ACROSS THE DITCH WITH MISHA WILKINSON

Will the WET season end soon?

The WET sun still shines on Terrace Heights Estate and all New Zealand producers.

Misha Wilkinson

"The Wine Equalisation Tax (WET) is a value based tax which generally applies on the last wholesale sale of wine, usually between the wholesaler and the retailer. If you make wine or import wine for consumption in Australia, or if you sell it wholesale, you normally have to pay WET" (Australian Tax Office).

The rate of the WET in Australia is 29% of the wholesale value, however Australian wine producers are entitled to a WET rebate – but so are New Zealand wine producers. Why?

Back in 2000 when the 10% goods and services tax (GST) was about to be introduced in Australia, many people were naturally concerned about the impact to the cost of living. The only vague glimmer of light was that potentially wine might become a lot cheaper as the GST would see the end of other taxes including the wholesale sales tax on wine, which was then 41%. However the sky blackened and things turned for the worse when the government announced a wine equalisation tax at the same time as the GST, adding a 29% loading at the wholesalers and then a 10% GST when you bought a bottle at retail.

But every cloud has a silver lining and after much lobbying from the Winemakers' Federation of Australia (WFA), a producer rebate scheme was introduced in 2004. This was done in the interests of supporting jobs in Australian rural and regional communities and particularly to give advantage to small wine producers over the larger ones. Australian wine producers were then entitled to a full rebate of 29% of the tax on domestic sales up to a limit of $290k per annum initially and a year later this was increased to $500k which translated to $1.7m worth of annual sales.

The rebates sent a chill across the Tasman, so when Trade and Economic Ministers from Australia and New Zealand met in Queenstown in December 2004, the Australian team agreed, in principle, to extend the national treatment to New Zealand wine producers selling into the Australian market. Agreement was reached due to the Closer Economic Relations (CER) which commenced in 1983 between the two countries. This has been described as the world's best example of a comprehensive free trade agreement and a model for both countries in their negotiation of subsequent free trade agreements. One can't help but wonder if the negotiation team celebrated their two days of discussions overlooking a spectacular Queenstown lake view, bathed in the warmth of a glorious summer evening sipping New Zealand Pinot Noir!

The extended producer rebate scheme was subsequently put into place in July 2005 and since that time, New Zealand producers have also been entitled to a full rebate of 29% of the selling price of the wine into Australia.

Popular misconceptions

Many Aussie winemakers want the wine equalisation tax changed to prevent New Zealand producers benefitting from the scheme. Apparently the scheme puts New Zealanders on a level playing field with the small and medium wineries in Australia – so what's the problem with that? There are complaints about New Zealanders dumping cheap Sauvignon Blanc in the Australian market and making it hard for Australian producers to compete and causing their Sauvignon Blanc sales to dry up. Is this really the case or is it just a storm in tea cup?

Philip Gregan, chief executive officer of New Zealand Winegrowers, believes that total rebate that New Zealand wineries receive through the WET rebate would be somewhere in excess of NZ$15 million. Some of the larger wine groups like Constellation Brands and Pernod Ricard who operate in Australia with sister operations in New Zealand aren't able to claim the rebates as rebates are payable to a producer, and where that producer is part of a group of companies, the capped rebate is only payable once to the group. So it's primarily the small and medium-sized companies that get this benefit.

In response to the bleating from across the ditch about New Zealand wineries benefitting from Australian rebates, Gregan says you just need to look at the export numbers. "Australia has a much greater share of the New Zealand market than New Zealand does of the Australian market," he says.

In New Zealand, only 65% of wine consumed is domestic product and in the year ending June 2010, Australian wine represented 75% of all imported wine. That means 29% of New Zealand's total wine consumption is Australian wine! And the average price per litre Australia gets for the wine that's shipped to New Zealand is 40% more than the average price it gets in its biggest export market – the United Kingdom. In fact New Zealanders pay more for Australian wine than any of Australia's other top six export markets (with the exception of Canada).

When you look at the latest published statistics from Wine Australia, during 2008-09 more than 87.4% of wine consumed in Australia was domestic product. Of the small percentage of wine that was imported into Australia, New Zealand wines represented nearly 60% by volume and value – so that's only about 7.5% of the total Australian market. And interestingly, Australians complain about New Zealand wine being sold cheaply in Australia, but after France, the value per litre of New Zealand wine in Australia was higher than wine imported from any other country – even with that WET rebate.

By the way, New Zealand also exported a similar amount of wine to the UK and there is definitely no WET rebate incentive there. Let's face it, no one is drowning in a downpour of New Zealand wine, they're actually demanding it! Some theories to explain this are:

1. New Zealand really has set that benchmark for the Sauvignon Blanc varietal;
2. There's a global shift in tastes going on and people have moved on from Chardonnay;
3. Kiwis are great marketers; and
4. Australian consumers just love New

What do Australian wineries think about WET?

The small but dynamic Capital Wines is a 4.5ha vineyard in the Canberra wine district producing 2,000 cases annually. According to Jennie Mooney, one of the owners, "the WET rebate provides additional cashflow which is critical in a growing small winery". As she points out, cashflow is the big killer, especially for those wineries producing red wines. "Due to the lag in wine production, it's approximately 22 months before you can sell the red wines, so growth is a very difficult phase," she explains. A small winery needs to carry the costs of production for almost two years before realising income from that production. "Without a rebate, things would be a lot more difficult," she adds.

Mooney thinks it's strange that an Australian tax concession like WET is given to other countries and says it places a strain on Australia's own domestic market, "particularly given the difficult climate that the industry has been in for the past few years". Although Mooney insists she doesn't give the New Zealand 'sauvalanche' too much thought, instead choosing to stay focused on her own sales, she admits, "I am very excited that there seems to be a counter culture starting to build against Sauvignon Blanc!"

Mooney says that fine wine buyers are turning away from Sauvignon Blanc, seeing it as a bit "pedestrian", and she sees a resurgence in Chardonnay and says Riesling is also on the rise. However, she's keeping her options open and will continue to produce a Sauvignon Blanc while the (pedestrian) market wants it. In fact she says that in Capital Wines' own restaurant, it's the Sauvignon Blanc that remains their biggest seller – double that of the next biggest varietal. But she's adamant there's no New Zealand Sauvignon Blanc on the list – just the locally-grown ones!

What's the impact in New Zealand?

Companies keen to make hay while the sun shines (and the WET season lasts) include Steve Hammond, owner/director of Terrace Heights Estate (THE). Hammond, who has a 30ha vineyard, has been exporting to the Coles Liquor Group in Australia since the 2007 vintage. He says that when he went into price negotiations originally back in late 2006 the WET rebate wasn't an issue. "Margins were good and the wine industry was in happy times," he says. Steve says now that situation has deteriorated and his FOB pricing has had to be adjusted downwards to keep it competitive with other offerings. Our market strategy is to fight for our SKU and keep our brand on the shelf so that when times improve we are able to increase sales and expand our portfolio to include other varietals. Without the WET rebate, we'd be pretty much doing it for love." This is the reality for a large number of wineries selling Marlborough Sauvignon Blanc into Australia, who, without the WET, would be exiting the Australian market.

Hammond also agrees it may seem strange that New Zealand wineries get the same treatment as Australian wineries in regards to WET, but says "the CER agreement works both ways – I am sure in other primary industries things work in Australia's favour so us 'lil NZ winegrowers will take what advantage we can for as long as the arrangement stands."

On the 'sauvalanche' issue, Hammond believes it is quite ironic that his 'customers' in Australia have become his biggest competitors in the Sauvignon Blanc market with buyer own brands. "I am sure these wines do not qualify for WET rebate but I remain sceptical because if there is a will there is a way," he says. But Hammond says of more concern to him now is the appearance of South African Sauvignon Blanc 2010 appearing on the New Zealand shelves of Australian-owned supermarkets at NZ$6.99 retail.

A quick investigation into what was currently adorning Woolworths' shelves in New Zealand showed the cheapest Sauvignon Blanc was actually from Australia – a Hardys brand at NZ$6.99 competing against a Woolworths' own brand at the same price. Next came Two Oceans from South Africa at NZ$7.49. Following that was Australia's Banrock Station which hit the lofty heights of NZ$7.99 and was matched in price by New Zealand's Montana. At least Montana provided Sauvignon Blanc at various price levels including one at NZ$34.74. Overall 87% of the New Zealand Sauvignon Blanc available sat above NZ$10 with 36% of brands above NZ$20.

We hear the constant rumbling from the big island but actually New Zealanders have much more to complain about. They have to take a bath on pricing in Australia because of the domination of Australian supermarkets who insidiously prise the margin from producers. These giants then compete with them using their own brands and do this by taking advantage of those producers with excess inventory or a lack of funds (presumably those same producers robbed of margin in the first place). And then to make matters worse, those same Australian supermarkets toss the cheap Australian Sauvignon Blanc, that no one wants to drink in Australia because they're full of the good imported stuff, across the ditch to become the price 'leaders' – somewhat of a contradiction in terms!

If there is to be any blame as to who is drowning the Australian industry with cheap wine, it shouldn't be directed at the Kiwis nor their WET rebates, but instead the monopolies who dominate the retail sector and who continue to boast about their growth at the expense of an ailing industry – and perhaps there's also a little blame that the Australians can shoulder too since they managed their slight oversupply all by themselves.

Capital Wines haven't turned their back on Sauvignon Blanc – yet!

Above, left, far left and right: The WET season in New Zealand (Photo: Tim Hawkins).

Who's trying to end it and why

There have been more potential storms on the horizon with the delivery of Australia's Future Tax System (AFTS), or the *Henry Report*, as it's more commonly referred to. It was a review of Australia's current taxation including alcohol taxes where it demanded that a volumetric tax on wine should be introduced as a matter of urgency to raise the tax paid on cheap wine. The rationale was that wines with the same alcohol content were subject to different levels of taxation which results in cheaper wine having less tax and so the report made a lengthy and detailed case for the introduction of a uniform tax on the basis of alcoholic strength.

In May, when the *Henry Report* was publicly released along with the Government's initial response, the idea of changing the tax was ruled out due to the current issues of the Australian wine glut and the industry restructuring that was going on.

As we know, the consumption of alcohol is taxed for a variety of reasons that include covering social costs associated with harmful alcohol consumption, changing drinking behaviour and, of course, revenue raising! the *Henry Report* was very focused on the abuse of alcohol aspect and the significant costs on society and believed a change to the taxation of alcohol would start to address the issue and effectively introduce a floor price on alcohol.

Kym Anderson from the Wine Economic Research Centre at the University of Adelaide has found that low or zero taxation is more common among the major wine-producing countries and Australia has a relatively high tax in comparison – especially for fine wines because of the use of a proportional tax rather than the more commonly used volumetric tax. He says that Australia's super-premium wine consumers are taxed three times greater than the OECD average while its consumers of non-premium wine are taxed only half of the OECD average. The issue wineries have with a proposed change is that it would potentially lead to a fall in sales of non-premium wines because prices would increase, but on the flip side, more premium wines may become more attractive. The bigger issue is that a change to volumetric tax puts wine in the same category as all other alcohol products and the tax simply becomes a 'sin tax'. Also, it would be unlikely that a rebate would be implemented under a volumetric tax system.

The forecast

The storm may have passed for the present time, but clear skies aren't guaranteed as the Government has simply said it won't change the alcohol tax in the middle of a wine glut and at a time when the industry is restructuring. The WET and its accompanying rebate is with us for the time being but one thing is certain – "If it disappeared for New Zealand, it would disappear for Australia too," says Gregan. Although he urges wineries not to build the WET rebate into the pricing in case it doesn't last, it's too late for most wineries, especially those supplying to the retail behemoths.

"If we look at the positive side for the New Zealand industry, WET has certainly encouraged small wineries to get into the Australian market as well as improve profitability for those companies," says Gregan. If the winds of change do finally bring an end to the WET season, there will certainly be an impact to the majority of small producers in both Australia and New Zealand, particularly in this current economic climate. At the end of the day, it's all a case of weather, or not!

MISHA WILKINSON owns Misha's Vineyard Wines in New Zealand. Phone +65 9828 5735 or email misha@mishasvineyard.com