FINLAYSONS

Winemakers' Federation of Australia

Returning WET Rebate to Fairness & Original Policy Intent

I. Overview

We have been asked to provide a recommendation for amending the WET producer rebate, so that the WET rebate accords with the original policy intent, namely to support local employment and tourism in wine regions.

Summary

We recommend the introduction of a Model whereby the WET rebate would only be available to wine businesses who:

- manufacture and sell wine in a **form fit for retail sale**, where the finished product is identifiably theirs; and
- have **business premises** in Australia (potentially, in a designated wine region in Australia); and
- hold a **licence to sell liquor** in an Australian state or territory; and
- are **self-employed** or engage **one or more employees**; and
- sell their wine either: (i) by **retail sale**, or **under quotation**, from the business premises referred to above; or (ii) by **internet** or **mail order sales**.

We also recommend that:

- the amendments to the WET Act in 2005, which established the **NZ WET rebate system**, be **repealed**; and
- the WET rebate on **bulk** and **unbranded wine** be **phased out** at the rate of 25% per annum, starting at 75%; and
- a transitional measure be introduced to allow **two wine businesses to merge** but still **claim a second WET rebate**, which would be phased out at the rate of 25% per annum over four years.

II. Recommended Model

We set out below a Recommended Model for eligibility for the WET producer rebate.

Under the Recommended Model, the rebate would only be available to wine businesses that:

- manufacture and sell wine in a **form packaged for retail sale**, where the finished product is identifiably theirs;[1] and
- have **business premises in Australia** (potentially, in a designated wine region in Australia); and
- hold a **licence**, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and
- are **self-employed** or engage **one or more employees** (including associates of the wine business) to perform work for the wine business; and
- sell their wine either:
    - by **retail sale**, or **under quotation**, from the **business premises** referred to above; or
    - by **internet or mail order sales** (in which case the sales would be *deemed* to take place at the above premises).

We make the following comments.

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[1] This measure would involve amending the definition of **rebateable wine* to refer only to wine packaged in a single container with a capacity not exceeding 5 litres, which is labelled with a brand that is wholly-owned by, or licensed exclusively to, the producer of the wine.

That would remove eligibility for the WET rebate from: (1) bulk, unpackaged and/or unbranded wine; (2) wine for the private labels of retailers; and (3) wine that is not a finished product fit for retail sale: see Section III (Phasing out WET rebate for bulk or unbranded wine).

Recommended Model intended to support local employment & tourism

1. The intention of the Recommended Model is to make the WET rebate available to wine businesses that are carrying on business in Australia, are self-employed or have employees, and have business premises in Australia – possibly, in a designated wine region.

2. By doing so, the WET rebate should be restricted to wine businesses that provide local employment and tourism in wine regions, in line with the original intention when the rebate was introduced in 2000.

> Note: The Explanatory Memorandum accompanying the introduction of the rebate in 2000, under the heading "Economic and social costs and benefits", stated:[2]
>
> *2.38 The threshold will also target the assistance towards small and medium sized winemakers.*
>
> *2.39 The WET rebate is designed to promote tourism and industry in regional areas.*

3. When the rebate changed to the current producer system in October 2004, the benefit no longer exclusively attached to cellar doors. The clear intention, however, was that the benefit should be received by wine producers in rural and regional Australia.

> Note: The Revised Explanatory Memorandum accompanying the 2004 amendments stated:[3]
>
> *1.7 … small wine producers in rural and regional Australia will benefit significantly, receiving around 85% of the rebate benefits.*

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[2] Supplementary Explanatory Memorandum, *Indirect Tax Legislation Amendment Bill 2000*, [2.38] – [2.39].

[3] Revised Explanatory Memorandum, *Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2009*, [1.7].

Wine business won't get rebate simply by registering for ABN and GST

4. Under the Recommended Model, the rebate will not be available simply because a wine business has registered for Australian ABN and GST purposes.

> Note: This deals with one of the perceived shortcomings of the current rebate.

Wine business doesn't need production assets

5. Under the Recommended Model, a wine business will not be required to own winery production assets; and new industry participants are thus not excluded.

> Note: Again, this deals with a perceived shortcoming of one of the models previously considered by the WFA.

Wine business must hold state or territory liquor licence

6. Under the Recommended Model, a wine business will be required to hold a liquor licence under relevant state or territory liquor licensing laws.

> Note: There is no current requirement, under the WET Act, for a wine business to hold a producer's licence, or any other state or territory liquor license, in order to claim WET rebates.
>
> As a practical matter, however, an entity that sells wine in Australia must hold a state or territory liquor licence of some description.
>
> Since rebates are only payable on wine sold domestically in Australia, Australian and foreign wine businesses (excluding certain NZ wine businesses) who claim WET rebates, are already required to hold appropriate liquor licences.
>
> The requirement under the Recommended Model therefore should not impose any additional burden for Australian or foreign wine businesses who currently claim WET rebates.
>
> However, NZ wine businesses who sell on FOB terms for export to Australia would in future be required to obtain a state or territory liquor licence in order to continue to be eligible for the rebate.

> The liquor licence requirement should thus eliminate the preferential treatment currently given to NZ wine businesses, as they would in future be in the same position as Australian and other foreign wine businesses.
>
> Accordingly, the change should remove one aspect of the current unfair treatment in favour of NZ wine businesses: see Section IV below.

7. In a separate report that accompanies this memorandum, PwC provide modelling that estimates:

   7.1. the cost of acquiring and maintaining a liquor licence and business premises; and

   7.2. the number of producers that potentially would exit the industry or would otherwise become ineligible to claim the rebate.

Wine business must sell by retail sale or under quotation from business premises

8. The Recommended Model contains a requirement that the wine business must sell wine either by retail sale, or under quotation, from its business premises (or sell by internet or mail order sales, in which case the sales will be *deemed* to take place at the above premises).

9. That will possibly result in foreign wine businesses having a "*permanent establishment*" (***PE***) in Australia, for Australian tax purposes. As such, it is likely that foreign wine businesses would be liable to Australian tax on the profits attributable to sales in Australia.

> Note: In broad terms, a PE is a fixed place of business through which the business of an enterprise (in this case, the foreign wine business) is wholly or partly carried on.
>
> The term includes a place of management, a branch, an office, a factory or a workshop and also a person — other than an independent agent — who substantially negotiates or concludes contracts on behalf of the enterprise in Australia.
>
> If a foreign wine business has a PE in Australia, the profits of the foreign wine business that are attributable to the PE will be taxable in Australia.

10. However, that should not change the current position in any great measure for most foreign wine producers, except possibly NZ wine businesses.

11. That is because foreign wine businesses who receive the WET rebate are currently: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns (subject to relief under any applicable double taxation treaty).

> Note: According to para 39 of Taxation Ruling TR 2006/3 ('Government payments to industry to assist entities (including individuals) to continue, commence or cease business'), the WET rebate is:
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> > *… received in the ordinary course of the entity's wine distribution activities. It is received to offset the liability that arises because of business operations and is calculated with reference to business income. The rebate is ordinary income and is assessable under section 6-5 in the income year that it is received.*

12. For NZ wine businesses, the WET producer rebate is considered to be assessable income for NZ tax purposes, and not for Australian tax purposes: see ATO guide '*Wine equalisation tax - producer rebate for New Zealand wine producers*' under the heading 'Reporting your producer rebate'.

13. Under the Recommended Model, it is likely NZ wine businesses would be: (1) treated as having derived Australian income from the sales on which they claim the WET rebate (as those sales will be made through Australian business premises); and (2) therefore required to lodge Australian income tax returns.

14. Accordingly, NZ wine businesses will be in the same position as Australian and other foreign wine businesses.

15. That is, NZ producers would be subject to Australian tax on the sales on which they have claimed the WET rebate, and on the WET rebate itself.

16. That would remove another aspect of the current unfair treatment granted to NZ wine businesses (discussed in greater detail in Section IV below).

Recommended Model should not breach ANZCERT Agreement

17. Under the *Australia & New Zealand Closer Economic Relations Trade Agreement* (***ANZCERT Agreement***), a Member State (i.e. Australian or NZ) must not levy on goods, which are imported from the other Member State, any taxes or charges in excess of those applied, directly or indirectly, to like domestic goods: see Article 7.2.

18. It might be argued that the Recommended Model would potentially breach the ANZCERT on the basis it differentiates between the tax treatment of Australian and NZ wine producers – since NZ producers don't generally have Australian business premises or Australian employees and, in the absence of such premises and employees, would not be entitled to the rebate.

19. Under the ANZCERT, New Zealand could therefore request Australia:

> … to enter into consultations with a view to seeking an equitable and mutually satisfactory solution if [NZ] considers that … an obligation under this Agreement has not been or is not being fulfilled.

20. However, as noted by the Australian Department for Foreign Affairs and Trade:

> Because consultations are non-binding, successful settlement relies on the goodwill of both parties to work out amicable and practical solutions.

21. Australia would strenuously argue that the proposed changes to the WET rebate would not give effect to a policy differentiation between the tax treatment of Australian and NZ wine producers; but instead – consistent with the original intention of the rebate (evidenced in the Explanatory Memorandum) – would promote employment and tourism in Australia's wine regions.

22. Australia would point to the fact there is nothing preventing NZ wine businesses qualifying for the rebate by having Australian premises and employees and, in that way, supporting employment and tourism. The rebate only applies to Australian domestic sales and if NZ wine businesses wish to claim the rebate, they need to be "on the ground" in Australia. Put at its simplest, you can't import employment or tourism.

23. Australia would also note that limiting the rebate in the manner proposed would be unlikely to reduce the volume of NZ wine sold in Australia due to the strength of the "*Malborough*" brand. In addition, even if certain NZ wine businesses find it uneconomic to import into Australia in the absence of the rebate, their sales will be taken up by other NZ producers.

24. Finally, Australia could refer to the fact that the current system potentially places Australia at risk of trade disputes with other countries, on the basis Australia may be breaching the "Most Favoured Nation" principle in Article I of the WTO General Agreement on Tariffs and Trade 1994 (***GATT***) (discussed in Section IV below).

25. The proposed changes would remove that risk as they would provide consistent treatment for all rebate claimants, regardless of their nationality.

Recommended Model should not breach Australia's WTO obligations

26. Under the GATT and the WTO Agreement on Subsidy & Countervailing Measures (***SCM Agreement***), "*actionable subsidies*", such as production subsidies, are not prohibited per se.

27. However, actionable subsidies may be subject to challenge through multilateral dispute settlement or countervailing action if they cause "*serious prejudice*" (in the case of another country's exports) or "*injury*" to another country's domestic industry (caused by importation of subsidized goods).

28. As with the ANZCERT, although it might be suggested the Recommended Model would potentially contravene Australia's WTO obligations, Australia should be able to displace any suggestion of "serious prejudice" (to NZ or any other importing country) by demonstrating:

    28.1. the effect of the WET rebate is not to displace or impede the imports of wine of another Member; and

    28.2. the effect of the subsidy is not a significant price undercutting by the subsidized Australian product.

29. The rebate would not be a subsidy for wine but for local employment and tourism.

III. Phasing Out WET Rebate for Bulk & Unbranded Wine

30. The principal recommendation in this memorandum is that the WET rebate should be restricted to wine businesses that provide local employment and support tourism, in line with the original policy intention when the rebate was introduced.

31. The development of wine brands enables producers to develop customer loyalty, to maintain sustainable price margins, and to generate profit growth that can be reinvested back into regional communities and infrastructure.

32. However, unbranded wine ('cleanskins') and private labels of retailers do not assist with the development of brand loyalty and therefore do not play a long-term role in encouraging regional development.

33. For this reason, unpackaged (bulk) wine, unbranded wine, wholesale and retail private label wine, and wine that is not fit for retail sale, should not be eligible for the WET rebate.

34. The rebate should instead only be available to those who manufacture and sell wine in a form that is packaged and ready for retail sale, where the finished product is identifiably theirs**.**

35. To enable the industry time to plan and adjust for this measure, the removal of rebate eligibility for bulk and unbranded wine should be phased out at the rate of 25% per annum, starting at 75% of the rebate rate.

Note: This proposal would be implemented by:

- amending the definition of **rebateable wine*, in section 33-1 of the WET Act, as follows:

  **rebateable wine* means **grape wine*, **grape wine products*, **fruit or vegetable wine*, **cider or perry*, **mead* or **sake*, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.

- including a transitional provision in the amending legislation which provides that the eligibility of bulk and unbranded wine for the rebate should be phased out at 25% per annum, starting at 75% of the rebate rate (currently $500,000), from the first day of the financial year in which the amending legislation receives Royal Assent.

36. In a separate report that accompanies this memorandum, PwC provide modelling that estimates the savings from removing the rebate from bulk and unbranded wine.

IV. Repeal WET Act Provisions Allowing NZ Wine Businesses to Claim WET Rebate

37. For the reasons set out below, there is also a strong case for abolishing the current New Zealand WET rebate scheme.

38. However, it is important that this recommendation does not breach Australia's obligations under the ANZCERT Agreement.

Current system provides preferential treatment for NZ wine businesses

39. As discussed above, foreign wine businesses who receive the WET rebate are: (1) treated as having derived Australian income; and (2) therefore required to lodge Australian income tax returns.

40. However, NZ wine businesses are not required to lodge Australian income tax returns, as the WET producer rebate is considered to be assessable in NZ and not Australia.

41. In addition, NZ wine businesses are not required to be registered for Australian GST purposes and hold a state or territory liquor license, unlike Australian wine producers and other foreign wine producers.

42. NZ wine businesses are therefore not subject to the compliance costs associated with lodging Australian income tax returns, Business Activity Statements (BAS), or with ongoing state or territory liquor licensing requirements.

43. Further, the ATO allows the NZ Inland Revenue to administer the WET rebate for NZ wine businesses. The ability for NZ wine businesses to deal with their local revenue authority is not available to other foreign wine producers.

44. These preferential conditions make it easier and cheaper for NZ wine businesses to access to the WET rebate, than for other foreign wine producers.

45. The following table summarises the requirements to claim the producer rebate, and the benefits afforded to NZ wine producers that are not available to other foreign wine producers.

Claim requirements under the current WET producer rebate schemes			
	Australian wine producers	*New Zealand participants*	*Other foreign wine producers*
GST registration required	✓	✗	✓
Wine tax must be paid	✗	✓	✗
Australian income tax obligations	✓	✗	✓
In-country administrative assistance provided	✓	✓	✗
Required to hold a State/Territory Liquor License	✓	✗	✓

Preferential treatment to NZ wine businesses may cause Australia to breach "Most Favoured Nation" principle

46. Under the WTO agreements, if Australia grants special treatment to goods from one country (such as a tax rebate or preferential administrative treatment), it must do the same for similar goods from all other WTO members.

47. This is known as the 'Most Favoured Nation' principle (***MFN principle***).

48. While the current WET rebate system remains in operation, it is arguable Australia may be breaching the MFN principle.

49. That is because the separate rebate scheme for NZ wine businesses discriminates against other foreign wine businesses, by giving preferential treatment to NZ wine businesses relative to foreign producers (as discussed above).

50. Such a breach potentially exposes the Australian government to trade disputes with other trading partners, claiming that NZ producers have preferential treatment relative to their producers.

51. However, if the current NZ rebate scheme is abolished, all foreign producers of wine would be treated equally in terms of access to the WET rebate.

52. There could then be no argument that the MFN principle had been violated.

However, ANZCERT may provide exception to MFN principle

53. It is possible, however, that Australia would have a defence to a claim that it had breached the MFN principle.

54. Article XXIV of the GATT provides that the MFN principle does not prevent the formation of a "free trade area".[4]

55. Since the ANZCERT has established a free-trade area that substantially eliminates trade barriers (such as duties and other restrictive regulations of commerce) between Australia and NZ, it is possible that this exception would apply.

56. At first sight, Australia therefore has a potential defence against any claims by other trading partners that it has breached the MFN principle by giving preferential treatment to NZ wine businesses.

57. However, before being able to rely on such a defence, Australia may need to demonstrate that the ANZCERT would not have been entered into, if the NZ WET rebate provisions were not incorporated into the WET Act.[5]

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[4] Article XXIV: 5(b) & 8(b).

[5] See WTO Appellate Body Report, *Turkey-Textiles*, adopted 19 November 1999 (***Turkey-Textiles***).

For example, in the Turkey-Textiles case, the Appellate Body considered whether Turkey could rely on Article XXIV as a defence to a claim by India that Turkey's quantitative restrictions on textile imports from India breached Articles XI (General Elimination of Quantitative Restrictions) and XIII (Non-discriminatory Administration of Quantitative Restrictions) of the GATT.

The Appellate Body held that:[6]

> *Turkey has not demonstrated that the formation of a customs union between Turkey and the European Communities would be prevented if it were not allowed to adopt these quantitative restrictions. Thus, the defence afforded by Article XXIV under certain conditions is not available to Turkey in this case, and Article XXIV does not justify the adoption by Turkey of these quantitative restrictions.* [Emphasis added.]

Accordingly, Turkey could not rely on Article XXIV as a defence.

Although Turkey-Textiles considered the application of Article XXIV with respect to customs unions, the decision could possibly, by parity of reasoning, also apply to free trade areas.

58. Unless Australia can demonstrate that the non-inclusion of the NZ WET rebate provisions would have been a "stumbling block" to the formation of the ANZCERT, Australia may not be able to rely on Article XXIV as a defence to any claim that it has breached the MFN principle by giving NZ wine businesses preferential treatment.

59. The repeal of the NZ WET rebate provisions would thus reduce the risk of Australia's trading partners arguing that the NZ WET rebate provisions breach Australia's international treaty obligations.

Abolishing NZ WET rebate scheme is logically consistent with Recommended Model

60. If the Recommended Model is implemented, NZ wine businesses should be in the same position as Australian and all other foreign wine businesses with respect to Australian tax.

61. That is, by having business premises and selling wine in Australia, NZ and other foreign producers will, with respect to their Australian sales, need to: (1) hold a state or territory liquor license; (2) register for GST; and (3) lodge Australian income tax returns.

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[6] Paragraph 63.

62. Therefore, regardless of whether the NZ WET rebate provisions breach the MFN principle, those provisions would essentially become redundant under the Recommended Model.

63. The NZ WET rebate system should thus be repealed, in order to create logical consistency in the WET Act.

64. The following amendments would be required to repeal the current NZ WET rebate scheme.

- Sections 19-5(2) (Entitlement to producer rebates for New Zealand participants) should be repealed to disallow eligibility to NZ entities via the separate scheme.
- In addition, the following sections should be repealed since, once the entitlement provisions in section 19-5(2) are removed, those sections become obsolete:
    - 17-10(2A) (Claims for wine tax credits);
    - 19-7 (Approval as NZ participant);
    - 19-8 (Revoking an approval as a NZ participant);
    - 19-9 (Notification of changed circumstances);
    - 19-10(3) and (4) (Exceptions);
    - 19-15(1C) (Amount of producer rebates); and
    - 33-1: (Dictionary) definition of '*New Zealand*' and '*New Zealand participant*'.

The reference in section 19-25(4) to '*except in the case of a New Zealand participant*' would also need to be removed.

65. In a separate report that accompanies this memorandum, PwC provide modelling that estimates:

    65.1. the cost for NZ producers of shifting to "*level playing field*" arrangements; and

    65.2. the number of NZ producers that would exit the industry or become ineligible for the rebate.

V. Allow Second WET Rebate on Merger of Two Wine Businesses

66. To generate long term sustainable profits in the industry, wine businesses need to rationalize and capture efficiencies and economies of scale.

67. However, wine businesses that believe their future lies in consolidation may be stymied by the fact that they would lose up to $500,000 in annual WET rebates if they merged with another wine business.

68. This issue could be overcome by introducing a transitional rebate rule, which, on a merger of two businesses that are entitled to the rebate, would allow for a second rebate to remain with the new entity.

69. As this is a transitional measure, the additional rebate would need to be phased out at the rate of 25% per annum over 4 years.

70. To allow time for adequate merger activity to occur within the industry, this transitional arrangement should be made available to the industry for up to 5 years from the date the amending legislation receives Royal Assent.

71. In a separate report that accompanies this memorandum, PwC provide modelling that estimates:

    71.1. the expected take up of the transitional measures; and

    71.2. the savings that would be generated.

Finlaysons
(MRB/ MJB/JJP)
January 30, 2015