Australian Grape & Wine Submission responding to:

“The new alcohol duty system” consultation paper (October 2021)

January 2022

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Introduction

Australian Grape and Wine Incorporated (Australian Grape & Wine) welcomes the opportunity to make a submission to the United Kingdom's (UK) alcohol duties consultation process. This submission responds to the proposals put forward in the HM Treasury and HM Revenue and Customs consultation paper, released in October 2021, entitled: *The new alcohol duty system* (Consultation Document).

Australian Grape & Wine endorses the policy objectives outlined in the Consultation Document, as they relate to efforts to simplify the current system for alcohol taxation and reduce the administrative burden for both businesses and the UK Government. However, there are a number of proposals in the Consultation Document which we are concerned could lead to unintended consequences for wine producers in Australia and elsewhere in the world, and for UK consumers. These are laid out in the submission.

This submission addresses consultation questions set out in Chapter 6 of the Consultation Document relating to the overview of rates and structure, being:

1. What are your views on the proposed new structures of alcohol duty?
2. Do you think the proposed duty rates are appropriate?
3. Are there any other changes that you think should be included in the new structures?

Executive summary

1. Australian Grape & Wine understands that the decisions about taxation are matters for the UK Government and we are grateful of the opportunity to make some comments about the proposed system
2. Australian Grape & Wine supports the intent of the proposed policy changes as they relate to simplifying the taxation system and providing incentives for production and sales of reduced and lower alcohol products.
3. Australian Grape & Wine notes that if the system proposed by in the Consultation Paper is implemented, there will be unintended consequences arising for wine producers globally.
4. Implementation of the proposed duty regime would disadvantage countries in which wine grapes naturally ripen at relatively high sugar levels.
5. We note the duties payable on Australian wines would be significant if the proposed duty regime were to be implemented as drafted, with Wine Australia estimating an 11 per cent increase in duties paid per annum, equating to an increase of approximately £82 million per annum.
6. The proposed duty regime would significantly disadvantage wine producers and the wine trade compared with other alcohol beverage product categories.
7. The disproportionate rates proposed for alcohol beverage product categories is inconsistent with the concept of equivalence, in which alcoholic beverages are taxed based on their concentration of alcohol by volume (ABV).
8. If implemented, the proposed duty regime would make the wine taxation system in the UK more complex, with businesses experiencing a greater compliance burden, and the UK Government having to navigate and administer a more difficult system. This outcome would not align with the stated policy objective of simplifying the system.
9. It is important that any reforms to the duties system is aligns with alcohol labelling requirements for Australian wine in the UK. As drafted, the proposed duty regime would be inconsistent and incompatible with this principle.

While we believe that any firm position needs to be worked through with industry and the collection agency, there are some common principles we believe can be supported:

1. To align with the UK Government's proposed objectives of simplifying the tax system and applying higher duty-rates to alcohol beverages with a higher ABV, we support two separate bands for wine:
    a. A first band for wines with ABV between 8.5 per cent and 15 per cent; and
    b. A second band for wines with ABV 15 per cent and 22 per cent.
2. The rates applied within each of these bands could be determined according to an approach decided by the UK Government, but a lower duty-rate should be applied for wines in the first band. Duty rates should be developed in consultation with stakeholders.
3. If increments are proposed within each of these bands, it is important that these are set at a minimum of 1 per cent per increment, as 0.5 per cent increments are unworkable from a winemaker's perspective.

a. Currently, in accordance with the Australia - UK Wine Agreement[1], Australian wines sold in the UK are afforded a labelling tolerance of 0.8 per cent ABV and the ABV may be presented in increments of 0.1 per cent ABV. Therefore, if increments are proposed, it is clear that increments of 0.5% are unworkable.
b. 1.0% or greater increments would improve efficiency of collection and reflect the complexities of the grape growing and winemaking process, as identified in earlier in this submission.

[1] The Agreement on Trade in Wine between the Government of Australia and the Government of the UK of Great Britain and Northern Ireland

Who are we

Australian Grape & Wine is Australia's national association of winegrape and wine producers. Our activities focus upon the objective of providing leadership, strategy, advocacy and support that serves Australian wine businesses now and into the future.

We represent the interests of the more than 2,500 winemakers and 6,000 winegrape growers working in Australia. Our role is to help forge a political, social and regulatory environment - in Australia and overseas - that enables profitable and sustainable Australian wine and winegrape growing businesses. These businesses make a significant contribution to underpinning regional economies by driving growth in jobs, regional exports and food and wine tourism.

Australian Grape & Wine's voluntary membership represents over 75% of the national winegrape crush. We represent small, medium and large winemakers and winegrape growers from across the country. Policy decisions by the Australian Grape & Wine Board require 80% support, ensuring no single category can dominate the decision-making process and guaranteeing policy is only determined if it provides significant industry benefit. In practice, most decisions are determined by consensus.

Australian Grape & Wine is recognised as a representative organisation for winegrape and wine producers under the Wine Australia Act 2013, and is incorporated under the SA Associations Incorporation Act 1985. We work in partnership with the Australian Government to develop and implement policy that is in the best interests of winegrape growers and winemakers across Australia.

Australian Wine and the UK

The United Kingdom is a currently Australia's number one export market for wine. Our presence in the market is longstanding, with strong relationships with consumers, retailers and restauranteurs built over more than two decades. This trading relationship sees Australia exporting 251 million litres of wine in the 12 months ended September 2021, valued at AUD $460 million[1]. The total value of Australian wine sold in the UK in 2020 was estimated to be around £2 billion.[2]

Much of the wine Australia exports is destined for the off-trade market, in which Australian wine has been the number one category for more than twenty years, currently holding approximately 23 per cent volume share.[3]

Australia's relationship with the UK is expansive and deep and we are pleased to note the recent moves towards greater economic and trade cooperation between our two countries. Australian Grape & Wine commends both the UK and Australian Governments on finalising the Australia - UK Free Trade Agreement negotiations that will, upon entry into force, result in the removal of tariffs on Australian wine imported to the UK, delivering a benefit to Australian exporters of approximately AUD $43 million.

Currently, the duty rates for still wine are:

- £297.57 per hectolitre <15% alc. (approx. £2.2 per 75cl bottle)
- £396.72 per hectolitre > 15% alc. (approx. £3 per 75cl bottle).

The current rate for sparkling wine is £381.15 per hectolitre (approx. £2.9 per 75cl bottle).

Accordingly, based on the current export figures, Wine Australia data estimates that £760 million in duties was paid on Australian wine sold in the UK in the 12 months ending 30 September 2021.

Australia currently has over 350 exporters of wine to the UK. Most of these exporters are small and medium family-owned companies who export small quantities of premium wine, sold both on-trade and off-trade. Following the completion of the Free Trade Agreement, we estimated that the number of exporters would double in the next five-years, providing and even greater choice of premium wine for the UK consumer. In addition to these smaller exporters, it is also noted that a significant proportion of Australia's wine exports to the UK are bottled and labelled in the UK, with direct employment benefits in these bottling hubs, and flow-on benefits to those working in the transport and logistics fields. These investments provide mutual benefits for participating Australian wine companies and the UK economy.

[1] Note this figure represents the Free on Board (FOB) value of Australian wine exported from Australia.
[2] International Wines and Spirits Record, May 2021.
[3] IRI Worlwide, figures to the year ending September 2021.

Implications of the proposed new duty system

Australian Gape & Wine understands that the UK Government has responsibility for taxation policy in the UK and we are grateful for the opportunity to provide comments on the proposals.

We understand the UK Government has decided all categories of alcohol should be taxed according to the alcohol they contain but at different rates per litre of pure alcohol according to strength based on 4 bands: 1.2-3.4% ABV, 3.5-8.5% ABV, 8.5-22% ABV and above 22%. Products falling in the higher bands are set to pay a higher rate than those in the lower bands.

Our submission focuses on the impacts of wine in the proposed 8.5-22% ABV band.

Key concerns

Our main concerns are threefold. First, we believe that the structure of alcohol duty as proposed will result in a large increase in tax on wine. This will likely lead to a significant number of alcohol consumers switching to other beverages, reducing overall demand for wine. This is likely to have flow-on impacts for the burgeoning, high-quality British wine producers in the medium-term. Consumer choice for high quality red wine is also likely to be impacted, with many smaller producers unable to enter the market. It is likely that European producers, with their closeness to the European market, cheaper transport and (subsidised) production costs, less-favourable growing conditions resulting in lower alcohol red wines, will benefit at Australia's expense.

Second, it is apparent that the duties payable on still wines with an alcohol content or more than 11.5 per cent ABV would increase dramatically under the proposed regime, impacting Australian producers more than most. To illustrate this point, approximately 97 per cent of still wine exported from Australia has an ABV of more than 11.5 per cent, and Wine Australia has estimated that this would result in an average of 11 per cent increase in the duties payable on Australian wine – an additional £82 million per annum.[4]

Accordingly, the proposed regime would have the unintended consequence of reducing the benefit derived by Australian wine producers from the Australia – UK Free Trade Agreement, and for the extensive wine trading network in the UK. These proposed changes would also favour European exporters who have a lower transport cost base over Australian exporters. It is also expected this will result in a redistribution of alcohol sales in favour of products other than wine. In the longer term this too will impact the growth and profitability of the UK wine sector.

While this proposed change will impact all Australian wine businesses already invested in the UK, the impacts will be greatest on small and medium-sized businesses. In 2021, there were 354 Australian wine businesses exporting to the UK which increased from 332 in 2020. The majority of these are small and medium-sized wine businesses that are now looking to the UK for investment following the changing market conditions that have seen the

[4] Note that wine falling within the duty bands of 13.5 – 13.99, 14.0 – 14.49, and 14.5 – 14.99 per cent ABV would increase by 17, 22 and 26 per cent respectively.

$AUD 1.2 billon dollar China market become unviable for them in 2020. With these changes in market conditions, the UK has become the key priority market for diversification and expansion for these businesses and we had expected that growth to continue. This would be unlikely under the current taxation proposal. These companies are the family owned and backed businesses which were central to the sector's export success in the UK by creating long lasting and mutual relations between the Australian Wine sector and the UK in the 1980's and 90's.

Not only would this proposal impact Australia's small and medium businesses it would have local UK business implications as well. A number of large Australian wine businesses support significant investment in jobs and local economies in the UK and this proposal would create doubt over these investments in the long-term.

The third issue is that this will cause significant collection problems. Although the proposal is silent about how the deemed value of 12% ABV will be calculated, if wines falling within bands of 0.5 ABV have individual duty rates based on the percentage ABV of the individual band, this will cause significant cost and difficulties. This is discussed further below.

Wine compared with other alcoholic beverages under the proposed regime

As noted above, we are concerned that the proposed duty regime would put wine at a distinct comparative disadvantage to other alcohol beverage products, with wine to be taxed at significantly higher rates than beer and cider products and products with less than 8.5 per cent ABV.

While other categories may be in a position to change the alcohol content of their products, UK wine producers are bound by UK regulations that require wine to have an ABV of no less than 8.5 per cent ABV. This means wine producers cannot alter the alcohol concentration of their wines to take advantage of the lower duty rates applied to products sitting below 8.5 per cent ABC. In addition to the clear regulatory constraints, the grape growing and winemaking process naturally inhibits most producers' ability to make dry wines at lower alcohol levels. This is because most wines are fermented to dryness (or close to dryness), and as a result, they naturally contain concentrations of ABV well above 8.5 per cent. Indeed, most wines naturally containing within 12 and 15 per cent ABV following fermentation.

Accordingly, the proposed duty regime would result in a significant disadvantage for wine producers and wine trade compared with other product categories.

No and low alcohol

Under the proposed new regime, wine and sparkling wine between 8.5 per cent ABV and 22 per cent ABV would be taxed at £25.88/litre pure alcohol. We are supportive of simplification of the tax system and believe that a taxation system providing incentives for low alcohol beverages and encourages reducing alcohol content is appropriate.

Indeed, Australia is investing heavily in research that will lead to higher quality products and lower alcohol levels in wine. It is abundantly clear that the no and low alcohol beverages category continues to grow in volume and value in both domestic and export markets and the Australian wine sector is readying itself to take advantage of this market opportunity. Diversifying markets and product categories will reduce the potential impact of external economic shocks arising from geopolitical tensions, exchange rate fluctuations and changing demand patterns in both domestic and export markets.

However, currently much of this technology is not advanced enough for many smaller companies to produce high quality products at lower alcohol levels. In addition, variability in existing domestic and international regulations around compositional requirements, labelling, certification requirements and taxation in major markets present challenges.

Preferential treatment issues

Australian growing conditions mean that wine grapes that ripen at a higher sugar level than many European countries. As a result, Australian wines are, on average, higher in alcohol. In Europe, many countries/regions permit chaptalisation (sugar addition) to low sugar must and juice to improve the flavor profile. This practice is not permitted in Australia. Australia's grape growers and winemakers work together to produce wines of balance, often working to employ viticultural and oenological practices that seek to keep alcohol level low. However, as noted above, there are natural limitations to this, and consumers often enjoy the rich, full-bodied wines that Australia is celebrated for producing. Wine Australia notes that the average alcohol concentration of Australian wines imported to the UK in the 12 months ending 30 September 2021 was 13.2 per cent ABV, which is higher than most other wine producing countries and a function of our climate.

Further, some viticultural areas within Australia naturally produce wines with higher ABV than others due to their individual climatic conditions. For example, the South Australian grape growing areas of Coonawarra, Barossa Valley and McLaren Vale produce wines with ABV above the national average. These regions produce internationally renowned red wines, but will be significantly disadvantaged by the proposed duty regime.

Uncertainty of measurement

We are concerned that the proposed system put forward in the Consultation Document does not adequately recognise the practical challenges of accurately measuring alcohol content in wine.

As with all analytical methods, accurately measuring the level of alcohol in wine carries a degree of uncertainty. To illustrate this point, we note that The Australia Wine Research Institute (an internationally renowned research institution), in conjunction with the Interwinery Analysis Group Incorporated (founded in South Australia), recently conducted a study to quantify the uncertainty of measurement in determining the alcohol concentration of wine using the five most commonly used analytical methods – distillation via density meter, distillation via hydrometry, ebulliometery, fourier transform mid-infrared spectroscopy (MIR-FTIR), and near-infrared spectroscopy (NIR).

The normalised results indicate that accuracy ranges between 0.2 and 1.0 percent ABV. Accordingly, accurately determining a duty band within which a product would fall under the proposed system would be challenging.

This uncertainty in measuring is reflected in the Australia - UK Wine Agreement[5], in which Australian wines sold in the UK are afforded a labelling tolerance of 0.8 per cent ABV and the ABV may be presented in increments of 0.1 per cent ABV.

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[5] The Agreement on Trade in Wine between the Government of Australia and the Government of the UK of Great Britain and Northern Ireland

In addition to acknowledging the difficulty of accurate measurement, this arrangement

- ensures brand owners can apply a common label to individual products despite individual batches of bottles, that vary in alcohol concentration, making up the volume of the product.

Accordingly, a wine with an alcohol concentration of 11.8 per cent ABV could be labeled as having an alcohol concentration of 12.6 per cent ABV, but would be deemed to fall within the 11.5 – 12.0 AVB duty band. This appears inconsistent with the rationale of the proposed duty regime and has the potential to cause significant confusion in its administration.

Therefore, we submit that *if* increments are proposed by the UK Government, increments of 0.5 % would be entirely unworkable. We suggest that if increments are proposed, then the system would require would require increments of at least 1.0% to be practical from a winemaker's perspective.

Testing

Further, if the intention is that the ABV duty band be determined based on the actual alcohol concentration, rather than the alcohol concentration stated on the label, the proposed duty regime would require that batches of bottles, rather than individual products, be assessed to determine the duty band within which they fall. Accordingly, there is significant risk that the proposed duty regime would significantly increase the administrative complexity of the current system, create confusion, and increase the cost of compliance.

An unintended likely consequence of testing regimes will be that it would likely create a significant barrier to export for smaller producers of high-value wine, diminishing the potential of the Australia-UK wine agreement for Australian grape and wine businesses and potentially limiting or reducing the choices available to UK consumers. To provide a hypothetical, but realistic example, we could envisage a situation in which a small Australian winery has not exported to the UK previously, but is approached by a UK importer who would like to import 6 cases of their $120 a bottle Shiraz for the restaurant trade. The winemaker is keen to pursue this offer, but notes that if multiple bottles of her wines are selected for testing, it could potentially undercut the viability of the deal. This would potentially lead to a chilling effect on small exporters, with Australian exporters looking other markets and UK wine lovers missing out on the cheaper, more diverse array of wines they were foreshadowed under the FTA.

The proposed regime would create uncertainty for businesses

The wine production process each year is subject to the variabilities of seasonal conditions. For many producers, the alcohol content of a single wine SKU is different from year to year. Consequently, under the proposed duty regime the duty rate is almost certain to vary from year to year for most producers, depending on conditions.

Australian and UK businesses work together closely to plan the commercial dealings, right along the supply chain, and business certainty is a key element of any such relationship. The proposed duty rate would likely result in significant challenges in financial planning, pricing, and commercial dealings between importers, distributors, and retailers, as a result of the impacts of variable seasonal conditions on alcohol content.

There is also a potential problem with the scheduled timeframe for implementing the proposed duty regime.

Regardless of the structure of the new duty regime, ideally, winemakers in the Southern Hemisphere would have enough notice of the implementation of a new duty regime to be able to plan ahead of vintage 2023 which, in most viticultural regions, occurs between January and April. This would require postponement of the intended implementation date of February 2023.

Furthermore, Australian Grape & Wine is concerned that the unintended complexity of the proposed duties regime could have the potential of creating a disincentive for stocking a diverse range of wine SKUs for UK retailers. As drafted, the proposed duties system would require significant changes to retailer record keeping requirements and we are concerned that some may choose to reduce this complexity by narrowing their range of wine SKUs. This would be an unfortunate, albeit unintended, consequence that would primarily hit SME market share, including for UK producers seeking to gain a foothold in the market.

Implementation arrangements should be developed in consultation with stakeholders

Australian Grape & Wine believes this consultation process should be the first step in a more detailed conversation about how the proposed duties regime for wine, and alcohol more broadly, will be implemented.

A comprehensive stakeholder engagement process, including technical submissions and the formation of a working group to co-design and test implementation proposals would ensure that all stakeholders, including the UK Government, can avoid unintended consequences and allow the UK to implement a system that is efficient and effective, in line with the policy principles outlined in the Consultation Document.

Australian Grape & Wine would be delighted to represent the views of Australia's grape and wine sector in such a working group.

Impact on UK consumers

As noted, there are a number of unintended consequences of the current proposal that will impact the wine category and these will be felt most by UK consumers. Wine quality could be impacted, with producers seeking to sacrifice quality and complexity of certain wine styles in order to produce lower alcohol wines that are naturally produced with higher alcohol content due to climate.

Furthermore, the benefits for UK consumers slated to flow from the Australia-UK Free Trade Agreement would, unfortunately, be largely negated under the proposed duty rates. A major benefit of announcement at the conclusion of FTA negotiations included lower prices and more choice of Australian wines for UK consumers. However, the likely outcome of the current proposal would be higher overall taxes - passed through to UK consumers increasing cost – and a reduced range of wines for consumers to choose from, as the number of exports recedes.

Proposed alternative

Australian Grape & Wine supports the UK's efforts to implement a simplified and more effective tax system. We believe that the current proposal impacts wine disproportionately and, due to the varying natural climatic conditions from vintage to vintage and the nature of the winemaking process, will not meet the objective of simplification.

However, there are alternative options available to the UK Government that align with its policy objectives, while mitigating some of the most potentially damaging impacts for wine businesses. It is clear that there is a high-level of goodwill between the Australian and UK Governments, with regular opportunities for dialogue and consultation on a range of issues. Respectfully, Australian Grape & Wine strongly recommends that HM Treasury and HM Revenue and Customs have regard to whether an alternative structure to the proposed duty regime ought to be considered in relation to wine. As noted above, we believe that there is considerable merit in establishing a working group to look at options that meet the policy objectives of the UK Government and are more efficient.

While we believe that any firm position needs to be worked through with industry and the collection agency, there are some common principles we believe can be supported:

1. To align with the UK Government's proposed objectives of simplifying the tax system and applying higher duty-rates to alcohol beverages with a higher ABV, we support two separate bands for wine:
    a. A first band for wines with ABV between 8.5 per cent and 15 per cent; and
    b. A second band for wines with ABV 15 per cent and 22 per cent.
2. The rates applied within each of these bands could be determined according to an approach decided by the UK Government, but a lower duty-rate should be applied for wines in the first band. Duty rates should be developed in consultation with stakeholders.
3. If increments are proposed within each of these bands, it is important that these are set at a minimum of 1 per cent per increment as 0.5 per cent increments are unworkable from a winemaker's perspective.
    a. Currently, in accordance with the Australia - UK Wine Agreement[1], Australian wines sold in the UK are afforded a labelling tolerance of 0.8 per cent ABV and the ABV may be presented in increments of 0.1 per cent ABV. Therefore, if increments are proposed, it is clear that increments of 0.5% are unworkable.
    b. 1.0% or greater increments would improve efficiency of collection and reflect the complexities of the grape growing and winemaking process, as identified in earlier in this submission.

Adherence to these policy principles has the advantage of reducing the complexity of the collection system and simplifying the tax structure, while also maintaining the incentives to produce lower alcohol products. It also takes into account the complexity of wine production and uncertainty of measurement as noted above. We would be delighted to participate in any working group aimed at developing a system that is efficient and equitable.

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[1] The Agreement on Trade in Wine between the Government of Australia and the Government of the UK of Great Britain and Northern Ireland

Conclusion

The impacts of the proposed changes will have significant economic impact in the UK and beyond its shores. It is vital that the ramifications of these are well understood and acknowledged. As such, Australian Grape & Wine welcomes the opportunity to contribute to this consultation and will continue to advocate for strong trade and economic relations between Australia and the UK.

We support the efforts of the UK to implement a simplified efficient tax system as well as incentivising low and no alcohol products.

Unfortunately, the current proposal is likely to add cost to collections and may harm consumption of wine in UK, thus harming the development of the UK wine industry. It will also impact on exports of quality red wine to the UK and thereby the choice of wines its consumers will enjoy.

There are options around alternative proposals that may meet the policy objectives of the UK Government and not impact as adversely on the wine sector.

We strongly recommend that UK Government gives consideration to the broader negative implications of this tax proposal on Australia's grape and wine sector and the flow-on impacts for the UK's producers and consumers and that consideration is given to an alternative regime that will be more equitable.

We seek to continue to evolve and discuss the sector's priorities with the Australian and UK Governments to ensure an outcome that meets the UK's objectives while not adversely impacting wine. We would welcome the opportunity for further engagement and to provide you more information should it be required.

For further information, please contact Australian Grape & Wine at the details below.

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