2016-2017

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (2017 MEASURES NO. 4) BILL 2017

EXPLANATORY MEMORANDUM

(Circulated by authority of the Acting Minister for Revenue and Financial Services,
Senator the Hon Mathias Cormann)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
ATO	Australian Taxation Office
CGT	capital gains tax
ITAA 1997	*Income Tax Assessment Act 1997*
GST	goods and services tax
PST	pooled superannuation trust
SIS Act	*Superannuation Industry (Supervision) Act 1993*
WET	wine equalisation tax
WET Act	*A New Tax System (Wine Equalisation Tax) Act 1999*

General outline and financial impact

Wine equalisation tax producer rebate

Schedule 1 to this Bill amends the *A New Tax System (Wine Equalisation Tax) Act 1999* (WET Act) to improve the integrity of the wine equalisation tax (WET) producer rebate.

The amendments make integrity changes to the WET producer rebate, quoting and WET credit rules, reduce the WET rebate cap from $500,000 to $350,000, tighten the associated producers rule and repeal the earlier producer rebate rule.

Date of effect: The new WET eligibility criteria generally apply to wine for which the wine-making process commenced on or after 1 January 2018 and to most other wine from 1 July 2018.

The reduction of the WET rebate cap to $350,000 applies to dealings in wine made on or after 1 July 2018.

The amendments to the associated producers rule apply to dealings in wine from the day that Schedule 1 to the Bill commences.

Proposal announced: This measure was announced by the Treasurer in the 2016-17 Budget. The changes to the producer rebate were announced by the Minister for Revenue and Financial Services on 2 December 2016.

Financial impact: This measure is estimated to result in a gain to revenue of $300 million over the forward estimates period comprising:

2016-17	***2017-18***	***2018-19***	***2019-20***	***2020-21***
-	$20m	$75m	$100m	$105m

- Nil

Human rights implications: This Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — paragraphs 1.80 to 1.84.

Compliance cost impact: There is expected to be a small compliance cost impact from the measures as affected businesses and their advisers become familiar with the changes to the law.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure has a compliance cost impact of $0.3 million. A regulatory offset has not been identified. However, Treasury is seeking to pursue net reductions in compliance costs and will work with affected stakeholders and across Government to identify regulatory burden reductions where appropriate. The Regulation Impact Statement is in Chapter 3.

Main points:

- The WET producer rebate has distorted production in the wine industry, contributing to the increased supply of wine and wine grapes and preventing necessary adjustments that would improve the long term strength of the industry.

- Reform of the WET producer rebate would better target the rebate and improve its integrity. It would also ensure consistency with the original policy intent of benefitting small wine producers who are making a genuine investment in the wine industry, many of whom are in rural and regional Australia. Small wine makers are an important source of economic activity and employment in their regions. The WET producer rebate assists small wine makers and delivers benefits to their communities.

- The WET producer rebate, if left in its current form, will continue to encourage businesses to restructure to maximise rebate claims and encourage excess production of wine and wine grapes, exacerbating challenging market conditions.

Income tax relief for transfers within a fund to a MySuper product

Schedule 2 to the Bill amends the *Income Tax Assessment Act 1997* (ITAA1997) to provide asset roll-over relief for mandatory transfers within a superannuation fund in the transition to a MySuper product.

Date of effect: The amendments apply to transfers within a superannuation fund to a MySuper product made between 29 June 2015 and 1 July 2017.

Proposal announced: The amendments were announced by the then Assistant Treasurer on 29 June 2015.

Financial impact: The amendments will have an unquantifiable financial impact.

Human rights implications: This Schedule does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 2, paragraphs 2.51 to 2.54.

Compliance cost impact: Nil.

Chapter 1
Wine equalisation tax producer rebate

Outline of chapter

1.1 Schedule 1 to this Bill amends the *A New Tax System (Wine Equalisation Tax) Act 1999* (WET Act) to improve the integrity of the wine equalisation tax (WET) producer rebate.

1.2 The amendments make integrity changes to the WET producer rebate, quoting and WET credit rules, reduce the WET rebate cap from $500,000 to $350,000, tighten the associated producers rule and repeal the earlier producer rebate rule.

1.3 All legislative references in this Chapter, unless otherwise stated, are to the WET Act. All references in this Chapter to purchasers are to entities that purchase wine for the purpose of resale other than for retail sale (as defined in the WET Act).

Context of amendments

1.4 A WET producer rebate of WET is available under the WET Act for producers of eligible wine that are registered or required to be registered for GST in Australia and also for New Zealand participants. The maximum WET producer rebate prior to these amendments was $500,000 for a financial year. The rebate is in the form of a WET credit.

1.5 These amendments to the WET producer rebate are intended to support the Australian wine industry by ensuring that wine producers who build brands, invest in regional communities and create local jobs are the beneficiaries of the rebate and not wine traders and retailers.

1.6 The Government announced these reforms to support the Australian wine industry by addressing industry concerns about distortions in the market through the misuse and exploitation of the WET producer rebate. The rebate has encouraged artificial business restructuring to maximise claims and has also contributed to excessive wine grape production particularly of low value wine, leading to distortions in the wine market in recent years.

Summary of new law

1.7 This Schedule amends the WET Act to improve the integrity of the WET producer rebate scheme. The reforms limit the WET producer rebate to wine that:

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

1.8 The reforms also:

- create a stronger link between entitlement to the WET producer rebate and the payment of WET;
- make integrity changes to the WET credit rules;
- reduce the WET producer rebate cap from $500,000 to $350,000;
- tighten the associated producers rule; and
- repeal the earlier producer rebate rule.

Comparison of key features of new law and current law

New law	***Current law***
WET producer rebate eligibility criteria	
A WET producer rebate for wine is available if: • the producer satisfies an ownership requirement for the wine’s source product throughout the wine-making process; • the producer satisfies a wine packaging requirement for retail sale; and • WET has been paid or is liable to be paid on the wine.	Not applicable.

New law	***Current law***
WET producer rebate eligibility criteria: ownership of source product throughout the wine-making process	
A producer's wine satisfies the ownership requirement if: • at least 85 per cent of the wine by volume in its final form as packaged branded product fit for retail sale originated from source product that was owned by the producer before the wine-making process commenced; and • the producer owned this wine throughout the wine-making process.	Not applicable.
WET producer rebate eligibility criteria: packaging requirement	
A producer's wine satisfies the packaging requirement if it is: • packaged in a container that does not exceed five litres (51 litres for cider and perry); • branded with one of the following trade marks owned by a producer or an entity associated with the producer and that trade mark readily identifies, or can be associated with the producer of the wine: – a registered trade mark; – a trade mark for which an application to register is under consideration; – a trade mark for which registration is pending; – a trade mark that has been used in the course of trade throughout the period beginning from 1 July 2015 and ending at the time an assessable dealing with the wine occurred (for example a common law trade mark that has been recognised by the courts or the Registrar of Trade Marks); and	Not applicable.

New law	***Current law***
• as packaged, suitable for retail sale or retail sale from the container.	
WET producer eligibility criteria: WET must have been paid or is liable to be paid	
A producer is eligible for a WET producer rebate (subject to the other criteria) if the producer: • has or will have a WET liability; or • sells wine to a purchaser under quote and the purchaser quotes that they intend to use the wine to make a dealing other than: – a dealing that is a GST-free supply; – use it as an input into manufacture; or – on-sell it under quote.	A producer is eligible for a WET producer rebate if the producer: • has or will have a WET liability; or • sells wine to a purchaser under quote and the purchaser notifies them that they intend to use the wine other than for making a GST-free supply.
Purchaser has an assessable dealing with certain wine they purchase under quote from a producer	
A purchaser has a taxable dealing with wine if: • they purchased the wine under quote from a producer; • they quoted to the producer that they intend to make a taxable dealing with that wine; and • the wine was: – used to make a GST-free supply; – sold under quote; or – used as an input into manufacture.	Not applicable.
Quote for the purchase of certain wine is ineffective	
A quote for the purchase of wine is ineffective if the entity to which the quote is made purchased the wine for a price that included WET.	Not applicable.
WET credits	
A purchaser is only entitled to claim a WET credit for WET imposed on wine if it makes a taxable dealing with that wine.	A WET credit is available for all WET credit events.

New law	***Current law***
WET producer rebate cap	
Producers of eligible wine that are registered or required to be registered for GST in Australia and also New Zealand participants are entitled to a maximum $350,000 WET producer rebate for a financial year.	Producers of eligible wine that are registered or required to be registered for GST in Australia and also New Zealand participants are entitled to a maximum $500,000 WET producer rebate for a financial year.
Associated producers rule	
A producer is an associated producer of another producer for a financial year if the associated producers test is met at any time during that financial year.	A producer is an associated producer of another producer for a financial year if the associated producers test is met at the end of that financial year.

Detailed explanation of new law

1.9 The amendments made by Schedule 1 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.

WET producer rebate eligibility criteria

1.10 Schedule 1 amends the WET Act to introduce additional eligibility criteria to claim the WET producer rebate to ensure that the rebate is only available as intended and is not subject to exploitation. A producer is only entitled to a WET producer rebate for wine if all of the WET producer rebate eligibility criteria are satisfied for that wine.

1.11 Accordingly, if a wine producer sells multiple batches of wine, some of which satisfy all of the WET producer rebate eligibility criteria and some batches that do not, then the producer is only entitled to a WET producer rebate for the qualifying batches.

Ownership of source product throughout the wine-making process

1.12 A producer is not entitled to the WET producer rebate for wine unless they satisfy a test concerning the ownership of the wine's source product throughout the wine-making process.

1.13 Wine satisfies the ownership test during the wine-making process if:

- at the end of the wine-making process, at least 85 per cent of the wine by volume that is in its final form as packaged branded product fit for retail sale was produced from the source product owned by the producer before the wine-making process commenced (as summarised in Table 1.2 below); and
- the producer maintained ownership of the source product and the resultant wine throughout the wine-making process.

[Schedule 1, item 8, section 19-5]

Source product

1.14 Source product is the product, in its original unprocessed form, from which wine is made. The source product for each type of wine is set out in the table below:

Table 1.1: Source products for wine types

Type of wine	***Source product for this wine***
grape wine	whole unprocessed grapes
grape wine product	whole unprocessed grapes
fruit or vegetable wine	whole unprocessed fruit or vegetables
cider	whole unprocessed apples
perry	whole unprocessed pears
mead	honey that has not been subject to fermentation
sake	rice that has not been subject to fermentation

1.15 The source product of wine must be in its unprocessed form, for example, for grape wine, fresh whole unprocessed grapes would satisfy this requirement. However, purchased dried grapes or grape juice do not qualify as source product. ***[Schedule 1, items 8 and 18, subsections 19-5(3) and (4) and definition of' 'source product' in section 33-1]***

1.16 The producer must own all, that is 100 per cent, of the source product used to satisfy the 85 per cent requirement before crushing and maintain that ownership throughout the wine-making process. Mead and sake producers must own the source product immediately prior to initial fermentation. This is because honey and rice are not crushed as part of the wine-making process. The wine-making process includes all steps in the manufacturing of wine from its source product form, including its crushing, to when the wine is packaged, ready for retail sale. The producer may rely on documentary evidence such as copies of weighbridge documents, purchase receipts for purchased grapes and production records for self-produced grapes, and to the extent it contains relevant information, documentation under the label integrity program to demonstrate ownership of source product. ***[Schedule 1, item 8, subsections 19-5(1), (2) and (3)]***

1.17 At the conclusion of the wine-making process, at least 85 per cent of the wine, by volume, in its final form as packaged branded product fit for retail sale must have originated or be taken to have originated from the wine producer's source product. The source product must have been owned by the producer before the wine-making process commenced until the wine is packaged suitable for retail sale. For example, wine in one litre bottles will satisfy the test if at least 85 per cent of that wine originated or is taken to have originated from the wine producer's source product that was owned by the producer before the wine-making process commenced until packaging. ***[Schedule 1, item 8, subsections 19-5(1), (2) and (3)]***

Ingredients that are taken to be source product owned by the producer before crushing

1.18 Most wine contains a number of ingredients in addition to product derived from the producer's source product. Examples of ingredients from other sources include purchased grape juice, purchased grape juice concentrate, purchased wine (including partially fermented wine or wine in its final form), purchased grape spirit, purchased brandy and other additives. Other additives include yeast, preservatives and other ingredients such as energisers, enzymes and colouring agents. Many of these ingredients, particularly other additives, are added in small quantities.

1.19 Producers would incur significant compliance costs if they were required to keep records of every minor ingredient (on the basis of where it was sourced from) that was put into wine as part of the wine-making process to determine if wine satisfied the ownership of source product throughout the wine-making process requirement. To ease this compliance burden, the other wine ingredients listed below are taken to be source product that the producer owned immediately before crushing of the source product commenced (even though they otherwise may not be). The other wine ingredients are:

- grape juice concentrate – only if the grape juice concentrate is no more than 10 per cent of the final wine, measured by volume (if the 10 per cent is exceeded then this rule does not apply to any of the grape juice concentrate with its status to be determined by whether the producer actually owned the source product from which it was made);
- water; and
- any substance, that together with similar substances, makes up one per cent or less of the final wine, measured by volume – this would generally be other additives.

[Schedule 1, item 8, subsections 19-5(5) and (6)]

1.20 Other wine ingredients have their volume determined as part of the wine-making process. This requires conversion to volumetric measurement if the ingredient is in a solid or gaseous form and remains in the final wine product. To protect the integrity of the ownership of source product rule, similar substances must be combined to ensure that they are one per cent or less by volume of the final wine. ***[Schedule 1, item 8, subsection 19-5(6)]***

1.21 An ingredient may be added with its percentage by volume exceeding one per cent. However, if it is later filtered out and the remaining ingredient in the final wine does not exceed (together with similar ingredients) one per cent by volume then the ingredient is taken to be source product that the producer owned immediately before crushing of the source product commenced. This is because the threshold test of the ingredient's percentage by volume is determined once the wine is in its final form.

1.22 Accordingly, a producer could add up to one per cent of yeast and also up to one per cent of preservatives to wine as the yeast and preservatives are not similar substances. They would both be treated as source product that the producer owned immediately before the crushing of the source product commenced. However, the producer could not add five portions of different types of grape juice that are each one per cent by volume and have them treated as being source product. This is because the different types of grape juice are all similar substances and therefore in applying the test their volume is combined. However the wine would still be eligible for the WET producer rebate, if at least 85 per cent of the other ingredients in the wine satisfy the ownership test.

Fortifying substances

1.23 Fortifying substances are taken to be source product that the producer owned immediately before crushing of the source product commenced (even though they otherwise may not be). This ensures that fortified wines continue to be able to qualify for the WET producer rebate, that fortified wine producers are not disadvantaged compared to producers of other wines and avoids the need for complex integrity rules that would otherwise be required. For the purposes of this rule fortifying substances are:

- grape spirit;
- brandy;
- alcohol used in preparing vegetable extracts (including spices, herbs and grasses); and
- ethyl alcohol from another source that can be added to the wine under the existing paragraphs 31-4(b), 31-5(b), 31-6(b), 31-7(b) and substances prescribed by regulation under paragraph 31-8(2)(a).

[Schedule 1, item 8, paragraphs 19-5(5)(a) to (d)]

Table 1.2: Ingredients that are, or are taken to be, source product owned by the producer before the wine-making process commenced

Wine ingredient	*Status as source product*
Whole unprocessed product	
Whole unprocessed grapes, whole unprocessed fruit or vegetables, whole unprocessed apples or pears, honey that has not been subject to fermentation or rice that has not been subject to fermentation if the grapes, fruit, vegetables, apples, pears, honey or rice were owned prior to wine-making commencing.	Qualifies as source product.
Purchased grape juice concentrate	
Purchased grape juice concentrate.	Only taken to qualify as source product if it does not exceed 10 per cent by volume of the final wine. If the volume exceeds 10 per cent of the final product then none of the added purchased grape juice concentrate qualifies as the producer's own source product.
Other ingredients (including purchased grape juice and wine)	
Other ingredients such as yeast, preservatives, energisers, enzymes and colouring agents.	Any ingredient that, together with same or similar ingredients, that are added to the wine, make up one per cent or less of the final wine (measured by volume).
Purchased grape juice and purchased wine (including partially fermented wine or wine in its final form).	These ingredients would generally not qualify. The exception where they are taken to qualify is if they, together with same or similar ingredients, that are added to the wine, make up one per cent or less of the final wine (measured by volume).
Fortifying substances	
Fortifying substances added to wine as follows: • grape spirit; • brandy; • alcohol used in preparing vegetable extracts (including spices, herbs and grasses); • certain other forms of ethyl alcohol; and • any other substances prescribed by regulation.	Taken to qualify as source product.

Contract manufacturing

1.24 These amendments also update the definition of producer to take into account the changes made by the 85 per cent requirement. A 'producer of wine' is defined as 'an entity that manufactures wine or supplies the source product to one or more entities from which the wine is manufactured'. ***[Schedule 1, item 17, definition of 'producer' in section 33-1]***

1.25 Manufacturing includes having a product made by a contract manufacturer on the wine producer's behalf from inputs that they own. Therefore an entity that owns the source product and maintains that ownership throughout the wine-making process but has that wine manufactured under contract on its behalf by another entity is still regarded as the producer of that wine for the purposes of the WET and is eligible to claim the WET producer rebate (provided it satisfied all of the other criteria for claiming the WET producer rebate).

1.26 Provided the wine producer continues to maintain ownership of the wine then it does not matter that the wine producer undertakes parts of the wine-making process in different places, including at another producer's wine-making plant. For example a wine producer that crushes the grapes at one location owned by another producer, ferments the wine at a second location and bottles the wine at a third location owned by a different producer can qualify provided that they maintain ownership of the wine throughout (and satisfy the other components of this requirement).

1.27 A minor technical amendment also clarifies that wine that has been manufactured by New Zealand producers by a contract manufacturer can qualify for the WET producer rebate. ***[Schedule 1, item 8, paragraphs 19-5(2)(b) and (c)]***

Example 1.1 Ownership of source product throughout the wine-making process

Chris is a producer of port wines. Chris purchases his grapes from wine growers, taking full ownership of the grapes immediately before they are crushed. Chris contracts Kylie to undertake the wine-making on his behalf. Chris continues to maintain ownership of the wine throughout the wine-making process, up to and including the bottling, labelling and packaging of the wine.

Each one litre bottle of wine contains the following ingredients:

- 500 millilitres originating from grapes he owned immediately before they were crushed;
- 200 millilitres of brandy;

- 150 millilitres of purchased wine;
- 80 millilitres of purchased grape juice concentrate;
- 50 millilitres of water; and
- 20 millilitres of additives (yeast, colouring and tartaric acid).

The 500 millilitres originating from source product Chris owned is source product. The following ingredients are taken to be source product for the purposes of the ownership test:

- 200 millilitres of brandy (as a fortifying substance);
- 50 millilitres of water;
- 80 millilitres of grape juice concentrate (as this is 10 per cent or less by volume of the final product, that is 100 millilitres);
- 20 millilitres of additives (comprising equal amounts of yeast, colouring and tartaric acid) (none of these ingredients are similar substances and therefore as they each make up 10 millilitres or less (one per cent or less) of the final volume of the wine they are treated as forming part of the source product).

Therefore, for the purposes of the ownership test, 850 millilitres of the final wine originated from, or is taken to originate from, source product owned by Chris before it was crushed. This wine satisfies the ownership test as this is at least 85 per cent by volume of the final wine, that is 850 millilitres.

As this wine satisfies the ownership test Chris can claim the WET producer rebate for this wine (provided that the wine also satisfies the other eligibility requirements).

Example 1.2 Source product component of ownership test is not satisfied

Savannah grows her own wine grapes which she crushes and uses to produce Riesling wine. Savannah owns the grapes, from when they are grown and picked through to crushing and she continues to maintain ownership of the wine throughout the wine-making process, up to and including bottling.

Each one litre bottle of wine contains the following ingredients:

- 700 millilitres originating from grapes she owned immediately before they were crushed;
- 200 millilitres that is purchased wine;

- 50 millilitres of grape juice concentrate;
- 40 millilitres of water; and
- 10 millilitres of additives (yeast, colouring and tartaric acid).

The 700 millilitres originating from source product Savannah owned is source product. The following ingredients are taken to be source product for the purposes of the ownership test:

- 50 millilitres of grape juice concentrate (as this is less than 10 per cent by volume of the final product, that is 100 millilitres):
- 40 millilitres of water; and
- 10 millilitres of additives (containing equal quantities of yeast, colouring, tartaric acid) as each of these additives are different substances and each ingredient makes up one per cent or less of the final product.

Therefore, for the purposes of the ownership test, 800 millilitres of the final wine originated from, or is taken to originate from, source product owned by Savannah before it was crushed. As this is less than 85 per cent by volume of the final wine, that is 850 millilitres, this wine does not satisfy the ownership test.

As the wine does not satisfy the ownership test, Savannah cannot claim a WET producer rebate for this wine. However this does not prevent Savannah from claiming the rebate for other wine she produced, provided that wine satisfies all of the requirements for the rebate.

Example 1.3 Time of ownership is not satisfied

Patricia is a producer of sauvignon blanc wine. Patricia purchases crushed grape pulp (unprocessed crushed grapes) which she uses to produce her wine. She continues to maintain ownership of the wine throughout the wine-making process, from when she purchases the grape pulp up to and including the bottling, labelling and packaging of the wine.

As Patricia has not owned any of the source product used to make the wine before it was crushed she does not meet the ownership test. Therefore she will not be able to claim a WET producer rebate for this wine.

Grape wine products

1.28 A grape wine product that contains grape wine of between 700 millilitres but less than 850 millilitres per litre, (that is 70 to

85 per cent grape wine) does not generally satisfy the ownership requirement and therefore does not qualify for the WET producer rebate.

1.29 Under section 31-3 of the WET Act grape wine product is a wine that contains at least 700 millilitres of grape wine per litre (that is at least 70 per cent grape wine). Examples of grape wine products include a wide range of wine types including wine based cream and marsala.

1.30 A grape wine product that contains 70 to 85 per cent grape wine does not generally satisfy the ownership requirement. The ownership requirement requires at least 85 per cent of the wine by volume in its final form as packaged branded product fit for retail sale to have originated from source product that was owned by the producer before the wine-making process commenced. This will not be satisfied for wines that have had products added to them that are not derived from source product (for example cream) or where those products are derived from source product that the producer did not own (for example fruit juice for fruit flavoured wines).

Packaging requirements

1.31 To qualify for the WET producer rebate wine must also be:

- packaged in a container that does not exceed five litres (51 litres for cider and perry);
- be branded with one of the following trade marks owned by a producer or an entity associated with the producer that readily identifies, or can be associated with the producer of the wine:
  - a registered trade mark;
  - a trade mark for which registration is pending;
  - a trade mark that has been used in the course of trade throughout the period beginning from 1 July 2015 and ending at the time an assessable dealing with the wine occurred (for example a common law trade mark that has been recognised by the courts or the Registrar of Trade Marks); and
- wine, that as packaged, is ready for retail sale.

[Schedule 1, item 8, paragraphs 19-5(1)(e) and 19-5(2)(f) and subsection 19-5(7)]

1.32 The wine must be packaged in a container that does not exceed five litres in capacity. The container (such as a bottle) in which wine is sold would be suitable for retail sale if purchasers would ordinarily expect to find wine packaged in such a container with appropriate labelling (complying with the Label Integrity Program where appropriate) when it is sold on a retail basis. The exception is cider and perry for which the container (such as a keg) must not exceed a capacity of 51 litres and the container must be suitable for making retail sales of portions of the cider or perry in the container, such as 'on-tap' sales over the counter at licensed premises. ***[Schedule 1, item 8, paragraph 19-5(7)(a)]***

Trade marks

1.33 The wine must be packaged so that each container is directly branded with a trade mark that is owned by the producer or an entity associated with the producer that readily identifies, or can be associated with the producer of the wine. It is not sufficient for the brand to be placed on a box of wine. The brand must be included on each individual bottle of wine within the box. An entity will be associated with the producer if, assuming it were a producer (regardless of whether in fact it is), it would be an associated producer under paragraph (a) of the definition of associated producer under section 19-20 of the WET Act. ***[Schedule 1, item 8, paragraphs 19-5(7)(b), (c) and (d)]***

1.34 While the wine must be branded with a trade mark as outlined in paragraph 1.33 for it to qualify for the WET producer rebate, provided that this is done, the wine can still be branded with other trade marks that the producer does not necessarily own but has some association or connection with (for example through a commercial arrangement) and this will not affect their rebate entitlement.

1.35 To qualify, the trade mark must be either a trade mark within the meaning of *Trade Marks Act 1995* or the *Trade Marks Act 2002* of New Zealand and one of the following must apply to the trade mark:

- it is registered;
- an application for registration of the trade mark is pending; or
- it has been used in the course of trade throughout the period beginning from 1 July 2015 and ending at the time an assessable dealing with the wine occurred.

[Schedule 1, item 8, paragraphs 19-5(7)(e) and (f)]

1.36 A trade mark is a registered trade mark if it is registered under:

- for an Australian producer – the *Trade Marks Act 1995* with IP Australia[1]; or
- for a New Zealand producer – the *Trade Marks Act 1995* with IP Australia or with the Intellectual Property Office under New Zealand law[2].

1.37 An application for an Australian trade mark is pending from the time when the application has been filed until:

- the application lapses, is withdrawn or is rejected;
- if the Registrar of Trade Marks refuses to register the trade mark and there is no appeal against the decision, the end of the period allowed for the appeal;
- if the Registrar refuses the decision to register the trade mark, the decision is appealed and the decision to refuse registration is upheld, the day on which the decision is upheld; or
- the trade mark is registered.

1.38 A trade mark also qualifies if it has been used in the course of trade throughout the period beginning from 1 July 2015 and ending at the time an assessable dealing with the wine occurred. Examples of trade marks of this type include:

- an Australian common law trade mark – that is a trade mark that an Australian court or the Registrar of Trade Marks has recognised as a common law trade mark in Australia;
- a New Zealand common law trade mark – that is a trade mark that a New Zealand court has recognised as a common law trade mark in New Zealand; or
- a trade mark that a producer has applied to their product that has not been registered as a trade mark.

Example 1.4 Packaging requirements

Kerry is an Australian red wine producer. Kerry bottles her wine in 750 millilitre bottles each containing a label that prominently displays

[1] https://www.ipaustralia.gov.au/trade-marks for further information
[2] https://www.iponz.govt.nz/about-ip/trade-marks/ for further information

the brand name and the information required to satisfy regulatory requirements. Kerry has registered her brand name as a registered trade mark with IP Australia which she owns. As a registered trade mark, Kerry's trade mark satisfies the definition of a trade mark as defined in the *Trade Marks Act 1995*. This wine therefore meets the trade mark condition of the packaging requirement for the WET producer rebate.

Had Kerry's trade mark not yet been registered, she could still have applied that trade mark, provided it satisfied the definition of a trade mark as defined in the *Trade Marks Act 1995* and she had lodged an application for registration and that application was pending.

Kerry's trade mark would also satisfy the requirement if it had been unregistered provided that it satisfied the definition of a trade mark as defined in the *Trade Marks Act 1995* and she had used it on an ongoing basis from 1 July 2015 until the time when she made an assessable dealing with (for example sold) the wine.

Example 1.5 Applying a trade mark where an application to register the trade mark as a registered trade mark is pending

Belinda commences production of sparkling white wine in January 2018. Belinda uses the trade mark White Night Sparkling Wine.

Belinda's trade mark satisfies the definition of a trade mark as defined in the *Trade Marks Act 1995*.

Belinda lodges an application with IP Australia to register her trade mark White Night Sparkling Wine and pays the application fee on 1 February 2018. It takes IP Australia some time to review and consider the application. As part of this process they seek further information from Belinda. IP Australia formally advises Belinda of the refusal of her application on 1 March 2020. The time to appeal the decision expires on 30 June 2020. Belinda decides not to lodge an appeal.

Belinda commences selling sparkling white wine packaged in 1 litre bottles from 1 July 2019 that meet the packaged for retail sale requirement. In doing so, she brands the bottles of wine with the trade mark White Night Sparkling Wine.

Assume that Belinda's wine satisfies the other requirements for claiming the WET producer rebate.

Belinda is able to claim the WET producer rebate for the wine that she sells on and from 1 July 2019 until 30 June 2020, the day on which the time to appeal the decision denying her application for a trade mark for White Night Sparkling Wine expires. This is because the application for registration of her trade mark is pending during this period. The fact that the application for the trade mark is refused does not change her entitlement to the WET producer rebate up until 30 June 2020 when her right to appeal expires.

Example 1.6 Applying a common law trade mark that has been recognised by an Australian court

Nik owns and operates a winery as a business. He is about to sell a batch of wine. He has been producing wine and selling it through his winery branded with the trade mark Futuristic Wines on an ongoing basis since 1 January 2014.

In November 2015, Gary, another wine producer, commences legal proceedings against Nik alleging that the branding that Nik used infringed a trade mark that he owned. Gary claimed that by selling his wine, Nik was committing an act of ‘passing off’ his product as Gary’s. Following a hearing, in August 2016 the court handed down its decision, dismissing Gary’s case and, in doing so, recognising Nik’s trade mark.

Nik’s trade mark satisfies the definition of a trade mark as defined in the *Trade Marks Act 1995*. As Nik has been using his trade mark on an ongoing basis in the course of trade in his business since 1 July 2015 his trade mark satisfies the packaging requirement to brand his wine with a trade mark. Therefore he will be entitled to claim the WET producer rebate for this wine (provided it satisfies all of the other requirements).

Offsetting the WET producer rebate against WET that is ultimately paid

1.39 For a producer to qualify for the WET producer rebate for wine, WET must ultimately be paid on that wine. Therefore a producer is only able to claim a WET producer rebate for wine if either the producer or the purchaser of wine from the producer incurs a WET liability for that wine. As the WET liability offsets the WET producer rebate that is claimed there is no net outflow of funds from the WET system. It is no longer possible for the sum of the WET producer rebate and credits claimed for the wine to exceed 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 with 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;

- making the purchaser liable for WET if they purchase wine from the producer under quote and quote 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.

When the producer can claim the WET producer rebate

1.40 A producer is entitled to claim a WET producer rebate if either the producer has, or the purchaser of the wine is taken to have, a WET liability for the wine.

1.41 The producer of the wine has a WET liability for the wine if they make a taxable dealing with the wine. ***[Schedule 1, item 8, subparagraph 19-5(1)(b)(i))]***

1.42 A purchaser of wine is taken to have a WET liability for wine if they purchase the wine by quoting to the purchaser that they intend to make a taxable dealing with the wine. A purchaser quoting that they intend to make a taxable dealing with the wine is sufficient for the producer of the wine to satisfy this requirement for claiming the WET producer rebate. There is no need for the producer to verify, in any way, what the purchaser actually does with the wine. ***[Schedule 1, item 8, paragraphs 19-5(1)(b) and (c)]***

1.43 Section 13-20 of the WET Act requires a quote to be made in the approved form. Currently the approved forms for quoting require the purchaser, if they acquire wine from a producer, to declare whether they intend to make a GST-free supply of that wine. Once the WET producer rebate integrity measure amendments take effect, these forms will be updated. They will require, if the purchaser is purchasing wine from the producer, for the purchaser to, in the same way they do for the intention to make a GST-free supply, to also declare if they intend to sell the wine under quote or to use the wine as an input into manufacture (including as an input to make further wine).

1.44 Following the amendments, if an entity that is a purchaser of wine sells that wine to another entity (second purchaser) that purchases the wine under quote then the second purchaser will not have to provide any declaration about its intended use of the wine.

1.45 The two changes to the quoting system for WET made by this Schedule are:

- to require a purchaser to declare in the quote if they intend to sell the wine under quote or to use the wine as an input into manufacture (see paragraph 1.43); and
- that a quote for the purchase of wine is ineffective for a dealing if the entity to which the quote is made purchased the wine that is supplied in that dealing for a price that included WET (see paragraphs 1.49 to 1.52).

1.46 A consequential amendment is also made to repeal section 19-10 as subsections 19-10(2), 19-10(3) and 19-10(4) no longer apply. The new paragraph 19-5(1)(c), updated to take account of the amendments made by this measure, now contains the exceptions to claiming the WET producer rebate that were previously contained in subsection 19-10(1). ***[Schedule 1, items 8 and 9, paragraph 19-5(1)(c) and section 19-10)]***

Purchaser of wine under quote liable for WET if they quote to the producer their intention to make a taxable dealing with the wine

1.47 A purchaser that purchases wine from a producer under quote and quotes to the producer that they intend to make a taxable dealing with the wine is liable to pay WET. This is because no exemption or exclusion from WET applies for wine if that purchaser:

- makes a GST-free supply of the wine;
- sells the wine under quote; or
- uses the wine as an input into manufacture.

[Schedule 1, item 1, section 5-50]

Example 1.7 Purchaser of wine under quote from producer quotes that they intend to make a taxable dealing with the wine

Yvonne purchases wine under quote from Camille, the producer of the wine. Yvonne has quoted to Camille that she intends to use the wine to make a taxable dealing by including a statement to that effect in the quote she makes to Camille as part of her purchase of the wine. There is no need for Camille to verify what Yvonne actually does with the wine.

The statement by Yvonne in her quote to Camille that she intends to use the wine to make a taxable dealing is sufficient for Camille to offset the WET producer rebate against WET that is ultimately paid. Therefore Camille claims the WET producer rebate (on the assumption that the other requirements are met).

If Yvonne exports the wine she will have an assessable dealing giving rise to a WET liability for that wine. This is because in this situation

> the exemption for dealings that are GST-free supplies or non-taxable importations does not apply. If the exemption were to apply then there would be no WET liability payable to offset the WET producer rebate that Camille has claimed.
>
> If Yvonne sells the wine under quote she will have a taxable assessable dealing with that wine. This is because the exemption for quoting does not apply. If the exemption were to apply then there would be no WET liability raised to offset the WET producer rebate that Camille may have claimed.
>
> If Yvonne uses the wine as an input into manufacture then she will have a taxable assessable dealing with that wine. This is because in this situation the wine is treated as being an application to own use of that wine. If the exemption were to apply then there would be no WET liability raised to offset the WET producer rebate that Camille has claimed.

1.48 Section 19-30 is also repealed. The removal of the exemptions and exclusion outlined in paragraph 1.47 now apply where section 19-30 would have previously applied to recover the loss to the WET system from the producer claiming a WET producer rebate in this instance. This provides a more appropriate outcome as the amendments ensure that the WET producer rebate can only be claimed if WET is ultimately paid. Prior to these amendments, section 19-30 imposed a penalty on an entity that purchased wine from a producer if it purchased that wine under quote and intended to use the wine to make a GST-free supply, but failed to notify the producer correctly of that intention. That penalty was not always proportional to the amount of WET that was lost to the system in these situations. ***[Schedule 1, item 12, section 19-30]***

Quote for purchase of wine is ineffective if the entity to which the quote is made purchased the wine for a WET inclusive price

1.49 A quote for the purchase of wine is ineffective for a dealing if the entity to which the quote is made purchased the wine that is supplied in that dealing for a price that included WET. Therefore the entity is liable to pay WET for the assessable dealing it makes. This is because an exemption under section 7-10 based on quoting does not apply. ***[Schedule 1, item 3, section 13-32]***

1.50 Entities that on-sell wine (on-sellers – entities that do not produce wine, but purchase wine to sell it to other entities) are affected by making the quote ineffective if wine that has borne WET is supplied. When an on-seller receives a quote with an order from a purchaser it needs to determine what wine it will use to fill that order. If the on-seller:

- bore WET on the purchase of that wine – the quote the on-seller receives from the purchaser is ineffective and the on-seller is liable to pay WET on the wine they sell (provided no other exemption applies) under that dealing. However the on-seller will be able to claim a credit for the WET they bore on their purchase of the wine, provided they are entitled to do so (see paragraphs 1.53 to 1.58);

- did not bear any WET as part of the purchase price of the wine – then the on-seller is able to sell the wine under quote and benefit from the quoting exemption (as is currently the case).

1.51 The purchaser that purchased the wine from the on-seller is also entitled to claim a credit for the WET paid to the on-seller, provided they are entitled to do so (see paragraphs 1.53 to 1.58).

1.52 In conjunction with the amendments to the WET credit rules (see paragraphs 1.53 to 1.58), the change to make a quote ineffective if the entity to which the quote is made purchased the wine for a WET inclusive price ensures that WET that has been imposed to offset the WET producer rebate that a producer has claimed continues to be included in the price of the wine. Therefore there is no net outflow of funds from the WET system. However, a net outflow could result, if the wine that has WET applied to it to offset the producer rebate claimed could be sold under quote. This is because the purchaser selling the wine under quote could claim a WET credit for any WET that had been paid, effectively resulting in no net WET being paid. There would then be an outflow of funds if there is no later taxable dealing with that wine under which further WET is imposed.

Example 1.8 Selling wine that has had WET imposed on it

Tony is a fine wine trader. He purchases wine from a range of producers and purchasers. He purchases wine for a goods and services tax (GST) exclusive price of $1935 which includes WET of $435 (29 per cent of the GST and WET exclusive price of $1,500).

Tony receives an order for wine from a purchaser who provides a quote for the purchase of the wine. Tony fills the order with wine he purchased for which the purchase price included WET. He sells the wine for a GST exclusive price of $2000.

As the purchase price included WET, the purchaser’s quote will not apply for the supply of this wine as it is ineffective. Therefore Tony will be liable to pay WET on the supply he makes of $580 (29 per cent of the GST and WET exclusive price of $2,000) with this wine which he will on-charge to the purchaser. Tony will be entitled to a credit for the WET he paid on the wine that he sells to the purchaser.

Tony remits $145 of WET to the Australian Taxation Office (ATO) relating to the sale of the wine at the time he lodges his next business activity statement. This is the net of the following amounts:

- $580 WET liability – the amount of WET that arises from the assessable dealing of selling the wine; less

- $435 WET credit – the WET credit Tony is entitled to claim under WET Credit event CR4 (as he bore WET on the whole of the wine he purchased that he used to fulfil this order) – this prevents double taxation on the same wine as he has made a taxable dealing with the wine.

As WET is included in the sale price of the wine, the purchaser is entitled to a WET credit, provided that the purchaser makes a taxable dealing with that wine (see paragraphs 1.53 to 1.58).

WET credits

1.53 The WET crediting provisions are amended so that a purchaser of wine is only able to claim a WET credit for WET included in the purchase price of that wine if it makes a taxable dealing with the wine. To give effect to this rule, the following WET credit events that give rise to WET credits in other circumstances are repealed:

- CR2 – borne wine tax even though entitled to quote;

- CR3 – liable to tax because the quote was ineffective under section 13-30;

- CR5 – exemption applies if latest assessable dealing is non-taxable;

- CR6 – tax excluded from sale price of tax-paid wine sold to quoting purchaser;

- CR10 – wine exported while still assessable wine;

- CR11 – tax excluded from sale price of a GST-free supply of tax paid wine; and

- CR13 – refund of customs duty following destruction of imported wine.

[Schedule 1, items 4 and 6, subsection 17-5(3)]

1.54 Section 17-37 and paragraph 31-15(4)(c), which deal with the application of CR10 and CR2 respectively, are also repealed.

Section 13-30 and the definition of CR1 in section 33-1, which refer to CR2, CR3 and CR6 respectively, are amended to remove those references. ***[Schedule 1, items 2, 7, 13, 14 and 15, sections 13-30 and 17-37, paragraphs 31-15(4)(b) and (c) and the definition of 'CR1' in section 33-1]***

1.55 The linking of the WET producer rebate to WET paid in all circumstances by offsetting the WET producer rebate against WET that is ultimately paid (refer paragraphs 1.39 to 1.52) ensures that if the WET producer rebate is claimed then a WET liability must arise for the producer or the purchaser of that wine from the producer. If a purchaser of wine claimed a WET credit for WET paid for which a WET producer rebate has also been claimed without that entity making a taxable dealing with the wine then this could result in a net outflow of funds from the WET system. For example a net outflow arises if the wine was subsequently exported, as WET is paid once, but there are two outflows in the form of the producer rebate and the WET credit.

1.56 However a purchaser of wine is able to continue to claim a WET credit for WET embedded in the purchase price of wine if that entity:

- makes a taxable dealing with the wine under CR4; and
- the purchaser bore WET on all of the wine that is the subject of the taxable dealing.

1.57 However, no WET credit can be claimed if the purchaser mixed the wine with other wine for which they had not borne WET (for example wine they produced or purchased under quote) before it was then sold. This ensures that the correct amount of WET is ultimately imposed on wine, being an amount equal to 29 per cent of the taxable value (excluding WET and GST) that applies to the last taxable dealing of that wine (for wine that is subject to a taxable dealing). ***[Schedule 1, item 5, subsection 17-5(3)]***

1.58 Purchasers of wine that acquire wine for a non-taxable purpose (such as a GST-free supply, on-selling under quote or an input into manufacture) should ensure that they purchase wine under quote by quoting to the producer that they do not intend to make a taxable dealing with that wine. This ensures that wine that is used for non-taxable purposes does not have any WET included in its price. This also maintains the integrity of the WET system as a producer is not able to claim a WET producer rebate for such wine. This outcome is consistent with the intent that the producer rebate only apply to wine to which WET applies (see paragraph 1.17 of the Explanatory Memorandum to Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004).

Example 1.9 Purchaser acquires wine that has WET embedded in the purchase price and makes a taxable dealing with the wine

George, a purchaser of specialty wines, purchased wine from another entity for a GST exclusive price of $3,870. George bore WET on that purchase as the purchase price included WET of $870 (29 per cent of the GST and WET exclusive price of $3,000). George sells the wine to a wine retailer for a GST exclusive price of $4,515, including WET of $1,015 (29 per cent of the WET and GST exclusive price of $3,500).

As George has made a taxable dealing with the wine and he bore WET on all of that wine, he is entitled to claim a WET credit for the WET that was included in the purchase price under WET credit event CR4.

George remits $145 of WET to the ATO relating to the sale of the wine at the time he lodges his next business activity statement. This is the net of the following amounts:

- $1015 WET liability – the amount of WET that arises from the assessable dealing of selling the wine; less

- $870 WET credit – the WET credit George is entitled to claim under WET Credit event CR4 (as he bore WET on the whole of the wine he purchased that he used to fulfil this order) – this prevents double taxation on the same wine as he has made a taxable dealing with the wine.

Example 1.10 Purchaser acquires wine that has WET embedded in the purchase price and makes a non-taxable dealing with the wine

Aaron, a purchaser of fine wine, bears WET on the purchase of wine as the purchase price included WET. Aaron exports the wine.

As Aaron has not made a taxable dealing with the wine, he is not entitled to claim a WET credit for the WET borne on that wine. This is because there is no WET credit event that allows for a WET credit to be claimed in this circumstance.

Example 1.11 Ensuring that the correct amount of WET is imposed if the wine passes through a number of purchasers in a supply chain

Bill operates a wine wholesale business. He purchases wine under quote from Jim (who is a producer) for $600 plus GST, quoting that he will make a taxable dealing with the wine.

As Bill has quoted to Jim that he will make a taxable dealing with the wine, Jim is eligible to claim the WET producer rebate (assuming that Jim meets all other requirements for claiming the producer rebate for that wine). The amount of the WET producer rebate is $174

(29 per cent of the $600 GST exclusive value that Jim sold the wine to Bill for).

Bill sells the wine to Maree, another wine wholesaler, for $1,290 plus GST. As the supply is an assessable dealing for which no exemption applies (that is Maree did not quote for the purchase of the wine) this price includes WET of $290 (29 per cent of the $1,000 GST and WET exclusive sale price). Bill remits the $290 of WET to the ATO relating to the sale of the wine to Maree at the time he lodges his next business activity statement.

Maree sells the wine to Boutique Wines, a wine retailer for $2,322 plus GST. The supply is an assessable dealing for which no exemption applies as it is a supply of wine to a retailer. Accordingly, this price includes WET of $522 (29 per cent of the $1,800 GST and WET exclusive sale price).

Maree remits $232 of WET to the ATO relating to the sale of the wine to Boutique Wines at the time she lodges her next business activity statement. This is the net of the following amounts:

- $522 WET liability – the amount of WET that arises from the assessable dealing of selling the wine to Boutique Wines; less

- $290 WET credit – the WET credit Maree is entitled to claim under WET Credit event CR4 (as she bore WET on the whole of the wine she purchased from Bill that she used to fulfil this order) – this prevents double taxation on the same wine as she has made a taxable dealing with the wine.

The total amount of WET paid on the wine is $522, being the $290 of WET paid by Bill and the $232 of WET paid by Maree. This is also 29 per cent of $1,800, which is the last GST exclusive price for which the wine was sold by a wholesaler. This demonstrates that following the amendments, the correct amount of WET will continue to be collected as intended.

The intent of offsetting the WET producer rebate against WET that is ultimately paid has also been satisfied as the WET producer rebate that Jim has claimed is offset by the WET liability that Bill has incurred.

Example 1.12 Ensuring that the purchase of wine for use for a non-taxable purpose does not have WET embedded in it

Kate operates a wine wholesale business that purchases wine from a wide range of producers and then on-sells it to entities that place orders with her.

Kate receives the following orders:

- Green Ltd which will be exporting the wine (a GST-free supply);

- Purple Ltd which will be using the wine as an input into manufacturing of food products (as an input into manufacture); and
- Yellow Ltd which trades in wine by on-selling wine to other purchasers, but only under quote (on-selling under quote).

When Kate purchases the wine, she quotes that she intends to on-sell the wine under quote. This has the effect that:

- no WET will be included by the producer in the price of the wine that Kate purchases;
- the producer that sells the wine to Kate will not be entitled to claim a WET producer rebate for the wine as the WET producer rebate is not offset against WET that is ultimately paid (that is the producer did not pay any WET and Kate did not quote for the wine on the basis that she was going to make a taxable dealing with the wine); and
- Kate will not be liable to any WET, when she on-sells the wine under quote to Green Ltd, Purple Ltd and Yellow Ltd.

The result is that the wine that Green Ltd exports, Purple Ltd uses as an input into manufacture and that Yellow Ltd on-sells under quote will not have any WET imposed on it.

Kate would also not be liable to pay WET if, instead of on-selling the wine under quote, she had herself exported the wine or used the wine as an input into manufacture.

Provided that the purchaser of the wine from the producer correctly declares their intended use for the wine then the exemptions from WET for wine that is subject to a GST-free supply, used as an input into manufacture or on-sold under quote remain following the amendments made by this measure.

WET producer rebate cap

1.59 This Schedule amends the WET Act to reduce the WET producer rebate cap to $350,000. Accordingly, producers of eligible wine are entitled to a maximum $350,000 WET producer rebate. ***[Schedule 1, items 23 and 24, subsections 19-15(2) and (3) and 19-25(2)]***

Associated producers rule

1.60 This Schedule amends the WET Act to tighten the associated producers rule by amending the timing of the application of the rule. There are no other changes to the operation of the associated producers rule.

1.61 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. ***[Schedule 1, item 26, subsection 19-20(1)]***

1.62 This change prevents artificial restructuring just prior to the end of a financial year to avoid the application of the associated producers rule for that financial year.

Example 1.13 – Associated producers rule

Black Pty Ltd is a wine producer. A review of Black Pty Ltd's ownership structure and operations finds that under the associated producers rule for the WET producer rebate it is associated with Red Pty Ltd from 1 July 2018 until 31 December 2018 and with White Pty Ltd from 1 February 2019 until 30 June 2019.

Under the associated producers rule, prior to this amendment, only White Pty Ltd would be taken to be an associated producer of Black Pty Ltd for the financial year as only it was an associated producer at the end of the financial year (that is on 30 June 2019). Red Pty Ltd would not be an associated producer of Black Pty Ltd as it was not one at the end of the financial year (irrespective of whether it was such a producer at any other time during the financial year).

Under the associated producers rule, following this amendment, both Red Pty Ltd and White Pty Ltd are taken to be associated producers of Black Pty Ltd for the financial year. This is because they were both associated producers of Black Pty Ltd at some (any) time during the financial year.

Repeal of the earlier producer rebate rule

1.63 Schedule 1 repeals the earlier producer rebate rule in section 19-17 and the associated offence provision in section 19-28 (except for wine to which the transitional provisions outlined in paragraph 1.68 to 1.78 apply). The earlier producer rebate rule that applied prior to these amendments to the claiming of a WET producer rebate by multiple producers for the same wine is repealed. This is because of the requirement included in this Schedule to own the source product throughout the wine-making process and the restriction that a WET producer rebate cannot be claimed on wine that is sold in bulk (rather than packaged in a form that is suitable for retail sale) make the rule redundant. The definition of earlier producer rebate in section 33-1 is also repealed. ***[Schedule 1, items 10, 11 and 16, sections 19-17 and 19-28 and definition of 'earlier producer rebate' in section 33-1]***

Application provisions

1.64 Schedule 1 commences on the first day of the next quarter to start following the day of Royal Assent.

1.65 The WET eligibility criteria apply to assessable dealings in wine in the 2018-19 and later financial years. ***[Schedule 1, subitem 19(1)]***

1.66 The amendments to reduce the WET producer rebate cap from $500,000 to $350,000 apply to assessable dealings in wine in the 2018-19 and later financial years. ***[Schedule 1, item 25]***

1.67 The amendment to the associated producers rule applies to dealings in wine made in financial years commencing on or after the day that Schedule 1 to the Bill commences. Accordingly, for example if the day that Schedule 1 commences is 1 January 2018 then the associated producers rule amendment applies to the 2018-19 financial year and later years. ***[Schedule 1, item 27]***

Transitional provisions

Amendments to introduce the WET eligibility criteria

1.68 For the purposes of the transitional provisions all product derived from source product included in the wine is taken into account in working out if the transitional provisions apply to the wine. It does not matter if the source product would satisfy the ownership test. Accordingly, it can be purchased wine or purchased grape juice but not, for example, added water or ingredients that are not derived from source product.

2018 year vintage wine

1.69 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; and
- mead and sake if the initial fermentation of the source product for more than 50 per cent of the wine (measured by volume) started on or after 1 January 2018.

[Schedule 1, subitem 19(2)]

Example 1.14 Wine to which transitional application provision applies

Maria is a wine producer. Maria has produced and packaged grape wine ready for retail sale. One litre of the wine, by volume, contains the following ingredients:

- 300 millilitres of grape wine made from source product for which crushing occurred on 1 February 2018;
- 200 millilitres of grape wine made from source product for which crushing occurred on 1 March 2018;
- 350 millilitres of grape wine made from source product for which crushing occurred on 1 March 2015;
- 100 millilitres of purchased grape juice made from source product that Maria did not own for which crushing occurred on 1 February 2018; and
- 50 millilitres of other ingredients and additives that are not derived from source product.

The transitional application rule for 2018 year vintage wine applies to this wine as 63 per cent of the wine by volume originated from source product that was crushed on or after 1 January 2018. This is because 950 millilitres of the wine is source product and 600 millilitres of this source product was crushed on or after 1 January 2018. If the transitional provision applies because the threshold test is met then the WET eligibility criteria apply to the whole of that wine (see paragraph 1.68).

2017 year and earlier year vintage wine (excluding fortified wine)

1.70 The ownership of source product through the wine-making process requirement does not apply to wine that:

- is grape wine, grape wine products, fruit and vegetable wine, cider or perry if the crushing of the source product for more than 50 per cent of the wine (measured by volume) occurred before 1 January 2018; or
- is mead and sake if the initial fermentation of the source product for more than 50 per cent of the wine (measured by volume) started before 1 January 2018; and
- the producer of the wine owned it immediately before 1 January 2018; and

- meets the following requirements:
  - an assessable dealing with the wine (in most cases a sale) occurs on or before 30 June 2023; and
  - was bottled on or before 30 June 2018, or correctly labelled with a vintage date of the wine as being for the 2017 year or an earlier year.

[Schedule 1, item 20]

1.71 However, as the earlier producer rebate rule continues to apply to wine to which this transitional rule applies, the producer is only able to claim a WET producer rebate to the extent another producer has not already claimed the rebate on that wine.

2017 year and earlier year vintage fortified wine

1.72 Fortified wine, for the purposes of the transitional rules, is wine that meets the requirements for fortified wine set out in Standard 4.5.1 – Wine Production Requirements as made under section 92 of the *Food Standards Australia New Zealand Act 1991* as Standard 4.5.1 applied on the day of commencement of this Bill[3]. ***[Schedule 1, item 22]***

1.73 The ownership of source product through the wine-making process requirement does not apply to wine that:

- is grape wine, grape wine products, fruit and vegetable wine, cider or perry if the crushing of the source product for more than 50 per cent of the wine (measured by volume) occurred before 1 January 2018; or
- is mead and sake if the initial fermentation of the source product for more than 50 per cent of the wine (measured by volume) started before 1 January 2018; and
- the producer of the wine owned it immediately before 1 January 2018; and
- meets the following requirements:
  - an assessable dealing with the wine (in most cases a sale) occurs on or before 30 June 2025; and

[3] The standard can be accessed at https://www.legislation.gov.au/Details/F2017C00112.

– before 1 July 2018 the wine was in the process of being manufactured into fortified wine or the wine was fortified wine that had been bottled.

[Schedule 1, item 20]

1.74 However, as the earlier producer rebate rule continues to apply to wine to which this transitional rule applies, the producer can only claim a WET producer rebate to the extent another producer has not already claimed the rebate on that wine.

2017 year and earlier year wine that is being manufactured into fortified wine

1.75 Wine that is in the process of being manufactured into fortified wine that is in tanks and barrels, for example a solera system for blending different vintages, immediately prior to 1 January 2018 is taken to satisfy the ownership of source product requirement. This reduces the compliance costs for producers and provides a transition period for producers to start to keep records of the ownership of source product. Accordingly, any product that is derived from source product that is in the wine at the start of 1 January 2018 is treated as being derived from source product that the producer owned before it was crushed. ***[Schedule 1, item 21]***

1.76 On and after 1 January 2018 it is then the responsibility of the producer to ensure that the wine in tanks and barrels that is to be manufactured into fortified wine continues to satisfy the ownership of source product throughout the wine-making process requirement and to maintain records to be able to demonstrate that this is the case. This removes the need for a producer to retrospectively trace back the ownership of inputs to wine production before 1 January 2018 that are derived from source product to prove that wine bottled from output from the tanks and barrels meets the ownership requirement.

1.77 However, as the earlier producer rebate provision also continues to apply to wine to which this transitional rule applies, the producer can only claim a WET producer rebate to the extent another producer has not already claimed the rebate on that wine.

1.78 This transitional rule does not apply to wine if it is bottled on or before 1 January 2018. However, instead the transitional rule outlined in paragraphs 1.72 to 1.74 applies in this circumstance.

Example 1.15 Transitional rule – 2017 and earlier vintage wine that is being manufactured into fortified wine

Dimitri is a fortified wine producer using a solera system as part of his wine-making process to produce fortified wine.

Immediately prior to 1 January 2018 any product in Dimitri's solera system (that will be wine when the wine-making process is completed) that is derived from source product is taken to be derived from source product that he owned before it was crushed.

However, Dimitri will need to maintain records of the ownership of any part of products that are derived from source product that he adds to his solera system on and after 1 January 2018. He also then needs to regularly evaluate from 1 January 2018 if the wine taken from the solera system for bottling that has had additional source product added on or after 1 January 2018 to the solera system meets the ownership requirement.

Dimitri would also need to take account of any WET producer rebate that an earlier producer of the wine had claimed.

Associated producers rule

1.79 The associated producers transitional rule applies to dealings in wine on and after the date of commencement of Schedule 1 to the Bill until the end of the financial year in which the day of commencement occurs (transitional period). It makes a producer an associated producer of another producer for that financial year if the associated producers test is met at any time during the transitional period. Accordingly if Schedule 1 commenced on 1 January, for example, then the transitional rule would apply from 1 January to 30 June of that calendar year. ***[Schedule 1, subitem 27(2)]***

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Wine equalisation tax producer rebate

1.80 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

1.81 Schedule 1 to the Bill amends the *A New Tax System (Wine Equalisation Tax) Act 1999* (WET Act) to improve the integrity of the wine equalisation tax (WET).

1.82 The amendments make integrity changes to the eligibility criteria for the WET producer rebate and the WET credit rules, reduce the WET producer rebate cap (currently $500,000) to $350,000 from 1 July 2018, tighten the associated producers rule and repeal the earlier producer rebate rule.

Human rights implications

1.83 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

1.84 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 2
Income tax relief for transfers within a fund to a MySuper product

Outline of chapter

2.1 Schedule 2 to the Bill amends the ITAA 1997 to provide asset roll-over relief for mandatory transfers within a superannuation fund in the transition to a MySuper product.

2.2 All legislative references in this explanatory memorandum are to the ITAA 1997 unless indicated otherwise.

Context of amendments

2.3 MySuper products were introduced to improve the experience of superannuation members that accept the default option offered by their employer by placing them in products that are appropriate and ensure their financial interests are protected.

2.4 The transition to MySuper products must be completed by 1 July 2017.

2.5 As a transfer of a default member's account balance may create an income tax liability from the realisation of fund assets, asset roll-over relief is currently available for such a transfer to a MySuper product in another superannuation fund to ensure that the default members are not disadvantaged.

2.6 Schedule 2 to the Bill will extend the asset roll-over relief to mandatory transfers to a MySuper product within a superannuation fund. This will ensure that default members of superannuation funds will not incur adverse and unintended consequences when their account balances are transferred to a MySuper product within the fund.

Summary of new law

2.7 Schedule 2 to the Bill provides asset roll-over relief to ensure default members of superannuation funds are not adversely affected if their superannuation benefits are mandatorily transferred to a MySuper product within the same superannuation fund.

2.8 The roll-over relief allows a complying superannuation fund to defer an income tax liability for assets transferred to the MySuper product so that the liability will not arise until an ultimate disposal of the asset.

2.9 Where the superannuation fund invests in a life insurance company or a pooled superannuation trust (PST) to support its default members, the same relief is provided to those entities.

2.10 The relief is also available to the interposed entities that transfer the assets pursuant to the mandatory transfer.

Comparison of key features of new law and current law

New law	*Current law*
A trustee of a complying superannuation fund, a life insurance company or a trustee of a PST can choose an asset roll-over to defer income tax consequences from a mandatory transfer to a MySuper product in another superannuation fund or within the same superannuation fund.	A trustee of a complying superannuation fund, a life insurance company or a trustee of a PST can choose an asset roll-over to defer income tax consequences from a mandatory transfer to a MySuper product in another superannuation fund.
A trustee of a trust, which is not a PST, can choose an asset roll-over to defer income tax consequences from a mandatory transfer to a MySuper within the same superannuation fund.	No equivalent.

Detailed explanation of new law

2.11 The amendments ensure an asset roll-over can be chosen by a transferring entity in relation to a transfer of a complying superannuation fund member’s accrued default amount to a MySuper product within the same superannuation fund, if certain conditions are satisfied. ***[Schedule 2, items 2 and 6, section 311-1 and subsection 311-12(1)]***

2.12 The transferring entity can be:

- a trustee of a complying superannuation fund;

- a life insurance company;
- a trustee of a PST; or
- a trustee of an interposed trust.

[Schedule 2, item 6, subsection 311-12(1)]

2.13 In this regard, complying superannuation funds, life insurance companies and PSTs may invest in assets attributable to default members' account balances in interposed trusts by acquiring units in those trusts.

2.14 In such cases, the transfer of accrued default amounts to a MySuper product would involve:

- the complying superannuation fund, the life insurance company or the PST redeeming units in the interposed trust;
- the complying superannuation fund, the life insurance company or the PST applying for units in another trust supporting the investments in respect of a MySuper product; and
- the assets of the interposed trust attributable to the accrued default amounts being transferred to the interposed trust supporting the MySuper product as consideration for the application for the units in the interposed trust supporting the MySuper product.

2.15 The asset roll-over is being extended to interposed trusts because the redemption and the transfer of assets between the interposed trusts are capital gains tax (CGT) events that may give rise to the realisation of capital gains or revenue gains.

2.16 An asset roll-over allows the transferring entity to defer income tax consequences pursuant to the transfer. This will ensure that the members are not adversely affected by the transfer of assets supporting their superannuation benefits.

Conditions for asset roll-over relief

2.17 For a transferring entity to access the asset roll-over, it must satisfy four key conditions:

- condition one — entity's assets must support interests in a fund;

- condition two — accrued default amount must be transferred;
- condition three — investment structures of default product and MySuper product must be substantially the same; and
- condition four — account balances must be transferred within certain time period.

Condition one — entity's assets must support interests in a fund

2.18 The transferring entity accessing the relief must either hold the default members' account balances or be the entity whose assets support the default members' account balances.

2.19 If the transferring entity is a trustee of the complying superannuation fund holding the default members' account balances, the condition is satisfied if, just before the arrangement was made, the fund held assets that are not complying superannuation life insurance policies or units in a PST. ***[Schedule 2, item 6, paragraph 311-12(2)(a)]***

2.20 If the transferring entity is a life insurance company, the condition is satisfied if, just before the arrangement was made, a complying superannuation life insurance policy issued by the entity was held by a complying superannuation fund. ***[Schedule 2, item 6, paragraph 311-12(2)(b)]***

2.21 If the transferring entity is a PST, the condition is satisfied if, just before the arrangement was made, units in the PST were held by a complying superannuation fund. ***[Schedule 2, item 6, paragraph 311-12(c)]***

2.22 If the transferring entity is a trustee of an interposed trust that is not a PST, the condition is satisfied if, just before the arrangement was made, all or substantially all of the units in the trust were wholly owned (directly or indirectly) by one or more of:

- a trustee of a complying superannuation fund;
- a life insurance company that has issued a complying superannuation life insurance policy that, just before the arrangement was made, was held by a complying superannuation fund; or
- a trustee of a PST that has issued units that, just before the arrangement was made, were held by a complying superannuation fund.

[Schedule 2, item 6, paragraph 311-12(2)(d)]

Example 2.1

Caelum Super holds all the units in Orion Trust to support the members investing in its default product.

Orion Trust holds all units in Lyra Trust, which holds 90 per cent of all units in Dorado Trust. None of those trusts are PSTs. Consequently, Dorado Trust is indirectly owned by Caelum Super and most assets in Dorado Trust are attributable to the accrued default amounts of Caelum Super members.

As a result of the MySuper reforms, Caelum Super decides to offer a MySuper product and determines that all members investing in its default product are eligible to hold the MySuper product.

Caelum Super intends to acquire all of the units in Cassiopeia Trust, which would hold the assets to support the members investing in the MySuper product. Cassiopeia Trust is not a PST.

On 13 September 2016, Caelum Super transfers the accrued default amounts of its members to its MySuper product. It is agreed that Dorado Trust will transfer the assets attributable to the accrued default amounts to Cassiopeia Trust as consideration for the redemption of its units by Lyra Trust, prompted by Caelum Super redeeming its units in Orion Trust.

However, due to the size of the total accrued default amount of Caelum Super members, Dorado Trust undertakes the transfer in tranches over a period of time to manage the complexity in transitioning the large amounts.

Dorado Trust transfers the assets attributable to the accrued default amounts to Cassiopeia Trust in four tranches — on 5 October 2016, 14 November 2016, 14 December 2016 and 17 January 2017.

Dorado Trust can choose an asset roll over for the assets transferred to Cassiopeia Trust. The transfers were part of the same arrangement despite the transfers occurring over a period of time. In addition, substantially all of Dorado Trust's units were indirectly owned by Caelum Super at the start of the arrangement.

Condition two — accrued default amount must be transferred

2.23 In order for the transferring entity to access asset roll-over relief, an accrued default amount must be mandatorily transferred to a MySuper product offered by the same fund.

2.24 The fund is required to make the transfer if it offers a MySuper product and its default members are eligible to hold the MySuper product (see paragraph 29SAA(1)(a) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)). ***[Schedule 2, item 6, subsection 311-12(3)]***

2.25 An accrued default amount is broadly the entire balance of a member's account where an investment choice has not been exercised or if it is held in a default investment option of the fund.

2.26 Accrued default amounts must be transferred to a MySuper product by 1 July 2017 (see subsection 29SAA(1) and section 388 of the SIS Act).

Condition three — investment structures of default product and MySuper product must be substantially the same

2.27 In order for the transferring entity to access asset roll-over relief, the investment structure of the default product to which the accrued default amount is attributable must be substantially the same as the investment structure of the MySuper product that the amount is transferred to. ***[Schedule 2, item 6, subsection 311-12(4)]***

2.28 This condition requires the default product and the MySuper product to invest in the same type of entities. That is:

- if the accrued default amount was invested in a life insurance company — the fund must invest in a life insurance company to support its MySuper product;
- if the accrued default amount was invested in a PST — the fund must invest in a PST to support its MySuper product; or
- if the accrued default amount was invested directly by the fund — the fund must directly invest the transferred amounts to support its MySuper product without investing in a life insurance company or a PST.

Example 2.2

Malama Super holds a complying superannuation life insurance policy issued by Life Co to support members investing in its default product. Life Co uses the premiums received for the life insurance policy to acquire various assets.

As a result of the MySuper reforms, Malama Super decides to offer a MySuper product and determines that all members investing in its default product are eligible to hold the MySuper product. Malama

Super intends to acquire units in Rock Trust (a PST) using amounts in the MySuper product rather than acquire another life insurance policy.

On 19 September 2016, Malama Super transfers the accrued default amounts of its members to its MySuper product. It is agreed that Life Co will transfer the assets supporting the life insurance policy to Rock Trust as consideration for the redemption of the life insurance policy.

Life Co would not be eligible for an asset roll-over for the assets transferred to Rock Trust as the investment structure of the default product and the MySuper product are not substantially the same. Life Co would be subject to the income tax consequences for the transfer of those assets.

2.29 The condition does not require the number of entities involved in the chain of investment to be the same. In transitioning to a MySuper product, the fund may consider the number of entities through which it invests and rationalise the number of interposed entities.

2.30 Although satisfying this condition does not require a MySuper product to replicate the investment structure of a default product, any difference between the investment structure of the default product and the MySuper product must be necessary to facilitate the mandatory transfer of accrued default amounts to the MySuper product. For example, the condition will be satisfied if the difference in investment structure is necessary for the product to satisfy the requirements to be a MySuper product under Part 2C of the SIS Act.

Example 2.3

Aumakua Super holds all the units in Michelangelo Trust to support the members investing in its default product.

Michelangelo Trust holds all units in Donatello Trust, which holds all units in Raphael Trust. Raphael Trust indirectly holds a diversified portfolio of assets through its 92 per cent ownership of the units in Leonardo Trust. None of those trusts are PSTs. Consequently, Leonardo Trust is indirectly owned by Aumakua Super and most assets in the diversified portfolio are attributable to the accrued default amounts of Aumakua Super members.

As a result of the MySuper reforms, Aumakua Super decides to offer a MySuper product and determines that all members investing in its default product are eligible to hold the MySuper product.

In order to comply with the MySuper rules of ensuring a lower fee structure, Aumakua Super intends to acquire 95 per cent of the units in Zen Trust. Zen Trust (which is not a PST) would hold a diversified portfolio of assets, to support the members investing in the MySuper product.

On 27 September 2016, Aumakua Super transfers the accrued default amounts of its members to its MySuper product. It is agreed that Leonardo Trust will transfer the assets attributable to the accrued default amounts to Zen Trust as consideration for the redemption of its units by Raphael Trust, prompted by Aumakua Super redeeming its units in Michelangelo Trust (which triggered a flow on effect on Donatello Trust and Raphael Trust).

Leonardo Trust can choose an asset roll-over for the assets transferred to Zen Trust as:

- substantially all of its units were indirectly wholly owned by Michelangelo Trust; and
- the investment structure of the default product and the MySuper product are substantially the same, despite the reduction in the number of interposed trusts in the structure.

2.31 Under the substantially the same investment structure condition, the proportion of investment in particular types of entities must remain substantially the same. That is, if a quarter of the accrued default amount was invested directly by the fund and the remaining portion is invested in a PST, to satisfy this condition approximately a quarter of the amount transferred must be invested directly by the fund and the remaining amount must be invested in a PST.

Condition four — account balances must be transferred within certain time period

2.32 The accrued default amounts must have been transferred between 29 June 2015 and 1 July 2017. These dates align with the Government's announcement for the extension of the roll-over relief to transfers within a fund and the deadline for the transfer of a default member's accrued default amount to a MySuper product. ***[Schedule 2, item 6, subsection 311-12(5)]***

Choosing the asset roll-over

2.33 If a trustee of a complying superannuation fund, a life insurance company or a trustee of a trust meets the four key conditions outlined above, they may choose a CGT and revenue asset roll-over for each asset that is transferred to entities supporting a MySuper product. ***[Schedule 2, items 6 and 15, subsections 311-12(1) and 311-42(1)]***

2.34 The choice is evidenced by the manner in which the transferring entity completes its income tax return for the income year in which the accrued default amounts are transferred (see section 311-60).

Assets eligible for an asset roll-over

2.35 Where a trustee of a complying superannuation fund transfers assets to a MySuper product within the fund, it can choose a roll-over for those assets that, just before the arrangement is made, are reasonably attributable to the accrued default amounts of its members. ***[Schedule 2, item 15, paragraph 311-42(2)(a)]***

2.36 Where the transferring entity accessing the relief is a life insurance company or a trustee of a PST, the assets must, just before the arrangement is made, be reasonably attributable to the accrued default amounts of the members and be reflected in the value of the fund's interest in the life insurance policy or the units in the PST. ***[Schedule 2, item 15, paragraphs 311-42(2)(b) and (c)]***

2.37 Where a transferring entity accessing the relief is a trustee of an interposed trust that is not a PST, the assets must, just before the arrangement is made, be reasonably attributable to the accrued default amounts of the members and all or substantially all of the units in the interposed trust are wholly owned (directly or indirectly) by one or more of:

- a trustee of a complying superannuation fund that holds the accrued default amounts; or
- a life insurance company or a trustee of a PST in which the trustee of the complying superannuation fund invests the accrued default amounts to support its default members.

[Schedule 2, items 6 and 15, paragraphs 311-12(2)(d) and 311-42(2)(d)]

2.38 After the transfer is complete, the asset becomes an asset of the receiving entity.

2.39 For transfers of accrued default amounts to a MySuper product within the same complying superannuation fund, a receiving entity must be:

- a trustee of the complying superannuation fund;
- a life insurance company whose complying superannuation life insurance policy is being held by the complying superannuation fund just after the completion of the transfer;

- a trustee of a PST whose units are being held by the complying superannuation fund just after the completion of the transfer; or
- a trustee of a interposed trusts whose units are all or substantially wholly owned (directly or indirectly) by one or more of the entities listed above just after the completion of the transfer.

[Schedule 2, item 15, subsection 311-42(3)]

Consequences of choosing asset roll-over for CGT assets

2.40 Section 295-85 makes the CGT regime the primary code for determining the tax consequences of the gains or losses generated on the realisation of certain assets owned by a complying superannuation fund or a PST. Section 320-45 provides for the same rules to apply for the complying superannuation assets of life insurance companies.

2.41 If the asset roll-over is chosen by the transferring entity, it disregards any CGT consequences associated with the asset transfer. Also, the receiving entity is treated as having acquired the asset for the transferring entity's cost base (and reduced cost base). This ensures that any CGT consequences are deferred until a later dealing with that asset by the receiving entity (see section 311-45).

Consequences for choosing asset roll-over for revenue assets

2.42 A revenue asset is an asset for which a profit or loss on disposal would be taken into account in calculating assessable income, other than a capital gains or capital loss, and that is not trading stock or a depreciating asset (see section 977-50).

2.43 For revenue assets subject to the asset roll-over, the transferring entity is taken to have realised the asset for an amount that would result in it not making a profit or loss on that realisation. Furthermore, the receiving entity is taken to have acquired the revenue asset for that amount (see section 311-50).

2.44 This ensures that any income tax consequences are deferred until a later dealing with that asset by the receiving entity.

Consequential amendments

2.45 This measure inserts provisions into Division 311, so that the Division governs tax relief for mandatory transfers of amounts to a

MySuper product, regardless of whether the MySuper product is provided by another complying superannuation fund or the same fund.

2.46 Consequential amendments are made to various provisions in the Division to:

- ensure that the provisions that are applicable to transfers within a fund do not continue to restrict their application to transfers to another fund;
- delineate the provisions which apply to transfers to another fund and those that apply to transfers within the same fund; and
- clarify the entity that makes the choice for tax relief and which provision the choice is made under.

[Schedule 2, items 2 to 5, 7 to 14 and 16 to 18, sections 311-1, 311-5, 311-10, 311-15, 311-20, 311-40, 311-45, 311-50 and 311-55]

2.47 Finally, although the ITAA 1997 contains references to *MySuper product* the term is not defined in the ITAA 1997. The Bill introduces the definition, which refers to the meaning of the term given in the SIS Act. Thus, the existing references to the term are amended to refer to the meaning as provided by the dictionary in the ITAA 1997. ***[Schedule 2, items 1, 3, and 19, item 7 in the table in subsection 40-340(1), section 311-5 and subsection 995-1(1) (definition of 'MySuper product')]***

Application and transitional provisions

2.48 The new law applies to mandatory transfers of members' accrued default amounts occurring on or after 29 June 2015. ***[Schedule 2, item 20]***

2.49 In this regard, the new law is beneficial to, and has been sought by, affected taxpayers as it provides roll-over relief for income tax consequences that may result from a mandatory transfer of a default member's account balance to a MySuper product within the same superannuation fund.

2.50 Affected taxpayers have been consulted during the development of the measure and strongly support the legislation, because it will ensure that default members of superannuation funds will not incur adverse and unintended consequences when their account balances are transferred to a MySuper product within the fund.

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Income tax relief for transfers within a fund to a MySuper product

2.51 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

2.52 Schedule 2 to the Bill amends the ITAA 1997 to provide asset roll-over relief for mandatory transfers within a superannuation fund in the transition to a MySuper product.

Human rights implications

2.53 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

2.54 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 3
Regulation impact statement: Wine equalisation tax producer rebate

3.1 This Regulation Impact Statement covers the Wine equalisation tax rebate integrity measure in Schedule 1 to this Bill (as explained in Chapter 1.

Background

Context

3.2 The wine industry is an important contributor to the Australian economy, employing around 30,000 people directly and many more indirectly. Over 2,400 wineries and approximately 5,900 independent wine grape businesses operate in Australia, comprising mostly small operations located in rural and regional areas in all States and the Australian Capital Territory, but predominantly in South Australia, New South Wales and Victoria.

3.3 The wine equalisation tax (WET) came into effect in 1999 alongside the GST, replacing wholesale sales tax (WST). The rate of WET (29 per cent) was designed so that it would be equivalent to the WST rate of 41 per cent once GST was included.

3.4 The WET rebate was introduced in 2004 to provide wine producers a rebate of 29 per cent of the wholesale value of eligible domestic sales. The rebate cap was set at $290,000, later increased to $500,000 in 2006. The rebate was originally intended to support small wine producers in rural and regional Australia by offsetting their WET liabilities.

3.5 Prior to 2004, wine producers had access to a maximum rebate of $42,000 for cellar door and mail order sales under the Australian Government Cellar Door Rebate scheme.

3.6 Since the introduction of the WET rebate, two rebate specific integrity measures have been introduced, the associated producers provision and the earlier producer rebates provision.

3.7 The associated producers provision was introduced in 2004 and provides that if two or more producers are associated (where they act under the direction or control of one another), they can only claim the maximum rebate of $500,000 for a financial year as a group.

3.8 The earlier producer rebates provision was introduced in 2012 to ensure the rebate could not be claimed more than once on a single quantity of wine. The provision requires that, where a producer blends or further manufactures wine using wine bought from another producer, they must reduce the amount of rebate they claim by any earlier rebates the other producer is entitled to claim (whether or not the previous entitlement was actually claimed).

3.9 However, both measures have proved insufficient, as detailed below in Section 1.

3.10 In the 2016-17 Budget, the Government announced that it would reduce the WET rebate cap and introduce eligibility criteria to return the rebate to its original intent of supporting small wineries including in regional Australia. An interim RIS was prepared prior to the Budget decision.

Current operation of the wet and wet rebate

WET

3.11 All sales of wine in Australia attract the WET, which is applied at the rate of 29 per cent of the final wholesale price on domestic sales of both Australian and imported wine. In 2015-16 the WET accounted for $853 million in Commonwealth revenue.

3.12 As wine may be bought and sold many times throughout the production process, the WET is usually applied on the last wholesale sale of wine. The last wholesale sale of wine is typically to a retailer, such as a bottle shop, hotel or restaurant.

3.13 Producers are able to defer the payment of WET through a process called quoting. In general, quoting occurs when a GST registered purchaser of wine quotes their Australian Business Number to a supplier of wine, which allows a particular supply or sale of wine to be exempt from the WET. Quoting is also used to exempt WET in other circumstances, such as where the purchaser exports the wine.

WET Rebate

3.14 The WET rebate entitles all individual wine producers, regardless of business size, to a rebate of 29 per cent of the wholesale value of eligible domestic sales up to a maximum rebate of $500,000 each financial year. The maximum rebate amount also applies to a group of associated producers. The vast majority of claimants are small and medium size business. Roughly 3,000 producers claimed the WET rebate in 2014-15. Of these, 9 out of 10 producers claim less than $350,000 worth of rebate.

3.15 To be eligible for the WET rebate, an entity must be a producer of wine. The term producer is defined quite broadly under the current provisions to include entities that are registered or required to be registered for GST, and:

- 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 manufacture. This includes blending a distinct finished wine from two or more different wines and further manufacturing raw or unfinished wine (including stabilising, fining, filtering, secondary fermentation, maturation and racking to clarify the wine by removing unwanted solids).

3.16 In order to be eligible for the 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 wine not quoted for the sale of the wine.

3.17 New Zealand wine producers are also able to receive a rebate of 29 per cent of the approved selling price of wine in Australia. This is in accordance with Australia's obligations under the Australia-New Zealand Closer Economic Relations Trade Agreement 1983.

1. The problem

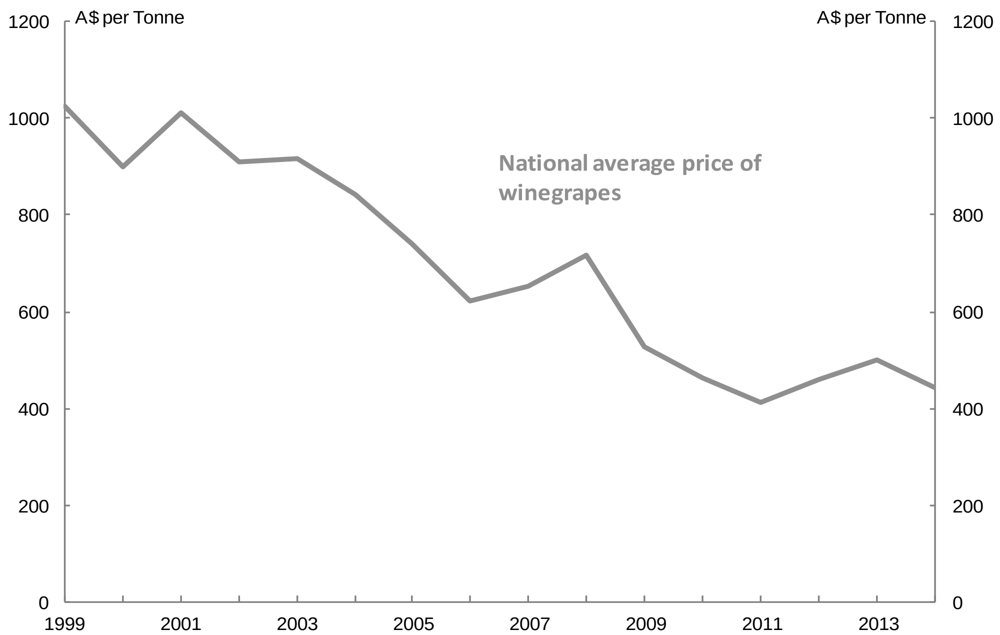
3.18 Reform of the WET rebate would better target the rebate, consistent with the original policy intent, and improve its integrity. The Government is seeking to address several integrity issues that have been identified with the rebate in its current form. The broad eligibility criteria and level of rebate currently in place has allowed unintended recipients to access the rebate and altered the behaviour of wine producers. This has contributed to economic distortions in the Australian wine market. These problems are examined in detail below.

1.1 Market distortions

3.19 The WET rebate has distorted production in the wine industry, contributing to the increased supply of wine and wine grapes, and preventing necessary adjustments that would improve the long term strength of the industry. In 2014-15 tax expenditure on the rebate was $315 million against total gross WET payable of $1.1 billion. The total value of domestic wine sales was 2.7 billion[4].

3.20 The wine industry has faced a significant decline in prices since 1999 when the WET was introduced (Chart 1). Falling prices have put pressure on winemakers by reducing profits and threatening the economic viability of many producers.

CHART 1 - AVERAGE WINE GRAPE PRICES



Source: Australian Grape and Wine Authority, Annual Price Dispersion Reports and Anderson K (2015) *Growth and Cycles in Australia's Wine Industry – A statistical compendium, 1843-2013*, University of Adelaide Press.

3.21 In an efficient market supply is expected to decrease in response to falling prices as producers decrease production or, in some cases, exit the market. Instead, production (grape crush) has stayed approximately steady since 2006 (Chart 2).

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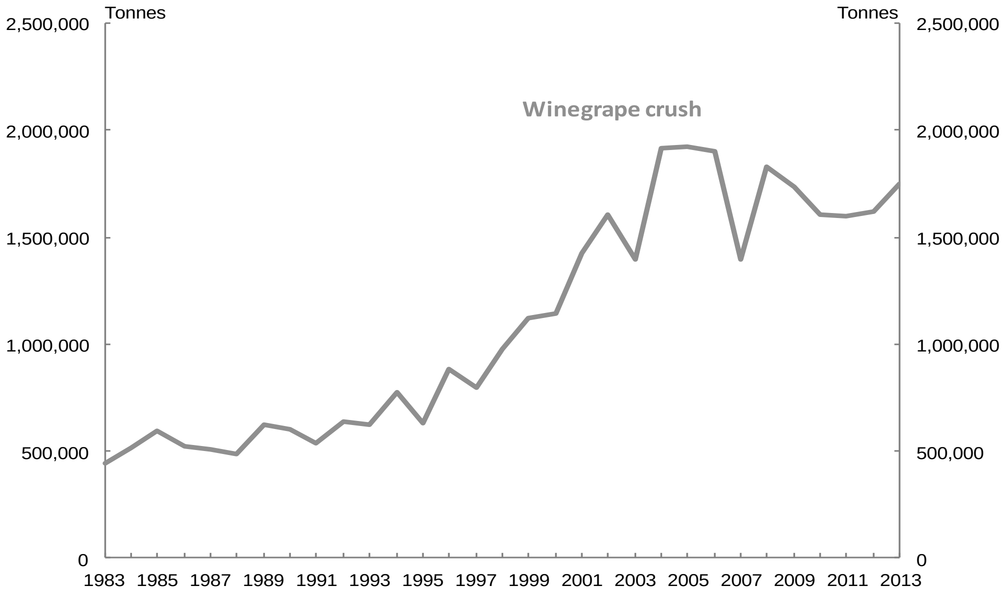
4 https://www.wineaustralia.com/en/market updates/~/media/0000Industry%20Site/Documents/Market%20bulletin/State%20of%20Australian%20wine%20report.ashx

CHART 2 - WINE GRAPE CRUSH



3.22 Evidence provided to the 2016 Senate Inquiry into the Australian grape and wine industry suggests a supply-demand imbalance in the wine industry has existed since at least 2005-2006[5]. Since 2009 this imbalance has been further exacerbated by a variety of factors, including an increase in the value of the Australian dollar, falling international demand, and competition with new low cost producers. By 2009, Australia was producing 20–40 million cases a year more wine than it was selling[6].

3.23 The WET rebate contributes to the additional supply problem outlined above by allowing uneconomic producers to remain in the industry, dis-incentivising consolidation to improve profitability and encouraging the production of bulk wine. The precise magnitude of the WET rebate's contribution to the supply problem is difficult to estimate due to the complexity and number of factors involved. However, Treasury's qualitative assessment of its impact suggests it is significant. This view was supported by a number of large industry stakeholders, both through submissions to the Senate inquiry on the Australian grape and

[5] Senate Inquiry into the Australian grape and wine industry, Senate Rural and Regional Affairs and Transport References Committee, February 2016, pg.6 available from: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry/Report

[6] Ibid. pg.6

wine industry and through numerous consultations conducted by Treasury. For example, the Riverina Wine Grape Marketing Board expressed a view that 'the WET rebate is subsidising cheap wine in the market' and that 'once we get that subsidy out of the way, wine should return to its correct value7.' Treasury Wine Estates also told the senate committee that current ‘wine tax arrangements actively distort the market, preventing necessary restructuring and sustaining structural oversupply’[8].

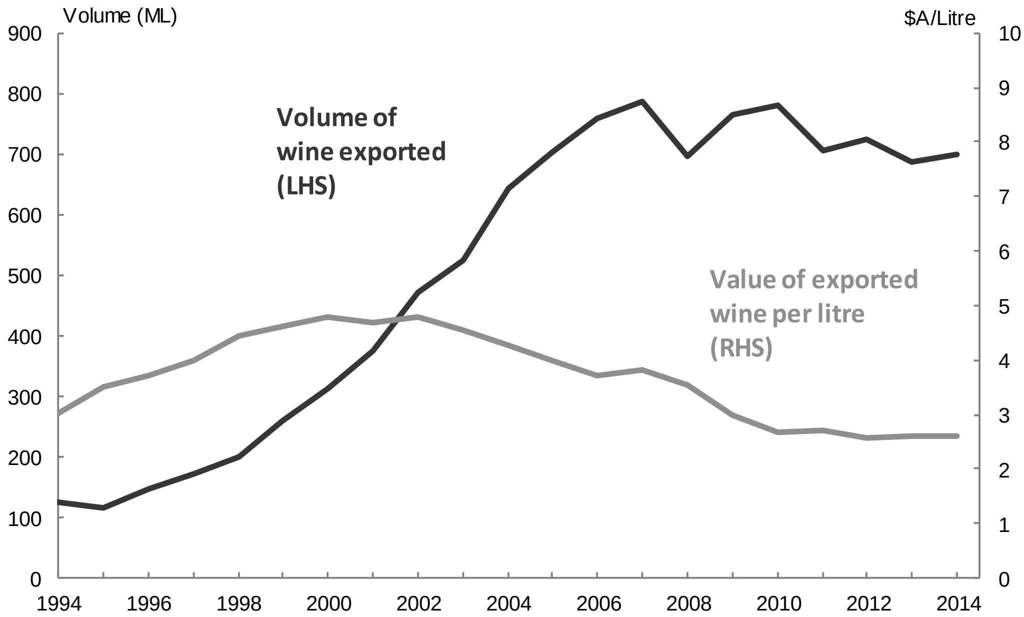
Encouraging the production of bulk wine

3.24 The high level of the WET rebate encourages producers to turn what would otherwise be uncommercial grapes into bulk wine for the purpose of claiming the rebate. This bulk wine competes with branded products, in both the domestic and export markets, lowering the price producers receive.

3.25 The majority of industry stakeholders have expressed the view that the Australian industry is best served by focusing on the premium wine market and cultivating a reputation for quality. Some stakeholders take the view that the additional supply of bulk wine at low prices in overseas markets has harmed the international brand image of Australian wine. Chart 3 shows that the value of exported wine has fallen as volume has increased.

[7] Ibid pg. 21
[8] Ibid pg. 20

CHART 3 - WINE EXPORTS – VOLUME AND VALUE PER LITRE



Source: Wine Australia, December 2014, *Wine Export Approval Report*. Accessed through Winetitles (2015) *Australian and New Zealand Wine Industry.*

Preventing the exit of uneconomic producers

3.26 Evidence provided to the Senate Inquiry estimated that a large segment of wine producers were operating below the cost of production. The Inquiry outlined that by 2014, an estimated 84 per cent of producers were not covering their variable costs, up from 77 per cent in 2019. The Wine Federation of Australia estimated that up to 70 per cent of Australian wine grape production may be uneconomic10. Without access to the rebate some of these businesses would exit the industry, reducing supply and creating a more sustainable environment for the producers remaining in the market. The WET rebate counteracts this market correction by allowing otherwise uneconomic producers to remain viable.

[9] Senate Inquiry into the Australian grape and wine industry, Senate Rural and Regional Affairs and Transport References Committee, February 2016, pg.7 available from: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Australian_wine_industry/Report

[10] Ibid.

Discouraging industry consolidation

3.27 In some cases consolidation of wine businesses could increase profitability by lowering costs and providing useful synergies. The rebate discourages this behaviour as consolidation can significantly reduce access to the rebate. If for instance two entities were claiming the maximum allowable rebate under the cap, the new consolidated entity would lose access to $500,000 worth of rebate. While the rebate is intended to benefit small producers it also needs to support small businesses to grow, increase their efficiency and make prudent business decisions without distortion from the WET rebate. In aggregate, the current level of the cap is resulting in a less profitable, less efficient industry than would otherwise be the case. The WET rebate cap could be lowered to reduce this distortion while still benefiting small producers given around nine out of ten wine producers currently claim less than $350,000 in rebate.

1.2 Integrity issues

3.28 The broad eligibility of the rebate and high cap of $500,000 incentivises producers to enter into structures to improperly access the rebate beyond its original policy intent. Eligibility for the rebate, as currently defined, includes grape growers who contract out the winemaking process, entities that blend wines, producers of bulk and unbranded wine and 'speculators' who trade in wine to access the rebate. A number of these structures and unintended consequences are detailed below.

Growers becoming 'producers' to claim the rebate

3.29 Industry stakeholders have indicated there has been a trend of wineries purchasing bulk wine from grape growers instead of purchasing grapes to make wine. This effectively enables wine grape growers to become wine producers and entitles them to claim the WET rebate on the wine sold to the winery. The winery is then able to purchase the wine at a subsidised, rebate inclusive price.

3.30 This transfers the benefit of the rebate to large producers at the end of the supply chain (such as large wine producers and major retailers) rather than grape growers or small wine producers, contrary to the policy intent of the rebate.

Blending and further manufacture

3.31 Producers can claim more than one rebate on a given parcel of wine through blending and further manufacture. To do so, producers undertake blending or further manufacture of wine, often by creating business arrangements involving additional interposed entities, solely so that the rebate can be claimed multiple times on the same wine. These arrangements can be structured to circumvent changes in the law in 2012 that were intended to prevent multiple rebate claims on the same wine.[11]

Producers accessing multiple rebates

3.32 Large producers can break down their winemaking business into multiple entities to circumvent the $500,000 cap and obtain access to multiple rebates.

3.33 An associated producers provision was introduced in 2004 to combat this behaviour. However, wine producers are still able to structure their affairs so they are not captured by the provision and the current rules are complex and time consuming in their application. The current law stipulates that an association can only be determined at year end, thereby making real-time compliance action difficult.

'Speculators'

3.34 'Speculators' is a term used by some stakeholders to describe those producers that enter the wine industry for the sole purpose of accessing the rebate. They have no involvement in the winemaking process and they do not have investment in the wine industry.

Wine Exports benefiting from the rebate

3.35 The WET rebate is intended to be paid only on wine for domestic sale, since exported wine is not subject to the WET. However, current rules allow producers to make WET declarations based on the intent of where the wine will be sold. This allows some producers to purchase wine slated for domestic sale and redirect it for export while still claiming the rebate.

Does not target small producers as intended

3.36 The WET rebate was intended to assist small wine producers. However, the cap limit has been set well above the level that most producers claim, principally benefiting large producers. While all producers can claim the rebate less than 1 out of 10 producers claim above $350,000. Producers claiming over $350,000 worth of rebate represent over 50 per cent of the value of all claims.

[11] Changes were made by the *Tax Laws Amendment (2012 Measures No. 5) Act 2012*.

2. The case for government action

3.37 The objective of the WET rebate is to benefit small wine producers who are making a genuine investment in the wine industry, many of whom are in rural and regional Australia. Small wine makers are important sources of economic activity and employment in their regions. They are less well equipped to manage the risks of external factors such as climate and disease compared to larger winemakers, which are able to utilise a diverse range of locations. The WET rebate assists small wine makers and delivers benefits to their communities.

3.38 However, as detailed above, the rebate has led to business structuring to maximise rebate claims and has contributed to increasing the supply of wine and wine grapes, exacerbating challenging market conditions. Reform of the WET rebate would improve its integrity and better target the rebate, consistent with the original policy intent.

3. Policy options

3.1. Summary of the recommended options

3.39 In light of consultation with the wine industry the following options were considered to achieve the Government's objectives:

- Option 1: No change (current system): Under this option, no action would be taken by the Government and the existing legislation would continue.

- Option 2: Reduce the WET rebate cap to $350,000 on 1 July 2018 and tighten eligibility criteria. The eligibility criteria would cover packaging, branding and ownership requirements. Additional integrity measures would also be given to the ATO to monitor and enforce compliance.

- Option 3: Reduce the rebate cap to $290,000 by 1 July 2018 and tighten eligibility criteria. The eligibility criteria would cover packaging and branding requirements, as in Option 2. An additional asset test would apply requiring producers to own or have long term lease of a winery in order to be eligible for the rebate. Additional integrity measures would also be given to the ATO to monitor and enforce compliance.

3.2. Detailed discussion of the options

Option 1: No change

3.40 This option involves no new actions by the Government and relies on the existing law. Consequently, it would introduce no new impacts on businesses, community organisations or individuals. At the same time, it would not address the issues identified in Section 1: *The Problem*.

Option 2 (proposed): Reduce the rebate cap and tighten eligibility criteria using an ownership test

3.41 This option involves introducing new eligibility criteria which would amend the definition of an 'eligible producer' and 'rebatable wine'.

3.42 The definition of rebatable wine would be amended to require wine be packaged in a container not exceeding 5 litres in a form fit for retail sale. Wine would also have to be branded with a wine producer's registered trade mark. Licensed trade marks would be excluded and common law trade marks would be allowed only by exception. There was strong support among stakeholders for these changes.

3.43 The definition of eligible producer would also be changed to include the requirement that 85 per cent of the rebatable wine must have been owned throughout the wine-making process. This requirement would demonstrate that producers have a long term investment in the industry and the products they sell. The 85 per cent rule would allow wine producers to blend a modest amount of wine into their products from other sources. This allows producers some flexibility to deal with poor harvests or other issues with their grape supply. This definition was largely supported by industry, though some stakeholders suggested a lower percentage requirement, such as 75 per cent.

3.44 The tightened eligibility criteria would be introduced 1 July 2018. This will minimise compliance costs by allowing time for wine producers to adjust their production to meet the new requirements.

3.45 Additional integrity measures would also be implemented to allow the ATO to monitor and enforce compliance. The first measure would better link the WET rebate payment with the payment of WET liability. Current rules allow producers to make WET declarations based on the intent of where the wine will be sold by the purchaser. This allows entities to purchase wine, indicate they intend to sell it domestically to allow the producer to claim the rebate, but then redirect it. This includes redirecting the wine for export (where no WET is paid) or blending the wine to claim the rebate again on the same parcel of wine. The updated rules would require purchasers to pay the WET on their next dealing of the wine in order for producers to claim the rebate. This would ensure the rebate on is only paid when a WET payment is made to the ATO by either the producer or another entity their wine has been sold to.

3.46 The second measure would improve the associated producers provision. The current provision aims to prevent entities artificially splitting themselves to claim multiple rebates. It is designed such that if two or more producers are associated (they act under the direction or control of one another), they can only claim the maximum rebate of $500,000 for a financial year as a group. The current law stipulates that an association can only be determined at year end, thereby making real-time compliance action difficult. The update would allow the ATO to monitor and enforce this law in real time. Stakeholders were supportive of additional measures that would give the ATO greater power to monitor and enforce the integrity of the rebate.

3.47 To better target assistance to small producers, the WET rebate cap would be reduced to $350,000 from 1 July 2018. Stakeholders were spilt on the merits of a cap reduction, with some suggesting the rebate provides important support to winemakers and their communities. However, a number of producers were also strongly in favour of reducing the cap to reduce the market distortions it causes. Less than 1 out of 10 producers claim above the $350,000 threshold, meaning the cap reduction would largely not affect the small wine producers who are the intended recipients of the rebate.

Option 3 (Budget announcement): Reduce the rebate cap and tighten eligibility criteria using an asset ownership test

3.48 The WET rebate cap would be reduced to $350,000 from 1 July 2017, followed by a reduction to $290,000 from 1 July 2018. This would be a larger reduction than option 2 and would occur sooner. The earlier timing of the cap reduction would give stakeholders less time to adjust to the lower cap.

3.49 Option 3 would adopt the packaging and branding requirements of option 2 but would introduce an alternative definition of eligible producer, requiring producers to own specified assets in order to access the rebate.

3.50 This option would require producers to own or have a long term lease on a winery to access the rebate. The intent of this approach is to ensure that producers accessing the rebate have a stake in the wine industry and have made an investment which benefits their community and region.

3.51 Stakeholders and pointed to a number of problems with this approach. The first is the existence of a variety of production models in the industry. Many producers, for example, contract out the production of grapes to a winemaking facility. New entrants to the industry generally do not possess physical assets but were acknowledged as an important source of innovation in the industry. An assets test would unfairly exclude some producers who have a legitimate stake in the industry.

3.52 A further problem would be incentivising overcapitalisation by producers. If an assets test was introduced there would be an incentive for producers to invest in physical assets where that may not otherwise be beneficial to their business. Driving producers to invest in more capital would be against an industry trend to specialise and maximise efficiency.

3.53 The final problem with an assets test is definition and enforcement. It would be difficult to fairly define a 'winery''. Monitoring and enforcing an assets test would also be time consuming and difficult for the ATO. These problems would apply equally to other asset tests, such as requiring producers to own a vineyard or cellar door.

3.54 As in option 2, the same associated producers measure would be implemented to allow the ATO to better monitor and enforce compliance.

4. Impact analysis

3.55 The proposed changes to the rebate seek to restore it to its original intent to support small wine makers in regional areas.

3.56 The changes would better target the rebate to small wine producers many of whom are in rural and regional Australia and improve efficiency for wine grape and wine markets in the long run, strengthening the prospects of the wine industry.

3.57 Community organisations and individuals are unlikely to be significantly affected by these reforms.

4.1 Impact on industry

Option 2

3.58 Reducing the cap and strengthening eligibility criteria would reduce market distortions in the wine industry.

3.59 As discussed in section 2, the WET rebate contributes to increasing supply in the Australian wine market by encouraging the production of bulk wine, and allowing uneconomic producers to remain in the market.

3.60 With a reduction in the cap, producers will reach the point where marginal production does not benefit from the rebate at lower volumes. Where this marginal production becomes unprofitable without the rebate, producers will reduce their volumes. In particular, this change would make the production of bulk wine less attractive.

3.61 The result would be a lower, more sustainable level of supply for the industry. The reduction of bulk wine volumes would also benefit the market for premium wine and the industry's aspiration of maintaining and further developing a reputation for quality in international markets.

3.62 A cap reduction would reduce the dis-incentive against entities consolidating, as the loss of access to the cap is less valuable. This is expected to improve the efficiency of the industry in the long term.

3.63 The cap reduction would also deliver increased revenue to the budget.

3.64 Both lowering the cap and introducing tightened eligibility criteria will make the rebate less attractive for contrived arrangements and artificial structuring. In particular, it will reduce practices aimed at claiming the rebate multiple times and will ensure the rebate is better targeted to its intended recipients. The new eligibility criteria are designed to directly combat the integrity issues identified in section 2.

3.65 Under the new eligibility criteria producers would need to own their grapes throughout the winemaking process. Bulk growers would no longer be able to access the rebate unless they produce their own appropriately packaged and branded wine. This would prevent arrangements where the benefits of the rebate is transferred from small producers to large producers that benefit from the rebate through lower prices on their bulk wine purchases.

3.66 Multiple rebate claims on the same wine would be reduced both through the new eligibility criteria and the new measure to better link the WET rebate payment with the payment of WET liability. These changes would target the rebate to legitimate producers and reduce the incentive to produce bulk wine.

3.67 Under the new eligibility criteria, package size would be limited to 5 litres, which would make the physical process of buying wine, blending it and repackaging more expensive. As producers would also have to own the wine throughout the process, blending wines purchased from other producers would not qualify a producer to receive the rebate.

Further, under the measure to better link the WET rebate payment with the payment of WET liability, the rebate would only be paid when a WET payment is made to the ATO by either the producer or another entity their wine has been sold to. If a producer attempted to blend wine and re-sell it to claim the rebate the ATO would have visibility of the transitions and be able to penalise any improper claims.

3.68 The new measure to better link the WET rebate payment with the payment of WET liability would help prevent claims being made on wine which is eventually exported. Under the new rule, if an entity attempted to purchase wine from a producer that has claimed the rebate and exports the wine without notifying the producer the purchaser will incur a penalty from the ATO. If the producer is correctly notified they would lose access to the rebate, preventing WET rebate claims on exported wine.

3.69 Eligibility requirements would stop ‘speculators’ accessing the rebate and better target it to its intended recipients. The requirement to own the wine throughout the winemaking process increases the time between a ‘speculator’s’ initial investment and their return, preventing transactions to quickly buy and sell wine to access the rebate. This will ensure that producers who access the rebate have substantial investment in the winemaking industry.

3.70 Lowering the cap would better target the rebate to smaller wineries as originally intended. Smaller wineries would be unaffected by the reduction in the cap as around nine out of ten WET refund claimants claim less than $350,000.

3.71 The reduction in the cap may have a small negative economic impact on non-premium producing wine regions. For example, modelling by Anderson of moving to a $150,000 cap found small, short run decreases in GDP and employment in affected regions[12]. Some wine producers would be expected to downsize their production or exit the market.

3.72 The changes to the eligibility criteria would have a low compliance cost impact. There would be no additional reporting requirements for the requirement to own 85 per cent of rebatable wine through the winemaking process. The 85 per cent figure aligns with the current reporting requirements for the label integrity program. Under this program, wine producers already keep records (e.g. weighbridge

[12] K. Anderson and G. Wittwer, *Australia’s Wine Equalisation Tax (WET): Impacts of Reforming its Rebate Scheme,* September 2015.

documents, grape crush data, purchase and processing invoices and agreements) to establish their ownership of 85 per cent of the grapes used in their production.

3.73 There is expected to be a low compliance cost impact associated with education and learning as wine producers would need to be informed of the changes. This is expected to be relatively straightforward and potentially part of the routine existing update processes. The new eligibility criteria would apply from 1 July 2018. This would minimise compliance costs by allowing time for wine producers to meet the new requirements.

3.74 There is expected to be a low compliance cost impact related to evaluation and planning. Taxpayers may undertake evaluation and planning to better understand the implications of this change on their business activities (consideration may be given to production decisions in light of the grandfathering provisions).

3.75 There is expected to be a low ongoing compliance cost associated with the requirement for purchasers to notify producers if the WET will not be paid on their next dealing of the purchased wine.

3.76 The aggregate compliance cost impact over ten years is estimated to be $1,350,000. This is $135,000 per year over 10 years. For all reporting periods, the Treasury portfolio has reported net compliance cost reductions and there is no reason why the portfolio will not continue to deliver on its red tape reduction targets this year, in line with the Government's regulatory reform agenda.

Table 1: Regulatory burden estimate

Average annual regulatory costs (from business as usual)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	$.135	-	-	$.135

Option 3

3.77 Some of components of option 3 are the same as option 2, including the packaging and branding requirements and the associated producers provision. For these components the impact on industry would be the same as option 2, described above. This section will analyse the impact of lowering the cap to $290,000 and using an assets test to determine eligible producers in addition to those impacts.

3.78 As described in option 2 a reduction in the size of the cap would result would be a lower, more sustainable level of supply for the industry. As the cap reduction is larger it would be expected to reduce supply by a larger magnitude and deliver greater revenue savings than option 2. Smaller wineries would be unaffected by the reduction in the cap as around nine out of ten WET refund claimants claim less than $290,000.

3.79 The earlier timing of the cap reduction under Option 3 would give less time for producers to adapt to the change.

3.80 Under the eligibility criteria of option 3 producers would be required to own or lease a winery. This would result in a number of small wine producers losing access to the rebate as many producers contract out the production of grapes to a winemaking facility. It would also discourage new entrants to the industry by creating a high barrier to entry due to the requirement to purchase or lease expensive physical assets. This would reduce an important source of innovation and growth in the industry.

3.81 The requirement to own or lease a winery would also incentivise overcapitalisation by producers. If an assets test was introduced there would be an incentive for producers to invest in physical assets where that may not otherwise be beneficial to their business. Driving producers to invest in more capital would reduce specialisation, efficiency and drive lower return on investment in the sector.

3.82 As with option 2 there is expected to be a low compliance cost impact associated with education and learning as wine producers would need to be informed of the changes. This is expected to be relatively straightforward and potentially part of the routine existing update processes.

3.83 There is expected to be a low compliance cost impact related to evaluation and planning, although this cost is higher than option 2 given the larger decrease in the cap. Taxpayers may undertake evaluation and planning to better understand the implications of this change on their business activities. There would be no changes to ongoing compliance cost.

3.84 The aggregate compliance cost impact over ten years is estimated to be $300,000. This is $30,000 per year over 10 years.

Table 2: Regulatory burden estimate

Average annual regulatory costs (from business as usual)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	$0.03	-	-	$0.03

5. Consultation

3.85 The Government has undertaken extensive consultation on the WET rebate including two formal public consultation processes led by Treasury, ongoing targeted consultation, and significant Ministerial engagement.

3.86 On 21 August 2015, the Government released the WET Rebate Discussion Paper for public consultation and announced the formation of the WET Rebate Consultative Group to consider submissions and provide advice to Government on possible options for reform.

3.87 Submissions to the discussion paper generally agreed that changes needed to be made to the rebate to ensure it was properly targeted. Opinions on the change to the cap were mixed; some stakeholder submitted that the rebate should be significantly reduced and eventually phased out, while others advocated retaining the current $500,000 cap and tightening the eligibility criteria.

3.88 The Consultative Group included the Winemakers' Federation of Australia (WFA) and a number of WFA members. The group agreed that the current use of the rebate has led to unsustainable outcomes in the industry and reform of the rebate is warranted to return the rebate to its original policy intent.

3.89 The Consultative Group's key recommendations were:

- Leave the cap unchanged at $500,000.
- Amend definitions of 'producer' and 'eligible wine' to better target the rebate.
- Introduce specific anti-avoidance provisions into the WET act.
- Provide transitional assistance to the industry.

3.90 The Government released an implementation paper on the eligibility criteria announced in the 2016-17 Budget, on 2 September 2016 to invite views from industry. Submissions to the paper formally closed on 7 October 2016. This consultation process was focused on implementing the eligibility criteria announced in the Budget.

3.91 In-person consultation sessions to discuss the changes to the rebate were also held from 20 September to 29 September 2016. The sessions were held in Melbourne, Hobart, Sydney, Perth and Adelaide.

3.92 While a wide range of views were expressed by stakeholder there were several broader themes. In general:

- The industry agreed there is a problem with artificial structuring and the integrity of the system and wants the rebate to return to its original policy intent of supporting small wine producers.

- The industry agreed there should be changes to the eligibility criteria and that bulk and unbranded wine should not have access to the rebate.

- The industry supported the Government's decision to limit the rebate to packaged, branded wine for domestic sale.

- The industry preferred an alternative definition of eligible producers than was announced in the Budget. Rather than requiring producers to own or lease a winery they suggested an alternative test which would require a producer to own the grapes throughout the winemaking process.

- Views on the cap reduction were mixed. Medium size producers that would be affected by the cap reduction did not support the reduction. Several large stakeholders support the cap reduction, as they consider changing the eligibility criteria by itself will not stop artificial structuring to access the rebate.

3.93 The Rural and Regional Affairs and Transport Reference Committee also conducted an inquiry into the Australian grape and wine industry. The report was released on February 2016. The inquiry recommended that the WET rebate be phased out over five years and replaced with a grant to cellar door operators.

3.94 Consultation was undertaken with industry on the draft legislation to assist with the implementation of the measure.

3.95 The draft legislation was released for exposure from 5 April to 28 April 2017. Sixteen submissions were received. Several discussions were held with the Winemakers' Federation of Australia to discuss the technical implementation issues.

3.96 The technical changes made to the legislation following consultation included:

- amending the 85 per cent ownership test by excluding certain products (e.g. additives and fortifying spirit) from the 15 per cent allowance.
- changing the timing of when the ownership of source product test is met from immediately after crushing to before crushing.
- amending the trade mark requirements to allow trade marks owned by an associated producer of the entity claiming the rebate, and by expanding the types of trade marks that would meet the test.
- amending the application provision to provide appropriate transition periods for wine and fortified wine sourced from the 2017 and previous vintages, and existing fortified wine stored in tanks and barrels.

6. Conclusion

3.97 Three options were considered in the context of reforms to WET rebate. These were:

- Option 1: maintaining the status quo;
- Option 2: Reduce the rebate cap and tighten eligibility criteria using an ownership test; and
- Option 3: Reduce the rebate cap and tighten eligibility criteria using an asset ownership test

3.98 Option 1, maintaining the status quo would have no net benefit, and would leave unresolved a number of issues caused by the current scheme. Issues with the current scheme include market distortions and supply issues, artificial structuring, and that that the scheme is poorly targeted to its intended recipients. Rather than benefiting small wine producers in regional Australia as originally intended the rebate often benefits large producers and producers without real investment in the

Australian wine industry. Reform is needed to return the WET to its original policy intent to support small wine producers in regional areas. Supporting these producers will continue to deliver economic benefits to their local regions.

3.99 Two options were considered to reform the rebate: Option 2 and Option 3. Both options seek to address the two main problems outlined in section 2: market distortion and integrity issues.

3.100 Both reform options include changes to eligibility criteria which would combat artificial business structuring and better target the rebate to its intended recipients. Option 3 uses an asset test to determine eligibility while Option 2 uses a wine ownership test. The eligibility criteria in option 2 is assessed as having a higher net benefit because it better targets the rebate to small wine producers in regional Australia, while still reducing artificial structuring and market distortions. The assets test in Option 3 would incentivise businesses to purchase physical assets, resulting in overcapitalisation, while also excluding legitimate producers. It would create a barrier to entry for producers looking to enter the market, depriving the industry of new sources of growth and innovation. Finally, it would be far more difficult to monitor and enforce compared to Option 2.

3.101 Both options would lower the rebate cap, reducing the incentive to engage in artificial structuring, while also reducing market distortions and improving the long term health of the Australian wine industry. The cap reduction in both cases is accessed as having a significant net benefit. Without a cap reduction the rebate would be less targeted to smaller producers and there would remain a significant incentive for entities to find new ways to game the system, even with the new eligibility criteria. A cap reduction would address the market distortions that have led to supply problems in the wine and grape market as it reduces the incentive to supply otherwise uncommercial grapes and encourages greater efficiency.

3.102 Option 2 would lower the cap to $350,000 by 1 July 2018, while Option 3 would lower it to $350,000 on 1 July 2017, followed by a further reduction to $290,000 on 1 July 2018. The earlier timing of the reduction under Option 3 would give less time for producers to adapt to the change. Option 2 provides a greater transition period for industry.

3.103 Both options include improvements to ATO integrity measures. These integrity measures would stop erosions of revenue to producers which are acting contrary to the intent of the rebate. Option 2 includes an additional integrity measure which would better link the WET rebate to the payment of the WET liability. As Option 2 includes this additional measure it would more effectively protect government revenue and improve the integrity of the system.

3.104 The option with the highest net benefit is one which applies the eligibility criteria in Option 2 combined with a significant cap reduction.

7. Implementation and evaluation

3.105 Legislation is required to implement the proposed reduction in the cap and to implement the new eligibility criteria.

3.106 The ATO would be responsible for administering the tax rules. The ATO will monitor compliance and will advise Treasury if any problems are identified so remedial action, if appropriate, can be considered.