Tax Working Group Public Submissions Information Release

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NEW ZEALAND WINE

PURE DISCOVERY

SUBMISSION TO THE TAX WORKING GROUP
on the
FUTURE OF TAX CONSULTATION

30 April 2018

Cheers.org.nz
DRINK LIKE
THERE IS A TOMORROW

Introduction to New Zealand Winegrowers

New Zealand Winegrowers (**NZW**) provides strategic leadership for the wine industry and is the body that represents the interests of all of New Zealand's grape growers and wine makers. Established in 2002, NZW has approximately 1,500 members. New Zealand is the only major wine producing country to have a single, unified industry body that represents both grape growers and winemakers.

NZW welcomes the opportunity to make a submission to the Tax Working Group (**TWG**) in respect of its paper "Future of Tax" (**Paper**). We appreciate the government's desire to consult with the public on the shape of the New Zealand tax system. We recognise that some matters are outside the TWG's remit, and have sought to limit our comments to matters within the remit.

A high quality taxation system is of great value to winegrowers

At least 95% of winegrowers in New Zealand are small or medium enterprises (**SME**s) – many of them family-owned businesses. For them, simplicity, transparency and ease of compliance, are high priorities in all regulatory matters, including taxation.

NZW believes that New Zealand, and New Zealand businesses, have been well served by the country's broad-based, low rate taxation system. Our tax system is largely free from the loopholes, exclusions and convolutions that feature in many other countries' systems. As a result, compliance and administration costs are relatively low, and there is a relatively low incidence of tax considerations distorting business decisions. Our view is that retaining a broad-based, low rate taxation system should be high priority.

We applaud the efforts being undertaken by Inland Revenue Department to reduce compliance costs via its Business Transformation programme. We welcome measures such as the Accounting Income Method and increasing digitisation of tax compliance. We urge IRD to continue these efforts, to carefully monitor the implementation of initiatives, and to adapt and improve them as necessary.

We note that, for SMEs, stability within the taxation system is itself of considerable value, because the cost of implementing change is proportionately higher for them than for larger businesses (which can afford specialist staff to identify and manage changed obligations and compliance).

New taxation measures are often posited as a panacea to any number of problems. We believe that changes to the taxation system – and particularly the introduction of any taxes directed at behaviour modification – ought not to be entertained unless a careful evidence-based analysis of the proposed policy and its likely outcomes shows clearly that the measures <u>will</u> result in the intended behaviour-change, and will not also have other unintended effects.

Excise on wine in New Zealand

Excise is a tax on locally manufactured products containing alcohol, tobacco products and fuels. It is collected by New Zealand Customs. In effect, it is a self-contained system quite separate from the mainstream of Government revenue gathering.

Rates of excise on alcohol are set in two tiers, a lower rate for beer and wine and a higher rate for spirits. They are based on the notion of a specific rate of excise being payable by litre of pure alcohol contained with a beverage. Because the alcohol level of standard wine is determined by natural factors and is therefore highly variable, the rate of excise is standardised on a *per litre of product* rather than a *per litre of alcohol basis*. This increases efficiency, and reduces administrative overhead both for producers and the government. NZW supports the fact that excise is levied on a volumetric basis; doing so incentivises the production of higher-value, premium product, whereas a levy imposed as a percentage of the product value would not provide that incentive.

As of April 2018, excise is levied on standard wine at a rate of $2.9054 per litre of product. Excise on fortified wine (ie wine produced with the addition of distilled spirit such as Port and Sherry) is levied at the rate of $52.916 per litre of alcohol - equivalent to $9.52488 per litre of product at the typical alcohol content of 18% by vol. The rate of excise is increased annually by reference to the Consumer Price Index for all goods. So long as excise is retained, NZW supports this annual CPI increase mechanism as an administratively efficient and fair way to maintain relativities in this tax.

The collection of excise requires the designation and administration of "Customs Controlled Areas" where wine is manufactured and stored under licence. Excise becomes payable by the winery in the month after the wine is removed from a Customs Controlled Area.

One impact of the steady increase in excise on wine has been to exclude New Zealand wine from the domestic market at the lower price-points; it has been replaced by cheaper foreign wine. For a bottle of wine sold at a $10 retail price, a total of $3.51 goes to the government in excise, HPA levy and GST. Once retailer margin, distribution and cost of goods are taken into account, little or no margin is left for the New Zealand winery. As excise continues to rise with inflation, the price-point below which only cheap foreign wine is economical in the New Zealand retail market will also rise.

The rationales for imposing excise on wine

At various times different justifications have been given by successive governments for the imposition of excise on wine.

(a) **Collection of revenue** was the historical justification given for the imposition of excise on alcohol in New Zealand. The government currently gathers around $213 million in excise per year from New Zealand wineries, plus a further $3 million as a levy to fund the Health Promotion Agency. The government takes significantly more in excise per litre of wine than is paid to the grower for growing the grapes[1]. No other agricultural or tourism industry in New Zealand is required to pay an indirect tax of this nature

As a rationale for excise, revenue gathering at least has the merit of honesty. However, as a straight revenue-gathering exercise, it is difficult to justify in the context of a more modern system of taxation which includes a comprehensive income tax regime (including a PAYE deduction mechanism) and a broad-based goods and services/point of sale tax. That is at least

[1] On average New Zealand grape growers receive around $1,750/tonne of grapes ($1.83/bottle). Excise and the Health Promotion Agency levy on the resulting wine is $2,118 ($2.21/bottle). In addition, GST on a $15 bottle of wine adds a further $1.96 per bottle – a total government impost of $4.17 on a $15 bottle.

part of the reason why the focus of policy rationales for excise has shifted towards social cost arguments in recent decades.

The imposition of excise on wine inefficiently requires a separate administrative framework, and costly storage requirements for wineries. Because the majority of excise must be paid to Customs before the winery receives payment for its goods, it also imposes significant cashflow constraints and financing costs on the wine sector, which inhibit growth. Excise also works to the advantage of imported products sold in New Zealand because it is, in effect, collected from imported products at the wholesale stage, rather than production stage.

We recognise the reality that no government is likely to forego this important source of revenue. However, we submit that the current system of collection is inefficient, archaic, and does not support innovation and growth.

(b) **Offsetting the social cost of the harmful use of alcohol** is another reason cited. Ministry of Health data[2] show that around 80% of those who drink in New Zealand are light to moderate drinkers; it is the remaining 20% who drink at levels considered by the Ministry of Health to be potentially hazardous.

Considerations of equity and fairness in the tax system dictate that any taxation measure directed at consumers with the intention of offsetting the social cost of harmful use of alcohol should be targeted at the 20% of consumers who consume at potentially hazardous levels and therefore potentially *cause* the negative externalities that need addressing. There is no persuasive rationale (other than administrative expedience) for recovering the social costs of harmful drinking off the 80% who consume only at moderate and light levels, and are therefore not causers of those social costs.

In addition, we note that patterns of harm arising from alcohol consumption are complex, and are not necessarily correlated with overall consumption. This means that those being taxed the most may not be those causing social harm.

- For example, binge drinkers and youth drinkers may have a pattern of drinking that is harmful and more likely to result in higher social cost; but their total annual consumption may, in fact, be *lower* than regular moderate consumers.
- Similarly, those moderate regular consumers of wine are likely enjoy more of the health and wellbeing benefits of wine consumption; yet they may have a higher total annual consumption than problem drinkers. These moderate consumers pay more excise even though they are actually *reducing* negative externalities.

The relationship between taxation (or price) and harm (or harm prevention) is complex, and is highly contingent on a wide range of social and economic factors. Any assumption that increasing excise on alcohol will reduce harmful consumption is not borne out by the available evidence regarding the nature of alcohol use, elasticity, and behavioural drivers.

[2] Annual Update of Key Results 2016/17: New Zealand Health Survey

Again, we submit that it is critical that any taxation policy adopted in New Zealand ought to be justified by a rigorous analysis of the evidential basis for the policy, and its intended outcome.

(c) **Influencing behaviour to reduce the harmful consumption of alcohol** is perhaps most commonly cited today as the primary rationale for excise on wine. Indeed, the TWG notes at page 5 of the Paper, that New Zealand has an alcohol excise tax which "is intended to discourage… drinking".

If behaviour change is the intended purpose of excise on wine in New Zealand, we strongly submit that its design is fundamentally flawed, and the tax is largely ineffective at achieving that purpose. This is because excise on wine is levied on *producers*, rather than on wholesalers or retailers, and in New Zealand wine producers have very little bargaining power with the two supermarket groups, which – through their supermarket stores and owned liquor retail chains – are by far the dominant force in the domestic wine market.

When the excise increase is levied on the producer, the producer must seek to negotiate a higher price from the retailer to recover that additional cost. The New Zealand retail market dynamic means that increases in alcohol excise are generally not able to be passed on to consumers; rather the dominant retailers simply force producers to absorb them.

In effect, the fact that excise is not passed on in the form of price increases to the consumer is a "circuit breaker". It means that there is no opportunity for price increases from the annual CPI increase in excise to have any impact on consumer behaviour and renders this policy justification meaningless. Not only is it ineffective in communicating messages to consumers but it strongly affects the profitability of hundreds of small and medium enterprises.

Note that this market situation for excise on wine is not at all comparable to the situation that exists for excise on fuels. In the fuel market, there is a very small number of market participants, and the producers/distributors are able to exercise a large degree of market power.

Our submission is that if the TWG is minded to make any changes to the alcohol excise tax regime, it should be changed so that excise is levied on *wholesalers or retailers – rather than producers.* If excise were levied on wholesalers or retailers, the annual CPI increase would be directly payable by them; and is therefore much more likely to be passed on to consumers by way of a corresponding retail price increase. Those excise increases are therefore more likely to have a chance of influencing consumer behaviour.

However, we do note that even if some or all of the increase is able to be passed on, there are still a range of factors at play in determining the relationship between taxes, or price, and consumption. Affordability is a more relevant indicator, taking into account a variety of economic indicators such as real disposable income, household income, the rates of income tax and GST, inflation/deflation and changes in the relative price of alcohol to other goods.

Effective tools for behaviour change

Wine, by its very nature, is intended to be consumed with food, and in good company. As noted, 80% of New Zealanders who drink alcohol already do so in a moderate, responsible manner. The New Zealand wine industry is absolutely committed to spreading and reinforcing these norms of responsible drinking.

In particular, the wine industry is a member of The Tomorrow Project, which through its *Cheers!* brand (www.cheers.org.nz) directly targets consumers with innovative campaigns that reinforce moderation as the only appropriate way to consume alcohol, and provides a wealth of resources to help consumers make better choices about their drinking.

Conclusion

In this submission we have expressed our belief that retaining a broad-based low rate taxation system should be a high priority, and have touched briefly on some of the concerns the New Zealand wine sector has about excise on wine. These concerns relate to:

(a) its inefficiency as a separate and somewhat archaic administrative process for gathering revenue, and the costs and brake on growth that it imposes on wineries;

(b) its inequity as a tool for seeking to offset some of the social costs of harmful consumption of alcohol, and in particular the low correlation between the causers of negative externalities and the payers of the tax; and

(c) the fact that excise in New Zealand fails as an instrument to incentivise behaviour change because the purported behaviour change signal – the annual CPI increase in excise – is all but silenced by the system's design, which imposes excise on *producers*, who are unable to pass the increase through to consumers.

We note that the nature of the relationship between price and impact on alcohol consumption is complex, and that evidence on the subject is also both complex and mixed. However, if the TWG believes the justification for excise on alcohol is to deliver a behaviour-change signal to consumers, we submit that the TWG should regard the current excise model as unsuccessful. In order for excise as a behaviour-change signal to be effective, the current system would need to be changed so that excise is levied on the *wholesaler or retailer* (as currently happens with respect to imported alcohol). In the absence of that change, the power dynamic in the current wine retail market will continue to ensure that any intended price signal from excise increases is muted and fails to reach the consumer.

NZW has conducted extensive research into all matters discussed in this submission. We would be happy for the Secretariat to contact us to discuss any of the points raised in more details, or to appear before the TWG to be heard in support of the points we have raised.

Yours sincerely

[1]

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