



2010–11 **20** Administration of the Wine Equalisation Tax

UNDER EMBARGO
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Performance Audit Report No.20 2010–11

Introduction

1. Wine production is a major agricultural industry in Australia, employing around 30 000 people directly, that many more indirectly,¹ and is important to tourism and regional development. Over 2400 wineries operated in Australia in 2009, comprising mostly small operations located in South Australia, New South Wales and Victoria. Australia is consistently among the 10 largest wine-producing countries, with around two-thirds of this wine exported and the other third consumed domestically. Export sales were valued at \$2.3 billion in 2009, and domestic sales of wine reached \$2.1 billion in 2007–08.²

2. The Wine Equalisation Tax (wine tax) is a value-based tax applying to wine consumed in Australia. It applies at a rate of 29 per cent to assessable dealings in wine which include wholesale sales, sales under quote³ and applications to own use.⁴ Wine tax is generally included in the price paid by retailers when they purchase the wine from a wholesaler, and is passed on in the retail price of the wine to the end consumer.

3. The wine tax was introduced from 1 July 2000 under the framework of *A New Tax System*, which also introduced the Goods and Services Tax (GST). A range of alcoholic beverages is subject to the tax, including grape wine, grape wine products such as marsala and vermouth, other fruit wines and vegetable wines, cider, perry, mead and sake. Those entities that are registered or required to be registered for GST purposes are typically liable to pay the wine tax,⁵ and this is recorded and paid via the Business Activity Statement (BAS). Since introduction, the wine tax has raised almost \$6.7 billion in net revenue.

4. A rebate scheme for Australian wine producers was introduced on 1 October 2004. The rebate entitles eligible producers to a rebate of 29 per cent of the assessable dealing, which is typically the price for which the producer sells the wine, excluding wine tax and GST. The maximum rebate that can be claimed for each financial year from July 2006 is \$500 000 per eligible producer. In addition to being offered to Australian wine producers, from 1 July 2005 a producer rebate has also been available to New Zealand producers, where that wine is subject to dealing in Australia on which the wine tax is paid.

¹ Winemakers' Federation of Australia, *Winescope*, Spring 2009, p. 2.

² Winetitles, *The Australian and New Zealand Wine Industry Directory*, 2010, p. 8.

³ Quoting is a mechanism to defer wine tax to a later assessable dealing or to give effect to exemption from wine tax for a particular supply of wine.

⁴ Application to own use refers to wine that is not sold but rather taken for own consumption or used for purposes such as cellar door tastings, various promotions and samplings, or given to staff or charity.

⁵ An exception is where an importer pays the wine tax at the border to the Australian Customs and Border Protection Service. The importer is not necessarily required to be registered for GST.

5. There is considerable complexity in calculating the wine tax. To calculate wine tax payable, the *A New Tax System (Wine Equalisation Tax) Act 1999* covers a number of factors such as the type of wine product, the point of sale, whether an exemption applies and the appropriate taxable value.

6. The wine tax is predominantly administered by the Australian Taxation Office (Tax Office), which collects wine tax on assessable dealings in wine in Australia, including on most imports. Within the Tax Office, the wine tax is primarily administered by the Interpretative Assistance, Risk and Intelligence and Client Relationship Management teams in Adelaide, as part of the Indirect Tax Business Line. The Australian Customs and Border Protection Service (Customs) collects wine tax on some imports on behalf of the Tax Office. In administering the producer rebate in New Zealand, the Tax Office works closely with New Zealand Inland Revenue.

Context for wine tax administration

7. The wine tax was introduced to maintain or 'equalise' wine prices and revenue collected from wine sales at levels prevailing at the time of the introduction of the GST and abolition of the Wholesale Sales Tax in 2000 in order to avoid 'dramatic and dislocating price falls'.⁶ A producer rebate was introduced in 2004 to support the financial viability of small wineries and their consequent capacity to generate employment and wealth in local communities. The rebate scheme was extended to New Zealand producers in 2005, largely to satisfy bilateral trade obligations.

8. Since 2006, the trend of strong export growth of Australian wine has stalled, exports have fallen, and together with other factors including increased competition from New Zealand producers in the domestic market, the Australian wine industry has faced considerable hardship. A prime outcome has been large surpluses of grapes and wine.⁷ This glut has exacerbated fundamental problems in the industry, notably inefficient vineyard and wine operations, and decreased the cost competitiveness of the Australian wine industry. A restructuring program is underway to reduce the number of vineyards and supply of grapes. Against this backdrop, many small producers rely on the producer rebate for financial viability.

9. These operating conditions have contributed to a difficult environment for the administration of the wine tax by the Tax Office. A number of schemes have arisen in recent years where grape growers are attempting to improperly access the producer rebate, while some wholesalers and retailers have also been inventive in minimising the amount of wine tax paid. Some of these schemes are within the

⁶ Hansard, Senate—*Parliamentary Debate*, 31 March 1999, p. 3268.

⁷ In 2009, Australia produced around 30 million cases of wine more than it sold, with the total surplus exceeding 100 million cases.

provision of current legislation but have the potential to erode revenue, contrary to the original intent of the tax.⁸ Other schemes and compliance issues can contravene wine tax legislation.

10. In recognition of the existence of these types of arrangements, the Winemakers' Federation of Australia has since late 2008 raised concerns with the Treasurer, the Tax Office and publicly about excessive claiming of the producer rebate that had 'turbo-charged' the wine glut. In response to apparent changes in taxpayer compliance behaviour and the extent of industry concern, the Tax Office has rated the risks to its administration of the wine tax as high.

Audit objective and scope

11. The objective of the audit was to assess the effectiveness of the Tax Office's administration of the wine tax.

12. Four key areas were examined in the audit: governance arrangements; interpretative assistance and advice; compliance approaches for Australian entities; and administering the rebate for New Zealand wine producers.

13. The ANAO conducted fieldwork in the Tax Office's Adelaide office between May and September 2010 and also held discussions with representatives from Customs, the Department of the Treasury (Treasury) and New Zealand Inland Revenue. The ANAO also consulted with representatives of wine producers, wholesalers, retailers, tax agents and key industry associations, seeking their views on elements of the Tax Office's administration of the wine tax.

Overall conclusion

14. The wine tax raised \$721 million in net revenue in 2009–10, comprising \$955 million in wine tax liabilities less \$234 million provided in credits, mainly for the producer rebate. Payment of the wine tax is highly concentrated, with around 90 per cent of the net wine tax typically paid by 20 entities.

15. The Tax Office has generally administered the wine tax effectively, having implemented sound governance arrangements and administrative practices focussed on gaining assurance of compliance by the larger taxpayers, and has responded reasonably to changes in taxpayer behaviours that have heightened compliance risks regarding the producer rebate.

16. Interpretative assistance and advice provided via taxpayer alerts, determinations and private rulings helped to reduce the incidence of major wine tax

⁸ Where such issues arise within the provision of current legislation, the key consideration is whether arrangements were established for the purposes of obtaining a tax advantage, rather than for legitimate commercial reasons.

minimisation arrangements. Greater timeliness in providing such information would have reduced uncertainty for wine industry participants.

17. The program of active compliance activities has been significantly expanded in recent years, and would benefit from further sophisticated interrogation of existing databases and improved processes for selecting entities to review and audit. It would also now be timely for the Tax Office to resume discussions with Treasury about the definition of a wine producer, in order to resolve unintended outcomes regarding access to the producer rebate.

18. Administration and compliance arrangements for producers accessing the New Zealand producer rebate systems are more extensive than for the Australian rebate. The main opportunity for further assurance about compliance by New Zealand wine producers claiming the rebate is for the Tax Office to assess risks associated with documentation provided by relevant Australian entities that demonstrates the wine tax had been paid.

19. The ANAO made three recommendations directed towards strengthening the Tax Office's compliance arrangements to better support voluntary compliance by taxpayers with the requirements of wine tax legislation.

Key findings

Governance

20. Organisational structures facilitate interaction between those areas within the Tax Office providing the major administrative functions for the wine tax. While there is a well-established framework for planning the administration of the wine tax, scope exists to improve the presentation of wine tax planning documents and to re-categorise wine tax sub-risks so they are clear, distinct and together comprehensively cover all wine tax risks in a logically consistent manner.

21. Internal and external performance monitoring and reporting is adequate, although determining budgets and monitoring against budget for the major wine tax administrative functions would assist the Tax Office to better manage the economy of wine tax administration.

Interpretative assistance and advice

22. A major and effective response by the Tax Office to address the heightened risks of administering the wine tax has been via interpretative assistance and advice. In particular, a taxpayer alert and associated determination contributed to the elimination of major indirect marketing schemes, protecting tens of millions of dollars in wine tax revenue over a number of years. Similarly, another taxpayer alert

regarding changed contractual arrangements⁹ has reduced the incidence of schemes designed to allow growers to improperly access the producer rebate.

23. More generally, larger wine entities are typically satisfied with the information¹⁰ provided by the Tax Office about the wine tax. However, many smaller wine entities would appreciate more information across a range of issues to enable them to confidently apply the wine tax to their particular circumstances. The main aspects nominated as requiring further advice involved the treatment of matters such as rebates, discounts and delivery costs.

24. To address concerns about the extent of information and advice available, the Tax Office could build on current initiatives by contacting mid-to-small wine entities and their advisers to determine key areas requiring additional advice, and develop an information program for common issues. There would also be benefit in the Tax Office providing all new wine tax registrants with a package of information explaining key aspects of the tax.

Compliance

25. Some significant results have been obtained from a larger program of wine tax compliance activities, with the total amount of tax liabilities raised from completed activities in 2009–10 increasing to \$8.3 million (or just over one per cent of net wine tax revenue). This was more than double that recorded in each of the previous two years. The Tax Office has recognised the importance of further upgrading the scale of wine tax compliance activities, with a significant increase in the number of activities proposed for 2010–11 compared to previous years.

26. The compliance strategy applying to the wine tax appropriately focuses on larger taxpayers. In this respect, eight of the 20 largest wine tax payers have been subject to risk reviews or audits over the past five years. Wine tax compliance activity also aims to cover the main risks related to smaller taxpayers, which typically involve the producer rebate. A major problem for the Tax Office in recent years has been that anecdotal stories of widespread non-compliance with wine tax requirements have not been supported by many specific tip-offs or other identification of entities actually conducting such inappropriate behaviour. It has therefore been difficult for the Tax Office to frame its active compliance program, or quantify the likely magnitude of risks such as those relating to inappropriate access to the producer rebate.

⁹ Changed contractual arrangements involve growers who had supplied grapes to wineries entering into contracts for wineries to manufacture wine on their behalf, so that the growers become eligible for the producer rebate.

¹⁰ This information included public rulings, fact sheets, content on the Tax Office website and contact arrangements involving dedicated client relationship managers.

27. Given the heightened wine tax compliance risk environment and lack of specific information, it is timely for the Tax Office to review key processes underpinning its compliance focus on pre-refund BAS integrity checking processes, continue to strengthen other intelligence-gathering analytical approaches, and improve case selection processes to better target compliance activities.

28. Active compliance activities for the wine tax, including audits, risk reviews and objections, have typically been conducted in a professional manner. The most common criticism from industry participants was the length of time taken to complete audits.

29. One option to mitigate wine tax compliance risks is through amendments to the legislation. Between 2006 and 2008, the Tax Office identified a number of legislative changes relating to the producer rebate,¹¹ to address practices that were arguably within the provision of current legislation and so difficult for it to address through compliance activities. Treasury considerations were delayed pending the Government's response to the review of Australia's Future Tax System (Henry Review). As the Government's response has been provided,¹² it is timely for the Tax Office to provide further advice to Treasury about proposals for amending the definition of a wine producer in the *A New Tax System (Wine Equalisation Tax) Act 1999*.

New Zealand rebate

30. The cost of the New Zealand producer rebate has risen each year since inception, from under \$6 million in 2006–07 to over \$19 million in 2009–10. This rise was largely due to the increased value of New Zealand wine exported to Australia. Another cause of this increased cost was a greater incidence of New Zealand grape growers using contract winemakers' facilities to enable them to register as wine producers and thus access the rebate.

31. New Zealand producers must submit a refund application form with supporting documentation for each rebate claim, which New Zealand Inland Revenue then checks on behalf of the Tax Office. This is a more demanding administrative and compliance framework than the Australian producer rebate scheme, as Australian producers can claim the rebate without attaching evidence that the wine tax has been paid.

¹¹ At that time, the focus was on whether producers could access the rebate on each of multiple occasions of blending wine.

¹² That response was provided on 2 May 2010, whereby the Government stated it would not implement the report's recommendation to replace the wine tax with a volumetric tax 'in the middle of a wine glut and where there is an industry restructure underway'. The Hon. Kevin Rudd MP, Prime Minister and The Hon. Wayne Swan, MP, Treasurer, Press Release 02 May 2010, *Stronger, Fairer, Simpler: A Tax Plan for our Future*, p. 4.

32. The Tax Office and New Zealand Inland Revenue are both satisfied that New Zealand wine producers are adequately supported with general information and access to technical advice regarding the producer rebate scheme. However, there is merit in raising awareness in New Zealand that the Tax Office has actively addressed issues involving the use of contract winemakers to access the producer rebate in Australia.

Summary of Tax Office response

33. The Tax Office's summary response to the report is reproduced below.

The Tax Office welcomes the recommendations and findings of the report. We are encouraged that the ANAO has recognised our sound governance arrangements and administrative practices and our effective general administration of the wine tax. The report also reflects positively on our major and effective response to addressing the heightened risks of administering the wine tax via interpretative assistance and advice. The Tax Office agrees with the three recommendations in the report.

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