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Appendix E1

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Wine Equalisation Tax – Back to the Future

Presented at the Finlaysons Wine Roadshow titled *WFA's Action Agenda. What Does it Mean for Individual Wineries?*

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Mathew Brittingham – Wine Equalisation Tax – Back to the Future

I. INTRODUCTION

This WET rebate was initially introduced as a $42,000 per annum cellar door subsidy to provide assistance to small and medium sized winemakers and to promote employment in regional areas. Over the next 6 years, the WET rebate expanded to a $500,000 per annum rebate available to all producers, including 'virtual blenders' and New Zealand producers. Such expansion resulted in the WET rebate paid to producers increasing from $60million per annum in the 2004/05 financial year to $280million per annum in the 2012/13 financial year.[1]

This paper looks at how we arrived at this position, and what the Winemakers' Federation of Australia (***WFA***), the Legislature and the Australian Tax Office (***ATO***) have done, are doing and propose to do to reign the WET rebate back in. As will been seen, the plan is to restrict the WET rebate to realign it with the objectives it was originally introduced to accomplish. The handbrake has therefore been put on, and it appears we are doing a U-turn back to the future.

II. ORIGIN OF WET REBATE

In order to obtain the support of the Australian Democrats for its GST reform package, the Liberal Government *'undertook to ensure that arrangements were established which provided a tax exemption for cellar door and mail order sales up to a wholesale value of $300,000 per annum'*.[2]

These arrangements were given statutory force by the *Indirect Tax Legislation Amendment Act 2000*, which in turn amended the *A New Tax System (Wine Equalisation Tax) Act 1999* (***WET Act***).

The *Indirect Tax Legislation Amendment Act* provided a 14% WET rebate from 1 July 2000 on cellar door and mail order sales (and applications to own use) up to a maximum of $300,000 of sales per annum.[3] The rebate tapered down to zero for sales between $300,000 and $580,000 per annum.[4] The WET rebate applied in conjunction with the applicable 15% State cellar door subsidy. The combination of the 14% WET rebate and the 15% State subsidy meant that cellar door and mail order sales up to $300,000 per annum were effectively WET-free.[5]

To be eligible to claim the WET rebate, the producer was required to hold a license issued under a State law to make retail sales of wine from particular premises as a wine producer or a

1 See Treasury, *Tax Expenditures Statement* 2006, table F16, p 159 and *Tax Expenditures Statement 2012*, table F21 p 183.
2 Supplementary Explanatory Memorandum, *Indirect Tax Legislation Amendment Bill 2000*, [2.27].
3 Ibid, [2.29] and [2.46].
4 Ibid.
5 Ibid, [2.29].

vigneron (i.e. a producer's license under State liquor licensing laws).[6] Hence, the WET rebate was limited to wine and did not include other products captured under the WET Act such as cider, perry and sake.

The WET rebate was inserted to primarily to provide assistance to small and medium sized winemakers and to promote tourism in regional areas through increased incentives to open cellar doors.[7]

III. FIRST EXPANSION OF WET REBATE

a) Cellar Door Scheme Replaced by Producer System

From 1 October 2004, the cellar door WET rebate scheme was replaced by the current system which allows a wine producer, or a group of associated wine producers, to claim an annual WET rebate regardless of whether they make cellar door sales.[8] The maximum rebate payable to a producer, or group of associated producers, was initially limited to $290,000 per annum.[9] The rebate therefore effectively exempted $1million of each producer's, or group of associated producers', domestic wine sales per financial year.[10]

The amount of the rebate was calculated as 29% of the 'wholesale value' of the wine.[11]

The Government predicted that these measures would allow around 90% of wine producers to fully offset their WET liability, and that 85% of the benefits of the WET rebate would be received by small wine producers in rural and regional Australia.[12]

b) No Requirement for Producers to Hold State Liquor License

Importantly, the WET rebate was paid to wine producers regardless of whether they held a producer's license under State liquor laws.[13]

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6 See sections 19-10 and 33-1 of the WET Act, as inserted by the *Indirect Tax Legislation Amendment Act 2000*.
7 Supplementary Explanatory Memorandum, *Indirect Tax Legislation Amendment Bill 2000*, [2.38-2.39].
8 *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004*, Schedule 1.
9 *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004*, Schedule 1, Item 1.
10 Revised Explanatory Memorandum, *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004*, [1.3].
11 Ibid, Comparison of key features of new law and current law.
12 Ibid, [1.7].
13 Ibid, Comparison of key features of new law and current law.

c) Rebate Extended to Cider, Perry and Sake

At the same time, the new WET rebate was extended to allow producers of all products to which WET applied (i.e. cider, perry and sake) to claim a rebate on wholesale sales of those products.[14]

IV. SECOND EXPANSION OF WET REBATE

a) WET Rebate Extended to New Zealand Producers

From 1 July 2005, the WET rebate scheme was extended to include New Zealand producers.[15] This was done to enable Australia to satisfy its obligations under the Australia and New Zealand Closer Economic Relations Trade Agreement of 1983; i.e. so there was no policy differentiation in the tax treatment of Australian and New Zealand wine producers.[16]
New Zealand producers became eligible to claim the WET rebate provided: (1) they produced wine in New Zealand; (2) exported that wine to Australia; and (3) Australian WET was paid on that wine.[17]

b) WET Rebate Increased to $500,000 p.a.

From 1 July 2006, the WET rebate each producer (or group of associated producers) could claim was increased to a maximum rebateable amount of $500,000 each financial year.[18] This enhanced assistance effectively exempts up to around $1.7 million of domestic wholesale wine sales from WET each year per wine producer (or group of associated producers).

V. CENTAURUS REPORT

In August 2013, Centaurus Partners delivered to WFA an '*Expert Report on the Profitability & Dynamics of the Australian Wine Industry*' (***Centaurus Report***). The Report, among other things, considered the WET rebate.

The Report noted that ATO data showed a continued increase in the WET rebate refunded

14 *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004*, Schedule 1, Item 6A.
15 *Tax Laws Amendment (2005 Measures No. 4) Act 2005*, Schedule 4.
16 Treasury Executive Minute No. 2010/3468.
17 *Tax Laws Amendment (2005 Measures No. 4) Act 2005*, Schedule 4, Item 9.
18 *Tax Laws Amendment (2006 Measures No. 3) Act 2006*, Schedule 14.

from $211.6 million in the 2007/08 financial year to $307.5 million in the 2011/12 financial year.[19] In that time, the ATO data also showed that there were an additional 365 claimants of the WET rebate.[20] Since the industry was experiencing a downturn during that time, the Report proffered that such a trend was indicative of the '*increased use of structuring (legal and accounting) techniques to access the rebate and/or access it more than once.*'[21]

Despite such observations, the Centaurus Report did not recommend that the WET rebate should be abolished. That was because doing so would '*negatively impact a large number of small to medium players that depend on the rebate to remain viable*'.[22] In addition, the Report noted there was an '*inability to draw a quantitative link between the Rebate and oversupply with the information available*'.[23] The Report, however, concluded that the WET rebate '*warrant*[ed] *close inspection by the ATO*'.[24]

VI. WFA'S ACTIONS FOR INDUSTRY PROFITABILITY 2014 – 2016, DECEMBER 2013 (*WFA ACTION PLAN*)

a) Background

In December 2013, the WFA Action Plan was released, in response to the Centaurus Report and WFA's own consultation with the industry. The WFA Action Plan submitted 43 actions under 8 initiatives, of which one initiative (No. 5) dealt with the WET rebate.

Under that initiative, WFA noted that its consultation with industry confirmed that the WET rebate '*remains an important revenue source for small and medium winemakers*' and that '*without the rebate a significant number of wine businesses would be severely impacted financially*'.[25] WFA also noted that '*the rebate has been factored into business models and pricing strategies at all points in the supply chain*' and that '[*a*]*t this point in time, the majority of the Industry supports the retention of the rebate*'.[26]

On that basis, WFA concluded that the WET rebate should be retained.[27] However, WFA also

19 Centaurus Report, 42.
20 Ibid.
21 Ibid.
22 Ibid, 41.
23 Ibid, 42.
24 Ibid.
25 WFA Action Plan, 31.
26 Ibid.
27 Ibid, 32.

noted that '*the WET rebate has evolved beyond its original intent and is being compromised by the ability of brokers, intermediaries and foreign-based entities to access the entitlement*'.[28] To address those concerns, WFA argued that changes must be made to the WET rebate, so that it can be '*accessed only by those who make a contribution to regional communities*' in Australia, in line with the original policy intent.[29]

So to ensure the WET rebate is retained, but in a form which is more closely aligned to the original policy intent, WFA announced that it is committed to the three-stage approach out lined below.[30]

b) Stage 1 – Immediate Action

WFA believes that '*more can be done … within the existing legislative framework to improve compliance and restrict the eligibility of uneconomic arrangements and schemes designed primarily to access the rebate.*'[31] Accordingly, WFA plans to work in partnership with the ATO to understand and identify uncommercial arrangements designed principally to access the WET rebate, and what can be done to '*stamp them out*'.[32]

In addition, WFA and the ATO will examine the adequacy of the amendments made to the WET Act in December 2012, which were designed to reduce WET rebates claimed by manufactures of blended wine (***Blending Rules***), in preventing the WET rebate being accessed via such uncommercial arrangements.[33]

c) Stage 2 – Legislative Change in the Near Term

i. Phase Out WET Rebate for Bulk or Unbranded Wine

WFA believes that branding enables producers to develop customer loyalty, and thereby generate sustainable profits, which can be '*reinvested back into regional communities and infrastructure*'.[34] On the other hand, WFA believes that sales of unbranded bulk wine, cleanskins and private labels are not conducive to building sustainable businesses and therefore do not play a '*long term role in encouraging regional development*'.[35]

28 Ibid, 31.
29 Ibid, 32-33.
30 Ibid, 32.
31 Ibid, 33.
32 Ibid.
33 Ibid, 33.
34 Ibid, 34.
35 Ibid.

Accordingly, WFA proposes that the WET rebate should be limited to producers who '*sell wine in a form that is packaged ready for retail sale and where the finished product is identifiably theirs*'.[36] However, to allow the industry time to adjust, WFA recommends that the WET rebate on bulk (defined as wine in containers over 25 litres) and unbranded wine, be phased out at 25% per year, starting at 75%.[37]

ii. Restrict Eligibility to WET Rebate to Australian Producers

WFA believes that the expansion of the WET rebate to include New Zealand producers who import wine into Australia was contrary to the original intent of the WET rebate.[38] WFA notes that the increase in New Zealand wine imported to Australian, from 21m litres in 2007 to over 51m litres in 2012, has harmed Australian producers.[39]

In addition, WFA considers the circumstance, where a foreign entity registers for Australian GST and claims the WET rebate on stock traded within Australia, to be contrary to the intent of the WET rebate.[40] WFA therefore proposes to prevent foreign entities (including New Zealand producers) from being eligible to claim the WET rebate.[41] It will be interesting, however, to see how this proposal plays out with Australia's obligations under international law.

iii. Second WET Rebate on Merger of Two Wine Business

WFA believes that two wine businesses, who each separately claim the WET rebate, may be dissuaded from merging if they have to share an annual $500,000 cap, and thereby lose some of the, or the entire, WET rebate they would otherwise claim.[42] This is considered to be an undesirable effect of the 'associated producer provisions' (discussed below) in the current climate, when rationalization and economies of scale are required for wine businesses to remain viable.[43]

To address this issue, WFA proposes to introduce a transitional measure, which would allow two wine businesses to merge and claim a second WET rebate.[44] That second rebate would, however, be phased out at 25% per year over four years.[45]

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36 Ibid.
37 Ibid.
38 Ibid, 35.
39 Ibid.
40 Ibid.
41 Ibid.
42 Ibid.
43 Ibid.
44 Ibid.
45 Ibid.

d) Stage 3 – Ongoing Policy Review

The Centaurus Report was unable to reach a clear position on the effects of the WET rebate on the industry as a whole, particularly with respect to whether there was any link between the WET rebate and oversupply.[46] This was primarily caused by an absence of data on the WET rebate, in-turn due to Business Activity Statements (***BAS***) not requiring producers to report information specific to the WET rebate.[47]

Due to there being insufficient data on the WET rebate, WFA plans to continue its analysis of the WET rebate, particularly its impact on profitability and supply.[48] To assist that process, WFA plans to work closely with the ATO to build '*a better fact base*', and proposes that reforms be made to the BAS '*to enable the ATO to gather more insightful data*'.[49] WFA has already formed a 'standing tax task force', with Wine Grape Growers Australia, Treasury and the ATO to address the proposed reforms and implementation issues.

Three years after the implementation of the 'stage 2' reforms, WFA plans formally to review the analysis it will have undertaken, to assess whether the WET rebate should be kept, substituted, further restricted, reduced or phased out.[50]

VII. WFA'S CURRENT ACTIONS – ASSESSING ADEQUACY OF BLENDING RULES

a) Background

The Blending Rules were designed to prevent inappropriate access to the WET rebate and thereby protect the integrity of the WET rebate.[51] As stated above, WFA plans to examine the adequacy of the Blending Rules in achieving those objectives.

However, for the reasons discussed below, my view is that the manner in which the Blending Rules were drafted means they do not properly address the mischief they were enacted to fix.

46 Centaurus Report, 41-42.
47 Ibid, 42.
48 WFA Action Plan, 36.
49 Ibid.
50 Ibid.
51 Budget Measures Paper No. 2 2012/13, p.46; and Commonwealth, *Parliamentary Debates*, House of Representatives, 19 September 2012, 19 (David Bradbury).

b) Blending Rules Do Not Prevent WET Rebate Schemes

The inappropriate WET rebate claims which the Blending Rules were enacted to address arise where a producer, who has 'maxed out' its annual $500,000 WET rebate cap, 'sells' its remaining wine to 'connected entities' to blend, so those entities can access WET rebates that would not otherwise be available in relation to that wine.[52]

However, under the Blending Rules, a producer is not required to reduce the WET rebates, it would otherwise claim on a blend, to the extent any of the suppliers of wine used in the blend notify the producer that they were not entitled to claim a WET rebate on the wine they supplied.[53] Such notification will be provided where the supplier has already exceeded its annual $500,000 cap and thus exhausted its producer rebate entitlement for the financial year.

Accordingly, the Blending Rules do not stop large wine producers gaining access to additional rebates through sales of their wine to connected entities to blend. Instead, by allowing a blender an exemption from reducing the WET rebates they claim if they purchase wine from a producer who has maxed out its annual cap, the Blending Rules tend to promote WET rebate schemes. This can be seen from the following example.

Wine Producer C requires 100,000L of wine to mix with its own wine to make a blend for which it has a buyer who will pay it $300,000. Producer C can source the 100,000L of wine for its blend from either Producer A or Producer B for the same price of $100,000 (GST Exclusive).

Producer A is a small to medium producer who has not 'maxed out' its $500,000 annual WET rebate cap. Accordingly, Producer A notifies Producer C that it will claim the full $29,000 WET rebate on the 100,000L of wine it proposes to sell to Producer C.

Therefore, if Producer C buys the 100,000L of wine from Producer A, Producer C will not be entitled to claim the full rebate of $87,000 ($300,000 x 29%) on the blended wine it sells. That is because under the Blending Rules, the rebate claimed by Producer A will constitute an 'earlier producer rebate' which will reduce the WET rebate Producer C can claim on the blend. Producer C will therefore only be entitled to claim a $58,000 rebate on the blend (i.e. $300k x 29% - $29k).

Producer B, on the other hand, is a large wine producer closely affiliated with Producer C, who has 'maxed out' its $500,000 annual WET rebate cap. Producer C knows if it buys the 100,000L

52 See Taxpayer Alert 2013/2 (*Wine equalisation tax (WET) producer rebate schemes*) (***TA 2013/2***).
53 WET Act, section 19-17(2).

of wine from Producer B that Producer B will notify Producer C that it is not entitled to claim any WET rebate on the wine it will supply Producer C.

In that case, Producer C will not be required to reduce the WET rebate it will claim on the sale of the blend. Accordingly, Producer C will be able to claim the full $87,000 WET rebate on the sale of its blend, and will therefore be $29,000 better off.

This effect of the Blending Rules gives rise to a classic case of arbitrage. Indeed, anecdotal evidence from the industry suggests that, following the introduction of the Blending Rules, demand for wine sold subject to a notification that the supplier is not entitled to claim a WET rebate has spiked.

Therefore, the Blending Rules are of limited utility in tackling WET rebate schemes. This could explain why the Commissioner, shortly after the introduction of the Blending Rules, issued TA 2013/2, and subsequently *Wine Equalisation Tax Ruling* WETR 2014/1, which provide that the Commissioner will look to apply the 'associated producer provisions' in section 19-20 of the WET Act and the anti-avoidance rules in Division 165 of the GST Act (***Div 165***) to blending schemes.

VIII. WFA'S CURRENT ACTIONS – IDENTIFYING UNCOMMERCIAL ARRANGEMENTS

a) Recent Developments

On 8 October 2013, the ATO issued TA 2013/2 to most, if not all, wine producers.

The Alert identifies two arrangements the ATO believes are contrived, and which are designed to create additional WET producer rebates through non-commercial dealings between entities.

b) Arrangement 1 – Additional Manufacturer

Arrangement 1 centres around a wine producer who maxes out its annual $500,000 WET rebate cap early in the financial year.

It involves:

- an entity, not at arm's length to that wine producer (***linked entity***), being established to buy grapes from the wine producer or someone from whom the wine producer would normally buy grapes;

- the wine producer contract manufacturing those grapes into wine on behalf of the linked entity;

- the wine producer buying the resultant wine from the linked entity, which triggers a WET rebate claim by the linked entity;

- the wine producer quoting its ABN to the linked entity so no WET is payable on the sale; and

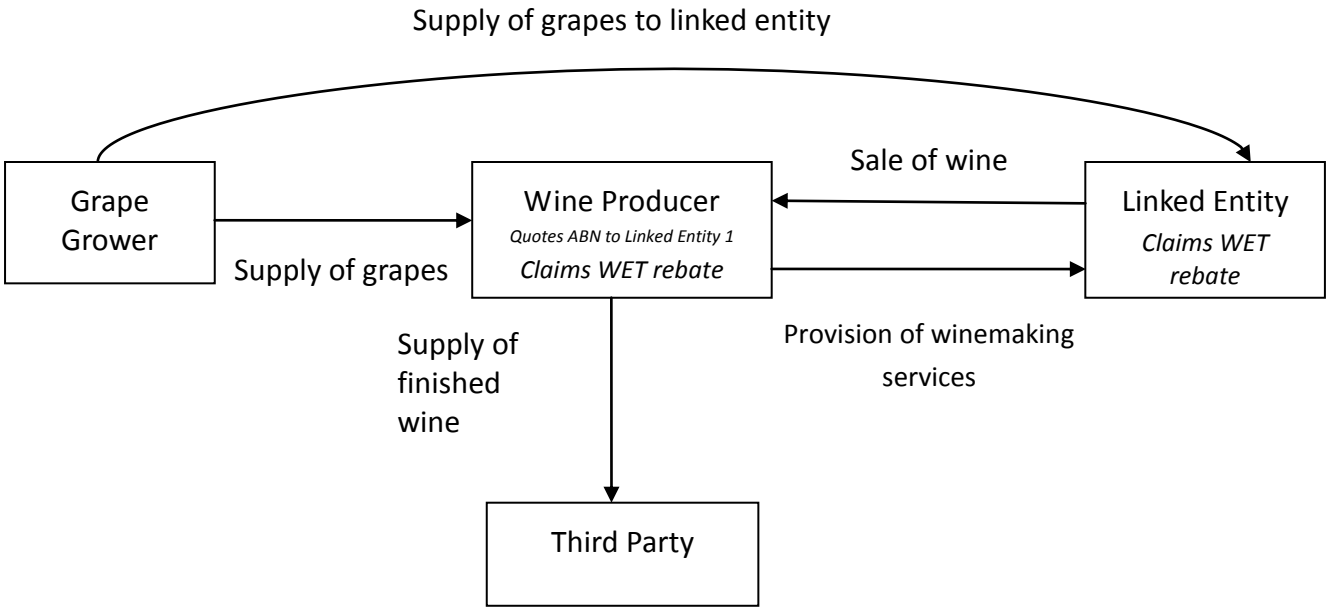
- the end buyers of the wine being those purchases to whom the wine producer would otherwise sell.

The combined WET rebates claimed in the financial year by the wine producer, and the linked entity, therefore exceed the wine producer's maximum entitlement.

A portion of the WET rebates claimed by the linked entity are passed through to the wine producer, by manipulating the prices charged between the parties for the grapes, wine or wine making services.

The Alert contains the following schematic representation of Arrangement 1:

Arrangement 1



c) Arrangement 2 – Blending Chains

The second arrangement also centres on a wine producer who maxes out its annual $500,000

WET rebate cap early in the financial year.

It involves:

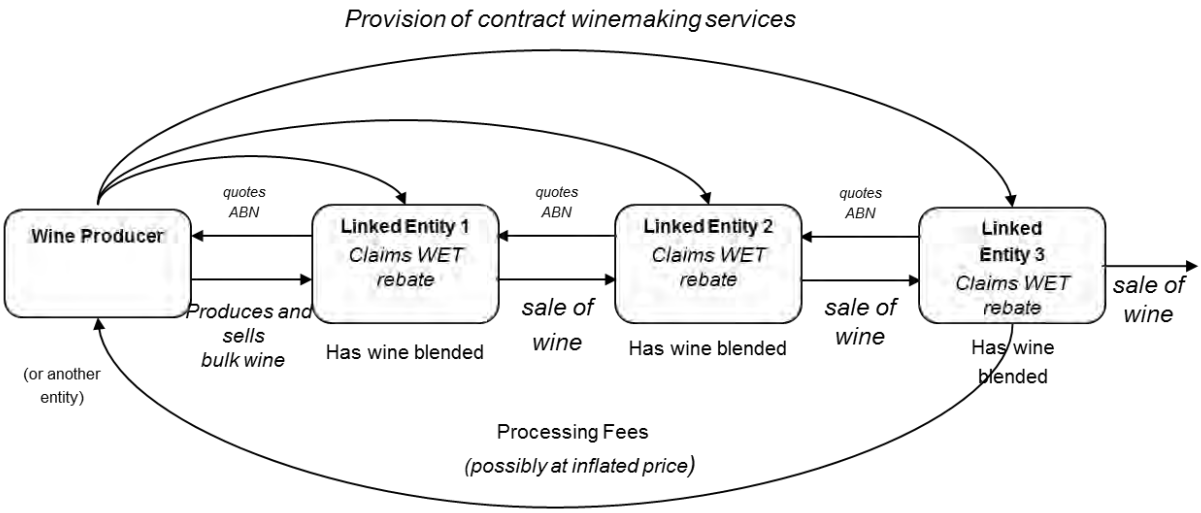
- an entity, which is not at arm's length to the wine producer (***linked entity 1***), buying bulk wine (or possibly grapes) from the wine producer and/or another supplier/s arranged by the wine producer;
- linked entity 1 contracting with the wine producer to blend the wine on its behalf, so that it is taken to manufacture the blend and thus qualify as a producer for WET rebate purposes;
- linked entity 1 selling the blend to another non-arm's length entity (***linked entity 2***), and claiming a WET rebate on the sale;
- linked entity 2 quoting its ABN to linked entity 1 so no WET is payable on the sale;
- the wine producer, as it did for linked entity 1, supplying or sourcing further bulk wine, or grapes, for linked entity 2 to blend; and
- linked entity 2, and potentially numerous other linked entities, repeating the same process as linked entity 1, until a batch of wine is sold, in accordance with the wine producers specifications, to same third party to whom the wine producer would ordinarily sell.

Accordingly, a significant number of extra WET rebates are created through the series of staged wine sales between interposed entities purporting to blend the wine. Since each entity in the chain quotes their ABN, no corresponding amount of WET is collected on each staged sale. Therefore, this arrangement is especially abhorrent to the ATO, as the WET rebates paid out far exceed the WET collected.

A portion of the WET rebates claimed by each linked entity are passed through to the wine producer, by manipulating the prices charged between the parties for the grapes, wine or wine making services.

The Alert contains the following schematic representation of Arrangement 2:

Arrangement 2



d) Application of Associated Producer Provisions to Arrangements 1 & 2

The 'associated producer provisions' in section 19-20 of the WET Act are integrity provisions designed to prevent large wine producers gaining access to multiple WET rebates.[54] They operate by limiting 'associated producers' to one annual $500,000 WET rebate as a group.[55] In broad terms, producers will be associated producers if:

1. one controls the other (i.e. holds at least 40% of the voting power in the relevant company or receives at least 40% of the income or capital of the relevant trust or partnership[56]), or both producers are controlled by the same third entity;[57] or

2. one could reasonably be expected to act in accordance with the directions, instructions or wishes of the other in relation to its financial affairs.[58]

Generally most WET rebates schemes can be easily structured to avoid the first limb. The real issue is whether the second limb will apply to arrangements which resemble Arrangements 1 or 2. This limb was judicially considered for the first time last year by the Administrative

54 Revised Explanatory Memorandum accompanying the *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004*, [1.24].
55 WET Act, section 19-15(3).
56 *Income Tax Assessment Act 1997*, section 328-125.
57 WET Act, section 19-20(1)(a).
58 WET Act, section 19-20(1)(b) & (c).

Appeals Tribunal in *SJ Buller Pty Ltd v Commissioner of Taxation* [2013] AATA 617 (***SJ Buller***).

The taxpayer, SJ Buller Pty Ltd (***SJB***), was a company which had been incorporated recently by the wife of one of the owners in the well-established family winemaking company RL Buller & Son (***RLB***), solely to make wine. The Tribunal noted the following features of SJB's business operations:[59]

- RLB sourced grapes, and negotiated quantity and price, for SJB;
- RLB arranged for the transport of those grapes to RLB's processing facility;
- SJB engaged RLB to process the grapes into wine in accordance with RLB's specifications;
- SJB engaged RLB to package the wine;
- SJB sold packaged wine solely to RLB;
- SJB sold that wine at a loss, to pass benefit of WET rebate to RLB;
- SJB had no funds to pay for the purchase of grapes or the processing of them into wine, and was reliant on RLB purchasing its wine to pay the growers;
- SJB did not have a website and did not advertise;
- SJB had no brand of its own, so its wine would ultimately be marketed under RLB's brand; and
- SJB had no employees, and all of its business activities were conducted by RLB's employees.

On the basis of those facts, the Tribunal concluded that SJB acted in accordance with RLBs directions and wishes in relation to its wine production activities.[60] In the context of WET, the Tribunal held that term 'financial affairs' should be construed as meaning financial affairs in relation to wine production activities.[61] The Tribunal therefore held that SJB and RJB were associated producers.[62]

59 SJ Buller, [28] - [29].
60 SJ Buller, [35] – [39].
61 SJ Buller, [11].
62 SJ Buller, [34] – [39].

Since the facts in SJ Buller were not dissimilar to Arrangement 1, it is likely the Commissioner will look to apply the associated producer provisions to any arrangement which resembles Arrangement 1. Given the result in SJ Buller, the Commissioner would also likely apply the associated producer provisions to any arrangement which resembles Arrangement 2.

e) Application of Anti-avoidance Rules to Arrangements 1 & 2

WET rebates are 'wine tax credits'.[63] Wine tax credits are incorporated into the amount of GST payable under Division 33, or refundable under Division 35 of the GST Act.[64] Accordingly, the anti-avoidance provisions in Div 165 can apply to a WET rebate scheme.[65]

Under Div 165, the Commissioner can cancel the GST benefit a producer obtains - as a result of entering into arrangements that allow the producer to increase the WET rebates it claims - by determining the producer is not entitled to all or part of those rebates.[66] In addition, the base penalty applied on an application of Div 165 will be 50% of the WET rebate cancelled.[67] Therefore, the application of Div 165 can have devastating financial consequences for a producer.

In a WET rebate context, Div 165 will apply where:

- there is a 'scheme';
- an entity gets a 'GST benefit' (i.e. a WET rebate) from the scheme; and
- it is reasonable to conclude that the dominant purpose or principal effect of entering into or carrying out the scheme was to obtain that GST benefit.[68]

On 23 April 2014, the Commissioner issued *Wine Equalisation Tax Ruling* WETR 2014/1. That Ruling set out the Commissioner's views on Arrangements 1 and 2. With respect to Div 165, the Commissioner states that to the extent the linked entity (or entities) and the wine producer in either Arrangements 1 or 2 are not associated producers, Div 165 will likely apply to both arrangements.[69] Therefore, any entity claiming the WET rebate is now on notice that if they are

63 WET Act, Table to section 17-5, No. CR 9.
64 WET Act, section 21-5.
65 *Wine Equalisation Tax Determination* (***WETD***) 2011/1, [22].
66 GST Act, section 165-40; WETD 2011/1, [58].
67 *Taxation Administration Act* 1953, Schedule 1, sections 284-145(1) & 284-160(1)(a).
68 GST Act, section 165-5.
69 WETR 2014/1, [16] – [17].

involved in an arrangement which resembles either Arrangement 1 or 2, they are at risk of the

Commissioner: (i) applying Div 165 to cancel the WET rebates they have claimed; and (ii) imposing a 50% penalty on the amount of WET rebates so cancelled.

The Commissioner notes that Div 165 will be applied to arrangements that resemble Arrangements 1 or 2, where the following factors are present:[70]

- the wine producer directly or indirectly funds the linked entity or entities operations or purchases;
- the interposed entity or entities add little or no value to the manufacture and sale of the wine;
- there is no material change to the manufacturing and sale processes that would be discernible to an entity outside the economic group;
- the linked entity or entities has/have not approached other wine producers to manufacturer its/their wine;
- the interposed entity or entities has/have not approached any purchases for its/their wine, but has left it to the wine producer to arrange the buyer for its/their wine;
- the wine producer deals with the wine as if it was its own;
- the terms of the dealing are dictated by the wine producer;
- there is an absence of contractual terms governing a party's recourse in the event the other party defaults; and
- prices are manipulated between the wine producer and the linked entity or entities so as to share the benefit of the additional WET rebates.

IX. GROWERS WHO BECOME PRODUCERS

On 6 April 2011, the Commissioner issued WETD 2011/1. That Determination applies to schemes where a producer and grower (where, in a number of cases, they had an existing fruit

70 WETR 2014/1, [58] & [88].

supply arrangement in place):[71]

- enter into a contract for the producer to make wine on behalf of the grower from the grower's fruit, so that the grower retains ownership of the wine that is produced;
- the grower is therefore taken to have manufactured that wine and is thus entitled to claim a WET rebate when it sells that wine;
- around the time of entering into that contract, the producer commits to buying the resulting wine;
- the grower sells that wine to the wine producer and claims a WET rebate;
- the producer quotes their ABN to the grower so the sale is exempt from WET;
- the producer blends that wine with other wine in its stock, to produce a commercially distinct product;
- the producer is therefore eligible to claim a WET rebate on that wine when it is sold; and
- the producer sells that blend, with the result that the sum of the WET rebates claimed by the grower, and the producer, in a financial year exceeds the $500,000 cap that the producer alone would have been entitled to claim.

In WETD 2011/1, the Commissioner has indicated he will likely apply Div 165 to such arrangements, especially if:

- there is no clear commercial rationale for altering any existing fruit supply arrangement;[72]
- the commercial substance of the arrangement remains unchanged from the prior fruit supply arrangement;[73]
- the grower and the winemaker share the economic benefits of the additional WET rebates generated from the venture through the grower accepting a lower price for its wine, compared to the price it would have accepted in the absence of the venture;[74] and

71 WETD 2011/1, [4].
72 WETD 2011/1, [32].
73 WETD 2011/1, [39].
74 WETD 2011/1, [50].

- the grower is protected from negligence claims and claims under the Competition and Consumer Act, with respect to the sale of its wine.[75]

Although WETD 2011/1 was issued several years ago, and the schemes described in Arrangements 1 and 2 are currently in the spotlight, the issue of growers becoming producers

is becoming increasingly topical.

The oversupply of fruit in the domestic market has meant that many growers have not been able to sell their fruit. Therefore, wrongly or rightly, many growers have had their excess fruit processed into wine so it can be stored while they search for a buyer. In such circumstances, one could argue that the growers have become producers due to commercial drivers, rather tax motivations. It will be watched with interest whether the Commissioner will accept such arguments, and not apply Div 165 to such arrangements.

X. CONCLUSION

As is evident from the above, the WET rebate has expanded significantly in both value and reach since its introduction. It is therefore not surprising that both WFA and the ATO have recently taken steps to rein it in. It now appears that the WET rebate is on a road back to the future to where it began. That is, as a subsidy to provide assistance to small and medium sized winemakers and to promote employment in regional areas.

In the short term, it needs to be decided swiftly exactly how far that road will wind back to provide commercial certainty in challenging times. Ultimately, Government and industry will need to decide if the road will go back past 'go', so as to see the demise of the WET rebate altogether.

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75 WETD 2011/1, [53].