

eJournal of Tax Research

Volume 15, Number 1

September 2017

CONTENTS

- 4 Comparison of a lower corporate income tax rate for small and large businesses
John Freebairn
- 22 Wine options of Australian tax reform|
Paul Kenny, Michael Blissenden and Sylvia Villios
- 51 Tax compliance of ethnic minority immigrant entrepreneurs: A social capital
Sue Yong and Fiona Martin
- 77 Tax compliance costs in developing countries: Evidence in Ethiopia
Wollela Abehodie Yesegat, Jacqueline Coolidge and Laurent Olivier Corthay
- 105 Retrospective tax law: Has Pandora's Box opened never to be shut again?
Rocco Loiacono and Colleen Mortimer
- 119 Risks of IFRS-based taxation: The application of section 24JB by authorized users to hedged relationships
Pieter van der Zwan

Wine options of Australian tax reform

Paul Kenny,¹ Michael Blissenden² and Sylvia Villios³

Abstract

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 Without a WET, it follows that the WET rebate also needs to be repealed, as it is costly, inefficient and inequitable.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

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

¹ Associate Professor in Taxation Law, Flinders Business School, Flinders University., paul.kenny@flinders.edu.au

² Professor of Law, Law School, Western Sydney University, m.blissenden@westernsydney.edu.au

³ Lecturer in Law, Law School, University of Adelaide, Sylvia.villios@adelaide.edu.au.

1. INTRODUCTION

From the 1980s to 2007 the Australian wine⁴ industry experienced explosive growth built on exports, innovation and differentiation.⁵ This came at the expense of ‘old world’ wine countries (such as France and Italy). Since 2007 the growth changed to a contraction with the value of domestic wine sales remaining flat and exports declining by 38 per cent between 2007–12.⁶ The decline coincided with emerging new competitors from Chile, Argentina and South Africa and a more competitive old world wine industry.⁷ Additionally, consumption habits in traditional and new wine consuming countries are converging, with premium wines gaining a considerable market share.⁸

Australia’s indirect tax policies for wine, the Wine Equalisation Tax (WET) and the WET rebate are very different to the policies of old world wine countries and emerging competitors. In the wake of a persistent grape surplus industry and low profitability, industry leaders have identified these tax policies as stymieing the industry’s ability to adapt to the increased competition.⁹ However, the Australian wine market is fragmented¹⁰ and thus other industry leaders and bodies argue for the status quo.¹¹ In light of these concerns the Commonwealth is currently proposing changes to wine taxation. In the 2016–17 Budget, the government announced that it will reduce the WET rebate cap from \$500 000 to \$350 000 on 1 July 2018 and tighten eligibility criteria. Additionally, producers who exceed the rebate cap can access a \$100 000 per annum grant to encourage wine tourism.¹²

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

⁴ This paper focuses on unfortified alcoholic grape wine.

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

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

⁷ Ibid 5.

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

⁹ Pernod Ricard Winemakers, Submission to the Tax White Paper Task Force, June 2015, 1–2 <http://bettertax.gov.au/publications/discussion-paper/submissions/>; Treasury Wine Estates, Submission to the Tax White Paper Task Force, June 2015, 5 <http://bettertax.gov.au/publications/discussion-paper/submissions/>.

¹⁰ Marketline, *Wine in Australia* (May 2015), 19, 21 <www.marketline.com>. Four producers accounted for around 56 per cent of the market.

¹¹ Accolade Wines, Submission to the Tax White Paper Task Force, 1 June 2015 <http://bettertax.gov.au/publications/discussion-paper/submissions/>.

¹² Kelly O’Dwyer and Anne Ruston, ‘Backing Australia’s Wine Industry’ (Joint Media Release, 2 December 2016) <http://kmo.ministers.treasury.gov.au/media-release/108-2016/>

optimal wine tax for Australia by evaluating reform options. This is highly relevant given the Commonwealth government's current wine tax review process.¹³

First, this paper sets out the supplementary wine taxes employed by Australia, and compares these to Italy, France, New Zealand and South Africa. The paper then examines the operation of the WET and the rebate before considering the recent wine tax review processes. An analysis of Australia's policy settings for wine taxation and reform options is then made having regard to four well accepted tax policy criteria: fiscal adequacy; economic efficiency; equity; and simplicity.

Five options for wine tax reform emerge: do nothing; repeal the WET; replace the WET with an excise; replace the WET with a higher goods and services tax (GST) rate on wine; and/or repeal the WET rebate. Whilst doing nothing appears to be the politically easiest option, an analysis of the tax policy criteria and industry concerns point to a need for reform. This paper supports the repeal of the WET. The WET (as well as a wine excise alternative) only raise small amounts of tax revenue but damage economic efficiency, fail to target externalities, appear inequitable and are too complex, particularly for the thousands of small wine producers. Without a WET, it follows that the WET rebate also needs to be repealed, as it is costly, inefficient and inequitable. Assistance would be needed to help those affected by the transition away from a WET.

2. SUPPLEMENTARY WINE TAXES COMPARED

A number of different indirect taxes are levied on domestically produced or consumed unfortified wine: the value added tax (VAT) (known as the GST in Australia and New Zealand); excise duties; and sales tax (such as the WET). Since the VAT on wine is applied at standard rates applicable to most other goods and services in all of the countries examined in this paper, this tax is not considered to be a wine tax and is not compared. The following wine taxes apply.

In Europe, the European Union in the EC Treaty Article 93 (ex 99) provides for the harmonisation of legislation concerning excise duties to the extent that such harmonisation is necessary to ensure the establishment and functioning of the internal market.¹⁴ Under the harmonisation of excise rates in *Council Directive 92/83* member states must apply an excise to wine which must be fixed by reference to the number of hectolitres of finished product.¹⁵ For still and sparkling wine, member states must levy the same rate of excise on all products chargeable with the duty.¹⁶ However, since 1 January 1993 the minimum rate of excise on still and sparkling wine has been zero euros per hectolitre of finished product.¹⁷ Italy applies a zero excise on still wine (where under 15 per cent alcohol by volume) and France has a minimal excise on wine in addition to the standard rate of VAT.

¹³ Ibid.

¹⁴ Laurence Gormley, *EU Taxation Law* (Richmond Law & Tax, 2005) 11.

¹⁵ *Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages* [1992] OJ L 316/21, arts 7(1), 7(2).

¹⁶ Ibid art 9(2).

¹⁷ *Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages* [1992] OJ L 316/29, art 5.

In New Zealand a substantial excise applies in addition to the standard rate of GST. Australia imposes the WET, a wholesale sales tax of 29 per cent in addition to the standard rate of GST on wine. However, a rebate of WET applies for wine producers.¹⁸

The following table provides a recent comparison of these taxes on bottles of non-premium, premium and super premium priced wine in Australia and selected competitor countries: Italy; France; South Africa; and New Zealand (in Australian equivalent dollars).

Table 1: Comparison of Wine Tax in Australia, Italy, France, South Africa and New Zealand in Australian Dollar Tax Equivalents on a 750 ml Bottle of Unfortified Wine¹⁹

	\$A tax equivalent on a \$5 750 ml bottle of non-premium wine	\$A tax equivalent on a \$12 750 ml bottle of premium wine	\$A tax equivalent on a \$32 750 ml bottle of super premium wine
Australia WET ²⁰	0.52	1.80	4.80
Italy Excise	0	0	0
France Excise	0.04	0.04	0.04
South Africa Excise	0.26	0.26	0.26
New Zealand Excise	2.07	2.07	2.07

The above table illustrates the minimal excises of old world wine producers Italy and France that apply to all price points of wine. South Africa, another ‘new world’ country has a relatively minor excise, whilst New Zealand has a significant excise, especially on non-premium wine. In contrast Australia moderately taxes non-premium wine but provides a significant tax on premium and super premium wine. Similarly, in 2010 Anderson found that relative to other wine exporting new world countries and certainly European wine exporting and other new world countries, Australia does indeed have higher ad valorem equivalent excise taxes for non-premium, premium and super premium priced wine.²¹ Yet as discussed above, premium wine is the growing world wine market that Australia needs to target.

¹⁸ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 19-5(1).

¹⁹ Exchange rates on 8 February 2016: A\$1 = EU\$0.6115; A\$1 = NZ\$1.0264; A\$1 = RD10.84 (Exchange Rates UK (8 February 2016) < <http://www.exchangerates.org.uk/currency-calculator.html>>).

²⁰ Winemakers’ Federation of Australia, ‘Australian wine: regional, sustainable essential’ (2008). The Winemakers’ Federation of Australia estimates that the WET (29 per cent of the wholesale sale value) would account for 15 per cent of the retail price. On this basis this analysis assumes that the WET accounts for 15 per cent of the \$50 retail price.

²¹ Kym Anderson, ‘Excise and Import Taxes on Wine Versus Beer and Spirits: An International Comparison’ (2010) 29(2) *Economic Papers* 215, 218.

3. AUSTRALIA'S WINE EQUALISATION TAX

The WET commenced on 1 July 2000 and was designed to replace the former wholesale sales tax²² on wine.²³ The former wholesale sales tax was abolished on 30 June 2000 with the introduction of the GST and the WET. The WET imposes a wine tax on the taxable value of assessable dealings²⁴ with wine²⁵ in Australia.²⁶ The tax is applied to both Australian produced wine and imported wine. The primary types of assessable dealings are: wholesale sales;²⁷ retail sales;²⁸ application of wine for own use;²⁹ and certain importations.³⁰ Some assessable dealings such as exports are exempt.³¹

The following diagram provides an overview of the WET:³²

²² Formerly the *Sales Tax Assessment Act 1992* (Cth), *Sales Tax (Exemptions and Classifications) Act 1992* (Cth), *Sales Tax Imposition (Excise) Act 1992* (Cth), *Sales Tax Imposition (Customs) Act 1992* (Cth), *Sales Tax Imposition (General) Act 1992* (Cth) and *Sales Tax Imposition (In Situ Pools) Act 1992* (Cth).

²³ Prior to the WET the last wholesale sale of wine was subject to a sales tax at the rate of 41 per cent. Given the GST rate of only 10 per cent wine prices would have dropped severely.

²⁴ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 5-5. Assessable dealings include selling wine, using wine, or making a local entry of imported wine at the customs barrier.

²⁵ *Ibid* ss 31-1, 31-2, 31-3, 31-4, 31-5, 31-6, 31-7. Wine is defined to include: alcoholic products that contain more than 1.15 per cent by volume of ethyl alcohol that are grape wine; grape wine products (such as marsala, vermouth, wine cocktails and creams); fruit wines or vegetable wines; and cider, perry, mead and sake.

²⁶ *Ibid* s 5-5.

²⁷ *Ibid* s 33-1: A wholesale sale 'means a sale to an entity that purchases for the purpose of resale, but does not include a sale of wine from stock in a retail store (or retail section of a store) to make up for a temporary shortage of stock of the purchaser, if the wine is of a kind that: (a) is usually *manufactured by the purchaser; or (b) is usually purchased by the purchaser for resale'. The most common assessable dealing involves the sale of wine by a winery to a retailer, or a sale of wine by a distributor to a retailer.

²⁸ *Ibid*: A retail sale is 'any sale that is not a *wholesale sale'. This commonly is a sale made to a person who does not purchase the wine for the purpose of resale. For example, a sale at the cellar door of a winery.

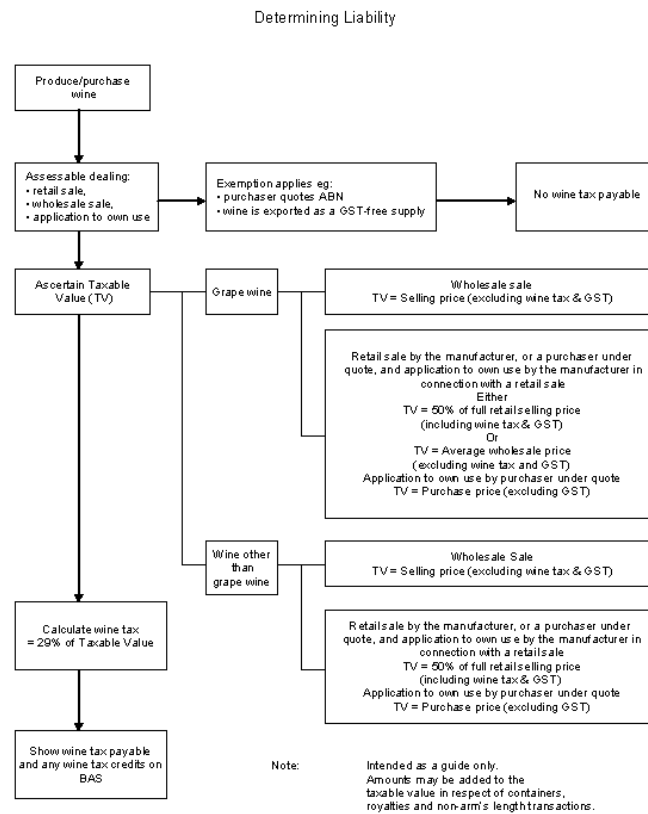
²⁹ Australian Taxation Office, *Wine Equalisation Tax Ruling Wine Equalisation Tax: the Operation of the Wine Equalisation Tax System*, WETR 2004/1, para 33. This usually involves: 'wine used for cellar door tastings; wine used for tastings at exhibitions; wine used for wine shows; wine used for promotions; wine donated to charity; wine given to retailers, restaurants and so on, as samples; wine given to staff; and wine taken for personal consumption'.

³⁰ Such as the entry of imported wine for home consumption.

³¹ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 7-5.

³² Australian Taxation Office, *Wine Equalisation Tax Ruling Wine Equalisation Tax: the Operation of the Wine Equalisation Tax System*, WETR 2004/1, Appendix C.

Figure 1: How the WET Works



As evident from the above diagram calculating the WET is complex, requiring taxpayers to consider factors such as the type of wine product, point of sale, exemption status and taxable value. The WET is payable by wine manufacturers, wine wholesalers and wine importers. Wine can be bought and sold numerous times and the WET is deferred and generally applied at the last wholesale sale of wine. Up until the last wholesale sale of wine, businesses quote their Australian Business Number (ABN) to gain exemption from WET (called ‘quoting’). Quoting is also used for exports. In this way WET is passed on in the price of the wine to the end domestic consumer. Retailers of wine pay WET in the sense that their payments to suppliers for wine include a mark up for WET paid. WET is calculated at the rate of 29 per cent³³ of the taxable value of assessable dealings with wine in Australia.³⁴ The WET is calculated on the selling price of the wine excluding wine tax and GST. Where wine is not the subject of a wholesale sale, for example where it is sold at the cellar door or used for tastings or promotional activities the WET provides for the calculation of alternative values for the tax payable.³⁵

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

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

³⁵ *Ibid* div 9.

The WET forms part of the GST tax base and GST is payable on the value of the wine including any WET component. For imports, an assessable dealing with wine is taxable when it enters Australia. The taxable value is equal to the GST importation value of the wine.³⁶ The GST importation value is the customs value plus the costs of transport, insurance and duty.³⁷

The WET³⁸ and the GST³⁹ provide a concessional cash accounting rule for businesses with annual turnovers of less than \$2 million. This means that eligible small wineries do not pay WET or GST until they actually sell the wine. Just 20 entities paid 89 per cent of the WET that totalled \$826 million in 2013–14, out of 3880 entities paying WET.⁴⁰

3.1 Imported wine

Imported wine into Australia has increased in recent years with New Zealand accounting for much of this growth (providing 64 per cent of wine imports in 2014).⁴¹ WET is paid by the importer unless an ABN is quoted for wine undergoing further processing and distribution. A wine tariff of 5 per cent also applies to imports unless a free trade agreement provides an exemption, as it does with New Zealand.⁴²

4. WET REBATE

A rebate of WET applies for producers of rebatable wine that are registered or required to be registered for GST in Australia.⁴³ The Explanatory Memorandum's rationale for the WET rebate asserted that it would effectively allow a majority of wine producers to be able to fully offset their WET liability by accessing the WET rebate and help small wine producers in rural and regional Australia to reduce or offset entirely their WET liability.⁴⁴ The WET rebate is significant amounting to \$311

³⁶ Assessable dealing AD10 in the assessable dealings table in *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 5-5.

³⁷ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ss 13-20, 33-1, 195-1.

³⁸ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 21-10.

³⁹ *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 29-40.

⁴⁰ Commonwealth of Australia, 'Final Budget Outcome 2013–14' (2014) Table 4: Australian Government General Government Sector (Accrual) Revenue.

⁴¹ Australian Bureau of Statistics, 'Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers' (Cat No 8504.0, June 2014); *Australian and New Zealand Wine Industry Directory 2015* (Winetitles, 2015).

⁴² No tariff applies to wine produced in the United States, New Zealand, Singapore, Chile, Thailand, Papua New Guinea, Malaysia, Japan, the Association of Southeast Asian Nations (ASEAN) countries, Pacific Island Forum countries, developing countries and least developed countries.

⁴³ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 19-5(1).

⁴⁴ Explanatory Memorandum, Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004 (Cth) [1.7]. See also the press release of the then Treasurer the Hon Peter Costello MP: Peter Costello, 'Wine Industry Assistance' (Press Release No 30) <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2004/030.htm&pageID=003&min=phc&Year=2004&DocType=0>>.

million in 2013–14 (25 per cent of WET).⁴⁵ Given this highly favourable rebate the vast majority of small wine producers do not have to pay WET.⁴⁶

From 1 July 2006, the maximum amount of rebate an Australian producer, or group of associated producers,⁴⁷ can claim in a full financial year is \$500 000.⁴⁸ This is equivalent to about \$1.7 million in the wholesale value of eligible sales and applications to own use per annum. To claim a rebate an entity must also be liable to pay WET on the wine or would have been liable to pay WET on the wine had the purchaser of the wine not quoted for the sale of the wine.⁴⁹ Producer is defined widely to include entities registered for GST that have manufactured wine, or provided their produce to a contract winemaker to make wine on their behalf, or have subjected purchased wine to a process of wine manufacture.⁵⁰ Many entities can access the rebate as follows:⁵¹

1. grape growers who undertake manufacture themselves (that is, crush grapes and ferment the juice);
2. grape growers who have the grapes processed into wine on their behalf;
3. winemakers who purchase grapes and manufacture the wine;
4. blenders and entities undertaking other further manufacturing processes;
5. contract winemakers (in some cases);
6. ‘virtual winemakers’ who have no involvement in the winemaking process (they do not own or lease vineyards, have no plant or equipment or a cellar door). These virtual producers acquire grapes and/or wine and contract out the manufacturing or blending process in order to claim the WET rebate;
7. producers of branded wine where the producer owns the brand;
8. producers of branded wine where the wholesaler or retailer owns the brand;
9. producers of bulk and unbranded wine; and
10. non-resident producers — producers that are based overseas but undertake winemaking in Australia.

Whilst New Zealand does not impose a WET, from 1 July 2005 the Australian WET producer rebate was extended to eligible New Zealand wine producers that have their

⁴⁵ Commonwealth of Australia, above n 40, Table 4: Other alcoholic beverages are those not exceeding 10 per cent by volume of alcohol (excluding beer, brandy and wine). This includes so-called ‘alcopops’ or ‘ready-to-drink’ beverages.

⁴⁶ Winemakers’ Federation of Australia, ‘Australian wine: regional sustainable essential’, above n 20, 20.

⁴⁷ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 19-20.

⁴⁸ *Ibid* s 19-15. Previously, from 1 October 2004 to 30 June 2006, the maximum amount of rebate was \$290 000, ie exempting \$1 million (wholesale value) of sales per annum.

⁴⁹ Australian Taxation Office, *Wine Equalisation Tax Ruling Wine Equalisation Tax: Operation of the Producer Rebate for Other than New Zealand Participants*, WETR 2009/2, 6.

⁵⁰ *Ibid*.

⁵¹ Commonwealth Treasury, ‘Re:Think Tax Discussion Paper, Better Tax System Better Australia’ (March 2015) 17 <http://bettertax.gov.au/publications/discussion-paper/>

wine exported to Australia.⁵² The maximum amount of rebate a New Zealand producer, or group of associated producers, can claim in a full financial year is the same as Australian producers.⁵³ Old world countries such as France and Italy (or any other countries), though, cannot access the WET producer rebate.

New Zealand wine producers can claim a rebate of 29 per cent of the approved selling price of the wine in Australia. The approved selling price is the price for which the wine is sold net of any expenses unrelated to the production of the wine in New Zealand. In order to obtain the rebate, a New Zealand winemaker must produce wine in New Zealand that is exported to Australia and substantiate that WET was paid in Australia on the sale of the wine.⁵⁴ Whilst the wine must be ultimately sold in Australia, a New Zealand producer does not have to sell the wine in Australia since a wholesaler or distributor can make the sale in Australia. In line with rising exports to Australia the New Zealand rebate has grown quickly from \$5 million in 2006–07 to \$25 million 2013–14. The Australian National Audit Office (ANAO) also noted that the increase arose from an increased incidence of New Zealand grape growers accessing the New Zealand rebate by using contract winemakers' facilities to enable them to register as wine producers.⁵⁵

A fundamental administrative flaw exists with the WET rebate. The Australian Taxation Office (ATO) data does not distinguish between WET rebates and other refunds, and thus does not allow a proper analysis of who gets the rebate.⁵⁶ This is a major problem for a rebate designed to assist small wine producers in rural and regional Australia.

5. RECENT WINE TAX REVIEWS

Prior to the Tax White Paper reform process there were nine recent government reviews that all recommended that the WET be replaced with a volumetric tax.⁵⁷ This included the 2009 Henry Review which found that 'all alcoholic beverages should be taxed on a volumetric basis, which, over time, should converge to a single rate, with a

⁵² *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth) s 19-5(2). New Zealand wine producers may apply to the Australian Commissioner of Taxation to become approved New Zealand participants.

⁵³ *Ibid* s 19-15.

⁵⁴ Australian Taxation Office, *Wine Equalisation Tax — Producer Rebate for New Zealand Wine Producers* (3 December 2015) <https://www.ato.gov.au/Business/Wine-equalisation-tax/In-detail/WET-and-New-Zealand-wine-producers/Producer-rebate-for-New-Zealand-wine-producers/>

⁵⁵ Auditor-General, 'Administration of the Wine Equalisation Tax' (Audit Report No 20, Australian National Audit Office, 2010–11) 17 [30].

⁵⁶ Centaurus Partners, above n 6, 42.

⁵⁷ Foundation for Alcohol Research and Education, Submission to the Tax White Paper Task Force, June 2015, 14 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>:

Reviews that have recommended a volumetric tax be applied to wine include: the 1995 Committee of Inquiry into the Wine Grape and Wine Industry; 2003 House of Representatives Standing Committee on Family and Community Affairs Inquiry into Substance Abuse; the 2006 Victorian Inquiry Into Strategies to Reduce Harmful Alcohol Consumption; the 2009 Australia's future tax system (Henry Review); the 2009 National Preventative Health Taskforce report on Preventing Alcohol Related Harms; the 2010 Victorian Inquiry into Strategies to Reduce Assaults in Public Places; the 2011 WA Education and Health Standing Committee Inquiry Into Alcohol; the 2012 Australian National Preventive Health Agency Exploring the public interest case for a minimum (floor) price for alcohol, draft report and the 2012 Australian National Preventive Health Agency Exploring the public interest case for a minimum (floor) price for alcohol, final report.

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

In March 2015 as part of a wider Tax White Paper reform process, Treasury released the tax discussion paper 'Better Tax System Better Australia'.⁶⁰ This paper briefly noted issues with wine taxes that offered favourable tax treatment particularly for low-value wine compared with other forms of alcohol such as beer and spirits, and how this influences production and consumption decisions.⁶¹ As part of this process the 'Wine Equalisation Tax Rebate Discussion Paper' was released in August 2015.⁶² This paper sought to better inform discussion and analysis of the WET rebate.

The discussion paper noted the many differences of wine production compared to the alternatives of beer and spirits. Wine production is subject to external factors such as climate and disease, less flexible, more capital intensive and less profitable.⁶³ The paper found that the wine industry faced significant challenges with low wine grape prices and weaker export performance resulting in many Australian winemakers and grape growers being unviable.⁶⁴ The paper observed a consensus of a sustained oversupply of wine.

Citing a 2011 Auditor-General report this review process identified problems with the administration of the WET rebate.⁶⁵ Tax schemes operated to improperly gain the rebate with wholesalers and retailers minimising WET liability and maximising WET rebates.⁶⁶ Arrangements to maximise the rebate included: bulk wine sales by grape growers to enable eligibility to growers; blending and further manufacture and the creation of interposed entities; restructuring contracts to inflate rebates; and virtual wine producers that acquire grapes or wine and contract out manufacture.⁶⁷ Thus the WET rebate may be distorting production patterns of wine by: leading to the oversupply of wine and wine grapes; preventing necessary industry adjustment; preventing market consolidation; and trapping businesses in the industry.⁶⁸

⁵⁸ Commonwealth of Australia, 'Australia's Future Tax System' (Report, 2009) 93
http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm

⁵⁹ Wine Grape Growers Australia, Submission to the Tax White Paper Task Force, May 2015, 5, 6
<<http://bettertax.gov.au/publications/discussion-paper/submissions/>> referred to modelling that a volumetric tax on wine would result in a 34 per cent reduction in wine sales, 20 per cent reduction in grape production and loss of 12 000 jobs mostly in regional Australia.

⁶⁰ Commonwealth Treasury, 'Re:Think Tax Discussion Paper, Better Tax System Better Australia', above n 51.

⁶¹ Ibid 61.

⁶² Ibid.

⁶³ Ibid 4–5.

⁶⁴ Ibid 1.

⁶⁵ Auditor-General, above n 55, 17, para 30.

⁶⁶ Commonwealth Treasury, 'Re:Think Tax Discussion Paper, Better Tax System Better Australia', above n 51, 18.

⁶⁷ Ibid 18–22.

⁶⁸ Ibid 23.

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

1. abolishing the WET rebate;
2. phasing out the rebate with a grant to existing recipients;
3. restricting eligibility for the WET rebate by excluding bulk, unpackaged and unbranded wine;
4. tightening the definition of 'producer of wine';
5. demonstrating that the WET has been paid on wine;
6. reducing the maximum amount of the WET rebate;
7. rebating less than the full amount of WET payable;
8. replacing the WET rebate and the Brewery Refund with a rebate scheme for all independent alcohol producers; and
9. removing the New Zealand rebate.

The paper then concluded with a summary of discussion questions. In response to the WET rebate discussion paper numerous industry and other submissions were received in September 2015 and published online.⁷⁰ A brief overview of the key submissions below illustrates the divisive nature of the reform process.

Reflecting the fragmented nature of the industry there was no consensus in the industry responses. Two major premium wine producers (Pernod Ricard Winemakers and Treasury Wine Estates) provided similar submissions that sought to replace the WET with a volumetric tax that would be revenue neutral for the industry, that is, levied at \$1.40 per litre if the WET rebate was removed or at \$2.20 per litre otherwise.⁷¹ However, Accolade Wines, a significant non-premium wine producer, sought to retain the status quo. Accolade Wines reasoned that a volumetric tax on wine risks devastating a wine industry that is undergoing restructuring.⁷² The differing views reflect the varying focus on premium and non-premium wines between these three wine companies.

Other wine bodies were generally against a volumetric tax. Wine Grape Growers Australia opposed a volumetric tax on wine, finding that such a tax would greatly reduce vineyards and jobs, as well as be too complex.⁷³ Riverland Wine similarly opposed the tax asserting it would have a devastating impact on the Riverland wine

⁶⁹ Ibid 1.

⁷⁰ See Australian Government, *Re: Think Better Tax, Better Australia Discussion Paper* <http://bettertax.gov.au/publications/discussion-paper/submissions/> Unhelpfully the wine submissions were published along with submissions on other tax issues making analysis difficult.

⁷¹ Pernod Ricard Winemakers, above n 9, 1–2, Treasury Wine Estates, above n 9, 5.

⁷² Accolade Wines, above n 11, 1.

⁷³ Wine Grape Growers Australia, above n 59.

industry.⁷⁴ Murray Valley Winegrowers pleaded that a volumetric tax on wine at a time when the industry is at its lowest would be catastrophic.⁷⁵ Wine Tasmania also argued that the WET be retained⁷⁶ as increasing wine tax would severely impact the industry.⁷⁷ The Winemakers' Federation of Australia sought a differentiated tax rate on wine but (not surprisingly) did not have a position on the preferred structure of the wine tax due to the different business models of its members.⁷⁸

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

There was considerable consensus for reforming the WET rebate. Most submissions advocated removing bulk, unbranded wine and foreign producers from eligibility for the rebate.⁸⁴ Some argued that the WET rebate should be abolished.⁸⁵ The New Zealand government stated that equal treatment of New Zealand producers was

⁷⁴ Riverland Wine, Submission to the Tax White Paper Task Force, 1 June 2015, 1, 3, 11–12 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>> referred to modelling that a volumetric tax on wine would increase a 4 litre cask price from \$18.99 to \$42.79; this would result in a 43 per cent drop in demand for Riverland fruit, equating to about one half of the growers leaving the industry.

⁷⁵ Murray Valley Winegrowers, Submission to the Tax White Paper Task Force, June 2015, 7 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>.

⁷⁶ Wine Tasmania, Submission to the Tax White Paper Task Force, May 2015, 2 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>.

⁷⁷ Ibid.

⁷⁸ Winemakers' Federation of Australia, Submission to the Tax White Paper Task Force, 29 May 2015, 4 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>.

⁷⁹ National Alliance for Action on Alcohol, Submission to the Tax White Paper Task Force, June 2015, 2 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>.

⁸⁰ Foundation for Alcohol Research and Education, above n 57.

⁸¹ Cancer Council, Submission to the Tax White Paper Task Force, June 2015, 7 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>.

⁸² Ibid 7.

⁸³ Australian Liquor Stores Association, Submission to the Tax White Paper Task Force, 2 <<http://bettertax.gov.au/publications/discussion-paper/submissions/>>.

⁸⁴ Accolade Wines, above n 11, 2; Riverland Wine, above n 74, 15–16; Wine Tasmania, above n 76, 2; Murray Valley Winegrowers, above n 75, 4; Pernod Ricard Winemakers, above n 9, 2, 13; Wine Grape Growers Australia, above n 59, 8–9.

⁸⁵ Foundation for Alcohol Research and Education, above n 57, 5; Cancer Council, above n 81, 10. Also, Pernod Ricard Winemakers, above n 9, 11; Treasury Wine Estates, above n 9, 5 noted that the removal of the rebate would allow a lower revenue neutral volumetric tax to be levied at \$1.40 per litre, rather than \$2.20 per litre if the rebate remained.

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

The Commonwealth government established the WET Rebate Consultative Group⁸⁷ to examine the submissions and provide advice to the government on options for reform. In the next step in the tax reform process a Green Paper was proposed in the second half of 2015. Following further community consultation on possible reforms a White Paper was expected to be published in 2016.⁸⁸ With the change of the Prime Minister and Treasurer in November 2015 this process appears to have been rescheduled.⁸⁹ Additionally, the Senate referred certain matters on the Australian grape and wine industry to be reviewed by the Senate Rural and Regional Affairs and Transport References Committee, and this included the impact and application of the WET rebate on grape and wine industry supply chains.⁹⁰ The WET was found to work against the profitability of the wine industry and was subject to unlawful claims or rorting. The Committee recommended that the WET rebate be phased out over five years, with the savings to assist the industry and include an annual grant to genuine cellar door operators to support their continued operation.⁹¹ Also, the Committee urged the government to undertake a comprehensive reform of wine taxation.⁹²

6. POLICY PERSPECTIVES FOR WINE TAX

A partial policy analysis is undertaken with a view to gaining an understanding of the wine tax options for Australia. This analysis is undertaken from the perspective of four well accepted tax policy criteria: fiscal adequacy; economic efficiency; equity; and simplicity. These criteria have been used by optimal tax theorists who seek to maximise social welfare⁹³ and have become prominent in certain tax reform processes.

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

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

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

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

⁹⁰ Senate Rural and Regional Affairs and Transport References Committee, Parliament of Australia, *Australian Grape and Wine Industry* (2016)

<http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry>.

⁹¹ Ibid 34.

⁹² Ibid.

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

For example, in Australia these four tax policy criteria were central to policy formulation in recent tax reform processes, the 1999 Ralph Review and the 2010–11 Henry Review.⁹⁴ Limitations of this study are acknowledged, since policy settings are also the result of other factors such as political, social, cultural and historical, which are beyond the scope of this paper. Additionally, this paper refers to a number of international studies on alcohol taxes and it is noted that much caution must be exercised in comparing or applying such research between countries. Further, a number of minor levies and other imposts also apply to wine⁹⁵ but these are also beyond the limits of this paper.

6.1 Fiscal adequacy

Fiscal adequacy⁹⁶ appears to be one of the primary reasons cited for specific alcohol taxes. For example, in respect of wine taxation, the Australian government provided revenue raising as its rationale for significant increases in the wholesale sales tax on wine in 1993 and 1997.⁹⁷ However, comparatively small amounts of revenue are raised by wine taxation. WET only represents 0.2 per cent of total tax revenue of Commonwealth government tax revenue.⁹⁸ A broadly based tax, such as a comprehensive GST set at a uniform rate, provides a more continual revenue source and is hence preferable for indirect taxation.⁹⁹

6.2 Economic efficiency

As evident in the current wine tax review, the arguments for and against wine taxation on economic efficiency¹⁰⁰ grounds are strongly debated. It is argued that higher taxes on wine are justified since they focus on the high external costs associated with

University Press, 2005) 233, noted that optimal taxation theory indicates a preference for broadly based taxes that impose less distortions on the allocation of resources and provide better sources of tax revenue over narrowly based taxes.

⁹⁴ Review of Business Taxation, 'A Tax System Redesigned, More Certain, Equitable and Durable' (Report, Australian Government Publishing Service, Canberra, July 1999) 9, 13; Australian Treasury, 'Australia's Future Tax System, Report to the Treasurer' (2009) Part One Overview, Objective 2, vii.

⁹⁵ For example, Australia levies a wine export charge on exporters to provide funds for the Australian Wine and Brandy Corporation to undertake international promotional work and increase wine demand. Also, a Grape Research Levy and Wine Grapes Levy are imposed to assist the wine industry.

⁹⁶ Fiscal adequacy refers to the ability of taxation law to finance government expenditure. Fiscal adequacy is a fundamental requirement for a tax system given the government's need for revenue to ensure good governance.

⁹⁷ For example, in Australia, on 18 August 1993 the Commonwealth government increased the tax on wine from the general wholesale sales tax rate (WST) of 20 per cent to 31 per cent. The rationale for this increase is clear given the name of the amending legislation: *Sales Tax (General) (Deficit Reduction) Act 1993*; *Sales Tax (General) (Wine - Deficit Reduction) Act 1993*. Also, on 6 August 1997 when the WST rate for wine increased from 26 per cent to 41 per cent the government provided revenue raising as its rationale. The Explanatory Memorandum to the *Sales Tax Assessment Amendment Act 1997* stated:

In order to protect the future revenue of States and Territories, and in response to the unanimous request of the States and Territories, it is proposed that Commonwealth excises on petroleum and tobacco and sales tax on alcoholic beverages be increased to collect the revenue which would be lost by the States and Territories [as a result of constitutional invalidity of the state franchise fee on alcohol].

⁹⁸ In 2013–14 the WET produced \$826 million of revenue and total tax revenue in 2013–14 was \$433 885 million: Australian Bureau of Statistics, *5506.0 — Taxation Revenue, Australia 2013–14* <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/5506.0>>.

⁹⁹ Frey, above n 93, 233.

¹⁰⁰ Alm, above n 93, 117. In respect of taxation, Alm defines economic efficiency as a tax that minimises interference in economic decisions.

alcohol consumption. It is also argued that wine has an inelastic demand and therefore, there are minimal distortions with taxes levied at a higher rate. Additionally, alcohol is seen as a complement to leisure and thus should be taxed at a higher rate. Further, it is argued that such taxes correct information failure. On the other hand, it is contended that wine should be taxed at the same rate as other goods to minimise economic distortions that impede the competitiveness of an important industry. There may also be adverse unintended consequences associated with wine taxation. Externalities should be addressed by corrective taxation that targets alcohol abusers.

6.3 Arguments for wine taxes

6.3.1 Corrects externalities

The externality costs generated from abusive alcohol consumption provide a seemingly sound rationale for supplementary taxes on alcohol. These costs are not included in the market price of the goods. External costs include the direct costs of abusive drinkers' car accidents, property damage and violence¹⁰¹ and the indirect costs of government-funded hospitals and health services for alcohol abuse and other government expenditures such as police.¹⁰² The costs to the individual alcohol consumer, though, from poor health and loss of work are not considered to be external costs.¹⁰³ Estimating health costs is difficult given that the private health insurance of individual victims of alcohol abuse will need to be excised from the external costs calculation. Since health costs can be a significant part of the external costs it appears that external costs will vary significantly between countries with mainly publicly-funded systems versus privately-funded systems. This creates problems in comparing externality costs between countries.

Without a supplementary tax on goods generating external costs, individuals engage in more of the activity than is socially optimal. Studies of alcohol consumption have found that higher prices reduce the consumption of alcohol.¹⁰⁴ A World Health Organisation committee found that taxes that increased the price of alcohol reduced the number of young people who are heavy drinkers and delayed the intention of younger teenagers to commence drinking.¹⁰⁵ A United States study found, though, that generally a 1 per cent rise in the price of alcohol resulted in less than a 1 per cent fall in consumption.¹⁰⁶

6.4 Designing an alcohol tax to address externalities

Under a Pigouvian tax the efficient consumption or production levels could be attained through an excise on the activity equal to the marginal cost of the damage caused to

¹⁰¹Stephen Smith, 'Economic Issues in Alcohol Taxation' in Sijbren Cnossen (ed), *Theory and Practice of Excise Taxation* (Oxford University Press, 2005) 67.

¹⁰² Ibid.

¹⁰³ Ibid.

¹⁰⁴ Philip Cook and Michael Moore, 'Alcohol' (Working Paper No 6905, National Bureau of Economic Research, 1999); L Crawford, Z Smith, and S Tanner, 'Alcohol Taxes, Tax Revenues and the Single European Market' (1999) 20 *Fiscal Studies* 287.

¹⁰⁵ World Health Organisation, 'Expert Committee on Problems Related to Alcohol Consumption' (Technical Report Series No 944, Second Report, Provisional Edition, 2007) 42–3.

¹⁰⁶ James Fogarty, 'The Demand for Beer, Wine and Spirits: Insights from a Meta Analysis Approach' (Working Paper No 31, American Association of Wine Economics) www.wine-economics.org

other people.¹⁰⁷ Hence alcohol content is commonly used as a basis for a wine tax, thus an excise on wine is preferred over a wholesale sales tax or retail tax. Alcohol content is used in Australia and elsewhere¹⁰⁸ to ascertain the excise tax on spirits and beer. Such an excise reflects that large scale spirits and beer industries are able to control the alcohol content, and an excise based on alcohol content is therefore practical in its compliance and administration. In Europe the wine excise is based on the volume of wine since producers (which include many small producers) are unable to change the alcohol content of still wine. With less control over alcohol content, a volume based tax is a practical solution.

The excise should be targeted at abusive drinkers since the external costs for moderate or low wine consumption may be zero or negligible. There may be benefits from low or moderate consumption of wine.¹⁰⁹ Also, the above normal drinkers of alcohol are not all abusive. An excise levied only on abusive drinkers would result in an imposition per-drink basis at a tax rate equal to the external costs. This would be very complex and impractical.

Given that most people drink alcohol in moderation, a uniform excise tax on alcohol content or volume consumed for the taxation of externalities constitutes a very imperfect proxy Pigouvian tax. Additionally, shifting to a wine excise tax has high transitional costs. Anderson et al and Fogarty et al provided economic modelling of national and regional implications of a change to a volumetric tax on domestic wine.¹¹⁰ Anderson et al modelled a change to a volumetric tax on domestic wine sales set at a light strength beer tax rate of \$28/litre of alcohol or a standard strength beer tax rate of \$40.82/litre of alcohol.¹¹¹ These changes would have a great impact on hot areas with a fall in regional GDP of about 19 per cent. The impact would be slightly positive for the warm areas but significantly benefit cool areas with an 8.9 per cent GDP gain. Domestic wine sales would fall significantly by 11.9 per cent and 15.1 per cent respectively for the light strength beer tax rate and the standard strength beer tax rate.¹¹² The burden would fall on non-premium wine where production would fall by about one-third. Commercial premium wines would fall between 8 to 13 per cent. Super premium wines would significantly gain with increases of about 15 per cent. Fogarty et al similarly found an adverse impact on the wine industry.¹¹³ There is also the complexity of a new excise tax which would be very regressive for the thousands of small wine businesses.

¹⁰⁷ Arthur Pigou, *The Economics of Welfare* (McMillan, 1918).

¹⁰⁸ Stephen Smith, above n 101, 74.

¹⁰⁹ Serge Renaud and Michel De Lorgeril, 'Wine, Alcohol, Platelets and the French Paradox for Coronary Heart Disease' (1992) 339 *Lancet* 1523; J E Kinsella et al, 'Possible Mechanisms for the Protective Role of Antioxidants in Wine and Plant Foods: Physiological Mechanisms by which Flavonoids, Phenolics, and other Phytochemicals in Wine and Plant Foods' (1993) 47 *Journal of Agricultural and Food Chemistry* 85.

¹¹⁰ Kym Anderson, Ernesto Valenzuela and Glyn Wittner, 'Wine Export Shocks and Wine Tax Reform in Australia: Regional Consequences Using an Economy Wide Approach' (2011) 30(3) *Economic Papers* 386, 392; James Fogarty and Guy Jakeman, 'Wine Tax Reform: The Impact of Introducing a Volumetric Excise Tax on Wine' (2011) 44(4) *Australian Economic Review* 387, 399–400.

¹¹¹ Anderson, Valenzuela and Wittner, above n 110, 392.

¹¹² *Ibid* 393.

¹¹³ Fogarty and Jakeman, above n 110, 399–400 modelled replacing the WET with a revenue neutral volumetric excise tax and found that this would have a small negative overall impact on the wine industry. The non-premium hot growing areas would be greatly affected whilst the premium wine areas would benefit.

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

6.5 Estimating the external costs of alcohol

Collins and Lapsley estimated that the tangible costs of alcohol in Australia were between 0.9–1.0 per cent of GDP. Crime, health cost and lost production amounted to \$11 billion¹¹⁵ and further intangible costs associated with the loss of life and pain were estimated at \$4.4 billion.¹¹⁶ Marsden Jacobs Associates estimated the cost of alcohol harm in Australia to be over \$15 billion per annum.¹¹⁷ The Foundation for Alcohol Research and Education estimated \$9.3 billion per annum for tangible social costs from an individual's alcohol misuse and \$14 billion for tangible costs in harm to others.¹¹⁸

These estimates appear high. Crampton disputes the Collins and Lapsley study.¹¹⁹ By applying mainstream accounting practices to the costs of alcohol the costs to society were found to be within the tax revenue collected.¹²⁰ Additionally, the intangible costs included in these studies are largely borne by the abusers of alcohol and these are not considered to be external costs. Any private health insurance costs of individual victims also need to be excluded.

Externality cost estimates can have a broad range of error.¹²¹ Different methods are used to calculate estimates and certain amounts such as costs to the individual of poor health should be excised from external costs. Further, a large part of external costs

¹¹⁴ Siu Leung and Charles Phelps, 'My Kingdom for a Drink...? A Review of Estimates of the Price Sensitivity of Alcoholic Beverages' in M E Hilton and G Bloss (eds), *Economics and the Prevention of Alcohol-Related Problems* (National Institutes of Health, NIH Publication 93-3513, 1993); Padmaja Ayyagari et al, 'Sin Taxes: Do Heterogenous Responses Undercut their Value?' (Working Paper No 15124, NBER, July 2009) <<http://ssrn.com/abstract=1434638>>

¹¹⁵ David Collins and Helen Lapsley, 'The Cost of Tobacco, Alcohol and Illicit Drug Abuse to Australian Society in 2004/05' (Monograph Series No 64, Department of Health & Ageing, 2008).

¹¹⁶ *Ibid.*

¹¹⁷ Foundation for Alcohol Research and Education, above n 57, 11.

¹¹⁸ *Ibid.*

¹¹⁹ Eric Crampton, Matt Burgess and Brad Taylor, 'The Costs of Costs Studies' (Working Paper No 29/2011, Department of Economics and Finance College of Business and Economics University of Canterbury, 2011); Eric Crampton and Matt Burgess, 'The Price of Everything, the Value of Nothing: a (Truly) External Review of BERL's Study of Harmful Alcohol and Drug Use' (Working Paper No 10/2009, University of Canterbury, 2009) 16. The authors estimated that in New Zealand the actual net external annual costs of abusive alcohol consumption was \$146.3 million, a 96.9 per cent reduction from Business and Economic Research Limited's (BERL) figure of \$4.794 billion in total costs. BERL published 'Costs of Harmful Alcohol and Other Drug Use', a report jointly commissioned by the Ministry of Health and Accident Compensation Corporation.

¹²⁰ Crampton, Burgess and Taylor, above n 119.

¹²¹ Eric Single and Brian Easton, 'Estimating the Economic Costs of Alcohol Misuse: Why We Should Do It Even Though We Shouldn't Pay Too Much Attention to the Bottom Line Results' (Paper presented at the Annual Meeting of the Kettil Bruun Society for Social and Epidemiological Research on Alcohol, Toronto, May 2001). The paper found that such social costs are difficult to measure and that there is no consensus on how to measure such costs.

comprises the impact on economic output.¹²² Whether this constitutes external costs depends on the extent to which alcohol affects worker productivity as seen in wages.¹²³ The costs of lower wages are costs to the individual and are not considered to be external costs. Research in the United Kingdom has actually linked a moderate level of alcohol consumption with higher wages than light or heavy drinkers.¹²⁴

6.6 Estimating the external costs of wine

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

The consumption of wine is generally not abusive.¹²⁶ An Australian Institute of Health and Wellbeing survey found that wine is consumed in moderation with food and by older consumers at home or in restaurants.¹²⁷ Thus, wine is not generally consumed by the young who constitute most of the abusive alcohol consumers. However, other research points to the high costs associated with cheap cask wine in Australia.¹²⁸

Srivastava and Zhao found heavy binge drinkers mainly drink regular strength beer or RTD spirits.¹²⁹ These drinkers were more likely to be under the influence of alcohol and drive a car or operate hazardous machinery or miss work.¹³⁰ Also, Gruenewald et

¹²² Alan Maynard, Christine Godfrey and Geoff Hardman, 'Conceptual Issues in Estimating the Social Costs of Alcohol' (Paper prepared for an International Symposium on the Economic Costs of Substances Abuse, Baniff, Canada, 11–13 May 1994).

¹²³ Ziggy MacDonald and Michael Shields, 'The Impact of Alcohol Consumption on Occupational Attainment in England' (2001) 68 *Economica* 427. This study examined the relationship between alcohol drinking and hourly wages. They found an inverse U shaped drinking wage profile. Moderate alcohol drinkers had higher wages than light or heavy drinkers. For men, 210 ml of alcohol per week (or two bottles of 750 ml wine at 14 per cent alcohol content per week) and women, 140 ml per week were associated with the maximum wage.

¹²⁴ *Ibid.* For men, 210 ml of alcohol per week (or two bottles of 750 ml wine at 14 per cent alcohol content per week) and women 140 ml per week were associated with the maximum wage.

¹²⁵ New Zealand Treasury, 'Tax Review 2001' <<http://www.treasury.govt.nz/publications/reviews-consultation/taxreview2001/taxreview2001-report.pdf>>.

¹²⁶ Wine Grape Growers Australia, above n 59, 7.

¹²⁷ Australian Institute of Health and Wellbeing, '2007 National Drug Strategy Household Survey, Detailed Findings' 29–37 <https://www.aihw.gov.au/>

¹²⁸ Tim Stockwell et al, 'Consumption of Different Alcoholic Beverages as Predictors of Local Rates of Night-Time Assault and Acute Alcohol-Related Morbidity' (1998) 22(2) *Australian and New Zealand Journal of Public Health* 237, showed that in Western Australia local rates of per capita consumption of cask wine (as well as high strength beer) are most highly associated with local rates of violent incidents and alcohol-related hospital admissions. By comparison, rates of consumption of bottled wine and low strength beer were weakly or not at all related to local rates of these problems. Maggie Brady and David Martin, 'Dealing with Alcohol in Alice Springs: an Assessment of Policy Options and Recommendations for Action' (Working Paper No 3, Centre for Aboriginal Economic Policy Research, Canberra, 1999) found that the Alice Springs region with a population of less than 35 000 people drank over 1.2 million litres of cask wine in 1998. This was equivalent to over 5500 four-litre casks per week. Because most of the population did not drink cask wine, this suggests the harmful levels of consumption by those that did.

¹²⁹ Preety Srivastava and Xueyan Zhao, 'What do the Bingers Drink? Micro-Unit Evidence on Negative Externalities and Drinker Characteristics of Alcohol Consumption by Beverage Types' (2010) 29 *Economic Papers* 229, 250.

¹³⁰ *Ibid.*

al found no impact from wine sales at licensed premises on drink-driving incidents.¹³¹ Rather, spirits and beer sales were associated with drink-driving and drink-driving incidents.¹³² Thus, it is reasonable to argue that wine consumption is associated with lower externality costs than other beverages.¹³³

Italy, one of the largest wine consumers¹³⁴ has the lowest estimated external costs in a survey of ten developed countries.¹³⁵ This suggests that external costs may only be moderately associated with wine consumption. Further, there are zero/minimal wine taxes in Italy and France yet these countries face a downward trend in domestic wine consumption.¹³⁶ This indicates that the nexus between higher taxes on wine and lower levels of consumption and external costs may not be strong. Further research is needed to assess this impact. A non-uniform excise for different types of alcohol would appear to be appropriate to address the different levels of associated external costs.

Additionally, health benefits are associated with low to moderate consumption of wine. Kinsella proposed that the natural antioxidant phenolic compounds of wine may protect against heart disease.¹³⁷ Renaud and De Lorgeril found that France's high consumption of fats but low incidence of heart disease may be explained by their high wine consumption.¹³⁸

6.7 Should wine, spirits and beer be taxed on a similar basis?

A number of submissions to the Tax White Paper Task Force discussed whether wine, spirits and beer should be taxed on a similar basis according to the amount of alcohol.¹³⁹ It may be efficient to subsidise or tax other goods that are substitutes for or complements the externality causing activity.¹⁴⁰ However, research in the United Kingdom¹⁴¹ and Europe¹⁴² has found that wine, spirits and beer are not close substitutes. Wine and spirits might be moderate complements.¹⁴³ Consequently a

¹³¹ Paul Gruenewald et al, 'Beverage Sale and Drinking and Driving' (1999) 20(5) *Australia and New Zealand Wine Industry Journal* 21, 46.

¹³² Ibid.

¹³³ Srivastava and Zhao, above n 129, 250.

¹³⁴ Wine Institute, *World Wine Production By Country, Per Capita Wine Consumption by Country, World Wine Consumption by Volume, World Vineyard Acreage by Country* (13 Apr 2010) <https://www.wineinstitute.org/resources/statistics>

¹³⁵ Sijbren Cnossen, 'Excise Taxation in Australia' (Draft presented at the Australia's Future Tax System Conference, 2009) 10 <<http://taxreview.treasury.gov.au>>. The other countries were Australia, France, Ireland, England, Wales, the United States, New Zealand, Germany and Canada.

¹³⁶ International Organisation of Vine and Wine, *World Vitivinicultural Statistics 2007* <http://www.oiv.int/>

¹³⁷ Kinsella et al, above n 109.

¹³⁸ Renaud and De Lorgeril, above n 109.

¹³⁹ See Pernod Ricard Winemakers, above n 9; Treasury Wine Estates, above n 9.

¹⁴⁰ Jerry Green and Eytan Sheshinski, 'Direct Versus Indirect Remedies for Externalities' (1976) 83 *Journal of Political Economy* 797.

¹⁴¹ Zoe Smith, 'The Revenue Effect of Changing Alcohol Duties' (1999) (Briefing Note 4, Institute for Fiscal Studies) .

¹⁴² Customs Associates Ltd, 'Study on the Competition between Alcoholic Drinks, Summary of Final Report for the European Commission' (February 2001) https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/study_comp_between_alcoholdrinks_en.pdf

¹⁴³ Zoe Smith, above n 141.

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

6.8 Limitations of alcohol tax

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

6.8.1 Inelastic demand

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

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

Leung and Phelps reviewed studies of price elasticity of alcohol in the United States and found elasticities of -0.3 for beer, -1.0 for wine and -1.5 for spirits.¹⁴⁹ Price elasticities vary with consumption levels; heavy drinkers are not very responsive to price, but light and moderate drinkers are.¹⁵⁰ The New Zealand Tax Review 2001 found that the demand for wine is often more elastic than the demand for petrol, tobacco and beer.¹⁵¹ Smith's literature review concluded that alcohol demand is insufficiently price-inelastic to warrant higher than average taxation on the basis of the

¹⁴⁴ Anderson, Valenzuela and Wittner, above n 110, 392; Fogarty and Jakeman, above n 110. Both papers reached this conclusion from analysing the replacement of the WET with a packaged beer volumetric excise tax.

¹⁴⁵ Frey, above n 93, 231.

¹⁴⁶ Frank Ramsey, 'A Contribution to the Theory of Taxation' (1927) 37 *Economic Journal* 47–61.

¹⁴⁷ Christopher Doran et al, 'Estimated Impacts of Alternative Australian Alcohol Taxation Structures on Consumption, Public Health and Government Revenues' (2013) 199 *Medical Journal of Australia* 619.

¹⁴⁸ International Organisation of Vine and Wine, above n 136.

¹⁴⁹ Leung and Phelps, above n 114.

¹⁵⁰ *Ibid.*

¹⁵¹ Robert McLeod et al, 'Tax Review 2001 — Issues Paper' (2001) 28.

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

6.8.2 *Alcohol as a leisure complement*

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

It is inconclusive, though, whether alcohol is complementary with leisure.¹⁵⁵ On the one hand the more leisure, the more time to drink alcohol. On the other hand alcohol may be complementary with work through social drinking with colleagues and unwinding from stress. At low consumption alcohol may be complementary with work but not at high levels. If alcohol is complementary with work, there is a basis for a lower average tax.¹⁵⁶ Overall, there is no clear reason to tax alcohol highly as a leisure complement.

6.8.3 *Corrects information failure*

Young people may not be fully aware of the adverse health impacts of drinking alcohol, thus, it is argued that a supplementary tax or excise would raise the price of alcohol and thus reduce consumption.¹⁵⁷ United Kingdom studies have found that the price elasticity of demand for alcohol among the young is on average twice the price elasticity of adults.¹⁵⁸ Thus, an excise or supplementary wine tax would appear to achieve this aim. The young, though, appear to drink relatively low amounts of wine in Australia.¹⁵⁹ Also, such an excise may only result in the young substituting alcohol for illegal alcohol or drugs, or homemade alcohol. Further, this results in a higher burden on older drinkers.

Advertising, education and restrictions on consumption targeted at young people are alternative strategies to supplementary wine taxes. However, more research is needed to assess cost effectiveness.

¹⁵² Stephen Smith, above n 101, 62.

¹⁵³ Ian Crawford, Michael Keen and Stephen Smith, 'Value-Added Tax and Excises' (Background Paper for the Mirrless Review, Reforming the Tax System for the 21st Century, 2008).

¹⁵⁴ Ibid.

¹⁵⁵ Ibid.

¹⁵⁶ Ibid.

¹⁵⁷ World Health Organisation, above n 105.

¹⁵⁸ Thomas F Babor et al, *Alcohol: No Ordinary Commodity Research and Public Policy* (Oxford University Press, 2003).

¹⁵⁹ Australian Institute of Health and Wellbeing, above n 127.

6.9 Arguments against wine taxes

6.9.1 Minimises distortions

The significant size of the Australian wine industry and its export orientation in a globalised wine world necessitates a competitive industry. As discussed above, concerns have been raised with the WET in harming the industry. For the economy to efficiently allocate resources and permit industry to compete effectively the indirect tax system should be competitive. To minimise efficiency costs the indirect tax base should be broad, including all goods and services taxed at one low rate.¹⁶⁰ This will cause fewer changes in the consumption and production decisions by the impact of tax on the prices of goods and services. A narrowly based wine tax is inefficient.

A wine tax such as an excise or WET has different impacts on consumers and producers and this creates different distortions. Specific (excise) taxation tends to lead to higher consumer prices, lower consumption and thus reduces tax collections.¹⁶¹ For example, the New Zealand Tax Review calculated that excises have high deadweight costs (losses in consumption efficiency) per dollar of additional tax revenue raised, relative to broadly based forms of taxation.¹⁶² However, excises do not directly distort manufacturers' decisions to invest in product quality;¹⁶³ rather such taxes have an improving impact on product quality.¹⁶⁴

Ad valorem taxation (WET) raises consumption and tax revenue but induces firms to reduce prices, downgrade product quality, and reduce advertising and marketing costs.¹⁶⁵ Ad valorem taxation has a multiplier effect, as increases or decreases in producer prices will have a larger effect on the price charged to the consumer.¹⁶⁶ Thus, ad valorem taxes dissuade costly product quality improvements and encourages price competition by producers. Further, ad valorem taxes are more attractive to producers who have a degree of monopoly power and where there is little product differentiation. In contrast the world wine industry has no high degree of monopoly power and there is considerable product differentiation.

The significant and growing world demand for premium wine and the high cost structure of Australian non-premium wine suggests that specific (excise) taxation is preferable over the WET. Anderson finds that if the switch to excise happens it will encourage more Australian vignerons to produce and more Australians to consume finer wines and in doing so bring Australia's tax system close to a socially optimal regime.¹⁶⁷ However, excises will inflate the price of non-premium wine and thus damage that part of the industry, having major implications for regional distribution of

¹⁶⁰ Australian Treasury, 'Architecture of Australia's Tax and Transfer' (2008) 277, Table 2.1 <http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/report/section_2-03.htm>; Sijbren Cnossen, *Excise Systems a Global Study of the Selective Taxation of Goods and Services* (John Hopkins University Press, 1977) 116 observed that in industrial countries efficiency appears to dictate a broad based sales tax that interferes as little as possible with economic behaviour.

¹⁶¹ See Cnossen, 'Excise Taxation in Australia', above n 135, 13.

¹⁶² McLeod et al, above n 151.

¹⁶³ Stephen Smith, above n 101, 73.

¹⁶⁴ Ibid.

¹⁶⁵ Yoram Barzel, 'An Alternative Approach to the Analysis of Taxation' (1976) 84(6) *Journal of Political Economy* 1177.

¹⁶⁶ Michael Keen, 'The Balance between Specific and Ad Valorem Taxation' (1998) 19 *Fiscal Studies* 1.

¹⁶⁷ Anderson, above n 21, 218.

wine grape production¹⁶⁸ and small wine producers. Consequently, as noted previously, the wine tax reform debate is balanced between the interests of the premium wine industry, small wine producers and the non-premium wine industry.

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

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

Pernod Ricard Winemakers concludes:

The current structure of the Wine Equalisation Tax and its rebate encourages oversupply, contributes to this structural imbalance and distorts both the domestic market and Australia's wine export markets.¹⁷¹

6.9.2 *Undesired side effects*

High priced wine results in the relative price of substitute goods (beer, spirits, homemade alcohol and illegal drugs) falling and the consumption of the substitute goods rising. United States research found that increasing the price of alcohol raised the consumption of marijuana.¹⁷² As discussed above, wine consumption is not generally complementary with beer and spirits.

6.9.3 *Corrective taxation*

Corrective taxation is most efficient where the external costs are taxed directly.¹⁷³ People who abuse alcohol should be targeted. Australian studies have found that the young in particular are likely to binge drink.¹⁷⁴ In a United Kingdom study, Mathews and Richardson found that young people are more likely to binge drink and become involved in drink-driving and crime.¹⁷⁵ Drinking is a habit and young people are susceptible. Drinking from adolescence to adulthood creates problems for human capital and family development.¹⁷⁶

¹⁶⁸ Ibid.

¹⁶⁹ Pernod Ricard Winemakers, above n 9, 11; Treasury Wine Estates, above n 9.

¹⁷⁰ Treasury Wine Estates, above n 9, 11.

¹⁷¹ Pernod Ricard Winemakers, above n 9, 1.

¹⁷² Matthew Farrelly et al, 'Response of Adults to Increases in Cigarette Prices by Sociodemographic Characteristics' (2001) 68 *Southern Economics Journal* 156.

¹⁷³ Australian Treasury, 'Architecture of Australia's Tax and Transfer', above n 160, 280.

¹⁷⁴ Stockwell et al, above n 128.

¹⁷⁵ Sian Mathews and Anna Richardson, 'Findings from the 2003 Offending Crime and Justice Survey: Alcohol Related Crime and Disorder' (Home Office Findings 261, 2005) <http://webarchive.nationalarchives.gov.uk/20110218135934/http://rds.homeoffice.gov.uk/rds/pdfs05/r261.pdf> In the United Kingdom 18–24 year old binge drinkers commit 24 per cent of violent offences, versus 16 per cent by moderate drinkers and 5 per cent by non-drinkers in the same age group.

¹⁷⁶ Philip Cook and Michael Moore, 'The Economics of Alcohol Abuse and Alcohol-Control Policies' (2002) 21(2) *Health Affairs* 120.

This problem can be resolved to some extent through intervention and regulation. Individual based interventions, generally by doctors, has proven to be an effective way to reduce abusive alcohol consumption.¹⁷⁷ Also, government regulation of wine and alcohol is stringent. There are restrictions on the time and place alcohol is sold, the minimum age for purchase, and advertising and sales is regulated. There are limits on the legal blood alcohol concentration when driving; for young people the limit is zero. The Henry Review asserted that the increased regulation of bars through licences with licence fees linked to the number and severity of violent incidents could address certain external costs.¹⁷⁸ However, Cobiac et al found that interventions targeted at young people were less effective than a minimum price of alcohol through a volumetric tax of reducing alcohol-related harm.¹⁷⁹

In the United Kingdom, Babor et al found that the enforcement of drink-driving laws and regulating the physical availability of alcohol are very effective.¹⁸⁰ Fleming et al also found in the United States that advertising is effective in influencing abusive young alcohol consumers.¹⁸¹ However, Babor et al concluded that advertising bans, designated drivers, voluntary codes of bar practice and educational and persuasion efforts are not very effective.¹⁸²

6.9.4 Summary

A wine tax impedes the economic efficiency of a significant export-orientated industry that faces an increasingly globalised wine industry where most competitors impose little or zero wine taxes. There are significant external costs associated with alcohol consumption but the external costs associated with wine consumption appear to be significantly lower than other forms of alcohol. More research is needed to quantify the externalities of abusive wine consumption. However, a wine tax is unable to target the sources of these externalities, those who abuse alcohol. There is no apparent reason why these external costs are addressed whilst many other substantial external costs are ignored. Overall there is a case on economic grounds for either a zero wine tax given the importance of the wine industry, or a revenue neutral wine tax. If a wine tax is retained, the WET should be repealed given its economic distortions. The WET could be replaced by either a revenue neutral excise based on the volume of wine (a complex tax) or a revenue neutral higher GST rate on wine (a far simpler tax). Assistance would be needed to help those affected by the transition away from a WET.

¹⁷⁷ David Collins and Helen Lapsley, 'The Avoidable of Alcohol Abuse in Australia and the Potential Benefits of Effective Policies to Reduce the Social Costs of Alcohol' (Monograph Series No 70, Department of Health and Ageing, 2008).

¹⁷⁸ Australian Treasury, 'Australia's Future Tax System, Final Report: Part 2 — Detailed Analysis' (2010) Vol 2, 434.

¹⁷⁹ Linda Cobiac et al, 'Cost Effectiveness of Interventions to Prevent Alcohol Related Disease and Injury in Australia' (2009) 104 *Addiction* 1646; John Holmes et al, 'Effects of Minimum Unit Pricing for Alcohol on Different Income and Socioeconomic Groups: A Modelling Study' (2014) 383 *Lancet* 1655.

¹⁸⁰ Babor et al, above n 158.

¹⁸¹ Kenneth Fleming, Esther Thorson and Charles Atkin, 'Alcohol Advertising Exposure and Perceptions: Links with Alcohol Expectancies and Intentions to Drink or Drinking in Underaged Youth and Young Adults' (2004) 9 *Journal of Health Communications* 3.

¹⁸² Babor et al, above n 158, 178.

6.10 Equity

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

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

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

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

A wine tax is arguably unfair since alcohol taxation is non-uniform (higher taxes apply per unit of alcohol to beer and spirits), thus breaching horizontal equity.¹⁸⁵ This issue though is not significant given that wine and other forms of alcohol consume a small part of household income. Also, a wine tax is inequitable in a sense since it places an extra tax people who consume responsibly, since it is impractical to target the abusers of alcohol.¹⁸⁶

Other countries have significant differences in patterns of wine consumption and income distribution and caution thus must be exercised in making comparisons. In the United Kingdom, a study of the distributional impact excise taxes on alcohol on households with different income levels found that tax on wine has a progressive incidence (beer has a proportional incidence to income and spirits is marginally regressive).¹⁸⁷ This supports research that argues that excises on luxury goods with an income elasticity of demand exceeding unity will improve the progressivity of the tax system.¹⁸⁸ This assumes, though, that consumption by higher income classes is substantial.¹⁸⁹

¹⁸³ Glen Barton and Dale Pinto, 'The WET: is it a Good Drop?' (2014) 18(2) *The Tax Specialist* 54, 56.

¹⁸⁴ Australian Bureau of Statistics, *1301.0 — Year Book Australia, Household Income, Expenditure and Wealth* (2012), Table 9.8

<<http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/1301.0~2012~Main%20Features~Household%20income,%20expenditure%20and%20wealth~193>>.

¹⁸⁵ Barton and Pinto, above n 183, 56.

¹⁸⁶ *Ibid.*

¹⁸⁷ Stephen Smith, above n 101, 64.

¹⁸⁸ Cnossen, 'Excise Taxation in Australia', above n 135, 11.

¹⁸⁹ *Ibid.*

Studies of distributional affects in the United States have found alcohol taxes to be regressive.¹⁹⁰ The finding of the studies varied according to the time line of the analysis; the longer the time line the less regressive.¹⁹¹ Using lifetime shares of income spent on alcohol there were about 40 per cent greater in the poorest lifetime income quintile than in the highest.¹⁹² In New Zealand, the Tax Review 2001 concluded that wine excises could not be justified on tax equity grounds.¹⁹³

Gruber and Köszegi analysed the implications of an increase in cigarette excise taxes and noted that an excise may work to be progressive in another way.¹⁹⁴ Cigarette excise taxes, serving as a self-control function, may benefit a low income smoker under the assumption that their demand for cigarettes is more price-sensitive. Thus, taking a wider view on the incidence of excise taxes, an excise on alcohol could be progressive since those who are most sensitive to the price of tobacco (low income earners) benefit the most from a price increase.

Wine only consumes a relatively modest proportion of one's income. The overall distribution incidence of all taxes (and government welfare support) appears to be more significant than the distributional incidence of one particular tax on the consumption of one good, assuming there are relatively few excises or regressive taxes and the overall distribution of taxes is sufficiently progressive. The progressive income tax rate structures and social welfare policy in Australia means that the equity criteria is not a material factor in designing an optimal wine tax.

6.11 Simplicity

Excises or wholesale sales taxes are in a sense relatively easy to comply with and administer given that there are relatively few producers or wholesalers. Further, it is argued that the administration costs of an excise depend on technological developments and the advances in computer technology have simplified the operation of such taxes.¹⁹⁵

Notwithstanding the computer technology advances, the more levels of indirect tax on wine (such as excises or sales taxes), the higher the levels of compliance costs for the wine industry (the many small winemakers) and administration costs for the government. Australia's WET provides a vivid example of the complexity involved.¹⁹⁶ This is evident from the legislation¹⁹⁷ and from the number of ATO publications.¹⁹⁸ Many of these publications are highly technical and lengthy. For example, WET Ruling 2004/1¹⁹⁹ on the operation of the WET system runs to some

¹⁹⁰ Stephen Smith, above n 101, 65–6.

¹⁹¹ Ibid.

¹⁹² Ibid.

¹⁹³ McLeod et al, above n 151, v.

¹⁹⁴ Jonathan Gruber and Botond Köszegi, 'Tax Incidence when Individuals are Time-Inconsistent: the Case of Cigarette Excise Taxes' (2004) 88 (9–10) *Journal of Public Economics* 1959.

¹⁹⁵ Sijbren Cnossen, 'Tax policy in the European Union: a Review of Issues and Options' (2002) 58 *Finanzarchiv* 466–558.

¹⁹⁶ Barton and Pinto, above n 183, 56 note that the WET fails the simplicity test.

¹⁹⁷ *A New Tax System (Wine Equalisation Tax) Act 1999* (Cth).

¹⁹⁸ There are 3 ATO Rulings, 8 Fact Sheets, 2 Forms, 3 How to complete your business activity statements and 8 New Zealand WET rebate papers.

¹⁹⁹ Australian Taxation Office, *Wine Equalisation Tax Ruling Wine Equalisation Tax: the Operation of the Wine Equalisation Tax System*, WETR 2004/1: 'The operation of the wine equalisation tax system'.

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

A different set of difficulties arise under an excise as noted in the submissions to the Tax White Paper Task Force²⁰⁰ Complexity would arise from costly bonded warehouses, inspections and permissions to move wine.²⁰¹ It would also be very regressive for the thousands of small wine producers affected. Significant transitional costs would arise in moving from the WET to an excise.

Ideally, from a simplicity point of view, a wine tax should be part of a comprehensive indirect tax base with a common tax rate such as a GST. This would remove a layer of tax law and the use of a uniform rate would remove the problem of having to classify goods against a range of taxation rates and/or structures. If an additional tax on wine was required, imposing a higher rate of GST on wine would provide a far simpler option than either a WET or excise.

7. WET REBATE

The WET rebate damages fiscal adequacy with a significant and growing cost to revenue. In its first year the WET rebate refunds amounted to \$199 million in 2006–07 and has increased each year, with \$311 million refunded in 2013–14.²⁰² In 2013–14 1967 entities claimed WET rebates and the number of entities claiming WET rebates has increased since its introduction.²⁰³ The rebate also leads to significant economic efficiency issues as it subsidises the inefficient producers²⁰⁴ and thus inhibits the industry from restructuring to clear the oversupply problems. It encourages an oversupply of low value wine that is damaging the export market²⁰⁵ and damages the profitability of the industry.²⁰⁶ It also provides a competitive advantage to the New Zealand wine industry that can access the rebate. New Zealand wine producers are not subject to the same tax compliance checks as Australian businesses but are able to claim the rebate, and do not lodge an Australian income tax return or Business Activity Statement (BAS) statement. The rebate was designed to help small producers but as the Foundation for Alcohol Research and Education points out it has not worked very effectively since 24 wine companies account for 90 per cent of the wine production.²⁰⁷ There are also serious equity problems with the WET rebate

²⁰⁰ Pernod Ricard Winemakers, above n 9, 16; Murray Valley Winegrowers, above n 75, 6–7; Riverland Wine, above n 74, 3; Accolade Wines, above n 11, 1, 23.

²⁰¹ Pernod Ricard Winemakers, above n 9, 16.

²⁰² Commonwealth Treasury, 'Wine Equalisation Tax Rebate Discussion Paper' (2015) 9 https://static.treasury.gov.au/uploads/sites/1/2017/06/C2015-045_WET_Rebate_Discussion_Paper_2015.pdf

²⁰³ Ibid.

²⁰⁴ Pernod Ricard Winemakers, above n 9, 1.

²⁰⁵ Pernod Ricard Winemakers, above n 9, 1; Treasury Wine Estates, above n 9, 11–12.

²⁰⁶ Senate Rural and Regional Affairs and Transport References Committee, above n 90, 34.

²⁰⁷ Foundation for Alcohol Research and Education, above n 57, 10.

which has been subject to rorting.²⁰⁸ However, abolishing the WET rebate would have a significant negative affect on small wineries.²⁰⁹

8. CONCLUSION

There are five readily apparent options for wine tax reform: do nothing; repeal the WET; replace the WET with an excise; replace the WET with a higher GST rate on wine; and/or repeal the WET rebate.

Retaining the existing WET or replacing it with an excise cannot be justified from a tax policy perspective. The WET or a wine excise only marginally aids tax revenue collection and consequently fiscal adequacy is considered to be of lesser importance. Whilst the WET or wine excise may be regressive, equity does not appear to be of prime importance given the presence of progressive income tax rates and social security benefits. The WET and wine excises clearly fail the simplicity criteria. They also both create economic distortions that damage the competitiveness of the wine industry. In particular, the WET should be repealed since it encourages the production of non-premium wine when the world is moving to the consumption of premium varieties. The main competitor wine producing countries Italy and France do not have to face such substantial taxes. The external costs from wine abuse have not been quantified and do not appear to be as significant as externalities from beer and spirit consumption, and these taxes do not specifically target the alcohol abusers. Overall, such complex wine taxes are difficult to justify given the economic distortions and the significant size of the Australian wine industry and its strong export orientation. There is a strong case to abandon any additional taxes on wine, thus the WET should be repealed and not replaced by any excises.

From a political-economic aspect, politicians generally develop tax policies that provide minimal public resistance, thus it is likely that the existing WET will either be retained, or replaced by another additional tax on wine so as to be revenue neutral. There is no case to increase the overall revenue from a wine tax, given the research that shows lower levels of externalities associated with wine consumption. A tax revenue neutral reform option as recommended by the many wine industry submissions to the White Paper process appears to constitute a reasonable second best position.

An excise tax based on alcohol volume would better aid economic efficiency than the WET,²¹⁰ although there would be significant transitional costs. Complexity would be a real issue for the many small wine businesses. Replacing a WET with another tax

²⁰⁸ Treasury Wine Estates, above n 9, 13; Murray Valley Winegrowers, above n 75, 4. See Australian Treasury, 'Australia's Future Tax System, Final Report: Part 2 — Detailed Analysis', above n 178, 438: 'The rebate has created risks for tax avoidance, through "double dipping" and attempts by small producers to transfer the value of the rebate to larger operators in the supply chain.' See also Australian Taxation Office, 'Uncommercial Contract Manufacture Arrangements to Claim the Wine Equalisation Tax (WET) Producer Rebate' (Taxpayer Alert 2009/7). This alert describes uncommercial and collusive arrangements where one or more growers use a contract winemaker, so each such grower can attempt to claim the WET producer rebate by retaining title to their produce and resulting wine, until a pre-arranged sale to the winemaker. See also Senate Rural and Regional Affairs and Transport References Committee, above n 90, 34.

²⁰⁹ Fogarty and Jakeman, above n 110.

²¹⁰ Barton and Pinto, above n 183, 57 conclude that the WET is not a good tax having regard to the hallmarks of sound tax law.

will provide serious political challenges. This is especially so given Australia's long standing minimal tax policy in respect of inexpensive wine. Consequential economic distortions/costs (employment losses) of excises would be significant in certain parts of regional Australia and the large wine players are politically very influential. Social and cultural factors may also be important given the popularity of wine and the regressive impacts.

Replacing the WET with a modest increase to the GST rate for wine so as to be revenue neutral would be a far simpler alternative and would appear to have a softer impact on regional Australia than an excise.

Community acceptance of a wine excise or higher GST rate for wine may be attainable through extensive education and marketing campaigns that promote the health benefits of the excise or a higher GST rate on a harmful good and focus on the economic benefits of removing the WET. Governments could facilitate a smoother transition for the wine industry by providing restructuring assistance for affected communities and producers. Additionally, wine tax reform could be phased in over a medium term period to enable consumers and producers to adjust.

To better inform the process of setting the optimal wine excise and other related policy settings further research is needed to quantify: the externalities of abusive wine consumption; the economic distortions of the WET, wine excises and a higher GST rate; and the cost effectiveness of alternative education and regulation policies.

Additionally, it is submitted that the WET rebate should be repealed. However, before removing the rebate, research into the value of the additional consumer surplus generated by additional wine consumption choices²¹¹ and the value of tourism and economic impact on regional economies should be assessed. To the extent that industry assistance is found necessary a direct grant could replace the rebate.

²¹¹ Fogarty, above n 106, 401.