Winemakers' Federation of Australia

28 April 2017

Submission on the exposure draft legislation to amend the *A New Tax System (Wine Equalisation Tax) Act 1999* to give effect to the reforms to the wine equalisation tax (WET) rebate

Purpose

The purpose in this submission is to provide comments on the exposure draft legislation and associated explanatory material that would amend the *A New Tax System (Wine Equalisation Tax) Act 1999* to give effect to the reforms to the wine equalisation tax (WET) rebate announced on 2 December 2016.

Background

On 5 April 2017, the Australian government released exposure draft legislation and associated explanatory material that would amend the *A New Tax System (Wine Equalisation Tax) Act 1999* to give effect to the reforms to the wine equalisation tax (WET) rebate announced on 2 December 2016.

The purpose of consultation is to seek industry views on the implementation details of the changes to the WET rebate as set out in the exposure draft legislation and explanatory material.

The key elements of the package as announced on 2 December 2016, were that from 1 July 2018, eligible producers will be required to own at least 85 per cent of the grapes used to make the wine throughout the winemaking process. The rebate will be limited to wine branded with a registered trademark, and packaged in a container not exceeding five litres for domestic retail sale. In addition, wine producers will need to better link their rebate claims to the wine tax being paid. The WET rebate cap will also be reduced from $500,000 to $350,000 from 1 July 2018.

The exposure draft legislation and explanatory material are available on the Treasury website. The consultation is open until 28 April 2017.

ISSUES

I. CHANGES TO ELIGIBILITY CRITERIA

The reforms limit the WET producer rebate to wine for which:

- producers maintain ownership throughout the wine-making process;
- 85 per cent of the final product originated from source product that was owned by the producer; and
- producers have branded and packaged for retail sale.

Ownership

During the consultation process, WFA argued that ownership or control of the grapes was required for eligibility. The government has drafted the legislation to reflect ownership of the grapes immediately before the wine-making process commences. This means grapes can be crushed and then must pass into the ownership of the winemaker to obtain eligibility. We still believe that the appropriate eligibility requirement is for wine produced from grapes owned or controlled at the crusher, with 15% of other wine permitted to be blended in. Delaying the ownership test to immediately after crushing appears to us to create ambiguity and may lead to an opportunity for grape wine ownership manipulation.

Contract processing

A potential issue with the producer definition within the draft legislation is that winemakers who have their grapes contract-processed by third parties may not be producers under the proposed amendments to the definition of "Producer"

The term 'producer' is currently defined in the WET Act as meaning:[1]

… an entity that *manufactures the wine, <u>or supplies to another entity the grapes, … from which the wine is manufactured</u>. [Emphasis added.]

In the draft legislation it is proposed for that definition be repealed and replaced with the following definition:[2]

> *producer*, of wine, means an entity that *manufactures the wine.

This new definition therefore simply removes the 'second limb' from the current definition, namely the words '*or supplies to another entity the grapes, from which the wine is manufactured*'. The reason given for this change is that the second limb of the definition will be redundant, as under the proposed changes, a producer must maintain ownership of the grapes throughout the winemaking process.[3] However, this change would appear to result in winemakers, who have their grapes contract-processed into wine by a third party winery, no longer qualifying as producers.

This was never the policy intention and would appear to disadvantage a considerable number of bona-fide producers.

II. 85% OF THE FINAL PRODUCT

Under the proposed definition, the 15% allowance covers all inputs that are not from the source material e.g., yeast, water, grape concentrate and alcohol, not just purchased wine.

> *At the conclusion of the wine-making process, 85 per cent of the wine, by volume, in its final form as packaged branded product fit for sale must have originated from the wine producer's source product. This means that 15 per cent of the wine, by volume, can come from other sources. This can include purchased grape juice, purchased grape juice concentrate, purchased wine (including*

1 WET Act, section 33-1.

2 ED, Part 1, Item 16.

3 Explanatory Memorandum to ED (***EM***) at paragraph 1.19.

partially fermented wine or wine in its final form), purchased grape spirit, purchased brandy or other additives. Other additives, include yeast, preservatives and other ingredients such as energisers and enzymes. ***[Schedule 1, item 6, paragraphs 19-5(1)(c) and (2)(d) and subsection 19-5(4)]***

This provision will impact on the whole fortified wine sector. Standard 4.5.1 of the Australia New Zealand Food Standards code permits the addition of ethanol so that the final product contains 'no less than 150 mL/L and no more than 220 mL/L of ethanol at 20˚C'. As the 15% allowance includes fortifying spirit, and many of the sweet fortified wines have more than 15% alcohol added, as well as other additives and processing aids, under the proposed legislation, all these wines would be unable to claim a WET rebate.

We strongly believe that fortified wines should maintain their ability to obtain the WET Rebate and the definition needs to be amended to reflect this. The simplest way to do this is to exclude spirit for fortification from the exclusions.

Indeed, it is difficult to see why the proposal for the inclusion of additives and processing aids is here. This is inconsistent with current compositional requirements and labeling provisions and it may be simpler to remove this provision entirely. It is unenforceable and doesn't appear to have the potential to permit abuses of the system. This would be our preferred and the simplest option.

Averaging

One of the points made strongly by WFA during the consultations was that having an 85% test was quite stringent and allowance needed to be made for adverse weather events. The WFA proposal was for a 4 year averaging of the 85% grape ownership rule to take into account these events, or the introduction of an exceptional circumstances clause. This has not been taken into account and is a matter of considerable concern to smaller wine producers. The averaging provision we would propose would relate to a weighted average for the particular branded bottled product. Records are kept to determine this by all producers to comply with the provisions of the Label Integrity Program.

Product branded and packaged for retail sale

The wine must be packaged in a container that does not exceed five litres in capacity. The container in which wine is sold would be suitable for retail sale if purchasers would ordinarily expect to find wine packaged in such a container when it is sold on a retail basis.

As flagged in the consultation, the wine must be packaged so that each container is branded with a trademark that is owned by the producer. Generally, this must be a registered trademark, however in the draft legislation, a common law trademark is allowed if it is not possible to register a trademark due to a Geographical indication conflict or other such circumstances.

Comment

1. The **trade mark clauses** do not appear to be logical in practice. Currently the Bill recognises either a registered trade mark <u>or</u> a common law trade mark established in Australia 'that cannot become a registered trade mark' [item 6].

   However, registered and common law trademarks have the same elements and are not mutually exclusive. If a trade mark is *prima facie* incapable of registration, then it is also incapable of functioning as a common law trade mark. For example, GIs alone are incapable of functioning as either a registered or a common law trade mark.

   In addition, recognising in any form a common law trade mark as 'established in Australia' for these amendments is problematic, as this is an issue to be determined exclusively by the Courts and the

ATO is not qualified to make this assessment. That is, the only way to prove the validity of a common law trade mark is through litigation. Without this, there is no *prima facie* common law trade mark that is capable of enforcement.

While we understand the Government's concern that some brands may be comprised solely of GIs that prevent the business registering a trade mark, the GI name similarly cannot, in and of itself be a common law trade mark. We note that the IP Australia website states that 'generally, you won't be able to register a geographical name as a trade mark unless you add your own distinctive elements such as a logo.' It therefore would be very unusual, and highly inadvisable from a business perspective for a winemaker/brand owner to have no other distinctive brand elements beyond the use of a GI trade mark, as this would essentially mean that they did not have a functioning viable trade mark to represent their brand. The vast majority of winemakers/brand owners would have an additional word in the brand name, a logo, or other identifying mark that was registerable. We cannot think of a single instance where it would not be possible to register such a mark.

2. Given it can take between 18-24 months to register a trademark, transitional provisions are required to allow for producers who currently haven't registered their trademarks to do so.

3. Currently there is no clear relationship between brief mentions in the draft EM of a need for 'branding' and the trade mark requirement and, to clarify, an entity stating that they have a 'brand' does not necessarily mean that they have a registered or viable trade mark. In other words, one does not necessarily denote the other. Item 6 of the draft bill refers to containers, and lists the requirements for containers, these requirements include that 'a trade mark owned by the producer of the wine is applied to the container in which the wine is placed at the time of the assessable dealing.' There is no mention in the draft bill that wine should be packaged so that 'each container is ***branded*** with a trade mark that is owned by the producer' (see para 1.23 of the draft EM).

   While it is a way to distinguish one business from another, trademarks can be a letter, word, phrase, sound, small, shape, logo, picture, aspect of packaging or a combination of these (see IP Australia website) and a container may have a number of different trademarks represented on it some of which do not represent the primary brand name of the product itself. As a result, trademarks are not always a part of the product branding and branding was a critical part of the reforms (ie eligibility should be limited to branded wines). The Government should consider whether to restrict the eligible containers to being ones that bare the primary trade mark that represents the product brand (being the wine brand) rather than the company brand or some other sub-tier brand (for example, for the label Penfolds Koonunga Hill, Penfolds is the primary brand identifier, not Koonunga Hill (which is a sub-tier/label)).

III. OWNERSHIP OF TRADE MARK REQUIREMENT

For a producer to be eligible to claim a rebate they will be required, pursuant to proposed sub-section 19-5(5)(b), to <u>own</u> the trade mark that is applied to the packaging of their wine. This requirement may prevent some producers from being eligible to claim rebates under their present operating structures.

Some producers, for asset protection purposes, hold their valuable assets, such as trademarks, in a separate entity from their trading entity, and license or lease those assets to their trading entity. Hence, as the trading entity does not own the trade mark, it will not be eligible to claim producer rebates on the wine it sells.

However, any changes must be carefully considered, as they may create loopholes.

While it is not recommended that the draft Bill recognise leased or licenced use of trade marks, as this is too broad and could easily undermine a key element of the reforms, we consider that the Government could consider requiring the container to be branded with a trade mark that is 'owned by, or owned by an entity that is connected with* (referencing ITAA 1997, section 328-125), the producer'. This ensures that only the situation above, where the trade mark is held by another entity for asset protection purposes is recognised.

This should not provide for the ability of related parties, that act under the direction of the entity that owns the trademark, to claim additional rebates.

IV. LINK BETWEEN ENTITLEMENT TO THE WET PRODUCER REBATE AND WET BEING PAID

One of the elements flagged in the consultation concerned a desire to create a stronger link between entitlement to the WET producer rebate and WET being paid. The details on this were never made clear, but these will have implications in business relationships. The principle underpinning these amendments is that for a producer to qualify for the WET producer rebate for wine, WET must ultimately be paid on that wine. This eligibility criterion ensures that the claiming of a WET producer rebate can no longer result in the sum of the rebate and credits claimed for the wine exceeding the WET
that is paid on that wine. This is achieved by:

- only permitting a producer to claim the WET producer rebate if:
  - the producer is liable for WET for a taxable dealing in the wine; or
  - a purchaser purchased the wine under quote to the producer quoting that they intend to make a taxable dealing with the wine; and
- making the purchaser liable for WET if they purchase wine under quote to the producer quoting that they intend to make a taxable dealing; and
- making a quote for the purchase of wine ineffective if the entity to which the quote is made purchased the wine for a price that included WET.

One issue that has been raised with WFA is where certain schemes are being proposed for packaged wine, whereby a producer sells to a wholesaler who sells to an exporter, each of whom have stated that their intention at the time of each sale is to not make a GST free sale.

We are aware of certain arrangements where additional labelling, reworking or over stickering is being considered additional manufacture and the creation of a new and different product.

It may be possible to strengthen legislation to deal with this by providing a WET Clawback when intent changes. In the event packaged wine is exported, the buyer must advise the seller that the previously declared intent to not make a GST free sale has changed and that a new WET liability has been created. In the event that the Seller has purchased the same wine as a GST supply they must also advise this to the seller from whom they have purchased the wine, even though they may have reworked the sealed wine by way of application of a label or over-stickering an existing label.

Clarifying the definition of packaged branded wine to specifically disallow rework or manufacture through the process of additional packaging such as labelling of clean skins or application of additional stickering or labelling may be required. Such additional rework does not constitute a new product giving rise to a WET benefit.

Quoting

Under the proposed quoting rules, wine producers will only be eligible for a producer rebate if they receive a quote which states that the purchaser intends to make a taxable supply of the wine.

Before claiming a rebate, wine producers will therefore need to satisfy themselves that the purchaser does not intend to:

- on-sell the wine under quote (for example, on-selling the wine to another wholesaler or by export); or
- use the wine as an input in the manufacture of another product.

Currently, before claiming a producer rebate, wine producers only need to consider whether a purchaser has correctly indicated in their quote that they do not intend to make a GST-free supply of the wine purchased. The amendments make it easier for the ATO to trace product to ensure the rebate is correctly claimed.

The proposed amendments to the quoting rules will result in certain types of supply chain arrangements giving rise to a WET liability, with no corresponding producer rebate.

- Under the proposed changes, a supply chain—which involves a wine producer selling wine to a purchaser who on-sells that wine under quote—will create a WET liability without a corresponding rebate for the producer of that wine.
- Under the proposed changes, a supply chain—which involves a wine producer selling wine to a second producer to use as an input to manufacture a blend or grape wine product—may create a WET liability, without a corresponding rebate for the producer of that wine.
- Wine which includes the WET which is then diverted to export.

However, on balance the quoting rules while complex appear workable. In order to make sure that producers understand the changes to these rules, we would request that the Australian Taxation Office (ATO) undertake a series of regional workshops for producers and accountants to ensure they understand the new rules and assist in compliance. WFA would be happy to work with ATO to coordinate this outreach program.

V. Reduction in the WET producer rebate cap from $500,000 to $350,000

The Schedule amends the WET Act to reduce the WET producer rebate cap to $350,000. Producers of eligible wine are entitled to a maximum $350,000 WET producer rebate.

We understand the policy rationale for this decision.

Changes in the eligibility of wine product to fall under the WET legislation

An unexpected and unrelated change to the legislation was to change the definition of a wine product that is eligible to be subject to the wine equalisation Tax (and therefore the rebate). Now, under the proposed legislation, a wine that contains grape wine of 700 millilitres but less than 850 millilitres is no longer regarded as grape wine product. Therefore, it is now not taxed under the WET, but is instead subject to taxation under the excise regime.

This issue was never discussed during the consultations. Wine products have been a traditional part of the wine industry for as long as the industry has existed. Vermouth, ginger wine, marsala style products and any number of cream liqueurs form the backbone of the segment. Under item 1.10 of the Explanatory Material it states:

"The amendments made by this Schedule improve the integrity of the WET producer rebate to better target the rebate so it supports wine producers who build brands, invest in regional communities and create local jobs."

Changing the status of wine products from a WET product to an excisable product will not help to achieve these stated objectives. It appears to be a very blunt way to include some of the other products that are appearing in the market place, mimicking spirit based products. There are other ways of achieving this objective. WFA is willing to work with ATO to achieve this objective.

For a product that has 13.9% alcohol by volume and a wholesale price of $70.00 per 12 x 750ml bottles (may be your average wine product) the tax take before GST will increase from about $1.70 per bottle to $8.58 per bottle. Depending on retail price the GST will increase from about $1.05 to $2.15 per bottle. Total government take per 750ml bottle will increase from $2.75 to $10.59. The impact on retail price is obvious. This seems extreme and beyond the ability of products in this category to withstand.

Increasing the wine content from 70% to 85% will also create production difficulties and increased cost of production. The extraction processes to generate flavors for wine products requires the provision of up to 30% of non-wine based product. Many are sweet and liquid sugar is often up to 25% of the final product volume. At 85% these products are impossible to make.

Under the definition of grape wine product, para 1.44 the reason given for the change is "This change is consistent with the requirement that 85% of the wine, in its final packaged form, must have originated from source product owned by the producer." This confuses the production standard in the Australia New Zealand Food Standards Code with eligibility criteria.
Possible options suggested is to grand-father existing wine products under the WET regime, or to make wine products non-rebateable but still subject to the WET tax.

Tightening of the associated producers rule
The associated producer rule has been tightened. A producer is taken to be an associated producer of another producer for a financial year if the associated producers test is met at any time during that financial year. The intent is to prevent artificial restructuring just prior to the end of a financial year to avoid the application of the associated producers rule for that financial year.

This rule appears appropriate.

Transitional periods
One of the critical elements of WFA submissions to government has been that start date for the 85% grape ownership rule is the 2019 vintage. The Explanatory Memorandum states that the WET eligibility criteria apply to assessable dealings in wine in the 2018-19 and later financial years, and the amendments to reduce the WET producer rebate cap from $500,000 to $350,000 and amend the definition of grape wine product will apply on and after 1 July 2018.

However, the legislation introduces a transitional rule that the amendments to introduce the WET eligibility criteria apply to: grape wine, grape wine products, fruit and vegetable wine and cider and perry if the crushing of the source product for more than 50 per cent of the wine (measured by volume) occurred on or after 1 January 2018. This seems to deal with the issue of wine made from the 2018 vintage.

Critically, wines from the 2017 and earlier vintages are not covered. This essentially makes the new grape ownership rule retrospective. We believe wines from the 2017 and earlier vintages that are packaged, branded and bear a vintage date should be eligible to claim the WET Rebate under the current rules, with a transition to 50% grape ownership in 2018 and 85% grape ownership from the 2019 vintage. This still leaves a potential issue for fortified wines that in many cases do not bear vintage dates, and indeed, may be produced by blending very old wines, or using a solera system. Clearly these wines are currently able to collect the WET rebate and retrospective taxation should not be applied to them.

Conclusion

The draft Legislation raises a number of key issues that require amendment to avoid unintentional consequences adversely impacting on the sector from the WET Reforms. We are happy to discuss these further. We would also draw your attention to the submission from Treasury Wine Estates and Pernod-Ricard.

Tony Battaglene
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