Chapter 8.

²² A standard drink is equivalent to 12.67mL of pure alcohol.

²³ The Australian, *Alcohol floor 'a hit on elderly and poor'*, 9 June 2011.

- adopts a ‘one-size fits all approach’.

DSICA contends that the low retail prices associated with cask and cleanskin wine products are primarily the result of the current ad valorem WET arrangements for wine-based products, which result in a low tax burden on low-value products. DSICA notes that a tax system based on a volumetric tax across all products would provide an effective minimum floor price for all alcohol beverages and hence remove the need to introduce a statutory minimum floor price mechanism.

Economic case against a minimum floor price

DSICA notes that there is a lack of economic evidence supporting the effectiveness of introducing a minimum floor price in reducing risky and high-risk drinking behaviours, and that it is likely to operate in contradiction to the Australian pro-consumer ethos.

DSICA strongly opposes the introduction of a statutory minimum floor price on alcohol beverages in Australia, and believes that such a reform would be regressive and contrary to competition in the alcohol beverage industry and, ultimately, to the detriment of the consumer. DSICA believes that statutory minimum floor pricing runs strongly counter to the pro-competition, pro-consumer ethos underpinning competition in Australia and is a blunt, population-wide instrument which does not target at-risk drinkers.

DSICA does not believe that a minimum floor price approach to pricing will impact on the purchasing behaviour of those who are determined to misuse alcohol. In particular:

- studies demonstrate that the use of minimum floor pricing is likely to be very limited in its effectiveness in curbing excessive alcohol consumption;²⁴ and
- while heavier drinkers tend to consume cheaper and stronger alcohol content products than the average consumer, most academic evidence shows that they are the least responsive to changes in the price of alcohol products.²⁵

DSICA notes that if the intention of introducing minimum pricing is to prevent retailers from pricing their products cheaply or below cost (to increase sales volumes), then increasing the margin pool available to those retailers may not be the most effective way of driving a different business model.

A minimum floor price could also have the effect of discouraging product innovation, as the capacity for manufacturers to differentiate on the basis of price will be reduced. To the extent that this reduces consumer choice, from an economic point of view, the introduction of a minimum floor price on alcohol would be socially inefficient.

Social equity case against a minimum floor price

DSICA considers that the introduction of a minimum floor price on alcohol will disproportionately affect responsible consumers and those of lower socio-economic backgrounds.

One-size fits all approach

A minimum floor price on alcohol is socially inequitable because it is borne by all consumers to discourage the behaviour of a (limited) few. The introduction of a minimum floor price on alcohol would represent a one-size fits all approach, which would unfairly penalise responsible drinkers. In particular, a minimum floor price mechanism would disproportionately impact

²⁴ UK Home Office, *The likely impacts of increasing alcohol price: a summary review of the evidence base*, 2011, p. 21.

²⁵ Centre for Economics and Business Research, *Review of Minimum Alcohol Pricing: Alcohol etc. (Scotland) Bill 2009*, 2009, p. 1; Centre for Economics and Business Research, *Minimum Alcohol Pricing: A targeted measure?*, 2009, p. 39.

responsible drinkers from low socio-economic backgrounds as they are more likely to be affected by an increase in the price of alcohol.²⁶

The majority of Australians drink responsibly

As noted earlier, alcohol is widely enjoyed throughout Australian society and is broadly accepted as a way of relaxing and as an accompaniment to socialising and celebration – it is intrinsically part of Australian culture.²⁷ It is important to note that the majority of Australians drink in a responsible manner without harm to themselves or to others. Introduction of a minimum floor price would disproportionately affect the majority of Australians who consume alcohol responsibly.

International evidence

DSICA notes that international experience has highlighted the difficulties in implementing a minimum floor price for alcohol products and there is a lack of evidence supporting its effectiveness in addressing risky and high-risk drinking behaviours.

Scotland

The Scottish Parliament passed legislation in November 2010 establishing a framework for setting a minimum floor price for alcohol products.²⁸ Despite having the framework in place, the Scottish Parliament has experienced difficulty in agreeing on the actual minimum price, primarily due to concerns regarding the disproportionate impact of the minimum price on low-income consumers.

The *Alcohol Minimum Pricing Bill 2011* was introduced to Parliament by the Scottish National Party (SNP) on 1 November 2011. This Bill is designed to introduce a minimum price per unit of alcohol, however does not contain the actual unit price to be applied. At the time of writing, the Bill was currently under debate.²⁹

Nicola Sturgeon, the Scottish Health Secretary, proposed a minimum price of 45 pence per unit of alcohol in 2010. However, the appropriate level is likely to be subject to public and Parliamentary debate. To this end, public health chiefs have suggested it should be as much as 60 pence per unit of alcohol.³⁰

England

In 2010 the UK Coalition Government released its statement *The Coalition: our programme for Government*, which made a number of commitments in relation to alcohol pricing as follows:

- banning the sale of alcohol below cost price; and
- reviewing alcohol pricing and taxation to ensure it addresses binge drinking without unfairly penalising responsible drinkers, pubs and important local industries; and
- the Home Office and HM Treasury subsequently jointly reviewed the impact of policies designed to raise the price of alcohol, with the Home Office focusing on price factors and HM Treasury on taxation aspects.³¹

²⁶ Preventative Health Taskforce, *Australia: The Healthiest Country by 2020, Technical Report 3, Preventing alcohol-related harm in Australia: a window of opportunity*, 2009, p. 26.

²⁷ *Ibid.*, p. 236.

²⁸ *Alcohol etc. (Scotland) Act 2010*.

²⁹ Scottish Government, *Alcohol – Minimum Pricing*, available at <http://www.scotland.gov.uk/Topics/Health/health/Alcohol/minimum-pricing>, accessed 6 December 2011.

³⁰ *Ibid.*

³¹ HM Government, *The Coalition: Our Programme for Government*, 2010, p. 13.

Later, in November 2010, HM Treasury released the *Review of alcohol taxation* which found that there is strong evidence that ‘consumers respond to changes in the price of alcohol and an increase in price will lead to lower average consumption’.³² However, while low prices play a role in encouraging excess consumption, ‘drawing out the links between price and alcohol-related harm is not as straightforward’.³³ Following this, in January 2011, the British Home Office released its report summarising the international research evidence on the likely impact of increasing alcohol price. This report concluded that:

- the international evidence base suggests that policies designed to increase the price of alcohol may be effective in reducing the harms caused by alcohol. However, there is a significant variation in the size of the relationship across the studies analysed;
- alcohol price is only one factor that may affect levels of alcohol consumption, with individual, cultural, situational and social factors also influential; and
- it is not possible to determine which alcohol pricing policies may be the most effective.³⁴

DSICA notes that these reviews demonstrate that there is no conclusive evidence indicating that an increase in alcohol prices (particularly through the use of a statutory minimum floor price) will lead to a reduction in alcohol-related harms.

Despite these research findings, the latest reports indicate that the United Kingdom’s Prime Minister David Cameron has ordered officials to develop a scheme to stop the sale of alcohol below 40 to 50 pence per unit of alcohol. Media reports indicate that Ministers tasked with developing this scheme may seek to copy the current Scottish minimum floor price proposal outlined above. However, no further details are available at the time of writing.³⁵

Conclusion

DSICA favours the introduction of a rationalised alcohol tax system based on a volumetric tax across all alcohol products. In effect, this would provide a minimum floor price on alcohol without incurring costs to retailers to implement the scheme or limiting consumer choice.

DSICA’s wine taxation reform proposal outlined in Chapter 0, which facilitates the introduction of tiered volumetric taxation for wine products, would alleviate concerns regarding very low-value wine products and purported abuse of cask and cleanskin wine products. In particular, this reform proposal would:

- remove the significant tax concessions afforded under the WET system to cheap, low quality wine products (relative to other types of alcohol beverages); and
- remove the incentive for producers to make cheap, low quality wines (such as cask wine).

³² HM Treasury, *Review of alcohol taxation*, 2010, p. 7.

³³ Ibid.

³⁴ UK Home Office, *The likely impacts of increasing alcohol price: a summary review of the evidence base*, 2011, p. 5.

³⁵ The Telegraph, *David Cameron Plans Minimum Alcohol Price in England*, 27 December 2011.

Budget priorities 2012-13

3 Reform of traditional cider taxation

3.1 Introduction

This Chapter demonstrates how the tax paid on traditional cider is far lower than that paid by other alcohol beverages of similar alcohol content, and how reform of traditional cider taxation from the ad valorem WET to a volumetric excise duty rate equivalent to that applied to RTDs and flavoured cider would result in significant revenue gains to Government.

3.2 A brief history of cider taxation in Australia

Since the introduction of the GST in July 2000, traditional cider (and perry) have been subject to a 29 per cent ad valorem tax (i.e. the WET).

The original design of the Howard Government's *A New Tax System* policy intended cider and perry to be subject to the same taxation treatment as RTDs (i.e. volumetric excise duty).³⁶ However, there were significant changes between the original *A New Tax System* policy design and the final tax structure adopted; the most significant of which was the exclusion of basic food products from the GST. Other changes included the introduction of concessional tax rates for draught beer, and the decision to tax traditional cider on the same basis as wine products (under the ad valorem WET) rather than under the excise system which applies to beer, RTDs and flavoured ciders.

This tax treatment gives traditional cider products a significant price advantage over other alcohol beverages with similar alcohol content which compete in the same alcohol market segment, namely full-strength RTDs, flavoured ciders and beer. In particular, the April 2008 excise duty increase on RTDs greatly increased the disparity between the tax paid by RTD and traditional cider beverages.

3.3 The current taxation disparity

Taxation disparities exist both within the cider market and between traditional cider products and other alcohol beverages, particularly RTDs and full-strength beer.

Current taxation disparity within the cider market

A taxation disparity currently exists within the cider market itself as a result of the definitions contained within the WET taxation regime.

For taxation analysis purposes, the cider market is comprised of 'traditional cider' and 'flavoured cider'. A 'traditional cider' product (for the purposes of this discussion) is a beverage that is the product of the complete or partial fermentation of the juice or must of apples.³⁷ On the other hand, a 'flavoured cider' product is a traditional cider product that has had added to it either ethyl alcohol or any liquor or substance (other than water or the juice or must of apples or pears) that gives colour or flavour.³⁸ In particular, flavoured cider products tend to have had lemon, blackcurrant, cola or other (fruit or otherwise) flavourings added.³⁹

³⁶ The Hon Peter Costello, MP, *Tax reform not a new tax, a new tax system: The Howard Government's Plan for a New Tax System*, 1998, p. 87.

³⁷ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 31-5.

³⁸ Note that all references to 'cider' throughout this Pre-Budget Submission relate to traditional cider products unless specified otherwise.

³⁹ WETR 2009/1 [28].

Although traditional cider and flavoured cider products are largely the same from a production and consumer perspective, at present, traditional cider pays a much lower rate of tax compared with flavoured cider:

- traditional cider is taxed under the WET and pays approximately 23 cents in tax per standard drink; while
- flavoured cider is taxed as an ‘other excisable good’ at the equivalent volumetric rate as RTDs and is subject to bi-annual CPI-based indexation (and pays approximately 95 cents in tax per standard drink).

Cider manufacturers are blurring the lines between traditional and flavoured cider products with ongoing product development, innovation and marketing. Traditional cider products are increasingly being marketed alongside RTDs as competitors in both advertising material and the placement of cider products in retail outlets. Figure 3.1 is an example of a recent advertising pamphlet from a large liquor retail outlet showing the placement of traditional cider marketing alongside RTDs.

Figure 3.1: Sample advertising of traditional cider products



Product	Price	Unit	Per Unit Price
Wild Turkey 5% Premix (4x340ml Bottles)	\$32	4x340ml Bottles	\$4.00 per unit
Strongbow Cider (24x355ml Bottles)	\$44.99 EA	24x355ml Bottles	\$1.87 per unit
Bundy Red or Johnnie Walker Red 4.8% Premix (10-pack)	\$32.99 EA	10-pack	\$3.30 per unit

There is no longer any rationale to continue the market-distorting anomaly under which traditional cider is taxed as wine, but flavoured ciders are taxed as RTDs. This fact has arguably been recognised by the Tasmanian Government, which recently withdrew a subsidy that has been available to Tasmanian cider manufacturers for many years.⁴⁰

Taxation disparity between traditional cider products and other alcohol beverages

The use of the ad valorem WET as the taxation regime for traditional cider products creates significant disparities between the effective taxation rates applied to traditional cider and its main competitors – flavoured ciders, RTDs and beer.

As traditional cider products are taxed under the WET, the taxation rate has the benefit of not being subject to indexation. Conversely, excisable goods (flavoured ciders, RTDs and beer) are subject to bi-annual CPI-based indexation increases. This means that the gap between the effective taxation rates for flavoured ciders and RTDs (when compared with traditional cider) widens whenever cider production costs are not increasing at the rate of increase in general consumer prices.

Furthermore, smaller boutique cider producers may also effectively pay no WET at all as they may be entitled to the Wine Producer Rebate. Any traditional cider producer with less than \$1.7 million in total annual sales effectively pays no WET, creating a further discriminatory advantage that is not available to small flavoured cider producers or RTD producers.

The original *A New Tax System* policy design intended that traditional cider would be subject to the same taxation treatment as RTDs, however, the final tax structure adopted facilitated the taxation of traditional cider products on the same basis as wine. DSICA recommends that the *Tax Expenditures Statement* include an expenditure description and analysis outlining the revenue foregone since 1 July 2000 as a result of the taxation of traditional cider under the WET. This would assist the Government in identifying not only the revenue foregone to date as a result of this decision, but also the revenue gains to be had as a result of this proposed change.

In light of the taxation disparities that currently exist, both within the cider market, and between cider products and other alcohol beverages, DSICA recommends that all cider products (both traditional and flavoured) should be taxed at the equivalent volumetric excise duty rate as RTDs.

3.4 The Australian cider market

AC Nielsen reports that the total Australian cider market grew by 23 per cent (in terms of volume) and 35 per cent (in terms of value) between 2010 to 2011.⁴¹ Much of this growth is from the flavoured cider component of the market, which industry data indicates is growing at a significantly faster rate than traditional cider due to recent product innovations.

The Australian traditional cider market is also growing rapidly. In 2010-11 approximately 4.2 million nine-litre cases of traditional cider were consumed (i.e. 1.9 million LPAs) and this accounts for one per cent of total alcohol beverages consumed (when measured in LPAs). Based on these figures, the amount of WET collected from these traditional cider sales was approximately \$30 million in 2010-11.

⁴⁰ The Hon Lara Giddings MP, *Media Release: No New Taxes to Fix Budget Challenge*, 16 June 2011.

⁴¹ The Age, *It's all apples for cider sales, but drinkers lacking in loyalty*, 29 October 2011.

The latest DSICA analysis estimates that in 2012-13:

- the quantity of traditional cider consumed in Australia will be 2.5 million LPAs; and
- the WET revenue collected from sales of this quantity of traditional cider will be \$44 million.

3.5 Traditional cider revenue gains under a volumetric tax

If traditional cider products are taxed at the equivalent volumetric excise duty rate as RTDs, additional revenue of \$496 million over the forward estimates could be gained.

Using the estimated volume of 2.5 million LPAs of cider in 2012-13, if traditional cider were taxed at the same rate as RTDs, the amount of excise collected would be **an additional \$115 million** in 2012-13 compared with the estimated WET collection of \$44 million.

This assumes that:

- traditional cider sales would decrease by one-third in response to a tax increase (as was the case with RTDs following the April 2008 tax increase); and
- the reduction in traditional cider consumption would result in an equivalent increase in the number of LPAs of other products being consumed (e.g. packaged beer). The April 2008 RTD tax increase showed that a tax increase on one product does not generally decrease the *total* amount of alcohol consumed; it merely results in consumers shifting their consumption from one type of alcohol beverage to another, resulting in increased revenue from sales of other more highly taxed beverages.

A full breakdown of the forecast additional revenue from the reform of traditional cider taxation for the 2012-13 to 2015-16 period is provided in Figure 3.2 below.

Figure 3.2: Forecast additional revenue from taxation of traditional cider at the Ready-to-Drink product excise duty rate (2012-13 to 2015-16)

(\$ million)	2012-13	2013-14	2014-15	2015-16	2012-13 to 2015-16
Taxation of traditional cider at RTD excise duty rate	115	121	127	133	496

The anticipated revenue acquired from the reform of traditional cider taxation can be used to fund other alcohol-related tax reforms, removing distortions in the current taxation system and moving towards an alcohol tax regime that is closer to the vision outlined in the Henry Review.

Recommendation 1: Taxation of traditional cider products at the Ready-to-Drink product excise duty rate

That the taxation of traditional cider products be amended from the current WET arrangement to a volumetric tax at the same rate as RTDs.

Estimated revenue impact: \$496 million in additional revenue over the forward estimates

4 Tightening of Wine Producer Rebate provisions

The Wine Producer Rebate is fraught with issues of tax abuse and ‘double dipping’ due to inadequate definitions of wine ‘producer’ and ‘manufacturer’. Revenue gains of \$237 million over the forward estimates could be realised if Wine Producer Rebate amendments are introduced.

4.1 Operation of the Wine Producer Rebate and issues of tax abuse

As discussed further in Section 8.5, a number of problems have arisen from the introduction of the Wine Producer Rebate, which has attempted to address the bias in favour of large producers created by the ad valorem nature of the WET, namely:

- the support it provides for small, otherwise uneconomic wineries, contributing to Australia’s purported ‘wine glut’;
- the fact that it operates as a disincentive against mergers of small wineries; and
- issues of tax abuse and ‘double-dipping’ due to inadequate definitions of wine ‘producer’ and ‘manufacturer’.

DSICA strongly supports abolition of the Wine Producer Rebate to reduce ongoing distortions within the Australian wine market. However, if the Government is reluctant to pursue this reform, legislative amendments to the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) (and Wine Producer Rebate provisions) to prevent ongoing Wine Producer Rebate abuse to reduce market distortions should be introduced.

4.2 Support for tightening of the Wine Producer Rebate

Major winemakers, the Winemakers’ Federation of Australia (WFA) and the Australian National Audit Office (ANAO) support tightening of the Wine Producer Rebate.

The WFA has previously suggested in its 2010-11 and 2011-12 Pre-Budget Submissions that the Government should amend the definitions of wine ‘producer’ and ‘manufacturer’ in order to address problems of tax abuse and double-dipping created by the Wine Producer Rebate. In its 2010-11 Pre-Budget Submission, the WFA estimated that making such changes to the legislation would save the Government approximately \$50 million per annum in 2010-11.⁴²

Two years have passed since then, and the ANAO has concluded that there is an urgent need for ‘more comprehensive changes to the definition of a “wine producer” to ... address other practices that potentially provide inappropriate access to the rebate’.⁴³ This was one of the key conclusions of the ANAO when it released the results of its review of the Australian Taxation Office’s (ATO) administration of the WET on 14 December 2010.⁴⁴

The ANAO reviewed, amongst other things, the ATO’s actions in improving compliance with the Wine Producer Rebate provisions. The ANAO observed that ‘it is sometimes appropriate to resolve wine tax technical issues through requesting legislative amendments rather than administrative arrangements’.⁴⁵

⁴² Winemakers’ Federation of Australia, *Pre-Budget Submission 2010-11*, 2009, p. 2. Note that the WFA’s 2011-12 Pre-Budget Submission did not contain an estimate of the cost savings to be realised in 2011-12 through legislative amendments to the Wine Producer Rebate scheme.

⁴³ Australian National Audit Office, *Administration of the Wine Equalisation Tax – Audit Report No. 20, 2010-11 Performance Audit*, 2010, p. 67.

⁴⁴ Ibid.

⁴⁵ Ibid, p. 65.

The ANAO recommended that ‘the Tax Office advises Treasury on options to clarify the definition of a wine producer for the purposes of the producer rebate’ in order to ‘resolve unintended outcomes regarding access to the wine tax producer rebate’.⁴⁶ The ATO agreed with the ANAO’s Recommendation,⁴⁷ as did Premium Wine Brands (Pernod Ricard), which stated that:

‘We recognise ... the Government’s desire to protect small vineyards offering a broader benefit, particularly in terms of tourism and employment, and should our proposal to abolish the WET rebate not be supported, we would propose reform of the rebate to limit its operation to the sale of packaged wine by producers direct to consumers. This would enable policy objectives to be pursued without the existing unintended consequences.’⁴⁸

DSICA strongly supports the ANAO’s Recommendation and recommends that all necessary legislative amendments to the A New Tax System (Wine Equalisation Tax) Act 1999 (Cth) and Wine Producer Rebate provisions should be introduced as a matter of urgency to reduce ongoing distortions within the wine market.

4.3 Cost savings derived through tightening of the Wine Producer Rebate

Figure 4.1 below outlines the expected budget savings for the periods 2012-13 to 2015-16 if the necessary anti-avoidance provisions were introduced. These cost savings could be used to fund other alcohol-related tax reforms.

Figure 4.1: Forecast anticipated revenue from tightening of the Wine Producer Rebate scheme (2012-13 to 2015-16)

(\$ million)	2012-13	2013-14	2014-15	2015-16	2012-13 to 2015-16
Tighten Wine Producer Rebate scheme	56	58	60	63	237

DSICA notes that the estimated revenue impact of \$56 million per annum in 2012-13 is approximately one-fifth of the value of benefits currently delivered to wine producers under the rebate scheme. This confirms that the Wine Producer Rebate is currently poorly targeted and supports DSICA’s more fundamental point that the Wine Producer Rebate scheme is flawed and should be removed entirely.

Recommendation 2: Introduce Wine Producer Rebate anti-avoidance amendments

That the Government make all necessary legislative amendments to the A New Tax System (Wine Equalisation Tax) Act 1999 (Cth) (and Wine Producer Rebate provisions) to prevent the current abuses.

Estimated revenue impact: \$237 million in additional revenue over the forward estimates

⁴⁶ Ibid, p. 14.

⁴⁷ Ibid, p. 67.

⁴⁸ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 4.

Application of cost savings to alcohol taxation reforms

In the lead-up to the federal election on 21 August 2010, the Coalition suggested that the savings from the tightening of the Wine Producer Rebate scheme should be committed to extending the Export Market Development Grant scheme.⁴⁹ However, DSICA believes that any savings from tightening the Wine Producer Rebate provisions should instead be used to fund other alcohol-related tax reforms.

⁴⁹ Liberal Party of Australia, *The Coalition's plan for real action to support Australian Exporters*, 2010.

5 Removal of the five per cent nuisance customs duty on imported spirits and Ready-to-Drink products

5.1 Introduction

This Chapter outlines DSICA’s reasons for seeking removal of the five per cent ad valorem nuisance customs duty applied to imported spirits and RTDs, namely:

- it is an inefficient, discriminatory and distortionary method of taxation for which there is no justifiable taxation or health policy rationale;
- there is no longer any sector of the domestic spirits industry in Australia which needs protection from imported spirits and RTDs;
- collection of the five per cent ad valorem duty imposes a significant administrative burden on the industry; and
- the duty has no effect other than causing Australian consumers to pay higher prices for imported spirits and RTDs than they otherwise should.

5.2 Operation of the customs duty

Imported spirits and RTDs are currently subject to a five per cent ad valorem customs duty (the duty) where imported from countries other than countries with which Australia has a preferential trade agreement. In addition to this ‘protective’ customs duty, a volumetric excise-equivalent customs duty of \$74.72 per LPA (as at 1 February 2012) applies to imported spirits and RTDs, whilst domestically produced spirits and RTDs are subject to an excise duty of \$74.72 per LPA only.⁵⁰ This volumetric component ensures equivalent taxation treatment of all spirits and RTDs consumed in Australia (whether imported or locally produced).

The five per cent duty applies on a customs value basis, and thus applies unequally to spirits with the same alcohol content and as such it is an inefficient, discriminatory and distortionary method of taxation. While the duty affects all imported spirits and RTDs originating in countries with which Australia does not have a preferential trade agreement, it has a significant impact on products of European origin, including brandy/cognac from France, liqueurs from Germany, aperitifs from Italy and vodka from the Netherlands, Poland and Sweden. Despite this, the most pronounced distortionary impact is seen in the whisk(e)y market, as discussed in Section 5.3 below.⁵¹

5.3 Whisk(e)y import statistics (2010-11)

A review of whisk(e)y import figures reveals significant discrimination between products imported from the United States, and those from other countries of origin.

Whisk(e)y products imported from Scotland, Ireland, Japan and Canada represent approximately 55 per cent of all whisk(e)y and bourbon products imported into Australia, with Scotch Whisky products comprising some 50 per cent. Meanwhile, 45 per cent of the imported

⁵⁰ Note that there is a concessional rate of \$69.77 per LPA applying to brandy products.

⁵¹ Note that the term ‘whisk(e)y’ is used to describe all possible products in this market segment. It includes Scotch Whisky, whisky products originating in Ireland and Japan and whiskey products (also termed bourbon) from the United States of America.

whisk(e)y category originates from the United States of America (i.e. bourbon products) (see Figure 5.1).

Figure 5.1: Summary of imports of whisk(e)y and bourbon products into Australia by country of origin (2010-11)

Country of origin	Imports (000s 9L cases)	Percentage of total imports
Scotland (i.e. Scotch Whisky)	1,600,675	49.7%
Ireland, Japan and Canada (i.e. Whiskey)	184,645	5.7%
United States of America (i.e. Bourbon)	1,434,384	44.6%
Total	3,219,704	100%

Sources: Liquor Merchants Association of Australia (LMAA) Database (Domestic Market; July 2010-June 2011; Industry figures converted to 100 per cent) and DSICA; bulk spirits imported for manufacture of beverages not exceeding ten per cent abv are assumed to be imported at 80 per cent abv

As a result of the *Australia-United States Free Trade Agreement*, 55 per cent of whisk(e)y products are subject to a five per cent customs duty discrimination, while 45 per cent of these products (i.e. bourbon imported from the United States) are free from this duty.

5.4 DSICA’s policy position on the customs duty applied to imported spirits and Ready-to-Drink products

DSICA seeks immediate removal of the five per cent ad valorem customs duty on all spirits and RTDs imported into Australia.

The Henry Review proposed the immediate removal of this duty on imported spirits, RTDs and wine in order to remove structural complexity from the current system.⁵² *DSICA strongly supports this recommendation.*

The Productivity Commission report *Bilateral and Regional Trade Agreements* also noted that unilateral reform (such as the removal of this duty) is the most direct means of reducing Australia’s trade and investment barriers.⁵³ Immediate removal of the five per cent ad valorem customs duty would be a perfect example of such a unilateral reform.

In addition to the duty anomaly which favours United States-sourced spirits, DSICA has advocated total removal of the five per cent ad valorem customs duty on the following grounds:

- **Little/no significant domestic spirits production:** with changing trends, there is no domestic spirits industry in Australia which justifies protection from overseas competition.
- **Administrative costs:** there are significant administrative costs to business of paying the five per cent ad valorem component, especially in the case of bulk imported spirits used in the manufacture of RTD beverages in Australia. Payment of the five per cent customs duty on the bulk RTD spirit is made to the Australian Customs and Border Protection Service. At the appropriate time, after manufacture of the RTDs, payment of the volumetric duty component (as excise duty) is made to the ATO. Dealing with, and making duty payments

⁵² Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part 2 – Detailed Analysis*, 2010, p 443.

⁵³ Productivity Commission, *Productivity Commission Research Report: Bilateral and Regional Trade Agreements*, 2010, p. 213.

to two separate agencies creates significant administrative issues for producers. The abolition of the five per cent customs duty would significantly simplify the administrative burdens imposed on DSICA members.

- **Increased retail prices for consumers:** the five per cent customs duty is generally ‘absorbed’ into a product’s cost base which is used as a basis for determining wholesale, and ultimately, retail prices. Accordingly, margins and GST are calculated on the ‘duty inclusive’ price paid by an importer. This import cost ‘flow through’ effect magnifies the impact of the duty component in the final retail price paid by the Australian consumer.

5.5 Australian Government trade policy statement

DSICA draws attention to the Government’s recently stated principle of unilateralism in trade policy in advocating the removal of the five per cent ad valorem customs duty on all full-strength spirits and RTDs imported into Australia.

Australia’s trade policy is currently driven by ongoing productivity-focused domestic reform coupled with the negotiation of improved access for exporters to overseas markets. The Government’s trade policy statement is framed around the principle that trade policy is an indivisible part of overall economic reform and is facilitated by unilateralism, non-discrimination, separation and transparency.

Under this principle, ‘adopting a bargaining-chip approach of refusing to liberalise at home unless other countries offer trade barrier reductions as a quid pro quo only damages the home country’s long-term prosperity. Using domestic reform as a bargaining chip in negotiations is akin to an athlete refusing to get fit for an event unless and until other competitors also agree to get fit’.⁵⁴

Removal of the five per cent ad valorem customs duty would be an example of unilateral reform which removes discrimination in the current customs tariff regime.

5.6 Cost of removing the duty

Based on information contained in the detailed Henry Review Costing Minute, DSICA estimates the cost to revenue of immediate removal of the five per cent ad valorem customs duty would be approximately \$80 million over the forward estimates.⁵⁵

A full breakdown of the forecast costs from the removal of the five per cent ad valorem customs duty for the 2012-13 to 2015-16 period is provided in Figure 5.2 overleaf.

⁵⁴ Department of Foreign Affairs and Trade, *Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity*, 2011, p. 7.

⁵⁵ Treasury, *Costing Minute: AFTS Proposal – Alcohol Tax Reform*, 2010.

Figure 5.2: Forecast costs from the removal of the five per cent ad valorem customs duty (2012-13 to 2015-16)

(\$ million)	2012-13	2013-14	2014-15	2015-16	2012-13 to 2015-16
Removal of five per cent ad valorem customs duty	17	19	21	23	80

Source: Treasury, Costing Minute: AFTS Proposal – Alcohol Tax Reform, 2010.

This cost could be funded from reforms suggested earlier, including tightening of the Wine Producer Rebate and taxation of traditional cider products at the RTD excise duty rate.

Recommendation 3: Removal of five per cent ad valorem customs duty

That the Government immediately remove the five per cent nuisance customs duty on imported spirits and RTDs in order to remove structural complexity from the current alcohol taxation regime.

Estimated revenue impact: \$80 million cost over the forward estimates

6 Tax equivalence for low- and mid-strength Ready-to-Drink products

6.1 Introduction

At present, all RTDs are taxed at a single volumetric rate (\$74.72 per LPA) (as at 1 February 2012), while beer products are taxed in bands according to alcohol content and receive a 1.15 per cent abv excise-free threshold. This inequitable system fails to support health and social policy objectives and creates distortions in the alcohol market.

This Chapter outlines the reasons for introducing tax equivalence for low- and mid-strength RTDs and the estimated cost to revenue of this taxation change.

6.2 Operation and effects of the Ready-to-Drink product excise duty rate

There is a significant difference in the excise duty paid by low- and mid-strength RTDs when compared to that paid by low- and mid-strength packaged beer products.

The current excise duty rates applied to beer products account for the different bands (i.e. low-, mid- and full-strength) of alcohol strength seen in this market segment, while RTDs are subject to a single excise duty rate regardless of product strength. In addition, beer products are subject to a 1.15 per cent excise-free threshold, while RTDs are not.

In practice, these anomalies result in significant differences in the excise duty paid by RTDs and packaged beer as follows:

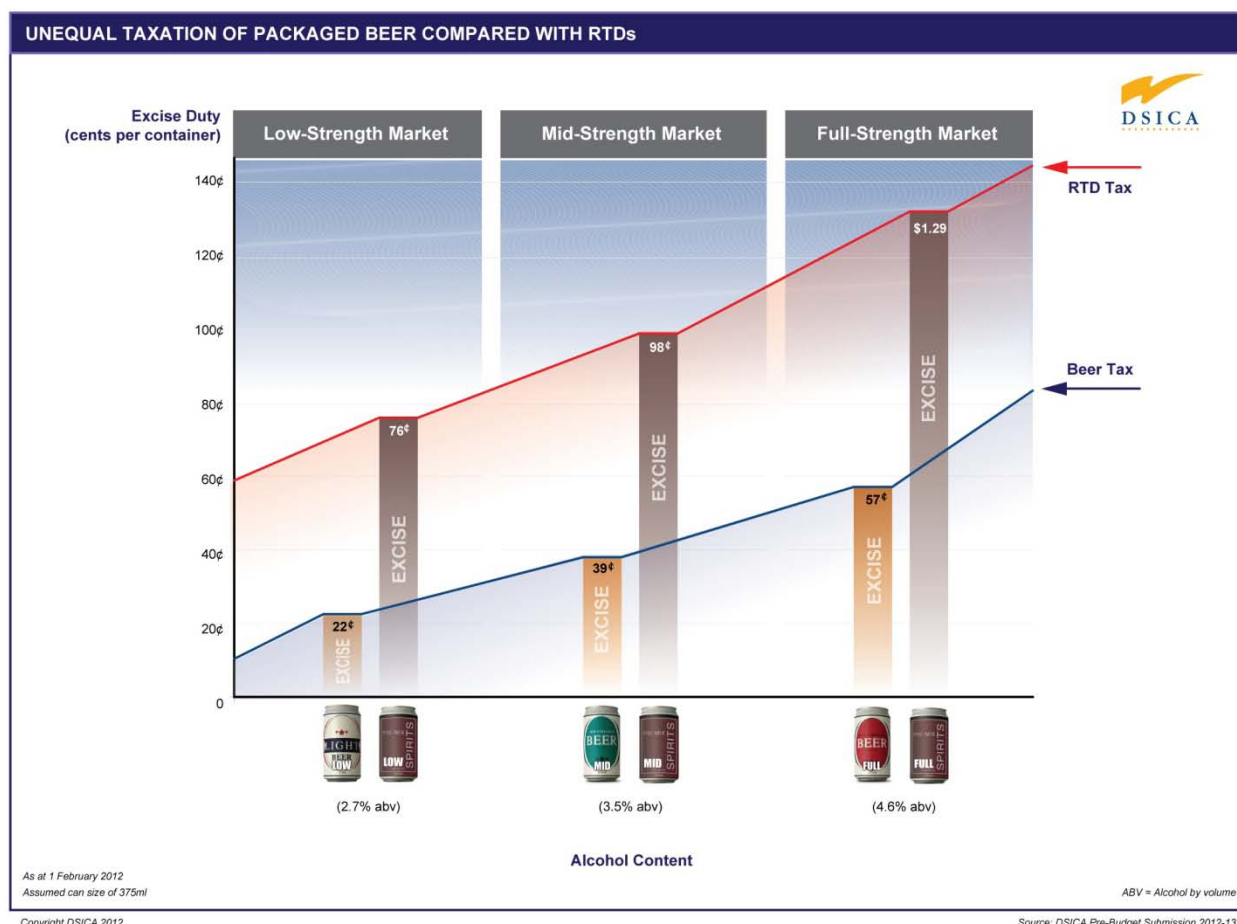
- the amount of excise duty payable on a mid-strength RTD can (98 cents) is almost twice as much as the amount of excise duty payable on a full-strength can of beer (57 cents);
- the amount of excise duty payable on a low-strength RTD can (76 cents) is approximately one-third more than a full-strength can of beer.

These flaws are a direct result of the fact that low- and mid-strength RTDs receive neither:

- the benefit of the 1.15 per cent abv excise-free threshold granted to packaged beer of similar alcohol strength; nor
- the concessional excise duty rates granted to low-strength packaged beer.

This is illustrated in Figure 6.1 overleaf.

Figure 6.1: Unequal taxation of packaged beer compared with Ready-to-Drink products as at 1 February 2012



The volumes of mid-strength RTDs are very small at present, and there are no low-strength RTDs that DSICA is aware of. Examples of mid-strength RTDs include *Bundaberg Rum and Cola Mid* (3.5 per cent abv) and *Jim Beam and Cola* (3.5 per cent abv). The lack of tax equivalence with mid-strength beer continues to prevent these products gaining any market share of significance. The absence from the market of low- and mid-strength RTDs is a glaring anomaly and suggests a loss of consumer welfare is being caused by the differential tax treatment between packaged beer and RTDs.

6.3 Reform to achieve health and social policy objectives

Submissions from both public health advocates and producers to the Henry Review process generally supported lower rates of tax on lower strength alcohol products. Even the Government has acknowledged the desirability of lower taxes on low-strength alcohol products as a means of incentivising the manufacture of these products.⁵⁶ However, there is presently no incentive for RTD manufacturers to develop lower alcohol pre-mixed spirit-based products, with all RTDs being taxed at the same volumetric rate as full-strength bottled spirits and lacking an excise-free threshold.

⁵⁶ Preventative Health Taskforce, Australia: *The Healthiest Country by 2020, National Preventative Health Strategy – The Roadmap for Action*, 2009, p. 254.

DSICA considers that there is a sound policy case for providing complete tax equivalence between low- and mid-strength RTDs and low- and mid-strength packaged beer. This would result in the 1.15 per cent abv excise-free threshold also applying to low- and mid-strength RTDs and is consistent with the findings of the Henry Review. As part of this proposal, full-strength RTD products would continue to be taxed at their existing excise duty rate, as outlined in Figure 6.2 below.

Figure 6.2: Proposed excise duty rates to facilitate tax equivalence between low- and mid-strength Ready-to-Drink products and packaged beer (as at 1 February 2012)

Product	Current excise duty rate (as at 1 February 2012)	Proposed excise duty rate (as at 1 February 2012)
Low-strength RTDs ($\leq 3^\circ$ abv)	\$74.72 per LPA	\$37.86 per LPA and subject to 1.15° abv excise-free threshold (same as low-strength packaged beer excise duty rate)
Mid-strength RTDs ($> 3^\circ$ abv $\leq 3.5^\circ$ abv)	\$74.72 per LPA	\$44.11 per LPA and subject to 1.15° abv excise-free threshold (same as mid-strength packaged beer excise duty rate)
Full-strength RTDs ($> 3.5^\circ$ abv)	\$74.72 per LPA	\$74.72 per LPA (same as existing RTD excise duty rate)

The Henry Review stated that ‘low-alcohol products can be considered as having a social benefit to the extent that they substitute for higher strength alcohol products that impose greater spillover costs on the community’, going so far as to characterise extremely low alcohol products as ‘harmless’.⁵⁷ The Henry Review also rejected submissions that sought to argue that RTDs caused more harm compared with other alcohol beverages, and therefore should be taxed at a higher rate.⁵⁸

The Henry Review also recommended that the 1.15 per cent abv excise-free threshold currently applying to beer should be extended to all beverages.⁵⁹ Furthermore, the Preventative Health Taskforce report also recognised that lower taxation rates for lower alcohol beverages are a desirable feature of a tiered volumetric alcohol tax system.⁶⁰

6.4 Cost of facilitating tax equivalence

A full breakdown of the forecast costs arising from facilitating tax equivalence for low- and mid-strength RTDs for the 2012-13 to 2015-16 period is provided in Figure 6.3 overleaf. This cost could be funded from the reforms suggested earlier, including tightening of the Wine Producer Rebate and the taxation of traditional cider products at the RTD excise duty rate.

⁵⁷ Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis*, 2010, p. 436.

⁵⁸ *Ibid*, p. 435.

⁵⁹ *Ibid*, p. 440.

⁶⁰ Preventative Health Taskforce, *Australia: The Healthiest Country by 2020, National Preventative Health Strategy – The Roadmap for Action*, 2009, p. 254.

Figure 6.3: Forecast costs from facilitating tax equivalence for low- and mid-strength Ready-to-Drink products (2012-13 to 2015-16)

(\$ million)	2012-13	2013-14	2014-15	2015-16	2012-13 to 2015-16
Tax equivalence for low- and mid-strength RTDs	5	5	5	5	20

Recommendation 4: Tax equivalence for low- and mid-strength Ready-to-Drink products

That the Government introduce taxation equivalence between low- and mid-strength packaged RTDs and packaged beer of similar alcohol content by applying the same volumetric rates as well as applying the 1.15 per cent abv excise-free threshold.

Estimated revenue impact: \$20 million cost over the forward estimates

7 Proposed offsetting of the Consumer Price Index impacts of the carbon price from automatic indexation of excise duty rates applying to spirits and Ready-to-Drink products

7.1 Introduction

This Chapter demonstrates how the bi-annual indexation of the spirits and RTD excise duty rates is having a discriminatory and distortionary effect on these products when compared to beverages taxed under the WET. This Chapter also outlines DSICA's proposal to discount automatic indexation of excise duty rates for spirits, RTDs and beer from 1 February 2013 to offset the second round effect on these products from the carbon price impact on CPI.

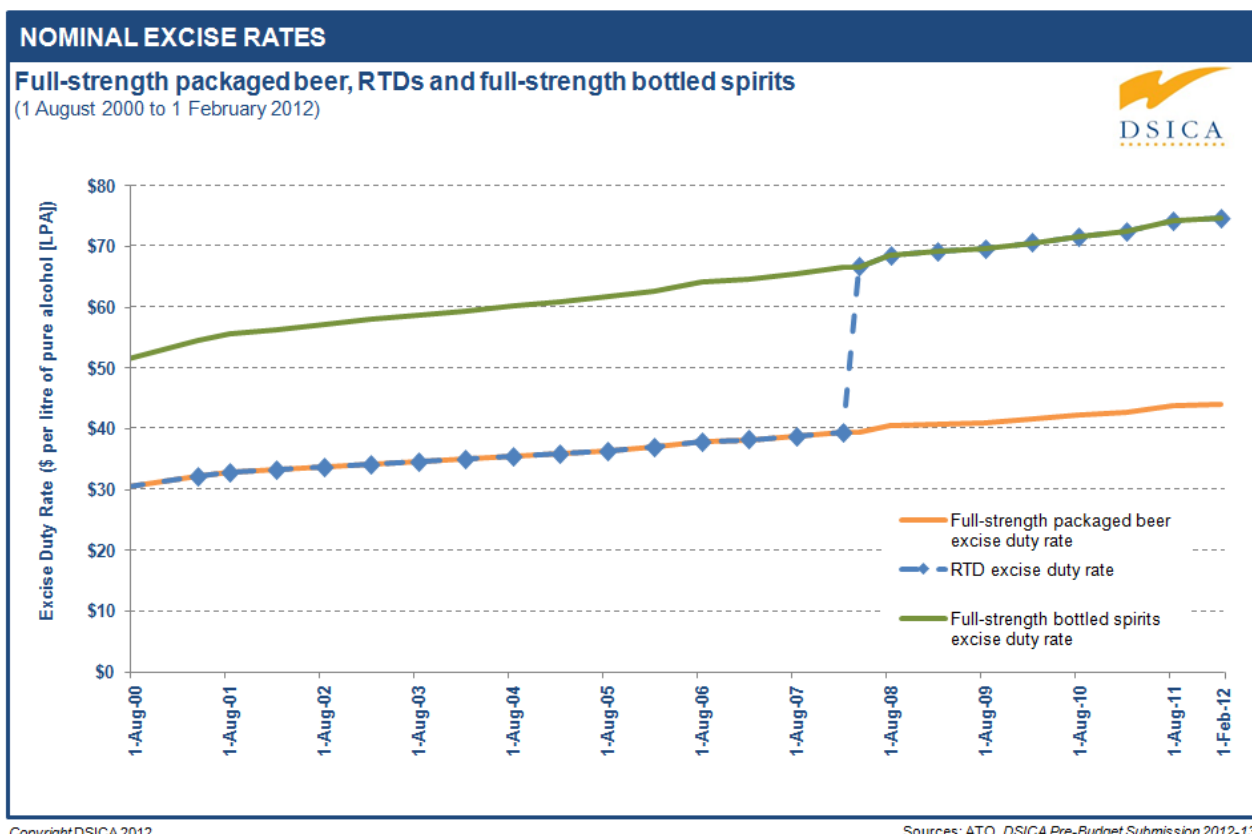
7.2 Indexation of excise duty rates for spirits and Ready-to-Drink products

The use of indexation has resulted in substantial increases in the excise duty rates applying to spirits and RTDs.

Since 1983, excise duty rates for certain excisable goods including spirits and RTDs have been subject to automatic six-monthly indexation on 1 February and 1 August. This practice continued with the introduction of the GST on 1 July 2000. The indexation factor applied is determined in accordance with the CPI change from the previous 1 July to 31 December and 1 January to 30 June periods (respectively). For example, the indexation rate applied on 1 February 2012 was calculated in accordance with the CPI change over the period 1 July 2011 to 31 December 2011.

Since 1 July 2000, the excise duty rate applying to spirits products has increased from \$51.58 per LPA to \$74.72 per LPA – an increase of 45 per cent over some 11.5 years. This is outlined in Figure 7.1 overleaf.

Figure 7.1: Increase in excise duty rates applying to full-strength packaged beer, Ready-to-Drink products and spirits (1 August 2000 to 1 February 2012)



7.3 Different treatment of products subject to the Wine Equalisation Tax

The use of indexation has a distortionary impact and limits the ability for spirits and RTDs to compete with products taxed under the WET.

As wine, wine products (e.g. port) and traditional cider (WET products) are taxed under the ad valorem WET regime (taxed at 29 per cent of the product's wholesale sales price), they are not subject to statutory indexation. This creates a substantial (and increasing) gap in the price and tax burden difference between WET products compared with spirits and RTDs.

The recently released report *The Australian wine tax regime – assessing industry claims* by The Australia Institute provides an analysis of ABS consumer price data which outlines how wine prices have changed in Australia over the past three decades, and contrasts this against overall movements in consumer prices. This research indicates that:

- from 1980 to 2000, wine prices changed roughly in accordance with other consumer prices;
- from 2000 onwards (the period which corresponds with the introduction of the WET), wine prices began to lag behind other CPI items; and
- by June 2011, wine prices were some 16 per cent below where they would have been had previous price trends persisted beyond 2000.⁶¹

⁶¹ The Australia Institute, *The Australian wine tax regime – Assessing industry claims*, 2011, p. 8.

This analysis highlights the distortionary and discriminatory impact of the application of automatic indexation on spirits and RTD excise duty rates when compared with WET products. As spirits and RTD excise duty rates are subject to automatic indexation, the retail price difference between these products and WET products increases with each indexation period. This results in a growing price and tax burden differential between WET products and spirits and RTDs.

This growing price and tax gap is highlighted in the traditional cider and RTD markets. As traditional cider products are taxed under the WET, they have the benefit of not being subject to statutory indexation, while one of the main competitors to the traditional cider market, RTDs, are subject to bi-annual indexation. As a result, the gap between the effective taxation rates for RTDs and traditional cider widens whenever traditional cider production costs are not increasing at the rate of increase in general consumer prices. This reduces the ability of RTD producers to maintain their competitiveness both against traditional cider producers and across the broader alcohol beverage market.

7.4 Impact of a carbon price on the Consumer Price Index

The impact of a carbon price on CPI levels will further increase the discrimination between products taxed under the WET and excisable alcohol beverages. DSICA strongly recommends that automatic indexation of excise duty rates for spirits, RTDs and beer be discounted from 1 February 2013 to offset the second round effect on these products from the carbon price impact on CPI.

Legislation provides that Australia will have a carbon pricing mechanism commencing on 1 July 2012 with a fixed price of \$23 per tonne of CO₂ emissions (through the issuance of fixed price units within an emissions trading scheme). A cap-and-trade emissions trading scheme will replace this pricing mechanism on 1 July 2015.

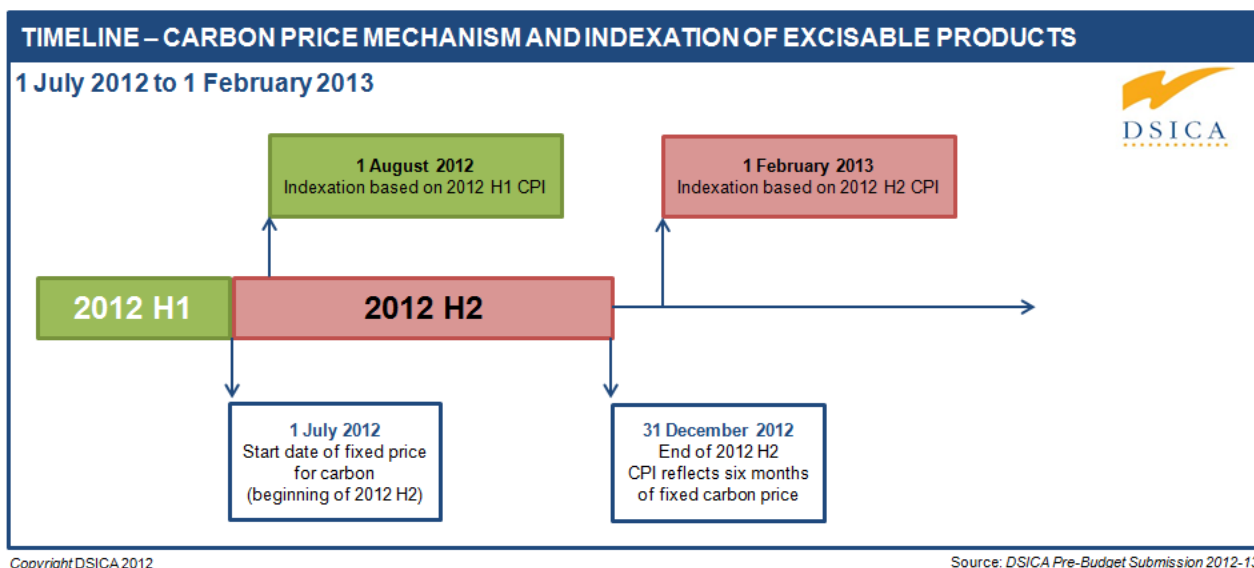
Treasury modelling has demonstrated that the introduction of a carbon price is expected to result in a 0.7 per cent increase to the CPI in 2012-13.⁶²

Secondary impacts (excise period commencing 1 February 2013)

The indexation factor to be applied to spirits, RTDs and beer on 1 February 2013 will include the impact of the fixed carbon price on the costs to the CPI basket of goods and services (see Figure 7.2 overleaf).

⁶² Treasury, *Strong Growth, Low Pollution: Modelling a Carbon Price*, 2011, p. 136.

Figure 7.2: Timeline – carbon price mechanism and indexation of excisable products (1 July 2012 to 1 February 2013)



Under the proposed carbon pricing mechanism and existing excise and customs legislation, excise and excise-equivalent customs duty rates for spirits, RTDs and beer will be subject, on 1 February 2013, to a CPI indexation factor that will include the impacts of a fixed carbon price. Treasury modelling indicates that this is likely to be 0.7 per cent higher than without a carbon price.

Flow-on effects of increased Consumer Price Index levels on excise duty rates

Second round impacts of GST implementation and lessons for carbon pricing

Under the *A New Tax System* policy that introduced the GST, the spirits excise duty rate increased by more than 35 per cent on 1 July 2000, and Commonwealth revenue from spirits excise duty alone increased by more than 60 per cent. This increase was designed to replace the Wholesale Sales Tax which previously applied at the rate of 37 per cent of the final wholesale selling price for spirits.

DSICA strongly believes that the forward estimates underlying the 1998 *A New Tax System* documents were prepared on the basis that the Government would discount the 2000-01 automatic excise duty rate indexation increases for the second round impact of the *A New Tax System* policy (that is, that there would be no second round effect of the *A New Tax System* policy on excise duty rates).⁶³

DSICA believes that the revenue estimate tables in the *A New Tax System* documents clearly show that the 2000-01 and the 2001-02 excise revenue estimates were discounted for the estimated impact of the second round *A New Tax System* effect. This can be seen in that the estimate for the increase in excise collections from beer and spirits between the 2000-01 and the 2001-02 years was only estimated to be \$43.4 million. Given the small annual fall in spirits volumes of -0.1 per cent per annum, and the likely low underlying inflation figures for these periods, this figure is only compatible with a fully discounted indexation increase on 1 February 2001.

⁶³ The Hon Peter Costello, MP, *Tax reform not a new tax, a new tax system: The Howard Government's Plan for a New Tax System*, 1998, p. 100.

Consequently, DSICA believes that the indexation increase on 1 February 2001 should have incorporated the planned discount for the impact of the A New Tax System component of CPI in the first half of the 2000-01 financial year. However, this never occurred. Therefore, the ongoing imposition of automatic six-monthly excise indexation increases since 2001 has subsequently compounded the impact of the second round effects of GST implementation.

Australian Competition and Consumer Commission Guidelines

DSICA notes that when implementing the GST, the Australian Competition and Consumer Commission's *Price Exploitation and the New Tax System Guidelines* (the Guidelines) indicated that regulated enterprises whose prices were subject to CPI escalators had the potential for 'over recovery' if the enterprise increased prices to recover its GST liability and also increased its prices for CPI adjustments, which may include the effect of the GST. The Guidelines indicated that this practice may constitute a contravention of the prohibition on price exploitation.⁶⁴ It should be noted that:

- the Guidelines required that, directly or indirectly, CPI escalators used to adjust regulated prices be discounted for the contribution of the GST to the CPI (the Discount Principle);⁶⁵ and
- while these Guidelines relate to implementation of the GST, DSICA considers that the Discount Principle outlined in relation to the CPI escalators is applicable to the implementation of a carbon price. This principle may be used as a basis on which to introduce a mechanism to eliminate the second round effects that the carbon price will have on CPI levels used to calculate the indexation of excise duty rates applying to spirits, RTDs and beer.

The GST increased the CPI by around 2.5 per cent through the year to the June quarter 2001.⁶⁶ This was around 3.6 times larger than the forecast impact of a \$23 per tonne carbon price.

DSICA strongly urges the Government to acknowledge the Discount Principle applied by the Australian Competition and Consumer Commission in the introduction of the GST. DSICA urges the Government to consider what options would be available to eliminate the second round effects that the carbon price will have on CPI levels used to calculate the indexation of excise duty rates.

DSICA notes that *The Garnaut Review 2011* (the Review) has acknowledged that the introduction of a carbon price will result in an increase in petrol prices. The Review further notes that this price increase could be offset through a one-off reduction in petrol excise, funded by other tax adjustments that had similar or larger positive effects on emissions.⁶⁷

The Review makes no reference to a similar offsetting scheme for excisable alcohol beverages. However, DSICA notes the similarities between these excisable products and considers that the application of the Discount Principle could easily be extended to include spirits, RTDs and beer.

There will be an ongoing impact of the later phased increases in the carbon price on the CPI, and therefore also on excise duty rate indexation. Later year discounting of the excise indexation factor should also be considered on similar lines as above.

⁶⁴ Australian Competition and Consumer Commission, *Price Exploitation and the New Tax System: general principles, information and guidelines on when prices contravene section 75AU of the Trade Practices Act 1974*, 2000, para. [1.45].

⁶⁵ *Ibid.*, para. [2.12].

⁶⁶ Treasury, *Executive Minute: CPI Impacts – Carbon Pricing Compared to the GST and Exchange Rate Movements*, 2011.

⁶⁷ Garnaut, R., *The Garnaut Review 2011: Australia in the Global Response to Climate Change*, 2011, p. 81.

Recommendation 5: Offset second-round Consumer Price Index effects of the carbon price on automatic indexation of excise duty rates

That the Government eliminate the unintended second round effects that the introduction of the carbon price will have on the automatic indexation of excise and excise-equivalent customs duty rates applying to spirits, RTDs and beer. CPI indexation of excise and excise-equivalent customs duty rates applying to these products on 1 February 2013 should be discounted to remove the estimated contribution of the carbon pricing package to CPI indexation in the second half of 2012.

Long-term reform objectives

8 Reform of the wine taxation regime

8.1 Introduction

The existing taxation regime applying to wine in Australia has created an incentive for low-value, high-volume wine production. Winemakers and health lobby groups are now calling for urgent reform to the wine taxation regime, noting that the very nature of the WET and Wine Producer Rebate are causal factors of the current ‘wine glut’ and oversupply of Australian wine.

Wine in Australia is currently taxed at a rate of 29 per cent of its wholesale sales price through the WET. This ad valorem tax was introduced in conjunction with the GST to maintain a tax treatment for wine roughly consistent with the previous Wholesale Sales Tax regime.

Because wine is taxed on a value basis, wines with the same alcohol content can be subject to different levels of taxation. The cheaper the wine, the less it is taxed. This has been the subject of considerable media attention, which has focused on the abuse of low-price cask (and low-price cleanskin bottled) wine, particularly in Indigenous communities.⁶⁸ It is noted that cask wine pays a minimal tax of approximately eight cents per standard drink, while wine produced by small winemakers pays no effective tax. Furthermore, the taxation of wine on a value basis creates incentives for the production of low-value, high-volume products which have contributed to the current ‘wine glut’ and oversupply of Australian-produced wine.

The current calls for reform of the WET to a volumetric taxation system are unprecedented in Australia. In particular:

- **Premium Wine Brands (Pernod Ricard) and Treasury Wine Estates** have now called for the introduction of a volumetric tax system for wine products. Premium Wine Brands (Pernod Ricard) has noted that the introduction of a volumetric tax system will ‘support sustainable value growth of the industry and ... incentivise the production of premium products’;⁶⁹
- the **Brewers Association of Australia and New Zealand** ‘believes that wine should be taxed on the basis of alcohol content, not price’ and ‘contend(s) that it would be good public policy to have all alcohol taxed on a category volumetric basis’;⁷⁰
- **health lobby groups** have noted that WET reform is the first step to be pursued in reform of the Australian alcohol taxation system;⁷¹ and
- **The Greens** support WET reform.⁷²

The Government has reiterated that it will not pursue reform of the Australian alcohol taxation system ‘in the middle of a wine glut and where there is an industry restructure underway’.⁷³ However, large wine producers note that existing WET arrangements are contributing to the ‘wine glut’. In particular,;

⁶⁸ The Australian, *Alcohol floor ‘a hit on elderly and poor’*, 9 June 2011.

⁶⁹ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 1. See also Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 4.

⁷⁰ Brewers Association of Australia and New Zealand, *Tax Forum Submission: For the Environmental and Social Taxes Session*, 2011, p. 2.

⁷¹ Alcohol Education and Rehabilitation Foundation, *Media Release: AER Foundation calls for urgent reform on the Wine Equalisation Tax*, 6 September 2011.

⁷² Senator Dr Richard Di Natale (Greens Senator for Victoria), *Media Release: Greens back report on alcohol tax reform*, 6 September 2011; Senator Dr Richard Di Natale (Greens Senator for Victoria), *Media Release: No excuse not to debate alcohol reform now: Greens*, 26 September 2011.

⁷³ The Hon Kevin Rudd MP and the Hon Wayne Swan MP, *Media Release: Stronger, Fairer, Simpler: A Tax Plan for Our Future*, 2 May 2010.

- **Premium Wine Brands (Pernod Ricard)** indicates that ‘taxing wine on the basis of value rather than alcohol content means that low cost wine products attract a significantly lower tax burden than premium products. This, in turn, creates a price incentive for people to buy (and therefore industry to produce) low cost wines, fuelling the oversupply and inhibiting industry restructuring’;⁷⁴ and
- **Treasury Wine Estates** notes ‘the Wine Producer Rebate is a damaging subsidy that has negatively impacted the profitability and productivity of the industry ... preventing consolidation and sustaining uneconomic production’.⁷⁵

Industry representatives contend that not only are existing WET arrangements contributing to the ‘wine glut’, but the Australian wine market is likely to return to an ‘in-balance position’ in the next 12 to 24 months. DSICA’s analysis of the Australian wine market supports these reports and demonstrates the urgent need for reform of the wine taxation regime.

This Chapter discusses the following issues:

- the effect of the WET on alcohol consumption patterns;
- the purported ‘wine glut’ and evidence indicating that the wine market is returning to an ‘in-balance’ position;
- proposed abolition of the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) (and affiliated Wine Producer Rebate provisions) to remove current ‘rorting’ of the system; and
- DSICA’s proposal for transitioning to a volumetric wine tax regime.

8.2 Effect of the Wine Equalisation Tax on alcohol consumption patterns

At a time when total alcohol consumption is in long-term decline, wine consumption is increasing rapidly.

As wine is taxed on the basis of value (rather than alcohol content), wine producers are encouraged to produce wine products on a low value, high volume basis. This has (in a large part) encouraged the production of cheap cleanskin and cask wine products using excess wine, resulting in considerable discounting of Australian wine products.⁷⁶ Indeed, some cleanskin and cask wine products now dominate sectors of the Australian wine market.

This has had an unfavourable impact on alcohol consumption levels. At a time when overall alcohol consumption is in long-term decline, wine consumption is increasing at a rapid rate. As Figure 8.1 overleaf demonstrates:

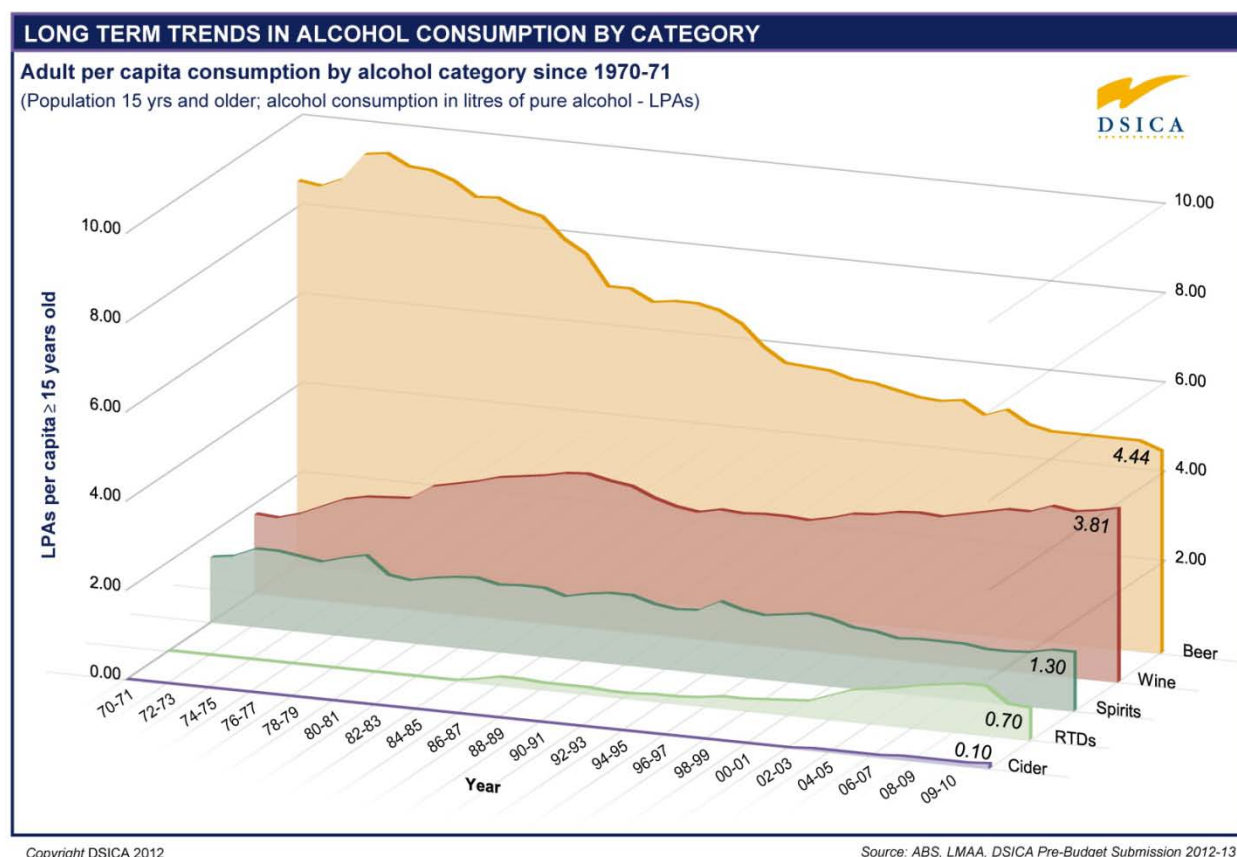
- beer consumption is in long-term decline, reducing from a high of 9.22 LPAs per capita in 1974-75 to only 4.44 LPAs per capita in 2009-10 (a reduction of 52 per cent);
- spirits consumption is stable at approximately 1.30 LPAs per capita in 2009-10; and
- wine consumption has risen from a low of 1.71 LPAs per capita in 1971-72 to a long-term high of 3.81 LPAs per capita in 2009-10, an increase of approximately 123 per cent over 38 years. Over the past ten years alone, wine consumption has grown by 17 per cent.

⁷⁴ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 4.

⁷⁵ Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 2.

⁷⁶ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 3.

Figure 8.1: Long-term trends in alcohol consumption by category (1970-71 to 2009-10)



The taxation of wine on an ad valorem basis fails to give effect to the Government's health and social policy goals and does not create an environment in which consumers can make responsible consumption decisions on the basis of alcohol content, rather than price.

8.3 End of the 'wine glut' and the opportunity for reform

Despite the Government's contention that it will not address alcohol taxation reform in the middle of a wine glut and where there is an industry restructure underway, industry comments and DSICA analysis indicate that the wine glut is likely to end in the next 12 to 24 months – making now an opportune time for the Government to consider reform options.

The *Tax Forum Discussion Paper – Tax Reform: Next Steps for Australia* indicates that the Government has committed not to change alcohol tax in the middle of a wine glut and where there is an industry restructure underway.⁷⁷ This is despite the fact that two existing anomalies in the Australian alcohol taxation system – the WET and the Wine Producer Rebate, are actually contributing to the wine glut.

Notwithstanding this, reports suggest that the wine glut is likely to end in the next 12 to 24 months. This has been confirmed by Mr David Dearie, Chief Executive Officer of Treasury Wine Estates, who is reported as saying that:

⁷⁷ Australian Government, *Tax Forum Discussion Paper – Tax Reform: Next Steps for Australia*, 2011, p. 30.

‘The Australian wine sector is 12 to 24 months away from supply and demand being in balance’,⁷⁸ and ‘the wine market is in balance globally but the local market is in oversupply, and could remain so for up to two years’.⁷⁹

The Treasury Wine Estates view is supported by Ms Aymee Mastaglia, General Manager of the Wine Industry Association of Western Australia, who is reported as saying:

‘Growers were daring to think that the glut which had kept prices low for years might finally be over’.⁸⁰

The end of the ‘wine glut’

In order to provide an evidence base demonstrating the upcoming end of the wine glut, two relevant measures are available to determine whether the supply and demand of wine is ‘in-balance’:

- **demand versus production** (measure one); and
- **the stock to sales ratio** (measure two).

DSICA’s analysis of historical demand versus production levels and stock to sales ratios supports industry comments.

Measure one: demand versus production

Analysis of demand versus production figures indicates that the Australian wine industry is moving to an ‘in-balance’ position between the supply and demand of wine.

The demand versus production measure compares the bearing area required to meet the demand for Australian wine (both domestic sales and exports) against the actual bearing area of Australian vines. DSICA’s assessment of the demand versus production measure for the period 1995-96 to 2009-10 indicates that:

- in three of the last four years, the ideal ‘in-balance’ bearing area has exceeded the actual bearing area; and
- the wine industry is moving to an ‘in-balance’ position between the supply and demand of wine. While there were eight per cent surplus bearing vines in 2007-08, in 2008-09 and 2009-10 there was a deficit of bearing vines of two per cent and ten per cent respectively.

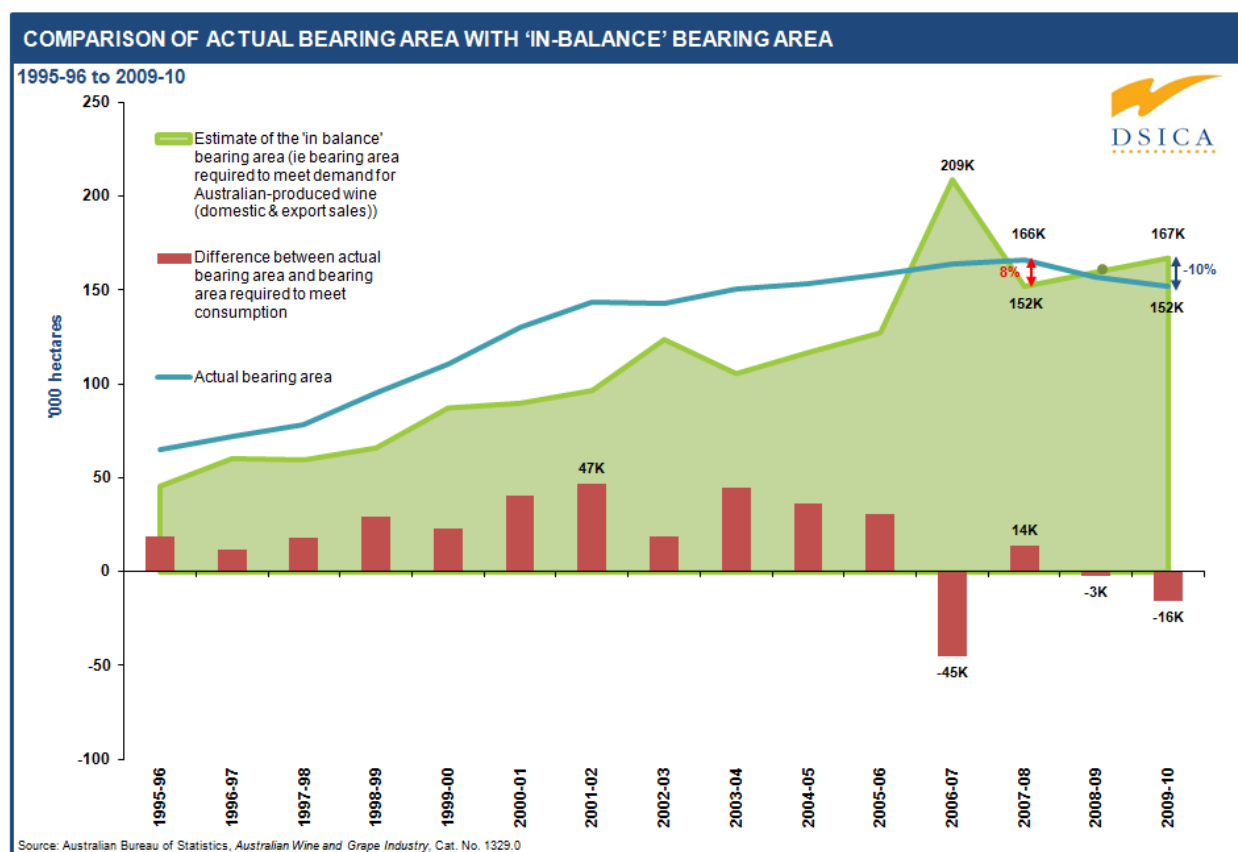
These findings are outlined in Figure 8.2 overleaf.

⁷⁸ The Australian, *Dollar drags on Treasury earnings*, 23 August 2011.

⁷⁹ Australian Financial Review, *Asia to get a bigger taste of Grange*, 23 August 2011.

⁸⁰ Australian Financial Review, *Rain may take sparkle out of bubbly*, 20 December 2011.

Figure 8.2: Comparison of actual bearing area with ‘in-balance’ bearing area (1995-96 to 2009-10)



Measure two: stock to sales ratio

Analysis of stock to sales ratio figures indicates that the stock to sales ratio is tending below the desired level of 1.67.

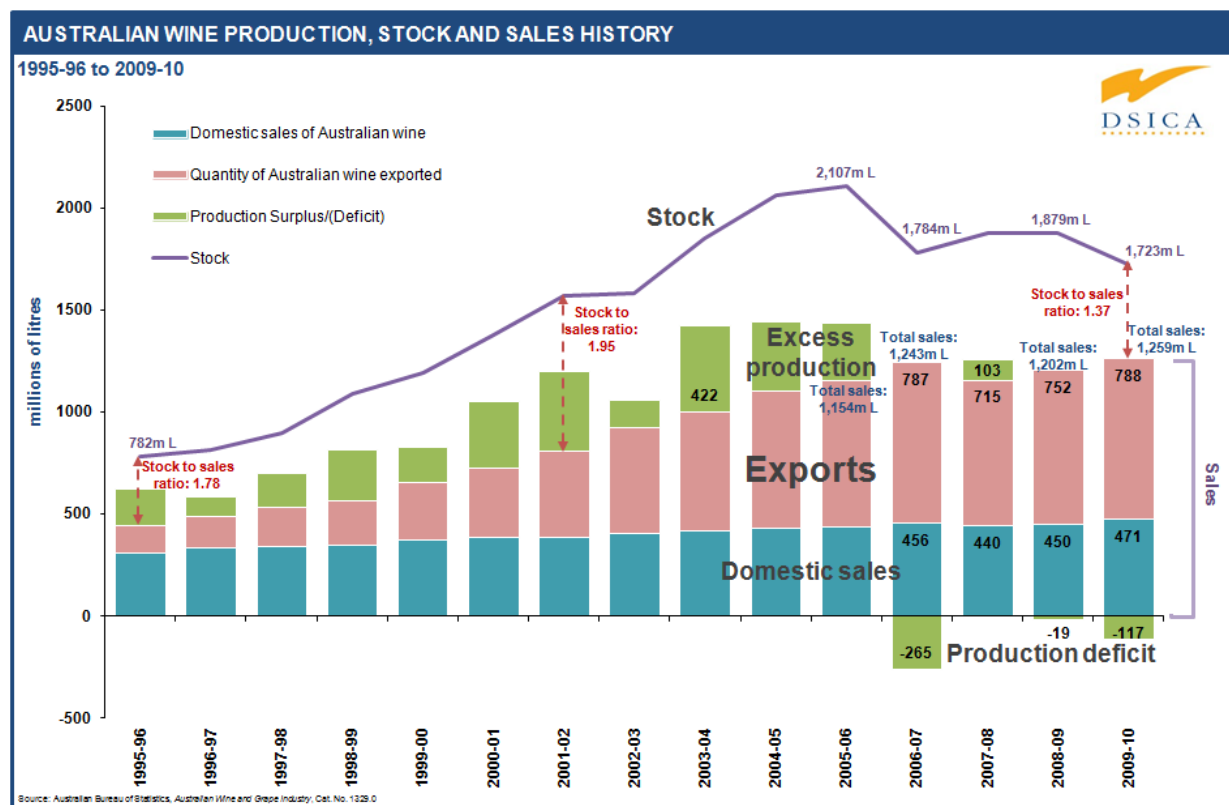
The stock to sales ratio measurement considers the volume of total stock beverage wine (i.e. inventory) against the total sales of Australian wine (both domestic sales and exports). The Senate Rural and Regional Affairs and Transport Reference Committee Inquiry into *The operation of the wine-making industry* (the Inquiry) noted that the stock to sales ratio is the main indicator of the supply/demand balance.⁸¹ In its submission to the Inquiry, the Department of Agriculture, Forestry and Fisheries noted that the comfort range (which indicates a balance between supply and demand) varies according to the nature of the stock (principally in relation to quality and red-versus-white holdings). However, a stock to sales ratio of 1.67 (i.e. 1.67 years of sales in stock) is considered a desirable level across all wine holdings in the current operating environment.⁸²

DSICA's analysis of Australian wine production and sales history indicates that the wine glut is coming to an end. While production has exceeded combined domestic and export sales demand in 12 of the last 15 years, there have been production deficits in three of the last four years, as demonstrated in Figure 8.3 overleaf.

⁸¹ Senate Rural and Regional Affairs and Transport References Committee, *The operation of the wine-making industry*, 2005, para. [2.13].

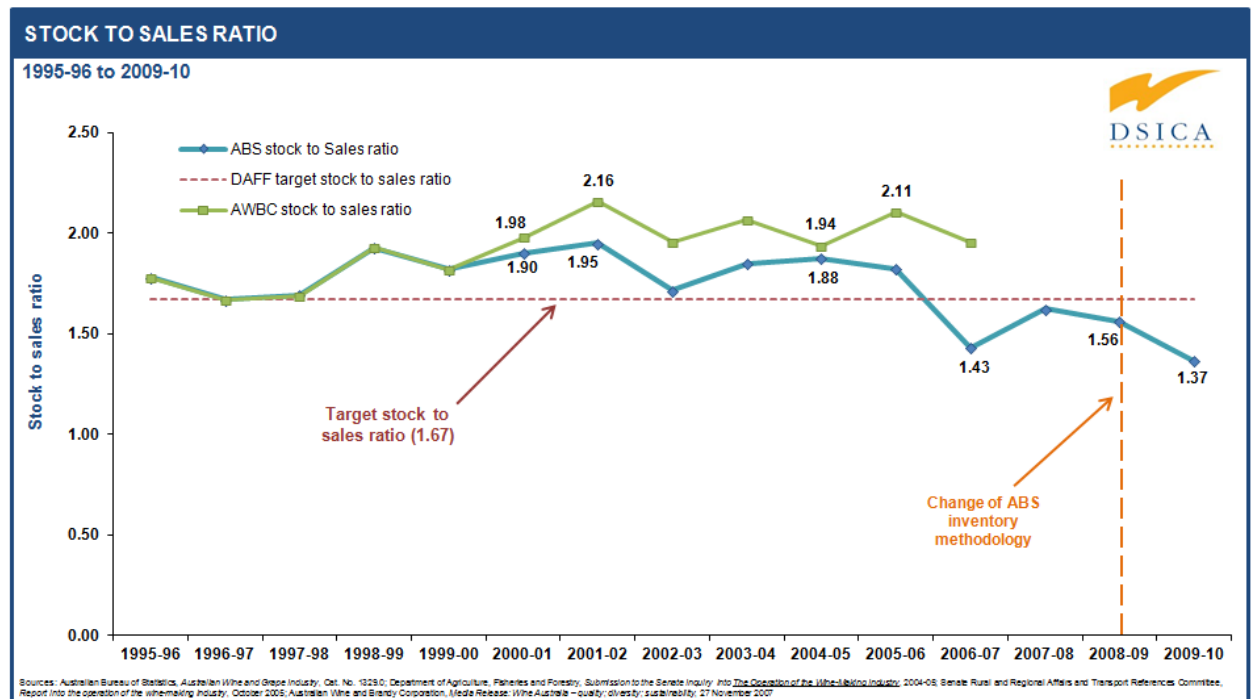
⁸² Department of Agriculture, Fisheries and Forestry, *Submission to the Senate Inquiry into the Operation of the Wine-Making Industry*, 2004-05, p. 5.

Figure 8.3: Australian wine production, stock and sales history (1995-96 to 2009-10)



These findings are further supported by an analysis of historical stock to sales ratios, which indicates that from 2006-07 onwards, the stock to sales ratio (which is calculated using ABS data) has consistently remained below the desired level of 1.67 (see Figure 8.4 overleaf). If there is a continued reduction in actual bearing area hectares (as the trends in Figure 8.3 suggest), inventory levels will fall further below the target stock to sales ratio over the coming years, as demonstrated in Figure 8.4 overleaf. Indeed, preliminary ABS data for the 2010-11 year indicates that sales will again exceed production in the 2010-11 production year, meaning that there will have been production deficits in four of the last five years, further eroding stock levels.

Figure 8.4: Stock to sales ratio history (1995-96 to 2009-10)



8.4 Causes of the wine glut

The WET and Wine Producer Rebate are systemic anomalies in the Australian alcohol taxation system which are contributing to the ‘wine glut’.

The wine glut has been raised as a hurdle to pursuing reform of the WET and Wine Producer Rebate. However, the wine industry confirms that the current ‘wine glut’ has been exacerbated by the operation of the existing WET and Wine Producer Rebate. In particular:

- **Premium Wine Brands (Pernod Ricard)** states that ‘the WET rebate system should be abolished’ as it is ‘inhibiting the industry reform agenda’;⁸³
- **Treasury Wine Estates** notes that ‘the Wine Producer Rebate stymies the achievement of sustainable efficiencies in the wine sector’;⁸⁴ and
- **The Allen Consulting Group** states that ‘the current taxation regime for wine is contributing to the very “wine glut” being used by the Government to justify delaying reform’.⁸⁵

As the WET encourages producers to produce wine on a low value, high volume basis and the Wine Producer Rebate supports the continuance of small otherwise unprofitable wineries, the following problems have arisen:

- the introduction of unsustainably low grape prices in Australia, which is threatening continued grape supply from all grape growers rather than only those who have uneconomic business structures;

⁸³ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 1.

⁸⁴ Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 5.

⁸⁵ The Allen Consulting Group, *Alcohol Taxation Reform – Starting with the Wine Equalisation Tax*, 2011, p. 13

- damage to the Australian wine brand resulting in considerable discounting of Australian wine products in domestic and export markets due to:
 - ⇒ poor-quality products entering the market due to a focus on the volume of wine sales rather than the development of high-value, quality products; and
 - ⇒ the emergence of cheap cleanskin and cask wine products produced using cheap excess wine, some of which dominate sectors of the wine market.⁸⁶

As such, the key design features of the existing wine taxation system are contributing to the current ‘wine glut’ and require reform. These considerations are discussed in greater detail in Sections 8.5 and 8.6.

Conclusion

Industry observations indicate that the Australian wine market is moving towards an ‘in-balance’ position, and, based on current trends, the wine glut is expected to end in the next 12 to 24 months. These observations are supported by DSICA’s foregoing analysis of demand versus production levels and historical stock to sales ratios.

Given that the wine glut is expected to end by 2014, there is increasing and unprecedented support from major players within the alcohol industry and the spirits and beer industry associations for Government consideration of possible reforms to the alcohol taxation system to coincide with the end of the wine glut. For example:

- **Premium Wine Brands (Pernod Ricard)** supports ‘a review of wine taxation in the run up to the next Budget with a view to securing agreement on reforms’;⁸⁷ and
- the **Brewers Association of Australia and New Zealand** ‘contend(s) that it would be good public policy to have all alcohol taxed on a category volumetric basis (and) changing wine taxation to this basis ... would be a major reform’.⁸⁸

DSICA supports these views and contends that now is the time for the Government to consider reform to the alcohol taxation system in order to implement reforms which will coincide with the end of the wine glut.

Recommendation 6: Government acknowledgement of the end of the ‘wine glut’

That the Government note that the ‘wine glut’ is likely to end within the next 12 to 24 months and therefore commence considering alcohol taxation reform options to ensure that they can be implemented in a timely manner following the end of the wine glut.

8.5 Wine Producer Rebate concerns and reform opportunities

Operation of the Wine Producer Rebate is fraught with problems, including support for otherwise unprofitable businesses, resulting in the oversupply of Australian wine and the purported ‘wine glut’. There are inadequate definitions of ‘producer’ and ‘manufacturer’ leading to tax abuse and ‘double dipping’ concerns. Major industry players and DSICA support abolition of the Wine Producer Rebate.

⁸⁶ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 3.

⁸⁷ *Ibid.*, p. 2.

⁸⁸ Brewers Association of Australia and New Zealand, *Tax Forum Submission: For the Environmental and Social Taxes Session*, 2011, pp. 2-3.

This Section outlines the problems that have arisen from the introduction of the Wine Producer Rebate which has attempted to address the bias in favour of large producers created by the ad valorem nature of the WET, namely:

- the support it provides for small, otherwise uneconomic wineries, contributing to Australia’s purported ‘wine glut’;
- the fact that it operates as a disincentive against mergers of small wineries; and
- issues of tax abuse and ‘double-dipping’ due to inadequate definitions of wine ‘producer’ and ‘manufacturer’.

In considering these problems, this Section further outlines reform opportunities and strong industry support for abolition of the Wine Producer Rebate to address distortions within the Australian wine market.

Operation of the Wine Producer Rebate

The Wine Producer Rebate supports small, otherwise uneconomic wineries and prevents the merging of small wineries, creating market distortions and reflects contradictory policies.

As wine is taxed under the ad valorem WET (i.e. on a value basis), wines with the same alcohol content can be subject to different levels of taxation. The cheaper the wine, the less it is taxed. Therefore, a value-based tax favours cheaper wines that tend to have lower profit margins, and are often made by large producers.

The Wine Producer Rebate was originally introduced in 2004 in an attempt to address the bias in favour of larger producers created by the ad valorem nature of the WET. The rebate of up to \$500,000 per year means that the first \$1.7 million of domestic wholesale wine sales per producer are effectively exempt from WET.

However, the Wine Producer Rebate does not provide an efficient solution to this problem because it creates biases of its own in favour of smaller producers. Small producers effectively pay no net WET, but the rebate reduces only a proportion of the WET paid by larger producers. As a result, two similar bottles of wine – one from a large producer, one from a small producer – pay different amounts of tax. Thus, while the Wine Producer Rebate does provide tax assistance to smaller producers, at the same time, it does not allow wines to compete on an equal footing.

The Wine Producer Rebate encourages small-scale production and supports some small, otherwise uneconomic wineries, contributing further to the oversupply of wine. The wine industry conducted a study which found that, in 20 of the 50 wine producing regions reviewed, more than half the production is uneconomic, while in ten regions 70 per cent or more is uneconomic.⁸⁹ The Henry Review, the WFA, Premium Wine Brands (Pernod Ricard) and Treasury Wine Estates have all expressed this concern as follows:

- The **Henry Review** found that ‘the Wine Producer Rebate fosters small-scale production and supports some small, otherwise uneconomic wineries’ and may be ... discouraging mergers within the industry’⁹⁰;
- The **Winemakers’ Federation of Australia** acknowledges that ‘structural surpluses of grapes and wine are now so large that they are causing damage to (the) industry by devaluing

⁸⁹ The Australian, *Storm clouds threatening wine industry’s blue sky*, 19 November 2009.

⁹⁰ Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis*, 2010, p. 438.

the Australian brand, entrenching discounting, undermining profitability and eroding profitability’ and the Wine Producer Rebate is a ‘contributing factor’ to this;⁹¹

- **Premium Wine Brands (Pernod Ricard)** has stated that ‘existing tax arrangements are distorting market forces by ... incentivising the production and sale of cheaper wines, contrary to the industry-endorsed strategy of value building through premium, branded products’;⁹² and
- **Treasury Wine Estates** has noted that ‘to the extent that genuine Australian wine producers are receiving the rebate, a significant percentage of these businesses are marginal and in effect being artificially sustained by it’.⁹³

Moreover, the Wine Producer Rebate also provides an incentive against mergers between small wineries, which may prevent producers being able to take advantage of economies of scale. This means that resources such as land, water and capital are not being used efficiently. By supporting uneconomic wineries, the current arrangements are likely to increase the costs of production for wineries which are efficient. This also serves to exacerbate the problem of excess production that recently characterised the wine industry in Australia.

Wine industry restructure

Wine industry restructuring attempts have been hampered by the operation of the Wine Producer Rebate, which shields unprofitable businesses and discourages mergers.

In November 2009, the national wine industry organisations launched a *Wine Restructuring Action Agenda* (the Action Agenda) aimed at confronting the issues of grape and wine oversupply. The Action Agenda identified that at least 20 per cent of bearing vines were surplus to requirements, and that the problem was not restricted to specific regions, varieties or price points.⁹⁴

The Rudd Government’s May 2010 decision not to commence implementation of the Henry Review recommendations on alcohol taxation was clearly influenced by the Action Agenda.⁹⁵

In December 2010, the national wine industry organisations made a second statement on the progress being made to address the oversupply situation. One of the key conclusions was that:

‘The process of adjustment is not proceeding at a sufficient pace. A combination of unrealistic expectations, non-commercial motives and short-term opportunism continues to motivate many operators to resist change.’⁹⁶

The statement identifies a number of factors contributing to the oversupply: total supply, domestic demand, and export demand. Of these, total supply is the one over which the wine industry has most control.

⁹¹ Winemakers’ Federation of Australia, Wine Grape Growers’ Australia and the Australian Wine and Brandy Corporation, *Statement to Industry: Wine sector must continue to focus on transition*, 6 December 2010.

⁹² Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 1.

⁹³ Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 5.

⁹⁴ Winemakers’ Federation of Australia, Wine Grape Growers’ Australia, the Australian Wine and Brandy Corporation and the Grape and Wine Research and Development Corporation, *Statement to Industry: Wine industry must confront the reality of oversupply*, November 2009.

⁹⁵ The Hon Kevin Rudd MP and the Hon Wayne Swan MP, *Media Release: Stronger, Fairer, Simpler: A Tax Plan for Our Future*, 2 May 2010.

⁹⁶ Winemakers’ Federation of Australia, Wine Grape Growers’ Australia and the Australian Wine and Brandy Corporation, *Statement to Industry: Wine sector must continue to focus on transition*, 6 December 2010.

In terms of oversupply in particular, the statement identifies the Wine Producer Rebate as one of the contributing factors which is ‘*shielding otherwise unprofitable businesses*’.⁹⁷

The Henry Review identified that around half of all wine producers are unprofitable. It further commented that the Wine Producer Rebate may be acting to prevent proper market responses by discouraging mergers.⁹⁸ This is also noted by Premium Wine Brands (Pernod Ricard) and Treasury Wine Estates, which state:

*‘The WET rebate is inhibiting industry restructuring as it subsidises producers who would otherwise not be able to compete in the market and restricts consolidation in the industry’;*⁹⁹ and

*‘It (the Wine Producer Rebate) is a damaging subsidy (which) is preventing consolidation and sustaining uneconomic production at a time when the industry urgently needs to retire excess supply and rebuild value’.*¹⁰⁰

DSICA shares Premium Wine Brands’ (Pernod Ricard) and Treasury Wine Estates’ concerns regarding the Wine Producer Rebate and the obstacles it presents to achieving the Action Agenda, and agrees that urgent reform is needed.

Reform option: abolition of the Wine Producer Rebate

There is strong support for abolition of the Wine Producer Rebate from major industry players. Abolition of the Wine Producer Rebate would result in cost savings of \$1.1 billion over the forward estimates.

In light of all of the above, it is unsurprising that there is increasing support for abolition of the Wine Producer Rebate. In particular:

- **Premium Wine Brands (Pernod Ricard)** states that ‘*the WET rebate system should be abolished*’ and ‘*abolition would be in the best interests of the wine industry*’;¹⁰¹ and
- **Treasury Wine Estates** states that ‘*the Wine Producer Rebate, while well intentioned, is a failed policy and must be abolished*’.¹⁰²

DSICA strongly supports abolition of the Wine Producer Rebate. Such a change would simultaneously remove the biases created by the rebate scheme and all of the problems of tax avoidance and double-dipping created by its very existence (see below).

Figure 8.5 overleaf outlines the expected budget savings for the periods 2012-13 to 2015-16 if the Wine Producer Rebate were abolished. These cost savings could be used to fund other alcohol-related tax reforms.

⁹⁷ Ibid.

⁹⁸ Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis*, 2010, p. 438.

⁹⁹ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 4.

¹⁰⁰ Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 2.

¹⁰¹ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, pp. 1, 4.

¹⁰² Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian wine Industry*, 2011, p. 6.

Figure 8.5: Forecast revenue from abolition of the Wine Producer Rebate scheme (2012-13 to 2015-16)

(\$ million)	2012-13	2013-14	2014-15	2015-16	2012-13 to 2015-16
Abolish Wine Producer Rebate scheme	270	280	290	300	1140

Sources: Treasury, Tax Expenditures Statement 2011 (F16), 2010, p. 76 and DSICA estimates

8.6 Reform of the Wine Equalisation Tax to a volumetric regime

There is strong support for reform of the WET from major industry players, industry associations and healthy lobby groups.

Major industry players and independent research indicates that the operation of the existing WET regime and Wine Producer Rebate are structural anomalies in the Australian alcohol taxation system which are key factors contributing to the purported ‘wine glut’.¹⁰³ Given this, reform of the WET to a volumetric taxation regime is being called for in an unprecedented way. In particular:

- **Premium Wine Brands (Pernod Ricard)** has stated that it ‘supports the reform of the wine tax system in Australia so that wine is taxed by alcohol content (i.e. a volumetric tax), with the tax rate set to reflect a revenue-neutral approach’;¹⁰⁴
- **Treasury Wine Estates** has stated that ‘wine should be taxed on a volumetric, revenue neutral basis’, and ‘a simple three-tiered structure based on alcohol content bands by volume would be most appropriate for wine’;¹⁰⁵
- the **Brewers Association of Australia and New Zealand** has indicated that it is ‘in agreement with (a) proposal that wine should be included in a category-based volumetric system’;¹⁰⁶
- peak health lobby groups including the **Foundation for Alcohol Rehabilitation and Education (FARE; formerly the Alcohol Education and Rehabilitation Foundation [AERF])** have indicated that ‘the current tax arrangement doesn’t make economic sense, it doesn’t make sense for the health of Australians, and it doesn’t make sense for the wine industry’.¹⁰⁷ The AERF-commissioned report *Alcohol Taxation Reform – Starting with the Wine Equalisation Tax* provides three wine taxation reform scenarios, each of which replace the WET with a volumetric tax;¹⁰⁸ and
- **The Greens** have demonstrated support for WET reform, noting that ‘the Wine Equalisation Tax is value-based, which creates a perverse incentive to produce cheap wine rather than high-quality product’.¹⁰⁹

¹⁰³ The Allen Consulting Group, *Alcohol Taxation Reform – Starting with the Wine Equalisation Tax*, 2011, p. 13.

¹⁰⁴ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 4.

¹⁰⁵ Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 2.

¹⁰⁶ Brewers Association of Australia and New Zealand, *Tax Forum Submission: For the Environmental and Social Taxes Session*, 2011, p. 2.

¹⁰⁷ Alcohol Education and Rehabilitation Foundation, *Media Release: AER Foundation calls for urgent reform on the Wine Equalisation Tax*, 6 September 2011.

¹⁰⁸ The Allen Consulting Group, *Alcohol Taxation Reform – Starting with the Wine Equalisation Tax*, 2011, pp. 16-22.

¹⁰⁹ Senator Dr Richard Di Natale (Greens Senator for Victoria), *Media Release: Greens back report on alcohol tax reform*, 6 September 2011.

8.7 DSICA’s four-step proposal for wine taxation reform

DSICA has developed a proposal for wine taxation reform which is designed to operate as a *transition step* in achieving the long-term aim of a single volumetric excise rate applying to all alcohol beverages. This proposal aims to facilitate an increase in the tax (and price) of cask (and low-price cleanskin bottled) wine, while preserving many of the existing features of the WET. This proposal comprises a four-step approach as follows:

- **retain the WET:** retain the WET as the legal structure for wine taxation, rather than moving wine tax into the excise system;
- **taxation tiers:** introduce several taxation tiers, based upon wholesale sales price points (or other criteria to be developed), equivalent to the economy, semi-premium and premium wine categories;
- **volumetric rate for economy wine:** introduce different taxation rates within those tiers, including a volumetric rate for the economy tier; and
- **accelerated indexation:** introduce an accelerated indexation factor for the volumetric rate in the economy tier which would allow convergence to a common rate with the semi-premium tier over a phase-in period.

Each of these steps is described in greater detail below.

Step one – retain the existing Wine Equalisation Tax as the taxing system

The proposal would involve retention of the existing WET system legislative infrastructure (rather than moving wine taxation into the excise system). This would minimise administrative disruption for wine producers and also minimise any compliance changes otherwise required under the excise system. It is proposed that:

- administration of wine taxation should continue under the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth); and
- wine products should continue to be taxed at the last wholesale sales point, as is current practice under the WET.

The objectives of this approach are to ‘neutralise’ the traditional resistance that is expected from winemakers regarding a potential move into the excise system. In particular, it will remove the need for winemakers to obtain excise licences or to implement bonded warehouses. In addition, this would also allow the Wine Producer Rebate to be retained (if the Government were reluctant to abolish it), possibly in an amended form, to continue to support legitimate small winemakers.

DSICA notes that this approach to amend the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) (rather than moving wine taxation into the excise system) is supported by Premium Wine Brands (Pernod Ricard).¹¹⁰

¹¹⁰ Premium Wine Brands (Pernod Ricard), *Premium Wine Brands’ Submission to the Federal Government Tax Forum*, 2011, p. 4.

Step two – introduce taxation tiers (possibly defined by wholesale sales price points)

The wine industry has traditionally opposed the concept of a single volumetric wine tax as a ‘flat earth’ approach that could not take account of the various categories within the wine market. DSICA’s proposal addresses this concern by introducing several taxing tiers (or taxing bands), which would be set for the commonly recognised categories of wine products. These taxing bands could be defined by wholesale sales price (or some other criteria to be developed).

This would allow three (or more) taxing bands with different (escalating) volumetric rates being set for each band. These bands could be based on the commonly recognised categories: economy (i.e. cask wine), semi-premium and premium wine products. An initial outline of the conceptual framework is outlined in Figure 8.6 below.

Figure 8.6: Illustrative wholesale sales price bands and equivalent volumetric taxation rates

Price band reference	Proposed wholesale sales price band	Volumetric rate reference
Band 1 or B ₁	Economy products	R ₁
Band 2 or B ₂	Semi-premium products	R ₂
Band 3 or B ₃	Premium products	R ₃

DSICA notes that Treasury Wine Estates supports a three-tiered volumetric wine taxation structure, however rather than defining the respective brands by wholesale sales price (as DSICA has proposed), it encourages the use of bands on the basis of alcohol content.¹¹¹ In its submission to the Tax Forum, Treasury Wine Estates notes that this approach is preferable as it would obviate the need for testing of each batch and the application of potentially multiple tax rates.¹¹² DSICA notes that the wholesale sales price banding approach it proposes may be refined and refer to some other criteria to be developed, rather than wholesale sales price points. *DSICA would welcome the opportunity to work with the Government and wine industry representatives to identify the most appropriate criteria by which to define the proposed bands.*

Step three – identify the volumetric taxation rate applicable to each band

This stage involves identification of the volumetric taxation rate for each of the three bands (B₁, B₂ and B₃). The rates would ideally be on a per litre of alcohol basis (i.e. not per litre, as is widely used in Europe).

For present purposes, these volumetric rates will be noted as R₁, R₂ and R₃. The rates for the bands could be selected/adjusted to achieve varying economic, social, industry or other objectives.

Economy band (B₁)

A volumetric rate would be introduced for the economy band. The setting of this rate (R₁) would effectively set the minimum price of alcohol in Australia.

The volumetric rate for the economy band could be initially set at a level that resulted in no immediate change in cask wine prices. This is similar to Costing Option 1 developed by the

¹¹¹ Treasury Wine Estates, *Submission prepared by Treasury Wine Estates Ltd for the Federal Tax Forum – Tax Reform for a Sustainable Australian Wine Industry*, 2011, p. 4.

¹¹² Ibid.

Federal Treasury team supporting the Henry Review panel.¹¹³ Under that Option, the commencing volumetric wine tax rate was \$7 per LPA and it required a 15-year transition period. This band would be subject to accelerated indexation (discussed in greater detail in step four below).

Semi-premium band (B_2)

The products falling within price band B_2 (i.e. semi-premium products) would be subject to a volumetric rate (R_2) which would be subject to twice-yearly indexation in accordance with CPI movements (as is current practice with excisable alcohol products – beer, spirits and RTDs).

Premium band (B_3)

The rate in the premium products band (B_3) could be set to minimise price falls of expensive super-premium bottled wine. This could counter one oft-cited argument against a shift to a volumetric wine tax, which is that ‘Grange will fall in price under a volumetric wine tax’.¹¹⁴

Transition options for the tax rate in the premium band include:

- retain the existing ad valorem rate of 29 per cent (for a period); or
- select a proposed volumetric rate (R_3) which would ensure no price change for a target premium bottle of wine of a selected retail price. The rate would then become subject to twice-yearly indexation in accordance with CPI.

Step four – accelerate the indexation factor applied to the economy band

In order to increase the tax paid by products in the economy band (B_1), an accelerated indexation factor would be applied to the volumetric rate selected for this band. This would allow for convergence to a common rate with the semi-premium tier over a phase-in period. The use of accelerated indexation draws on a key feature outlined by the Henry Review team in its Costing Minute which used accelerated indexation to achieve convergence of volumetric rates at different starting positions.

As the most significant tax differential is seen in the economy (i.e. economy/cask wine products) market, the primary aim of this proposal is to increase the tax paid by this market segment. Hence, it is proposed that the indexation factor applied to rate R_1 for this price band (B_1) could be *accelerated* to have the effect of increasing the effective minimum floor price (for low-value wine) over time.

Concept overview

The operation of the concept and the four stages described is outlined in Figure 8.7 overleaf. It is pertinent to note the following:

- in order to reduce the taxation distortions between cheaper wine products (i.e. those in B_1), the indexation factor applied to the volumetric rate for these products (R_1) could be accelerated. The acceleration factor could be defined by a known variable such as growth in Gross Domestic Product;¹¹⁵
- due to the accelerated indexation factor applying to R_1 , it is inevitable that R_1 will eventually converge with R_2 . At this point of convergence, the accelerated indexation will cease to apply to R_1 , and this rate will be subject to normal indexation on the basis of the CPI;

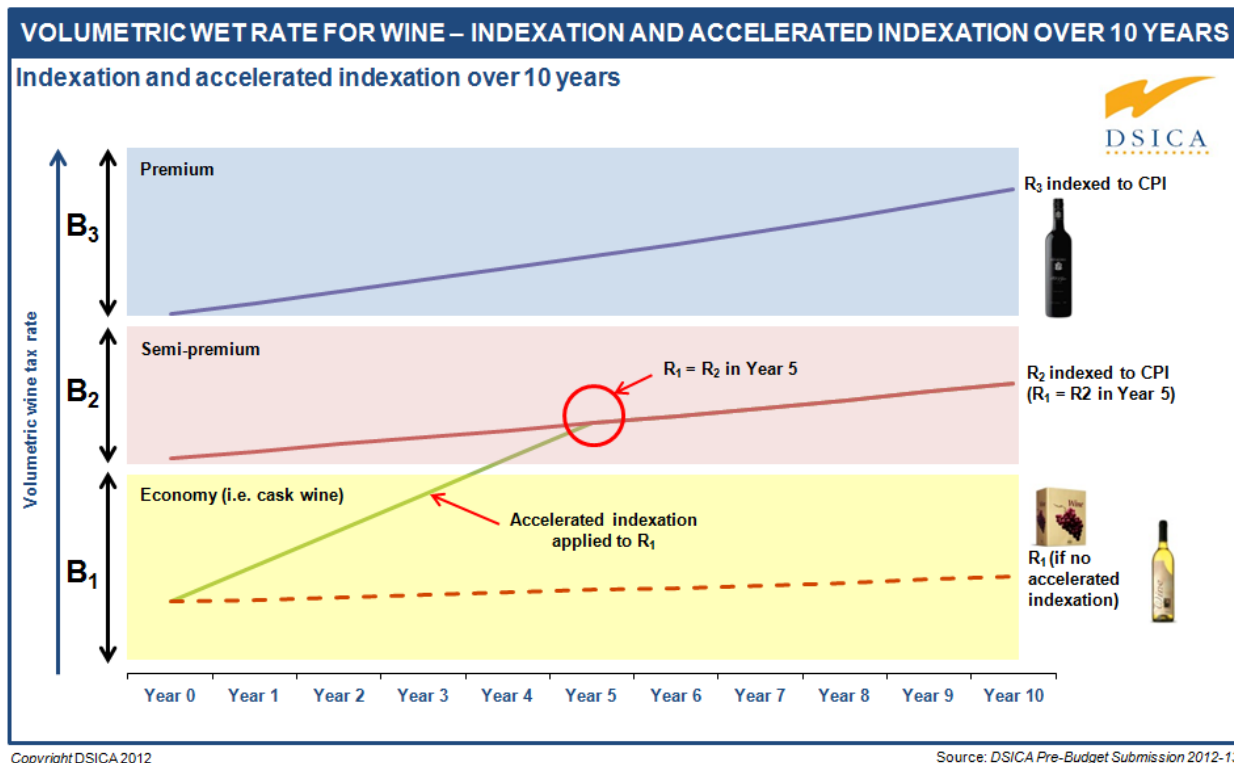
¹¹³ Treasury, *Costing Minute: AFTS Proposal – Alcohol Tax Reform*, 2010.

¹¹⁴ Sydney Morning Herald, *It’s shaping up to be a great year for Grange*, 1 May 2010.

¹¹⁵ Note that at present, Gross Domestic Product is growing at a faster rate than the Consumer Price Index.

- the acceleration of the R_1 rate is demonstrated by the bold green line. To simplify the analysis, the graphic demonstrates rates R_1 and R_2 converging at year five. This timeframe could be changed to accommodate preferred transitional arrangements; and
- later convergence to a single volumetric wine rate could then be designed.

Figure 8.7: DSICA's proposal for transitioning to a volumetric wine taxation regime



Advantages of this reform proposal

DSICA's volumetric wine taxation reform proposal has a number of advantages, namely:

- maintenance of the WET structure, which minimises winemaker resistance in moving to an excise regime and avoids the introduction of complex administrative requirements (e.g. bonded warehouses) that may be difficult for small winemakers to implement;
- allows for retention of the Wine Producer Rebate (if desired), providing assistance for legitimate small wine producers;
- use of a transition period and accelerated indexation which allows for a gradual increase in the tax rate applying to products in the economy band and prevents any 'price shocks';
- use of multiple taxation tiers which account for the different segments of the wine market;
- use of a volumetric tax which helps facilitate health and social policy objectives, promoting responsible consumption decisions; and
- use of a volumetric tax (as opposed to an ad valorem regime), which removes existing incentives in the tax system for the production of low-value wine. This allows the Australian wine industry to focus on its stated strategy of enhancing and developing the premium wine market segment and assists in ending the 'wine glut'.

Recommendation 7: Reform of the Wine Equalisation Tax to a volumetric taxation regime

That the Government pursue wine taxation reform using the four-step process devised by DSICA as a transition step to achieving the long-term goal of a fully volumetric taxation regime for all alcohol beverages. Introduction of a volumetric alcohol taxation regime will provide an effective minimum floor price.

8.8 Freezing of indexation to facilitate transition to a wholly volumetric alcohol taxation regime

Upon commencement of transition to a volumetric tax for wine products, DSICA supports the freezing of indexation of the spirits and RTD excise duty rates as a means of transitioning to a wholly volumetric alcohol taxation regime.

DSICA notes that in transitioning to a wholly volumetric tax regime for all alcohol products, as recommended by the Henry Review, a freeze on bi-annual indexation of the highest excise duty rates can be used as a method to achieve gradual convergence of all excise duty rates. This analysis has been undertaken by the Treasury while supporting the Henry Review panel in formulating their final recommendations. In undertaking this analysis, the Treasury analysed the revenue impacts of replacing ‘current excises on beer and spirits, and Wine Equalisation Tax, with a common alcohol tax based on alcohol content, set by reference to the net social costs of alcohol consumption and taxation, with a low-alcohol threshold for all products’.¹¹⁶

DSICA supports the transition methodology developed by the Henry Review and proposes that it is used following the introduction of a volumetric wine tax regime to facilitate convergence to a single volumetric rate for all alcohol beverages.

Treasury analysis indicated that rates could converge via the existing indexation arrangements for the volumetric excise duty rates currently applying to spirits, RTDs and beer in the following manner:

- bi-annual indexation increases of the full-strength packaged beer excise duty rate in line with movements in the CPI would continue;
- bi-annual indexation increases of all excise duty rates below the full-strength packaged beer excise duty rate would be accelerated so that they would converge with the full-strength packaged beer excise duty rate within a certain number of years (NB this includes the new volumetric rate for wine); and
- freezing of indexation increases of the spirits excise duty rate until such time as the full-strength packaged beer excise duty rate is equivalent to the spirits excise duty rate. Using Treasury’s assumption of 2.5 per cent per annum inflation, the spirits excise duty rate would be suspended/frozen for approximately 21 years.¹¹⁷

An example of the Treasury methodology is outlined in Figure 8.8 overleaf. Key features of this graphic are as follows:

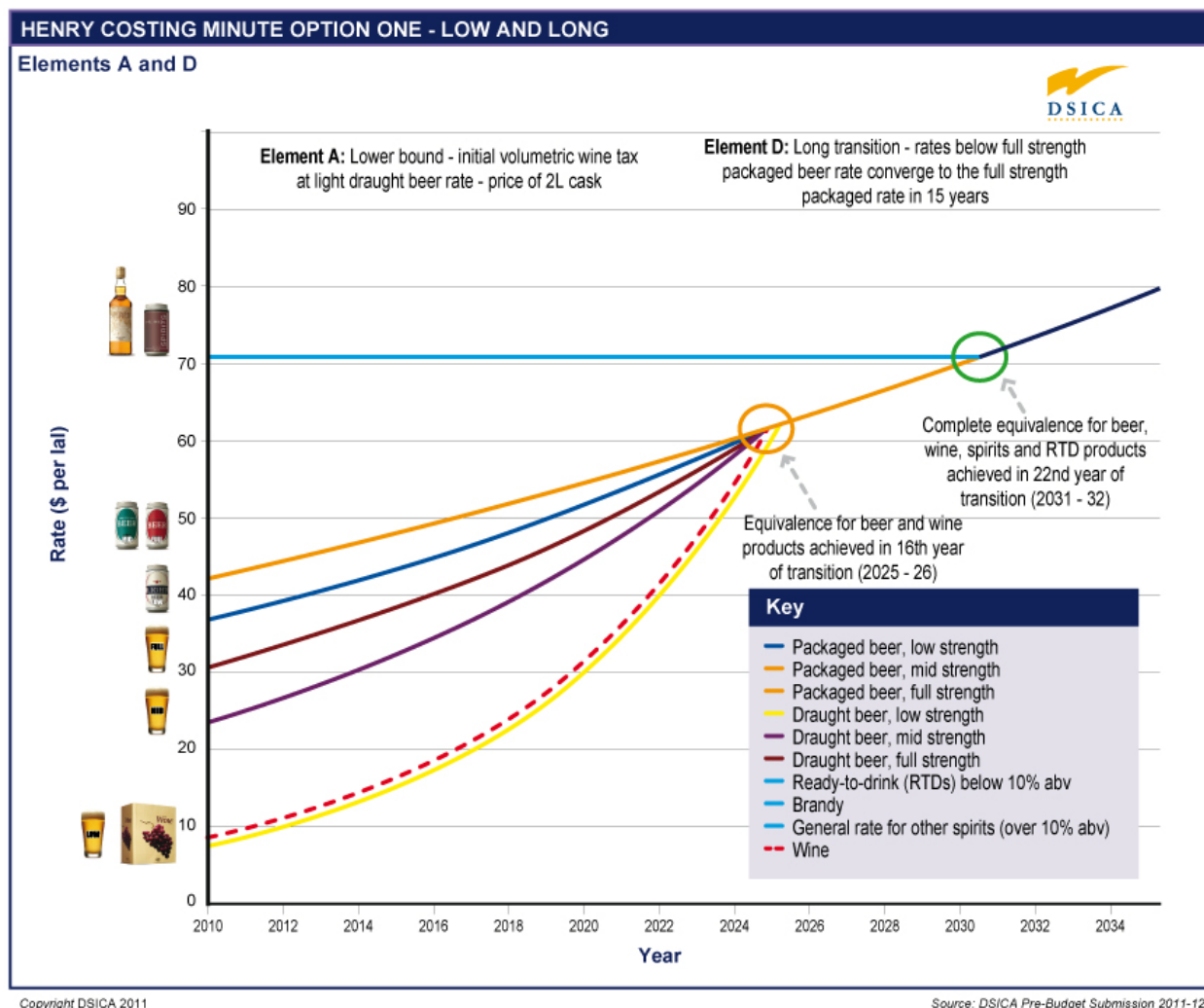
- **step 1:** automatic indexation of the spirits excise duty rate is suspended/frozen and after 15 years, all wine and beer products will be taxed at a single rate (equivalent to the full-strength packaged beer rate);
- **step 2:** the full-strength packaged beer excise duty rate converges to the spirits excise duty rate; and

¹¹⁶ Treasury, *Costing Minute: AFTS Proposal – Alcohol Tax Reform*, 2010, p. 1.

¹¹⁷ Ibid.

- **step 3:** indexation of the final converged rate recommences on a bi-annual basis, including for spirits and RTDs.¹¹⁸

Figure 8.8: Henry Review transition to a single volumetric duty rate for all alcohol products (Option One – low and long)



Recommendation 8: Freezing of statutory indexation of excise duty rates to facilitate transition to a wholly volumetric alcohol taxation regime

That the Government commit to freeze automatic (statutory) indexation of the spirits and RTD excise duty rates as a means of facilitating the transition to a single volumetric rate for all alcohol products, as recommended by the Henry Review.

¹¹⁸ Ibid.

9 Conclusion

Budget Priorities 2012-13

DSICA recommends a revenue positive package of alcohol tax changes for inclusion in the 2012-13 Budget. This package will assist the Government to achieve its goal of a budget surplus in 2012-13 and includes the following:

- traditional cider should be taxed at the same excise duty rate that applies to substitute competitor products (i.e. flavoured ciders and RTDs). **Additional revenue of \$496 million over the forward estimates.**
- the Wine Producer Rebate provisions of the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) should be amended to prevent ongoing abuse and ‘double dipping’. **Additional revenue of \$237 million over the forward estimates.**

The revenue from these measures should be used to:

- unilaterally remove the five per cent nuisance customs duty on imported spirits and RTDs (**cost of \$80 million over the forward estimates**);
- provide taxation equivalence for low- and mid-strength RTDs with packaged beer, as supported by the health lobby (**cost of \$20 million over the forward estimates**); and
- discount the automatic CPI indexation of excise duty rates on 1 February 2013 to remove the consumer price effect of the carbon price package.

Long-term reform objectives

Leading wine industry figures predict that the wine glut will be over in 12 to 24 months. There is now unprecedented support for reform of wine taxation:

- **Premium Wine Brands (Pernod Ricard), Treasury Wine Estates, the Brewers Association of Australia and New Zealand** and **DSICA** support volumetric taxation for wine and all alcohol beverages;
- health lobby groups (including **FARE**) are actively advocating for substantial reform to Australia’s alcohol taxation regime, particularly the WET; and
- the Henry Review identified wine tax reform as a priority.

DSICA supports these calls for reform and notes that the Henry Review’s long-term aim of a single volumetric tax rate applying to all alcohol beverages represents an international best-practice approach to alcohol taxation.

Given that the wine glut is likely to end in the near future, now is the opportune time for the Government to announce a wine tax reform review process.

DSICA has developed a proposal for implementation of a volumetric wine tax (within the WET) and later transition to a single volumetric rate for all alcohol beverages.

DSICA would welcome the opportunity to work with the Government to develop timeframes and transition arrangements to give effect to these reform proposals.

January 2012

A Appendix – The Australian alcohol market

A.1 Introduction

In this Appendix, DSICA provides an overview of the latest data on the make-up of the alcohol market in Australia in 2010-11 and provides estimates of revenue from alcohol products in 2012-13.

The alcohol market in Australia remains dominated by beer, which comprised over two-fifths (42 per cent) of consumption in 2010-11 (when measured in LPAs) (see Figure A.3 on page 77). By comparison, spirits and RTDs together comprise only 20 per cent per cent of the market, with RTDs comprising about 7 per cent. Traditional cider is the fastest growing category in the alcohol market.

A.2 Alcohol taxation in Australia

Revenue authorities around the world apply two main methods in taxing alcohol products:

- tax on the basis of the volume of alcohol in the beverage (a ‘volumetric’, or specific rate method); and
- tax on the basis of the value of the product (an ‘ad valorem’ method).

Australia uses a combination of both methods, depending on the beverage type.

Volumetric systems are usually described as ‘excise’ duties – that is, taxes which are selective in the product they cover and involve quantification of the product in determining the liability. In the case of alcohol, the quantification is in ‘litres of pure alcohol’, which is usually abbreviated to either LPA, or lals. Australia applies a volumetric excise duty to beer, spirits, RTDs and flavoured ciders.

Ad valorem taxes can take various forms. Broad-based general purpose taxes such as the GST are usually ad valorem taxes, but in some cases, ad valorem taxes are selectively applied. This is the case with the WET in Australia, which is levied on wine, grape wine products and traditional cider.

Architecture of Australia’s tax system

The Australian Government levies tax on alcohol beverages which are more than 1.15 per cent abv. The exact tax arrangements applicable depend on the type of alcohol beverage, as discussed below.

Beer

Beer is subject to seven different volumetric excise duty rates, depending on whether the product is brewed for commercial or non-commercial purposes (home brew), the alcohol content of the beer and the size of the container. There are three ‘tiers’ of taxation that apply to commercial beer products according to alcohol content, being, low-, mid- and full-strength. The complexity of Australia’s beer taxation rates is outlined in Figure A.1 overleaf.

Figure A.1: Excise duty rates applying to beer products as at 1 February 2012

EXCISE DUTY RATES APPLYING TO BEER PRODUCTS			
(as at 1 February 2012)			
Product Category	Packaged Beer ¹	Draught Beer ²	Non-Commercial Beer ³
Low-strength beer ($\leq 3^\circ$ abv)	\$37.86 per LPA	\$7.56 per LPA	\$2.66 per LPA
Mid-strength beer ($> 3^\circ$ abv $\leq 3.5^\circ$ abv)	\$44.11 per LPA	\$23.73 per LPA	\$3.07 per LPA
Full-strength beer ($> 3.5^\circ$ abv)		\$31.05 per LPA	
Note that all beer products are subject to a 1.15° abv excise-free threshold			
Note 1: Beer packaged in an individual container not exceeding 48 litres Note 2: Beer packaged in an individual container exceeding 48 litres Note 3: Beer produced for non-commercial purposes using commercial facilities or equipment			

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Source: Australian Taxation Office

In addition, beer products qualify for an excise-free threshold of 1.15 per cent abv. This means that excise is not payable on the first 1.15 per cent abv of a beer product. The effect of the threshold is to lower the ‘effective rate’ of excise duty on low and mid-strength beer compared with full-strength beer. There is a strong policy rationale behind this excise-free threshold: it encourages the production and consumption of lower-strength alcohol products.

Draught beer – that is, beer which is sold ‘on tap’ – pays a lower rate of excise duty than the equivalent packaged beer. To qualify for the ‘draught beer’ rates of excise duty, the beer must be sold in a container exceeding 48 litres in volume – for example, a keg.

Beer produced for non-commercial purposes also benefits from a concessional excise duty rate.

Wine, grape wine products and traditional cider

Wine, grape wine products and traditional cider are taxed on an ad valorem basis under the WET.

Wine Equalisation Tax is payable by manufacturers, wholesalers and importers of wine, grape wine products and traditional cider as defined. It is collected under the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) which is administered by the ATO.

The WET rate is currently 29 per cent and is applied to the wholesale sales price of the product. WET is levied on the last wholesale sale (or equivalent) of a product.

Wine Producer Rebate

A special Wine Producer Rebate was introduced by the Australian Government effective from 1 October 2004. The rebate sought to address the inherent bias created by the WET system in favour of large producers. The maximum rebate amount was increased on 1 July 2006 and now effectively provides an exemption from WET for a producer’s first \$1.7 million of domestic wholesale sales, meaning that these sales are effectively tax-free. This has the effect of removing WET liability for the wine sales of the large majority of small/medium producers.

The Henry Review identified that around half of all wine producers are unprofitable. It further commented that the Wine Producer Rebate may be acting to prevent proper market responses by discouraging mergers.¹¹⁹

¹¹⁹ Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis*, 2010, p. 438.

Premium Wine Brands (Pernod Ricard) and Treasury Wine Estates have now called for the abolition of the Wine Producer Rebate, stating that it is no longer in the best interests of the wine industry.

Spirits, Ready-to-Drink products and flavoured cider

All spirits (including RTDs and flavoured cider) are taxed at a single volumetric rate, with the exception of brandy. Brandy pays a lower rate of excise duty, an anomaly which dates back to a policy of providing a taxation concession to the local grape growing industry.

Prior to the tax increase on RTDs in April 2008, RTDs were subject to excise duty at similar rates as packaged beer. The rationale for this approach was that RTDs and beer were beverages of similar alcohol content, marketed in similar ways (i.e. bottles and cans) to a similar demographic (that is, primarily males 24 years and above). This was a deliberate policy decision, implemented with effect from 1 July 2000, at the time of the introduction of the GST.

Spirits and RTDs do not qualify for the 1.15 per cent abv excise-free threshold available to beer, despite spirits and RTDs being subject to a much higher rate of volumetric taxation.

Australia’s current alcohol tax arrangements are summarised in Figure A.2 below. It is pertinent to note that:

- imported beer, spirits, RTDs and flavoured ciders are subject to excise-equivalent customs duty as the same volumetric excise duty rate applied to domestically-produced products; and
- imported spirits, RTDs, wine and flavoured cider are subject to a five per cent nuisance customs duty. In the case of spirits, RTDs and flavoured cider, this customs duty is applied in addition to the excise-equivalent customs duty.

Figure A.2: Taxation of alcohol in Australia

TAXATION OF ALCOHOL IN AUSTRALIA					
Product Category	Beer	Spirits (including RTDs)	Wine	Traditional cider	Flavoured cider
Excise duty (locally produced goods)	✓	✓			✓
Customs duty – ad valorem (imported goods only)		✓	✓		✓
Customs duty – excise-equivalent (volumetric) (imported goods only)	✓	✓			✓
Wine Equalisation Tax (WET)			✓	✓	
Goods and Services Tax (GST)	✓	✓	✓	✓	✓

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Source: DSICA Pre-Budget Submission 2012-13

A.3 The Australian alcohol market in 2010-11 and revenue estimates for 2012-13

DSICA estimates that of the Australian alcohol market in 2010-11 (when measured in LPAs):

- beer comprised 42 per cent;
- spirits overall (including RTDs and flavoured cider) comprised 20 per cent;
- wine (and grape wine products) comprised 37 per cent; and
- traditional cider comprised one per cent, but was the fastest growing market segment (see Figure A.3 on page 77).

DSICA estimates that the Federal Government will collect approximately \$7.7 billion in taxation revenue from the production and consumption of alcohol beverages in the 2012-13 financial year (see Figure A.4 on page 78). This revenue will comprise:

- \$1.9 billion in customs duty;
- \$3.3 billion in excise duty;
- \$775 million in WET.

(resulting in \$6.0 billion in non-GST revenue); and

- \$1.8 billion in GST revenue.

The percentage shares of total estimated non-GST (alcohol tax) revenue for 2012-13 are illustrated in Figure A.5 on page 79.

DSICA estimates that the Government will receive \$1.8 billion in GST revenue from sales of alcohol products in 2012-13. This does not include GST on products bought ‘on premise’ or across the bar (e.g. draught beer, cocktails and spirits mixed across the bar) which includes a service component, so this is a conservative estimate.

A.4 Weaknesses in the current Australian alcohol tax structure

The current alcohol taxation system fails to adequately satisfy key criteria of a good tax system. This was confirmed in the Henry Review.¹²⁰ Furthermore, the system does not assist in achieving good health outcomes and it also distorts the alcohol beverage marketplace by unduly 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 traditional cider) and volumetric taxation rates (beer, spirits, RTDs and flavoured cider);
- a system of ten different rates – only some of which are inflation-indexed;
- automatic bi-annual indexation of spirits, RTD, flavoured cider and beer excise duty rates, resulting in growing disparities in the relativities with wine prices, which are not subject to similar increases;
- some products (i.e. spirits and RTDs) have import duty at ad valorem rates indiscriminately applied based on their country of origin; and

¹²⁰ Commonwealth of Australia, *Australia’s Future Tax System – Report to the Treasurer, Part Two – Detailed Analysis*, 2010, p. 431.

- rebates and tax free thresholds are available to some products (e.g. wine and beer) but not to others.

DSICA analysed the many shortcomings of the current alcohol tax system in its submissions to the Henry Review.

A.5 Conceptual framework of Australia’s alcohol tax system

DSICA has developed a graphical representation tool to illustrate the current taxation regime for alcohol in Australia (see Figure A.6 on page 80). The purpose of the graphic is to:

- demonstrate the current complexities and anomalies that exist, particularly in relation to differing tax treatments that apply to products that are substitutable;
- identify opportunities for incremental tax changes to remove unsustainable concessions; and
- act as a framework to assist in the development of alternative models for alcohol taxation reform.

Key features of Figure A.6 include:

- different beverage categories are listed horizontally across the page, with products levied the ad valorem WET coloured red;
- alcohol by volume content is listed along the left-hand side vertical axis of the graphic;
- there is a deliberate delineation in the graphic at ten per cent abv, as this tends to be the upper limit on ‘lower-strength’ beverages such as beer and spirit-based RTDs, while most wine, liqueur and spirits products are above this level. The exception to this is the red (ad valorem) category for wine and traditional cider products, which can be of lower alcohol content;
- we note that ten per cent abv is also a key reference point in the excise and customs legislation. It also separates Tax Base 1 from Tax Base 2 in Treasury’s *Tax Expenditure Statement* analysis;¹²¹
- the placement of the grape wine product category (in red) also reflects the definitional requirement in the *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) that grape wine products must be between eight and 22 per cent abv;
- different beverages are then listed in the category boxes in the graphic. Current taxation rates are indicated, as well as whether a particular beverage qualifies for the 1.15 per cent abv excise-free threshold;
- draught beer is separated as a category as it is subject to different excise duty rates compared with packaged beer.

Figure A.6 shows both the current taxation regime (including its anomalies and complexities) and provides a framework to consider possible tax changes and tax reform options.

¹²¹ Treasury, *Tax Expenditures Statement* 2010, 2011, p. 210.

The following pages contain a series of graphics relating to the Australian alcohol market and DSICA revenue estimates for 2012-13, as discussed in Appendix A.

Figure A.3 DSICA estimate of Australia's alcohol market (2010-11)

Figure A.4 DSICA estimates of Commonwealth revenue from alcohol taxation (2012-13)

Figure A.5 Market sector contribution to non-GST revenue (alcohol taxes) (2012-13)

Figure A.6 Australia's alcohol taxation system as at 1 February 2012

Figure A.3: DSICA estimate of Australia’s alcohol market (2010-11)

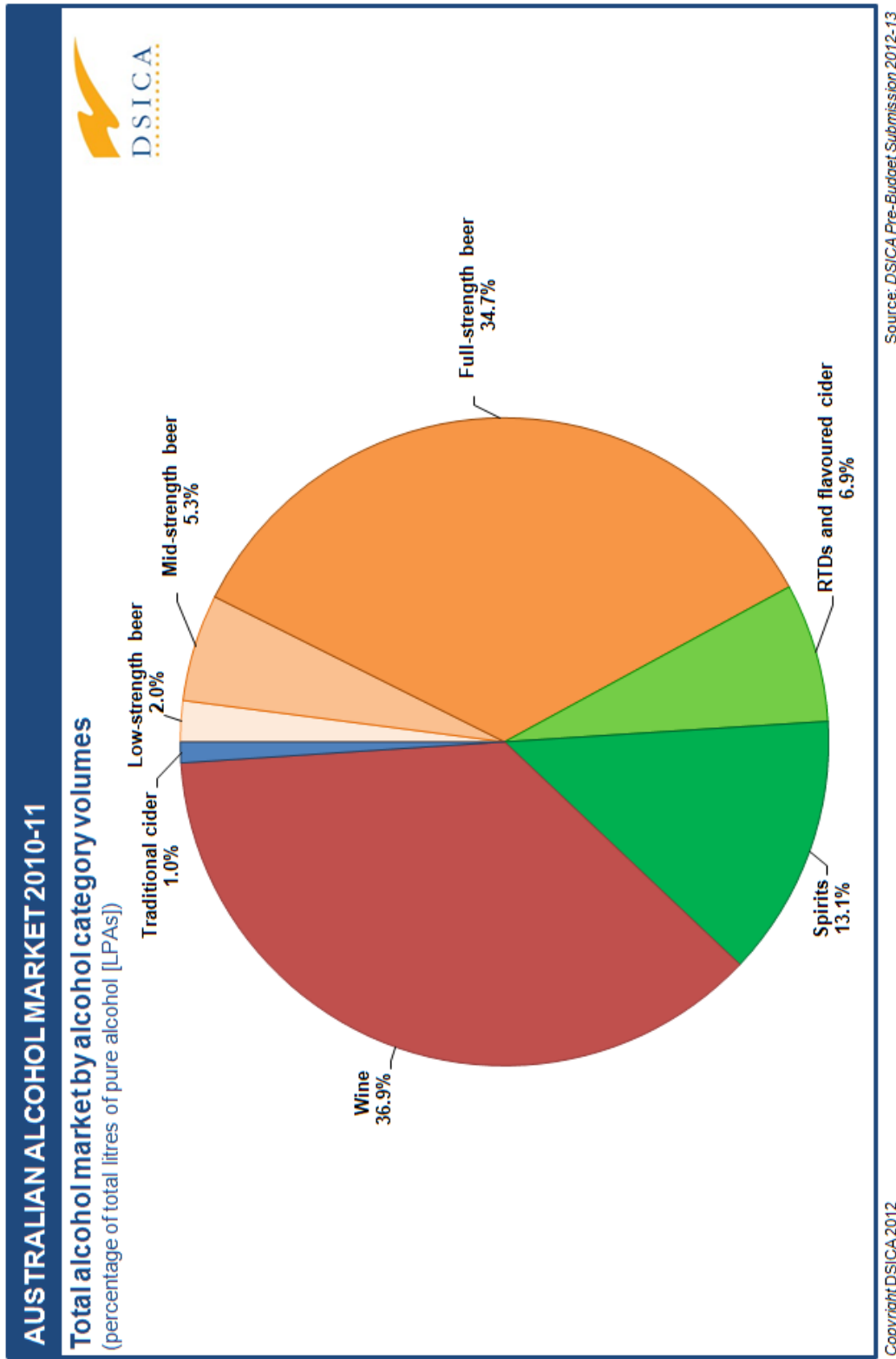


Figure A.4: DSICA estimates of Commonwealth revenue from alcohol taxation (2012-13)

DSICA REVENUE ESTIMATES 2012-13 (\$ MILLIONS)

Product Category	Customs Duty*	Excise Duty	WET	Total Non-GST Revenue	GST Revenue	Total	%
Beer low-strength	-	68	-	68	38	106	1.38%
Beer mid-strength	-	275	-	275	90	365	4.73%
Beer full-strength	264	1,781	-	2,045	472	2,517	32.61%
Total Beer	264	2,124	-	2,388	600	2,988	38.72%
RTDs and Flavoured Cider	+	920	-	920	330	1,250	16.20%
Brandy	26	25	-	51	7	58	0.76%
Spirits	1,597	214	-	1,811	306	2,117	27.43%
Total Spirits, Brandy, RTDs and Flavoured Cider	1,623	1,159	-	2,782	644	3,426	44.39%
Wine	12	-	731	743	481	1,224	15.86%
Traditional Cider	-	-	44	44	36	80	1.04%
Total Wine and Traditional Cider	12	-	775	786	518	1,304	16.90%
TOTAL	1,898	3,283	775	5,956	1,762	7,718	100.00%

* Customs duty includes both the five per cent ad valorem customs tariff applied to imported spirits, brandy, RTDs, wine and flavoured cider, and excise-equivalent customs duty applied to imported spirits, beer, brandy and flavoured cider.

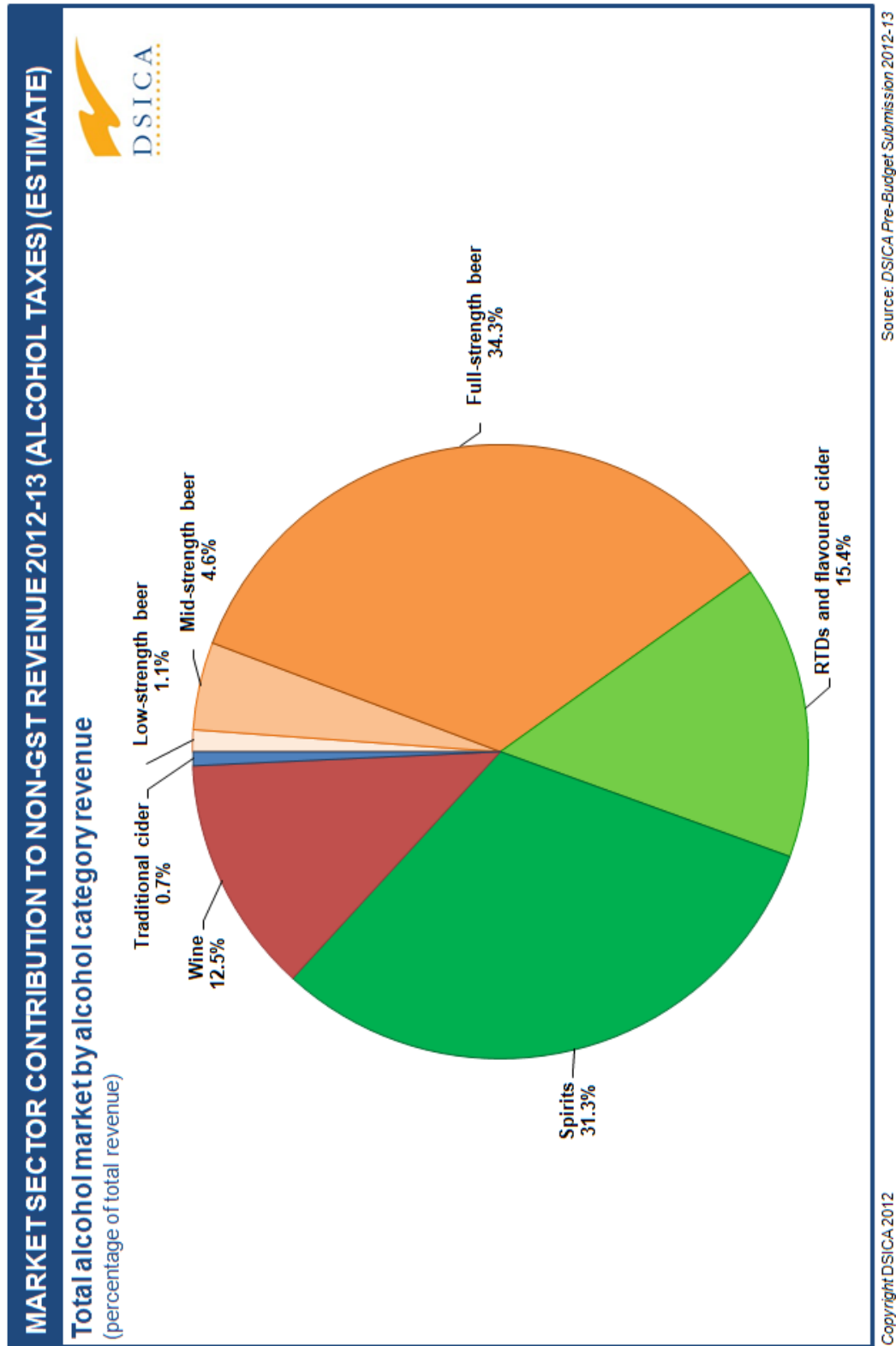
+ It has been assumed that 'imported' RTDs are imported in the form of bulk spirits then bottled as RTDs in Australia, therefore customs duty on imported RTDs has been included in the 'spirits' category. No estimate has been made of the very small customs duty amount paid by the imported flavoured cider market.



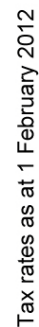
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Source: DSICA Pre-Budget Submission 2012-13

Figure A.5: Market sector contribution to non-GST revenue (alcohol taxes) (2012-13)



THE CURRENT ALCOHOL TAX SYSTEM



Source: DSICA Pre-Budget Submission 2012-13

Table of figures

Figure 1.1	Non-GST alcohol tax per standard drink as at 1 February 2012	7
Figure 2.1	Adult per capita alcohol consumption in Australia (1973-74 to 2009-10)	11
Figure 2.2	Australia's comparative alcohol consumption (2009)	12
Figure 2.3	Risk of long-term harm from alcohol consumption (risky and high-risk drinking behaviours, males and females 14-19 years, 2001-2010)	14
Figure 2.4	Long-term levels of risky and high-risk drinking by 14-19 year olds (males and females, 2001-2010)	14
Figure 2.5	Risk of short-term harm from alcohol consumption (weekly and monthly, males and females 14-19 years, 2001-2010)	15
Figure 2.6	Short-term risky drinking behaviours by 14-19 year olds (monthly and weekly, males and females, 2001-2010)	15
Figure 2.7	Consumption of beer, wine spirits, Ready-to-Drink and cider products (2007-08 and 2008-09)	17
Figure 2.8	Substitution of Ready-to-Drink product consumption into other alcohol beverage categories (2007-08 and 2008-09)	18
Figure 3.1	Sample advertising of traditional cider products	27
Figure 3.2	Forecast additional revenue from taxation of traditional cider at the Ready-to-Drink product excise duty rate (2012-13 to 2015-16)	29
Figure 4.1	Forecast anticipated revenue from tightening of the Wine Producer Rebate scheme (2012-13 to 2015-16)	31
Figure 5.1	Summary of imports of whisk(e)y and bourbon products into Australia by country of origin (2010-11)	35
Figure 5.2	Forecast costs from the removal of the five per cent ad valorem customs duty (2012-13 to 2015-16)	37
Figure 6.1	Unequal taxation of packaged beer compared with Ready-to-Drink products as at 1 February 2012	39
Figure 6.2	Proposed excise duty rates to facilitate tax equivalence between low- and mid-strength Ready-to-Drink products and packaged beer (as at 1 February 2012)	40
Figure 6.3	Forecast costs from facilitating tax equivalence for low- and mid-strength Ready-to-Drink products (2012-13 to 2015-16)	41
Figure 7.1	Increase in excise duty rates applying to full-strength packaged beer, Ready-to-Drink products and spirits (1 August 2000 to 1 February 2012)	43
Figure 7.2	Timeline – carbon price mechanism and indexation of excisable products (1 July 2012 to 1 February 2013)	45
Figure 8.1	Long-term trends in alcohol consumption by category (1970-71 to 2009-10)	52
Figure 8.2	Comparison of actual bearing area with 'in-balance' bearing area (1995-96 to 2009-10)	54
Figure 8.3	Australian wine production, stock and sales history (1995-96 to 2009-10)	55
Figure 8.4	Stock to sales ratio history (1995-96 to 2009-10)	56
Figure 8.5	Forecast revenue from abolition of the Wine Producer Rebate scheme (2012-13 to 2015-16)	61
Figure 8.6	Illustrative wholesale sales price bands and equivalent volumetric taxation rates	63
Figure 8.7	DSICA's proposal for transitioning to a volumetric wine taxation regime	65
Figure 8.8	Henry Review transition to a single volumetric duty rate for all alcohol products (Option One – low and long)	67
Figure A.1	Excise duty rates applying to beer products as at 1 February 2012	71
Figure A.2	Taxation of alcohol in Australia	72
Figure A.3	DSICA estimate of Australia's alcohol market (2010-11)	77
Figure A.4	DSICA estimates of Commonwealth revenue from alcohol taxation (2012-13)	78
Figure A.5	Market sector contribution to non-GST revenue (alcohol taxes) (2012-13)	79
Figure A.6	Australia's alcohol tax system as at 1 February 2012	80

List of abbreviations

ABS	Australian Bureau of Statistics
abv	Alcohol by volume
AERF	Alcohol Education and Rehabilitation Foundation
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
CPI	Consumer Price Index
FARE	Foundation for Alcohol Rehabilitation and Education
GST	Goods and Services Tax
Lal	Litre of pure alcohol
LPA	Litre of pure alcohol
OECD	Organisation for Economic Co-operation and Development
RTDs	Ready-to-Drink products
WET	Wine Equalisation Tax
WFA	Winemakers' Federation of Australia

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