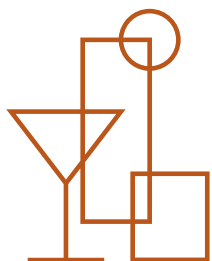


2020

PRE-BUDGET SUBMISSION



Spirits &
Cocktails
AUSTRALIA

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Introduction

Spirits & Cocktails Australia welcomes the opportunity to make a Pre-Budget Submission for consideration ahead of the October 2020 Federal Budget.

We are an incorporated association with a vision to promote and protect a spirits sector which improves Australia's drinking culture to create social and economic opportunities for future generations.

The association represents the interests of spirits drinkers and all involved in the production, marketing and sale of spirits in Australia.

Our members are:

- Bacardi-Martini Australia
- Beam Suntory
- Brown-Forman Australia
- Bundaberg Distilling Company
- Diageo Australia
- Moët Hennessy Australia
- Pernod Ricard Australia
- Remy Cointreau
- Spirits Platform
- William Grant & Sons Australia



Executive Summary

The October 2020 Budget provides a timely opportunity for the Federal Government to take a meaningful first step to reforming Australia's complex alcohol taxation system by implementing policy changes to reduce the tax disparity between spirits and other alcohol categories.

Australia has the world's third highest spirits tax, which impacts consumer choice and has the unintended effect of limiting ongoing development of an industry with significant tourism, hospitality and trade potential.

Excise on alcohol is increased twice a year in line with the consumer price index (CPI). The tax disparity between spirits and other alcohol categories grows every six months, as spirits and premixed drinks (RTDs) are taxed at a much higher rate than other alcohol categories.

The options presented in this Pre-Budget Submission provide an opportunity to maximise Government revenue, without needing to increase alcohol taxes on other products to compensate.

The impact of COVID-19 on the spirits industry

At the height of the COVID-19 pandemic in April 2020, spirits producers recorded sales volume declines of 21% for full-bottled spirits, and a further 37% volume decline for RTDs.¹ These impacts were heightened by the overnight closure of hospitality venues – a major sales channel for spirits producers. While several media outlets reported an initial 23 per cent increase in alcohol sales through bottle shops, reporting from the Sydney Morning Herald citing Commonwealth Bank credit card data later confirmed this was not enough to offset a 72 per cent collapse in spending through hotels, pubs and bars.² In total, hospitality revenue plummeted by \$8.5 billion during the crisis, representing 10% of annual sales.³ Local distillers reported revenue declines of up to 80% due to the sudden closure of distillery doors and regional tourism in line with nation-wide Stage 3 restrictions.⁴ As a result, April 2020 was recorded as the worst month on record for spirits, wine and beer producers.

The Government was quick to respond to the economic impacts of COVID-19 with major support measures such as JobKeeper and Boosting Cash Flow for Employers to provide economy-wide assistance. We commend the Government for the timeliness and scale of these measures.

Spirits & Cocktails Australia proposes that spirits excise changes are considered for the October Budget with the goal of increasing Government revenue to regenerate the Budget following record stimulatory spending. These changes will also support confidence, employment and business continuity, in line with the objectives of the Government's COVID-19 recovery initiatives.

How reducing spirits excise can increase Government revenue, and support spirits producers and consumers

A PwC analysis commissioned by Spirits & Cocktails Australia in January 2020 (Appendix A) revealed that the rate of spirits excise in Australia is now so high that the Government collects less revenue than it would if it was reduced.

PwC's modelling utilises the best and most recent evidence on how alcohol tax changes impact consumption, as detailed in Monash University's, 'Disaggregated econometric estimation of consumer demand response by alcohol beverage types (2015)'.⁵

The Monash study is significant as prior to its publication there was no suitable or recent empirical evidence on the Australian alcohol market that allowed proper consideration of any tax change.

The study enables consideration of the behavioural response from consumers to changes to alcohol taxes by delving deeper than the headline categories of ‘beer, wine and spirits’ to estimate both own-price and cross-price elasticities in sub-categories including light and dark bottled spirits and RTDs, full strength and low alcohol beer, and bottled and cask wine. PwC’s model uses these elasticities and applies them to the most up-to-date and granular information on Australian alcohol sales from IWSR.

In all three policy scenarios, PwC’s modelling shows that decreasing the spirits excise increases Government revenue as it accelerates an established market trend that sees consumers shift from lower taxed beer and wine to higher taxed spirits and RTDs.

Table 1: Summary of policy options, budgetary and alcohol consumption impacts

Policy option	Increased revenue in financial year post implementation (1 July 2020–30 June 2021)	Impact over forward estimates (2020–2024)	Pure alcohol consumption change (2020–2024)
Option 1: Cut the spirits excise rate to brandy rate	+ \$204 million	+ \$894 million	+ 0.24%
Option 2: Freeze spirits and brandy CPI indexation for three years	+ \$65 million	+ \$707 million	+ 0.17%
Option 3: Cut the spirits excise rate to brandy rate and freeze spirits and brandy CPI indexation for three years	+ \$251 million	+ \$1.4 billion	+ 0.57%

The three tax reform proposals summarised above would make purchasing spirits fairer for the 62% of Australians that choose to drink spirits,⁶ whilst providing much needed relief for spirits manufacturers that were adversely impacted by hospitality venue and distillery closures necessitated by the COVID-19 pandemic.

With a fairer alcohol tax regime in place, the spirits industry has the potential to significantly contribute to jobs growth, the rural supply chain and tourism. Additionally, spirits can emerge as a key agricultural export product.

Amending the craft distiller refund scheme

In addition to implementing policy changes to reduce the tax disparity between spirits and other alcohol categories, Spirits & Cocktails Australia also recommends providing short-term relief to local distillers by increasing the current excise refund scheme limit from \$100,000 to \$350,000 for two years at a full 100 per cent of excise duty paid on their products. Analysis of this change is detailed in Appendix A.

This policy change will achieve equivalency in the rebate currently offered to small wine producers under the Wine Equalisation Tax (WET), whilst ensuring distillers can maintain employment and supply chain opportunities in regional and rural Australia in their recovery from COVID-19.

Why now is the time for alcohol excise reform

The COVID-19 crisis significantly impacted the Australian spirits and hospitality industries, leaving many with an uncertain future

The COVID-19 pandemic delivered a series of inconceivable challenges for the spirits and hospitality industries. At the height of the crisis in April 2020, hospitality revenue dropped by \$8.5 billion, representing 10% of annual sales⁷ and over 500,000 hospitality jobs were lost across the sector.⁸ An initial 23 per cent increase in alcohol sales through bottle shops was not enough to offset a 72 per cent collapse in sales through hotels, pubs and bars⁹ resulting in April 2020 being the worst on record for Australian spirits, wine and beer producers.

Spirits manufacturers were impacted by volume declines of 21% for full-bottled spirits, and a further 37% volume decline for RTDs. Local distillers reported revenue declines of up to 80% due to the sudden closure of distillery doors and regional tourism in line with nation-wide Stage 3 restrictions.¹⁰

Distilleries across the country rose to the challenge of adapting their production lines to produce hand sanitiser to address shortfalls and meet increased consumer and health sector demand.

Spirits & Cocktails Australia and its members provided significant assistance to the hospitality and broader community through a range of initiatives, including:

- In June 2020, Bundaberg Rum announced a \$11.5 million fund called 'Raising the Bar' to support Queensland's bars, pubs and clubs as they rebuild following COVID-19. The programme offers free access to digital training through Diageo Bar Academy and funding for equipment to assist with reopening, including hand sanitiser dispensers and temperature scanners, contactless booking and payment systems, mobile bars and heaters to utilise outdoor spaces, and takeaway packages for environmentally friendly cocktail carriers.
- Around the world, William Grant & Sons, Diageo, Bacardi, Beam Suntory, and Brown-Forman distilleries shifted production at their facilities to produce hand sanitiser or to supply ethanol to the established manufacturers of hand sanitiser. Here in Australia, Bundaberg Rum produced 100,000 litres of ethanol for the Queensland Government, to forward to hand sanitiser manufacturers.
- Spirits Platform created 'Home Five O'Clock-tails' to support bartenders throughout venue closures. 100 bartenders from across Australia submitted cocktail tutorial videos and were paid \$250 for their approved video submissions that were shared and promoted on Spirits Platform's Simply Cocktails Facebook page and the bartenders' personal social channels.
- Bacardi-Martini Australia created 'Raise Your Spirits' hosting financial advice sessions for bartenders. Bacardi also offered its partners and their immediate family access to confidential counselling sessions and a host of supporting materials.
- Pernod-Ricard offered 'Meals for Mates', providing \$1 million toward meals for hospitality workers impacted by COVID-19. The widely utilised program provided a \$25 voucher to meals to thousands of hospitality workers, while helping keep the takeaway and delivery industry open.

- Spirits & Cocktails Australia partnered with the Night Time Industries Association to support the 'Keep Our Venues Alive' campaign to support hospitality venues throughout the COVID-19 pandemic, from mandated closures to reopening. Additionally, Spirits & Cocktails Australia donated \$100,000 to deliver The Community Spirit, a joint initiative led by Australian spirits distributor Nip of Courage to support local distilleries affected by the worst bushfire season on record and raise much needed funds for charities involved in relief and recovery efforts.

Stimulating the spirits industry through meaningful adjustment of current tax settings in the October 2020 Federal Budget will provide the certainty needed for spirits manufacturers to recover from COVID-19 and reinvest in their businesses to create employment and tourism opportunities throughout Australia.



Many Government inquiries have recommended review

Multiple inquiries, including the 2009 Australia's Future Tax System Review (the Henry Tax Review),¹¹ have been critical of inconsistencies in Australia's alcohol tax system. Other reviews over recent years have identified and articulated the same problem.¹² All have pressed for alcohol tax reform.

Here is how the Henry Tax Review expressed the ways inconsistencies in Australia's alcohol tax framework disadvantaged consumers:

*Taken together, current alcohol taxes reflect contradictory policies. They encourage people to drink cheap wine over expensive wine, wine from small rather than large producers, beer in pubs rather than at home, and brandy rather than spirits, and to purchase alcohol at airport duty-free stores. As a consequence, consumers tend to be worse off to the extent that these types of decisions to purchase and consume, which may have no spillover cost implications, are partly determined by tax.*¹³

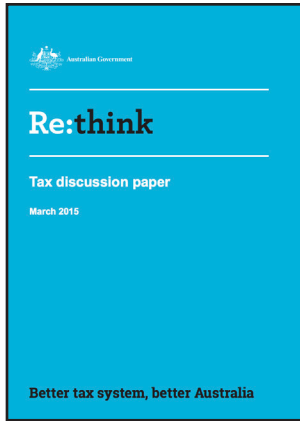
The Treasury identified in 2015 that the system had come to reflect multiple priorities—raising revenue, reducing social costs of excessive alcohol consumption, and providing support to certain producers.¹⁴

To address the inconsistencies, the Henry Tax Review had recommended that alcohol taxation be set to a single objective—to address the spillover costs of alcohol consumption to society.¹⁵

A decade later, the same contradictions remain, and the extremes of taxation are further pushed by twice-yearly CPI increases on some alcohol categories (such as spirits) but not on others (wine).

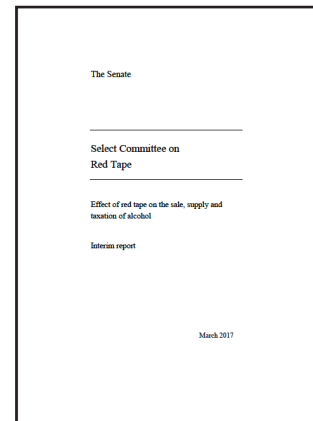
Several other anomalies compound the complexity. Spirits are taxed at one level if they are fermented from grapes (specifically brandy), and at a higher rate if fermented from grain (such as whisky). Cheap wine is taxed lightly, while premium wine is taxed heavily. Additionally, beer is taxed at one rate at the local pub and another when purchased to consume at home

Tax on beer and spirits is covered by 19 separate excise categories and 10 different excise rates,¹⁶ from nil to \$86.90 per litre of pure alcohol (/LAL). The WET, which covers wine, mead, sake and some forms of perry and cider, is levied at 29% of the product's wholesale value.



The taxation of alcohol is complex, with rates varying considerably for different types of alcoholic beverages. This reflects policy changes over time to meet multiple objectives that include raising revenue, reducing the social costs of excessive alcohol consumption, and supporting wine producers and independent beer producers (2015).¹⁷

The committee recommends that the Australian Government progress the reform of alcohol taxation, including the introduction of a single volumetric tax rate across all alcohol products, to be phased in to allow reasonable adjustment (2017).¹⁸



The Australian Government should move towards an alcohol tax system that removes the current concessional treatment of high-alcohol, low-value products, primarily cheap cask and fortified wines. Ideally, this would be achieved through a uniform volumetric tax rate for alcoholic beverages, calibrated to reflect the health impacts of alcohol consumption (2017).¹⁹

In a post-COVID-19 world, a reduction in costs to consumers and industry will be welcomed

Excise on alcohol is increased twice a year, every year in line with the consumer price index (CPI).²⁰ Because spirits and ready-to-drinks (RTD) are taxed at a much higher rate than other alcohol beverage categories, the indexation results in a tax disparity between spirits and other categories that increases every six months.²¹

Without taking action to deliver tax relief, there is a serious risk for Government that the excise base will be increasingly eroded, particularly if discretionary spending on spirits declines in Australia’s recovery from the COVID-19 pandemic.

<p>The excise (/LAL) on spirits has increased by \$16.30 over the past 10 years, representing an increase of \$4.22 per bottle of Bundaberg Rum.²²</p>		<p>vs.</p>		<p>The corresponding excise (/LAL) increase for mid-strength packaged beer was just \$9.62, representing an increase of just \$2.03 on a case of XXXX Gold²⁴ —less than half the excise increase applied to spirits.</p>
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CASE STUDY: HELLYERS ROAD VS BUDWEISER

Hellyers Road, a whisky distillery in Burnie, Tasmania, is owned by farmers from a local dairy cooperative. Named 2017 Tasmanian Exporter of the Year, Hellyers Road exports to 20 countries worldwide.³¹

Compare the effect of excise over the next 10 years:

- Excise on a 700mL bottle of Hellyers Road 10 Year Old Original Single Malt Whisky will rise from \$27.65 to more than \$35.80—an increase of \$8.15.³²
- Excise on a slab of Budweiser beer will rise from \$18.07 to \$23.40—an increase of just \$5.33.

The pure alcohol content of a Budweiser slab is comparable to a bottle of Hellyers Road whisky,³³ yet the excise would be \$4.25 lower on a slab of Budweiser in 2029 than it would be for one bottle of Hellyers Road in 2019.

Sustainable taxes reduce the risk of black market activity

High tax rates are not an excuse to break the law. However, if the level of tax becomes unsustainable, the risk of black market activity will increase.

Alcohol duty fraud is already occurring. In December 2019, the Australian Border Force (ABF) announced the disruption of an alleged multi-million dollar alcohol duty fraud.²⁵ The excise lost was estimated to have been around \$28m,²⁶ but this figure is expected to rise into hundreds of millions of dollars. Footage released by the ABF indicated that the alcohol seized was overwhelmingly spirits.²⁷

Compare this to the growth in trade of illegal tobacco after excise increases on tobacco products. In 2010, the Federal Government increased tobacco excise by 25%, followed by consecutive annual increases of 12.5% from 2013 onwards. KPMG estimated that illicit tobacco, as a proportion of legal tobacco consumption, rose from 8.3% in 2007 to 15% in 2017, falling slightly to 14.3% in 2018,²⁸ amounting to 2.1 million kilograms.²⁹ This represents an excise revenue loss of \$2bn.³⁰

These figures suggest that excessive alcohol excise will impact spirits prices sufficiently that illicit consumption will become more common.

It is time to reflect Australia's changing drinking habits

Drinking trends across Australia are changing dramatically, and for the better.^{34 35}

The most comprehensive independent data on Australian drinking trends, the National Drug Strategy Household Survey conducted by the Australian Institute of Health and Welfare, found that over the last 10–15 years there have been significant declines in people drinking at risky levels. Most Australians are drinking less frequently on a daily and weekly basis, and more are deciding not to drink at all.³⁶

Figure 1: Australia's improved drinking habits



Australians are choosing to drink more premium drinks, less frequently, than drinking greater quantities of lower quality drinks,⁴⁰ and their choices increasingly blur the traditional categories of 'beer', 'wine' and 'spirits'. The steady decline in the volume of alcohol consumption by volume over the past 50 years contrasts with the 3% dollar growth in total 2019 alcohol sales, to \$18.3bn.⁴¹

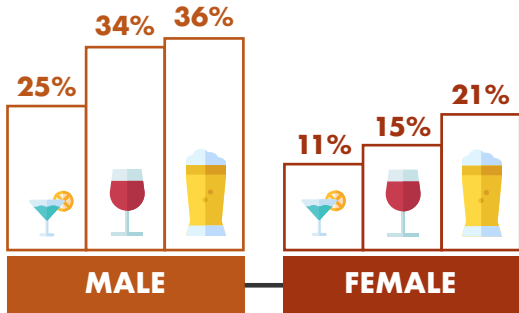
Spirits consumers play the biggest role of any alcohol drinkers in supporting more premium, higher value (but lower volume) revenue growth.⁴² This is consistent across consumption in venues and at home consumption, across socio-economic and age demographics, and in regional and metropolitan locations.

With Australians drinking less, but consuming more premium products, there is a strong economic policy rationale for Government not to discourage spirits drinkers from consuming products that sustain this 'premiumisation' of Government revenue.

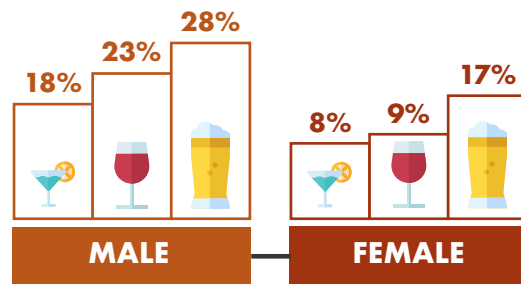
It is worth noting that no evidence suggests that spirits consumption comes at a greater social cost than the consumption of beer.

Figure 2: Predicted probability of exceeding National Health & Medical Research Council (NHMRC) 2009 Guidelines—by type of drink⁴⁷

LIFETIME RISK (GUIDELINE 1)



SINGLE OCCASION RISK (GUIDELINE 2)



KEY: SPIRITS WINE BEER

THE GROWTH OF SPIRITS IN AUSTRALIA



IN LICENSED VENUES

Spirits contribute 41% to the total value of sales in licensed premises

But account for just 13% of the total volume (in litres) of alcohol sold.

Spirits offer venues greater sales value than beer (39%) or wine (20%)⁴³

Growing twice as fast as beer

Spirits are growing twice as fast as beer in licensed premises, contributing 69% to value growth, compared to just 13% for wine and 18% for beer and cider⁴⁵



AT HOME

62% of Australians choose to drink spirits⁴⁴

75% of spirits growth comes from 'premium' bottles retailing at over \$50⁴⁶

Inconsistent price points for similar consumer choice can be eliminated

The extreme excise disparity between different alcohol categories is at odds with the consumer reality that individuals themselves are becoming more category agnostic, and do not identify as ‘beer’, ‘wine’ or ‘spirits’ drinkers. They increasingly focus on experiences and occasions—for example, low-key afternoon drinks or drinking with a meal.⁴⁸

Inconsistencies are shown by comparing two RTDs that share a similar taste profile and target market. Due to excise categorisations, the Absolut Botanik Berry & Lime is taxed at more than double the rate of Quincy Lime Alcoholic Seltzer.

Categories are further blurred in the way drinks are marketed. There is a trend for cans or bottles across all alcohol categories to be displayed in the same section of a bottle shop, similarly packaged, and often representing fusions of different categories, e.g. rosé gin or rosé cider.

Figure 3: Tax treatment of various RTD cans and tax per standard drink



TAX CATEGORY	CIDER	BEER	SPIRITS	WINE
TAX PER STANDARD DRINK	\$0.25	\$0.49	\$1.10	\$0.19

As with the comparison of the Quincy Seltzer and Absolut Botanik, the four products produce varying excise outcomes with no logical consistency, despite having similar levels of alcohol (4.5–8.5% ABV) and similar target markets. It should be noted that the seltzer produced by brewers may undermine the Government’s RTD revenue. It is a loophole already being exploited by some major multinational brewers.

Figure 4: Tax treatment of similar RTDs



**QUINCY LIME
ALCOHOLIC SELTZER**



**ABSOLUT BOTANIK
BERRY & LIME**

Product description (Dan Murphy’s website)	<i>This Australian Sparkling Alcoholic Seltzer is a new style of alcoholic drink, that uses rice to deliver a clean, dry taste that is gluten free. Infused with hints of natural lime juice flavour, it tastes as refreshing & light as sparkling water, only alcoholic.</i>	<i>Refreshing and summery, Absolut Botanik Berry Lime is bursting with Blueberry, Lime and Cucumber flavours matched with single-source Swedish Vodka. It makes for a fresh, lightly sparkling drink.</i>
Alcohol content	4.0%	4.8%
Calories per 300mL serve	534kJ	570kJ
Excise category	Packaged beer greater than 3.5% ABV	Other excisable beverage of less than 10% ABV (i.e. RTD)
Tax per 300mL serve	\$0.43	\$1.23
Tax per 24 x 300mL case⁴⁹	\$10.40	\$29.67

Small changes to spirits excise bring significant economic benefits

Learning from the success of the United Kingdom’s spirits excise freeze

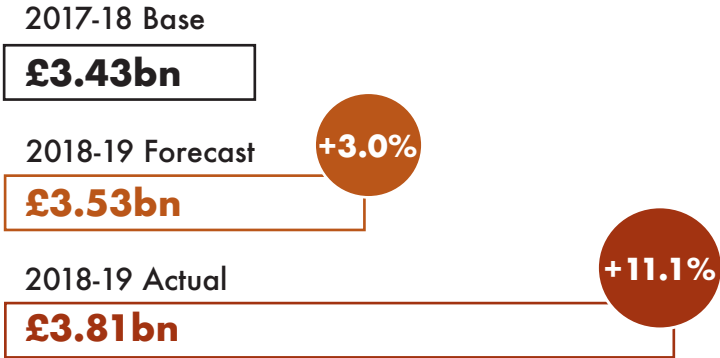
While the economic impact of COVID-19 will be felt throughout foreseeable Budget cycles, Australia can learn from the outcomes of excise freezes in the UK to guide potential spirits excise changes.

UK Government data shows that freezing the spirits excise has led to increased Government revenue, making more money available to fund public services.

HM Treasury initially forecast that following the freezing of the spirits excise in November 2017 revenue would increase by a modest 3% in 2018-19. The outcome surpassed expectations. Data from HM Revenue and Customs showed an increase in spirits revenue of 11%—£3.78bn—boosting HM Treasury by £380m. Spirits revenue alone accounted for 54% of the additional £566m revenue collected from all alcohol categories. It had the fastest growth of any alcohol category.⁵⁰

After a further spirits excise freeze in October 2018, real-world data showed that revenue continued to grow. The Moving Annual Total (MAT) to October 2019 showed spirits revenue had risen by 2.6%.⁵¹

Figure 5: UK Government Revenue—Forecast vs Actual



Source: HMRC Tax & NIC receipts, April 2019; OBR Economic & Fiscal Outlook, March 2018.

There has been a corresponding boost to investment across the UK, especially in rural areas.

The Scotch whisky industry supports a substantial and UK-wide supply chain that benefits from a fair and stable tax regime. Recent figures show that over the last four years—during a period of excise freezes—its contribution to the UK economy increased by 10%, to £5.5bn. Relevantly, Australia has more distilleries than in all of Scotland so the economic impact of similar changes here could be expected to be greater.

The industry is also crucial to other sectors, such as hospitality and tourism, which make significant contributions to the UK economy. Indeed, the Scotch whisky industry is now one of the UK's leading tourist attractions, and significantly contributes to job growth.

OVER THE LAST FIVE YEARS THE SCOTCH WHISKY INDUSTRY INVESTED MORE THAN £500 MILLION IN CAPITAL PROJECTS IN THE UK INCLUDING NEW DISTILLERIES, TECHNOLOGY & TOURIST CENTRES, SUPPORTING 42,000 JOBS.

THIS IS ONLY POSSIBLE WHEN THE INDUSTRY IS SUPPORTED THROUGH THE TAX SYSTEM.



In 2018, Diageo announced it will spend £150 million on an extensive upgrade of its Scotch whisky visitor centres, including Talisker Distillery on Scotland's Isle of Skye.⁵²

Boosting employment in spirits manufacturing and its supply chain

The Spirits & Cocktails Australia members behind household names such as Johnnie Walker, Jim Beam and Jack Daniel's have paved the way for a vibrant local distilling industry. They have built an affinity among consumers for spirits such as rum, bourbon, whisky, vodka and gin through a commitment to quality and international expertise over centuries, substantial marketing investment, and sponsorship of major music, sports and cultural events. They have invested in training programs to create world-class bartenders, who have in turn contributed to an emerging small bar scene, where the quality and provenance of centuries-old spirits brands can be enjoyed alongside emerging local spirits products.

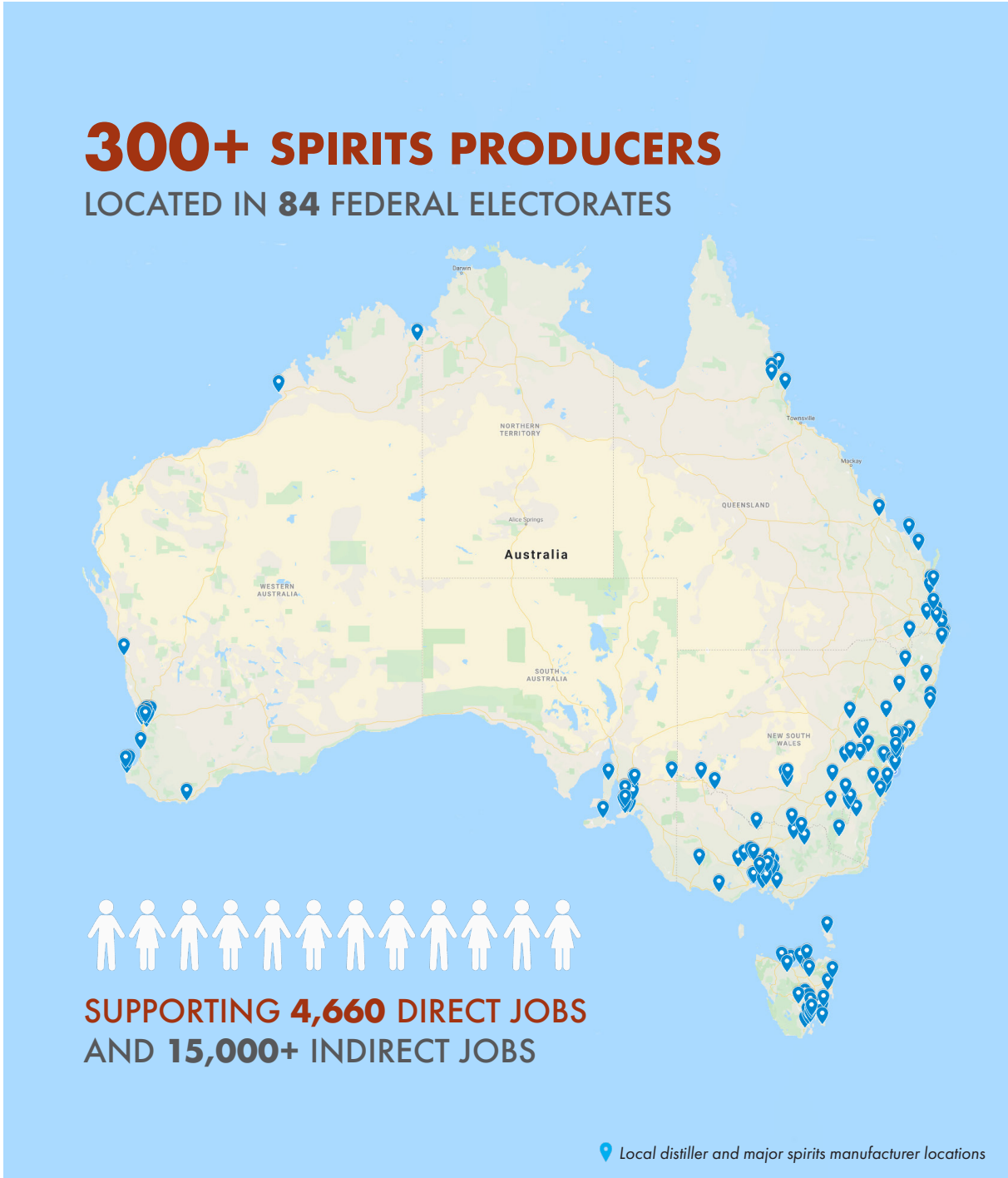
There are now over 300 distilleries in 84 Federal electorates – a significant increase since 2014, a time when Australia had just 28 distilleries.⁵³ Tax currently represents over 50% of many local distillers' overheads and a significant proportion of costs for global manufacturers operating within Australia. Taxation is an overhead that is holding everyone back, stifling job creation, manufacturing, tourism, agriculture and export opportunities.

Reducing tax and allowing spirits manufacturers greater margin will be important in the sector's recovery from significantly reduced trade and tourism throughout the COVID-19 pandemic. Additionally, it will provide incentive to expand operations, employ more people, support more local businesses throughout the supply chain, and for local distillers to market abroad and consider their export potential.



Distillers cutting sugarcane at Husk Distillery (Tumbulgum, NSW)

Figure 6: Distribution of Australian distillers and major spirits manufacturers



Stimulating tourism and supporting local communities and hospitality

Support for the spirits sector also equates to supporting tourism and the experience economy, which have been heavily impacted throughout the COVID-19 pandemic.

\$137 billion is spent on leisure and entertainment in Australia annually and, increasingly, people are willing to spend more on unique or special experiences.⁵⁴ Australian distilleries not only produce some of the world's best spirits but are now major attractions in tourism trails throughout regional and rural Australia – over 60% are located in rural and regional Australia, supporting a growing hospitality and tourism economy. Their contribution could be far greater.

CASE STUDY: BUNDABERG RUM DISTILLERY, QUEENSLAND

Bundaberg Rum Distillery sources 100% of its sugarcane from farmers in Bundaberg. 100% of waste water from the distilling process is treated and returned via irrigation to the sugarcane crops.

Since the \$8.5m upgrade to the Bundaberg Rum Visitor Experience, the Bundaberg Rum Distillery attracts over 75,000 visitors each year, most from outside the region, and makes an important contribution to the local community.

The Visitor Experience has won Gold at the Queensland Tourism Awards and Australian Tourism Awards for two consecutive years, and is consistently voted best tourism experience in the region.⁵⁵





CASE STUDY: CAPE BYRON DISTILLERY BYRON BAY, NEW SOUTH WALES

Cape Byron Distillery is located at the heart of the Brook Family's 96 acre farm (Brookfarm) in the hinterland of Byron Bay. The distillery rests amid a macadamia orchard and rainforest the family regenerated over 30 years.

The distillery employs 24 people in the local community and sources its botanicals and supplies from its very own rainforest and the Northern Rivers, creating flow-on employment opportunities in the local area.

"We estimate for every one person we employ here at the distillery, we create opportunities for up to five more throughout our supply chain," said Cape Byron Distillery Co-Founder and Head Distiller, Eddie Brook. "For instance, our distillery is now the largest purchaser of Davidson Plums across Australia, buying 24 tonnes to produce our Brookie's Slow Gin each year."



"Spirits excise is easily the biggest burden that we face as a young family distillery. The twice-yearly indexation of the excise makes it increasingly difficult to confidently reinvest in growing our business domestically and to realise our export potential."

Cape Byron Distillery has emerged as a major tourism drawcard for the Northern Rivers, attracting over 9,000 visitors each year. Distillery tourism in the area has also grown with Husk Distillers opening its distillery door in April 2019 and with Lord Byron Distillery commencing its rum production in 2018.

RECOGNISING THE POTENTIAL OF A LOCAL SUCCESS STORY



Prior to COVID-19, there was a 67% increase in drinking occasions in wineries, distilleries and breweries in 2019.⁵⁶

Gin and whisky trails have emerged across Victoria, Tasmania, New South Wales and Queensland. Many states are recognising the tourism benefit. The Victorian Government has developed its own craft distillery strategy.⁵⁷



In only a few years, the Four Pillars gin distillery has become the most visited destination in the whole of the Yarra Valley, ahead of every individual winery.

Australian spirits quality is consistently recognised around the world

SULLIVANS
COVE

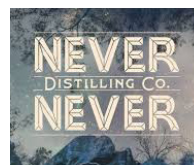
**2019 & 2018 World's Best
Single Cask Single Malt**
World Whiskies Awards



**2017 & 2016 Best
Dark Rum in the World**
World Drinks Awards



**2019 International
Gin Producer of the Year**
International Wine & Spirit Competition



**2019 World's Best
Classic Gin**
World Gin Awards

Making Australian spirits more affordable, at home and for export

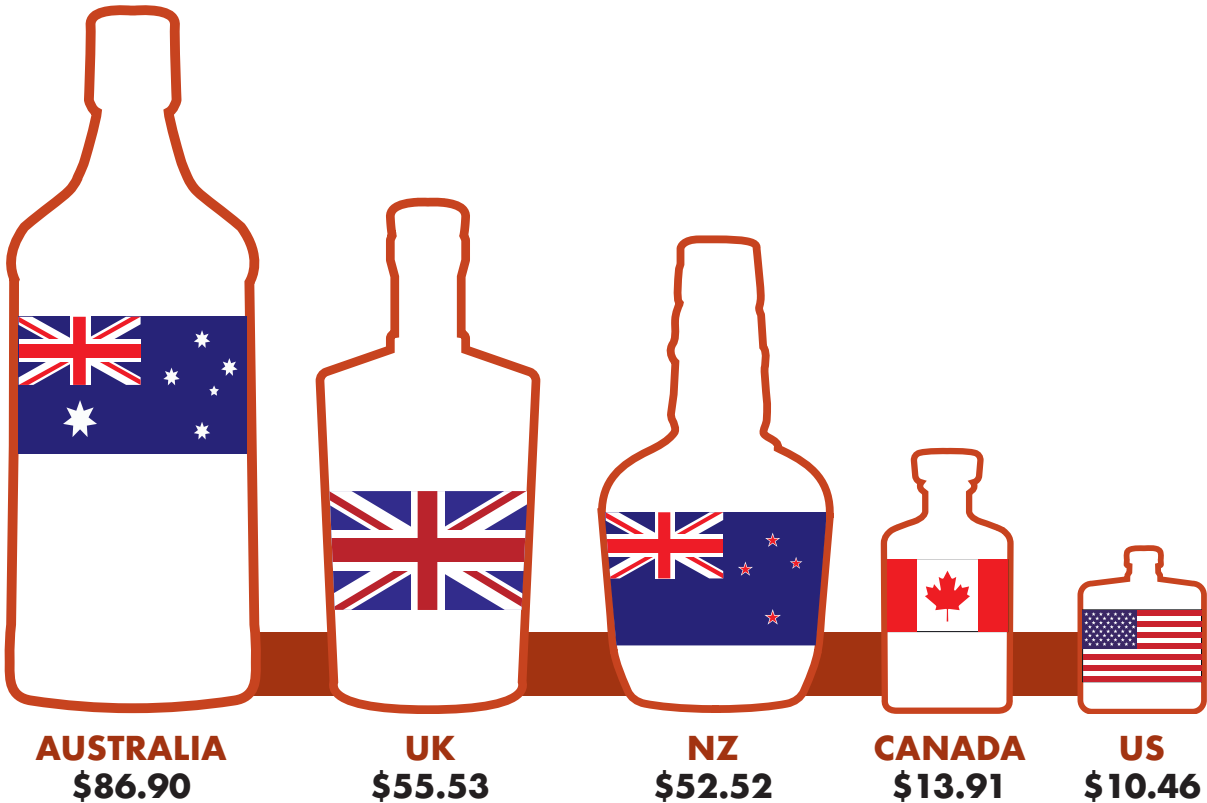
Despite Australian gins, whiskies and rums winning awards around the globe for their quality, Australia currently exports only \$4 per capita in spirits compared to \$171 in Ireland, \$85 in Estonia, \$70 in Sweden and \$11 in New Zealand.⁵⁸

The tax on spirits in Australia is the third highest in the world. Only Iceland and Norway's are higher.⁵⁹ It is 65% higher than New Zealand's,⁶⁰ and 730%—7.3 times—higher than the United States'.⁶¹

Additionally, local consumers pay more for spirits than just about anywhere in the developed world. Due to Australia's high spirits excise, it is often cheaper to buy Australian products abroad. For example, a bottle of Starward Whisky, distilled in Port Melbourne, sells for just US\$50 in the US, while consumers in Australia pay A\$95—around A\$23 more.

Without relief to the headline excise rate, Australian distillers are going to struggle to raise the necessary profits from domestic sales to invest in their business to the necessary level to enable them to export to lucrative growth markets in Asia and around the world.

Figure 7: Australia's spirits excise per pure litre of alcohol compared to comparable markets.



Flow-on benefits for Australia’s burgeoning small bars

Cocktails, mixology and popular food-drink culture add significantly to profitability for the hospitality industry throughout Australia. As people choose to consume fewer, higher-quality drinks rather than in greater volume, there has been a surge in new cocktail bars and small bars in metropolitan and regional areas. These types of bars offer a diverse night-time experience and are home to a more premium drinking culture, with highly skilled mixologists and world-class customer service. Bar training programs such as Beam Suntory’s *The Blend* and Diageo’s *Bar Academy* support the growth of domestic talent and creativity.

The value of spirits in the profitability of licensed venues and hospitality skills is particularly relevant given the wider social, cultural and economic benefit of supporting pubs and hotels – particularly as they recover from extended closures due to COVID-19 restrictions. With many small bars facing insolvency and the profitability and future of the pub and hotel industry under pressure, freezing or reducing excise is a positive way to support the hospitality sector.

In 2019-20, CPI excise increases on spirits will add a further \$26m to the cost of goods to be paid by hotels and small bars.⁶² This will form a significant portion of their cost base.

Australian bar culture continues to grow, winning global acclaim



In 2013, there were no small bars in NSW. Now there are 238 offering employment in a growing sector of the economy.⁶⁴



Melbourne’s Orlando Marzo won the Diageo *World Class* Bartender of the Year 2018 competition in Berlin.⁶³



Sydney’s *Maybe Sammy* was named **Best Bar in Australasia** in The World’s 50 Best Bars Awards 2019.⁶⁵



Policy options to deliver net increases to Government revenue and address tax disparities

The three tax policy options outlined by Spirits & Cocktails Australia in this submission would make purchasing spirits more accessible for the 62% of Australians that choose to drink spirits.⁶⁶ PwC's analysis of all options shows that each will deliver a net increase to Federal Government revenue. The difference in the outcome for each option lies in the size of the revenue increase to Government.

PwC's modelling utilises the best and most recent evidence on how alcohol tax changes impact consumption, as detailed in Monash University's, 'Disaggregated econometric estimation of consumer demand response by alcohol beverage types (2015)'.

The Monash study is significant as prior to its publication there was no suitable or recent empirical evidence on the Australian alcohol market that allowed proper consideration of any tax change. Commenting on the utility of previous studies, it said:

Existing estimates for alcohol demand elasticities in Australia are few, outdated and lack the level of disaggregation for the purpose of analysing any alcohol tax policy changes that involve detailed types of alcohol drinks.⁶⁷

The paper makes a number of key points about the importance of understanding the behavioural response of any tax change:

Essential and urgent to effective alcohol tax policy is empirical evidence of consumer price responsiveness by differentiated alcohol types. For instance, whilst an increase in 'alcopops' tax is aimed at shifting consumers to non-alcohol drinks, how much will the preference be shifted from premixed RTDs to straight spirits as a consequence.⁶⁸

In order to understand the revenue impacts of alcohol tax changes, the Monash study assessed AC Nielsen scan data to understand the own-price and cross-price elasticities in the Australian market. Critically, these did not solely examine the elasticities of headline categories of beer, wine and spirits, but the sub-categories within: premium beer, full strength beer, low alcohol beer and mid-strength beer; red bottled wine, white bottled wine, sparkling wine, cask wine; dark and light ready-to-drink (RTD); and dark and light spirits.. PwC's model uses these elasticities and applies them to the most up-to-date and granular information on Australian alcohol sales from IWSR.

In all three policy scenarios, PwC's modelling shows that decreasing the spirits excise increases Government revenue as it accelerates an established market trend that sees consumers shift from lower taxed beer and wine to higher taxed spirits and RTDs.

Importantly, all three options do not seek to increase tax on any other alcohol category and none result in any significant change to overall alcohol consumption (in all cases, overall alcohol consumption increases by less than one per cent).

As the policy options are primarily designed to benefit consumers, the model assumes that the full benefit of the excise increase is passed through to consumers, with producer and retailer margins remaining constant.

Additionally, the revenue generated by each policy option is significant enough to facilitate the implementation of Spirits & Cocktails Australia's recommendation to increase the craft distiller rebate from \$100,000 to \$350,000 to achieve equivalency with the WET rebate, whilst simultaneously delivering an increase to Government revenue. Importantly this will ensure distillers can maintain employment and supply chain opportunities in regional and rural Australia in their recovery from COVID-19.

For more detailed information on the assumptions, data and elasticities used by PwC in formulating revenue gain estimates, please refer to the PwC analysis (Appendix A).

OPTION 1 Reducing the spirits excise rate to the brandy excise rate

Estimated gain to Government revenue:

- PwC estimates that Option 1 would provide a gain to Government revenue of **\$894m** over the forward estimates period.
- Despite the cut in spirits and RTD excise rates, the share of excise revenue generated by these two categories is modelled to increase from 48.56% to 54.07% over the forward estimates period.

Brandy, a spirit distilled derived from fermented grapes, is currently taxed at a lower rate than all other spirits.⁶⁹ This policy is said to date back to 1979 and had the aim of boosting a then thriving grape wine industry.⁷⁰

Under Option 1, it is proposed that spirits, brandy and RTDs would be taxed at the brandy rate from 1 July 2020. This would result in the effective abolition of one excise category and deliver an immediate cut to the excise rate of approximately \$5 per litre of alcohol (/ LAL) for all spirits other than brandy. CPI increases in future years would be smaller given the reduction in the base rate of excise.

For example, under Option 1 excise on a bottle of Hellyers Road whisky would drop from \$27.65 in 2019 to approximately \$26.16 from 1 July 2020.

Table 1: Option 1 total Government revenue related to alcohol (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	4-year total
Option 1							
Spirits and RTDs excise	3,313	3,475	3,943	4,079	4,243	4,397	16,663
Other alcohol excise and WET	3,532	3,685	3,591	3,704	3,836	3,915	15,046
All excise and WET sub-total	6,845	7,160	7,534	7,783	8,079	8,312	31,709
GST on spirits and RTDs	762	795	903	914	925	935	3,677
GST on other alcohol	2,459	2,527	2,424	2,432	2,444	2,457	9,757
All GST sub-total	3,221	3,322	3,327	3,346	3,369	3,392	13,434
Total revenue	10,065	10,482	10,860	11,129	11,448	11,704	45,142
Base							
Spirits and RTDs excise	3,313	3,475	3,553	3,670	3,807	3,934	14,964
Other alcohol excise and WET	3,532	3,685	3,777	3,900	4,043	4,131	15,851
All excise and WET sub-total	6,845	7,160	7,330	7,570	7,850	8,065	30,815
GST on spirits and RTDs	762	795	805	815	824	832	3,276
GST on other alcohol	2,459	2,527	2,549	2,560	2,575	2,591	10,276
All GST sub-total	3,221	3,322	3,354	3,375	3,399	3,423	13,552
Total revenue	10,065	10,482	10,684	10,945	11,249	11,488	44,366
Difference							
Spirits and RTDs excise	0	0	390	409	436	463	1,699
Other alcohol excise and WET	0	0	-186	-196	-207	-216	-805
All excise and WET sub-total	0	0	204	213	229	247	894
GST on spirits and RTDs	0	0	97	99	101	103	401
GST on other alcohol	0	0	-125	-128	-131	-135	-519
All GST sub-total	0	0	-28	-29	-30	-32	-118
Total revenue	0	0	176	185	199	216	776
% change (excise)	0.00%	0.00%	2.78%	2.82%	2.92%	3.07%	2.90%
% change (all revenue)	0.00%	0.00%	1.65%	1.69%	1.77%	1.88%	1.75%

OPTION 2

Freezing CPI indexation of spirits and brandy excise for three years

Estimated gain to Government revenue:

- PwC estimates that Option 2 would result in a gain to Government revenue of **\$707m** over the forward estimates period.
- As with Option 1, the share of excise revenue generated by spirits and RTDs would increase. Over the forward estimates period, it would rise from 48.56% to 52.91%.

Another way to deliver tax relief to spirits consumers is to freeze the twice-yearly excise increases for a fixed period of three years. Option 2 ensures that issues discussed earlier in this submission do not worsen over this timeframe.

For example, Option 2 prevents an excise increase of approximately \$3–\$4 per 700mL bottle of spirits and \$4–\$7 per 24-pack RTD case over three years.

This option closely reflects the recent changes made by the UK Government, where several CPI freezes have delivered increased Government revenue with no increase to overall consumption trends.

A three-year indexation freeze would also provide time for the Government to consider and develop a longer-term strategy to holistically reform alcohol taxation.

Table 2: Option 2 total Government revenue related to alcohol (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	4-year total
Option 2							
Spirits and RTDs excise	3,313	3,475	3,672	3,945	4,249	4,437	16,303
Other alcohol excise and WET	3,532	3,685	3,723	3,771	3,832	3,893	15,219
All excise and WET sub-total	6,845	7,160	7,395	7,716	8,081	8,330	31,522
GST on spirits and RTDs	762	795	834	881	927	945	3,586
GST on other alcohol	2,459	2,527	2,513	2,475	2,442	2,443	9,873
All GST sub-total	3,221	3,322	3,347	3,356	3,369	3,388	13,459
Total revenue	10,065	10,482	10,741	11,072	11,450	11,719	44,981
Base							
Spirits and RTDs excise	3,313	3,475	3,553	3,670	3,807	3,934	14,964
Other alcohol excise and WET	3,532	3,685	3,777	3,900	4,043	4,131	15,851
All excise and WET sub-total	6,845	7,160	7,330	7,570	7,850	8,065	30,815
GST on spirits and RTDs	762	795	805	815	824	832	3,276
GST on other alcohol	2,459	2,527	2,549	2,560	2,575	2,591	10,276
All GST sub-total	3,221	3,322	3,354	3,375	3,399	3,423	13,552
Total revenue	10,065	10,482	10,684	10,945	11,249	11,488	44,366
Difference							
Spirits and RTDs excise	0	0	119	275	443	503	1,339
Other alcohol excise and WET	0	0	-54	-129	-211	-237	-632
All excise and WET sub-total	0	0	65	146	232	266	707
GST on spirits and RTDs	0	0	29	66	103	113	310
GST on other alcohol	0	0	-36	-84	-134	-148	-403
All GST sub-total	0	0	-7	-18	-31	-35	-93
Total revenue	0	0	57	127	200	231	615
% change (excise)	0.00%	0.00%	0.88%	1.93%	2.95%	3.29%	2.29%
% change (all revenue)	0.00%	0.00%	0.53%	1.16%	1.78%	2.01%	1.39%

OPTION 3

Reducing spirits excise to the brandy rate and freezing CPI indexation for three years

Estimated gain to Government revenue:

- PwC estimates that Option 3 would result in a gain to Government revenue of **\$1.4bn** over the forward estimates period.
- As with Options 1 and 2, the share of excise revenue generated by spirits and RTDs would increase. Over the forward estimates period, it would rise from 48.56% to 57.63%.

Option 3 would deliver the greatest Government revenue gains. It is a combination of the measures proposed in Options 1 and 2. Option 3 removes the existing spirits excise category, with all spirits and RTDs to be taxed at the brandy rate from 1 July 2020, and freezing CPI indexation of that rate for three years.

Option 3 has the advantage of also enabling the Government to deliver tax relief for consumers, and provides time to develop a longer-term alcohol tax reform plan that balances the many competing interests of the industry.

Option 3 would deliver greater revenue gains to the Government than Option 1 or 2 alone, while also having stronger benefits for consumers.

For example, Option 3 would deliver an immediate saving to consumers of approximately \$1.61 per bottle of spirits and \$2.48 per 24-pack of RTDs from 1 July 2020. It then prevents excise increases of around \$3–\$4 per bottle of spirits and \$4–\$7 per case of RTDs.

Table 3: Option 3 total Government revenue related to alcohol (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	4-year total
Option 3							
Spirits and RTDs excise	3,313	3,475	4,041	4,305	4,605	4,809	17,760
Other alcohol excise and WET	3,532	3,685	3,540	3,584	3,639	3,693	14,455
All excise and WET sub-total	6,845	7,160	7,581	7,889	8,244	8,502	32,215
GST on spirits and RTDs	762	795	928	972	1,016	1,036	3,953
GST on other alcohol	2,459	2,527	2,390	2,353	2,319	2,318	9,380
All GST sub-total	3,221	3,322	3,318	3,325	3,335	3,354	13,333
Total revenue	10,065	10,482	10,899	11,214	11,579	11,856	45,548
Base							
Spirits and RTDs excise	3,313	3,475	3,553	3,670	3,807	3,934	14,964
Other alcohol excise and WET	3,532	3,685	3,777	3,900	4,043	4,131	15,851
All excise and WET sub-total	6,845	7,160	7,330	7,570	7,850	8,065	30,815
GST on spirits and RTDs	762	795	805	815	824	832	3,276
GST on other alcohol	2,459	2,527	2,549	2,560	2,575	2,591	10,276
All GST sub-total	3,221	3,322	3,354	3,375	3,399	3,423	13,552
Total revenue	10,065	10,482	10,684	10,945	11,249	11,488	44,366
Difference							
Spirits and RTDs excise	0	0	488	635	798	874	2,796
Other alcohol excise and WET	0	0	-237	-316	-405	-437	-1,396
All excise and WET sub-total	0	0	251	319	393	437	1,400
GST on spirits and RTDs	0	0	123	157	193	204	677
GST on other alcohol	0	0	-159	-207	-256	-273	-895
All GST sub-total	0	0	-36	-50	-63	-69	-218
Total revenue	0	0	215	269	330	368	1,182
% change (excise)	0.00%	0.00%	3.43%	4.21%	5.01%	5.42%	4.54%
% change (all revenue)	0.00%	0.00%	2.01%	2.46%	2.93%	3.20%	2.66%

OPTION 4 **Increasing the craft distiller refund scheme limit from \$100,000 to \$350,000**

The revenue gains delivered by implementing Spirits & Cocktails Australia’s proposed changes to spirits excise could also be used to help address the disparity between the tax incentives available to domestic alcohol producers.

Spirits & Cocktails Australia recommends providing short-term relief to craft distillers by increasing the current excise refund limit from \$100,000 to \$350,000 for two years at a full 100 per cent of excise duty paid on their products. Analysis completed by PwC shows that this would increase rebate expenditure by \$33 million over two years; a 47 per cent increase from current arrangements for those years.

This policy change will achieve equivalency in the rebate currently offered to small wine producers under the Wine Equalisation Tax (WET), whilst ensuring distillers can maintain employment and supply chain opportunities in regional and rural Australia in their recovery from COVID-19.

Table 4: Option 4 total Government refund expenditure to craft distillers and brewers (2018-19 to 2023-24, \$ millions)

Option 4	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2-year total (2019-20 & 2020-21)
Current refund scheme arrangements							
Distillers	2	9	9	10	11	11	17
Brewers	8	26	26	30	34	34	53
Total	10	35	35	40	45	45	70
Proposed refund scheme arrangements							
Distillers	2	25	25	10	11	11	50
Brewers	8	26	26	30	34	34	53
Total	10	51	51	40	45	45	103
Net increases in refund payments	0	16	16	0	0	0	33

Note: Totals may not sum due to rounding. These are refund estimates, but they are presented on an accrual basis (i.e. the year in which the excise is paid) and not when the cash refund is received, which may be delayed. On a cash basis, the vast majority of the net increase in refunds will occur in 2020-21 (delayed lump sum for 2019-20 and then monthly payments for 2020-21), with a small amount in 2021-22 (any delayed monthly payments from 2020-21).

Conclusion

Australia's complex alcohol taxation system has long been considered in need of reform. As the Federal Government contemplates how it will shape the Budget to help the economy to recover and grow in the wake of COVID-19 pandemic, Spirits & Cocktails Australia recommends that alcohol tax reform is considered as part of the solution.

This Pre-Budget Submission proposes policy options to simplify alcohol tax while providing significant across-the-board benefits to Australian consumers and spirits producers. Importantly, all of the proposed changes to spirits excise will simultaneously provide meaningful net increases to total Government revenue to help repay the debt incurred by stimulating the economy throughout the pandemic, whilst promoting the recovery of the spirits and hospitality sectors. It is worth noting that gains would not be the result of increased consumption—analysis shows that the effect on alcohol consumption would be negligible.

Of the policy options proposed, Option 3 provides the most positive revenue outcome. It forecasts that Federal Government excise revenue would increase by \$1.4bn over the forward estimates.

The October 2020 Budget presents the ideal opportunity to take the first step towards reforming the alcohol excise system to benefit all Australians. Spirits & Cocktails Australia urges the Federal Government to take it.



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Spirits & Cocktails Australia
August 2020

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Spirits excise option modelling

Final report

January 2020



Disclaimer

This report is not intended to be read or used by anyone other than Spirits and Cocktails Australia.

We prepared this report solely for Spirits and Cocktails Australia's use and benefit in accordance with and for the purpose set out in our engagement letter dated 20 November. In doing so, we acted exclusively for Spirits and Cocktails Australia considered no-one else's interests.

We accept no responsibility, duty or liability:

- to anyone other than Spirits and Cocktails Australia in connection with this report
- to Spirits and Cocktails Australia for the consequences of using or relying on it for a purpose other than that referred to above.

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Overall results – all options

These results examines the revenue to government from three options of changes to taxation of spirits, as follows:

- **Option 1** - Applying the current brandy excise rate to all spirits and ready-to-drink beverages (RTDs). Currently, brandy is taxed at \$80.20 per litre of pure alcohol (LAL) and spirits at \$85.87 per LAL. This option would, in effect, abolish the existing spirits excise category and tax all spirits and RTDs, including brandy, at the existing brandy rate.
- **Option 2** - Freezing Consumer Price Index (CPI) increase of brandy and spirits excise at current rates for a period of three years. Currently rates are indexed with CPI twice a year in February and August.
- **Option 3** - A combination of option (1) and (2) above.

All changes are assumed to start at the beginning of the 2020-21 tax year.

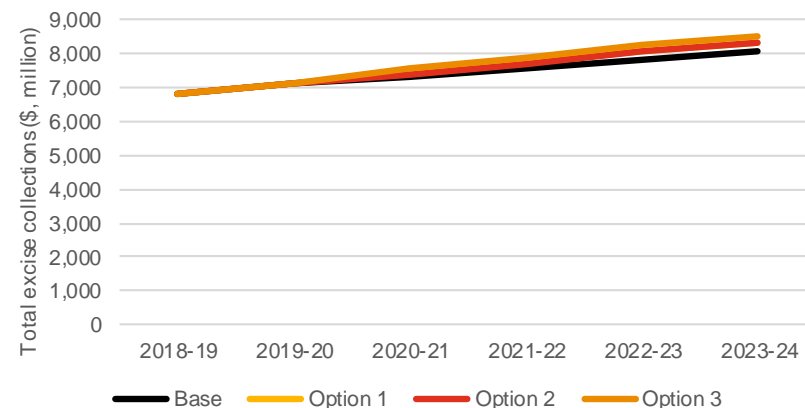
The graphs to the right show the impact of these options on total government revenue from alcohol excises, as well as collections just from excise of spirits and RTDs (i.e. excluding wine equalisation tax (WET) and excise on beer and cider). This shows that government collections from alcohol excise changes only marginally. The detail of each option is examined in the following pages and key approach assumptions are covered in the appendix.

This report also separately examines the impact to government expenditure from amending the craft distillers excise refund scheme.

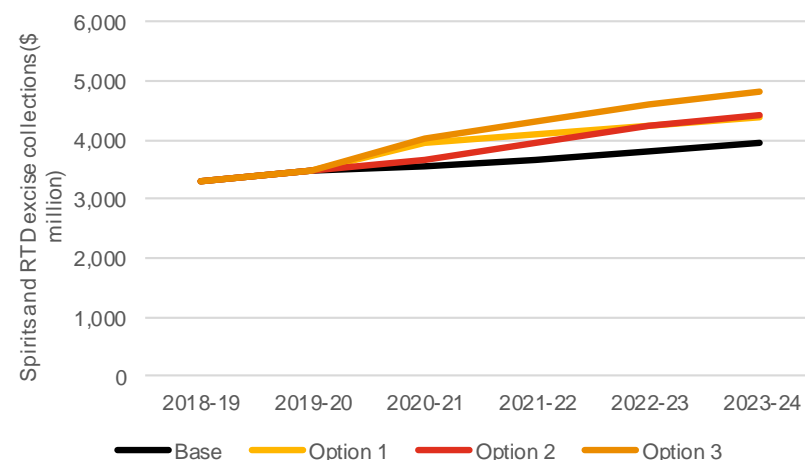
Throughout this report the term ‘excise’ is taken to mean both excise and excise equivalent customs duty as no distinction is drawn between domestically produced goods and excise equivalent goods in the analysis. Total revenue also includes changes to Goods and Services Tax (GST) collections.

It should be noted that analysis and forecasts in this report were prepared in January 2020 (with the exception of excise refund analysis which was added in June 2020) and so are on a pre-COVID-19 basis.

Total alcohol excise revenue (2018-19 to 2023-24)



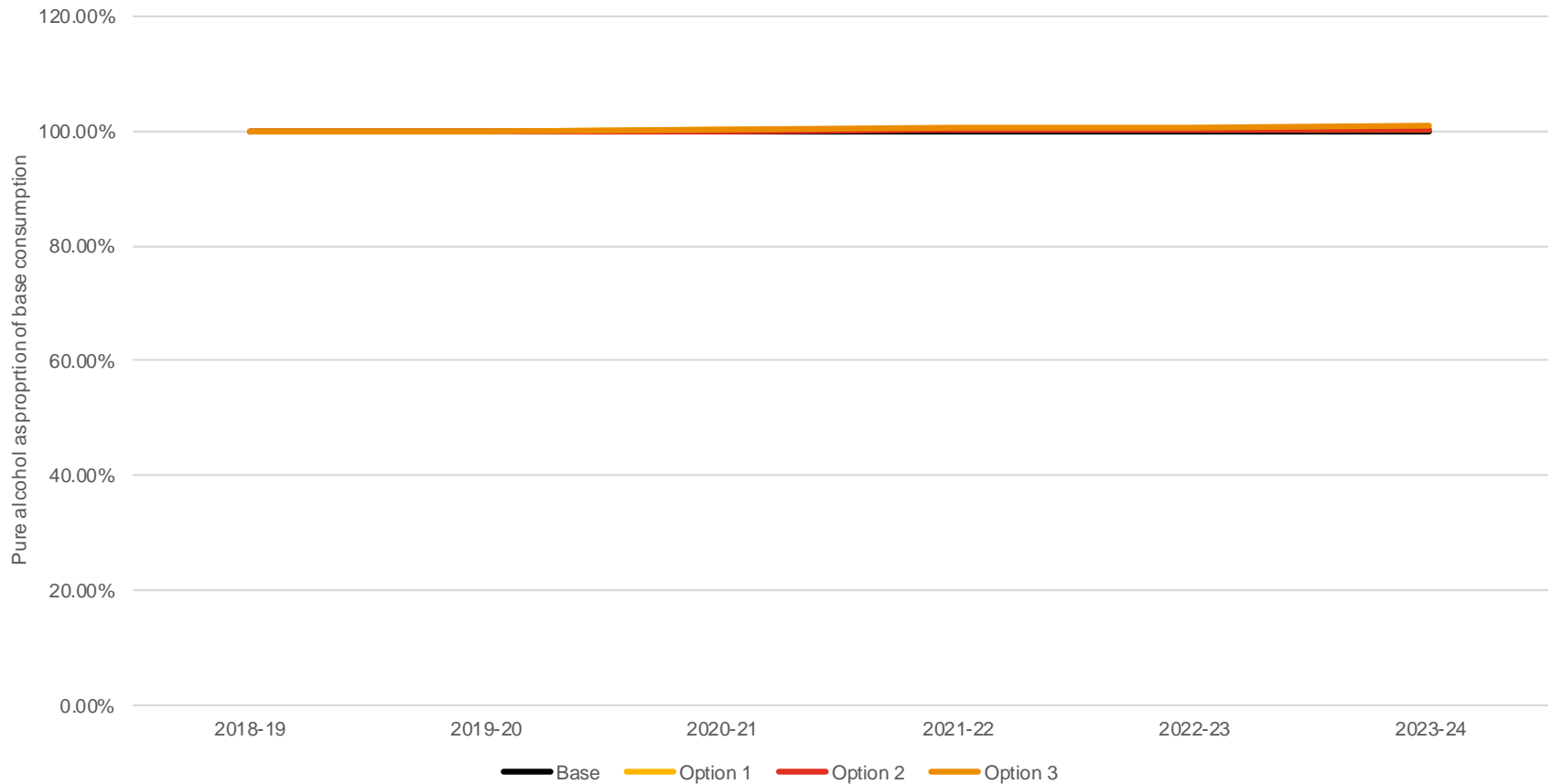
Spirits and RTD excise revenue (2018-19 to 2023-24)



Overall results – all options

The graph below shows proportional changes in total alcohol consumption associated with the three options. This shows minor increases in the volume of pure alcohol.

Total pure alcohol consumption, as proportion of base forecast (2018-19 to 2023-24)



Option 1 detailed revenue results

The table below shows detailed revenue impacts from applying the brandy excise rate to all spirits and RTDs from 1 July 2020.

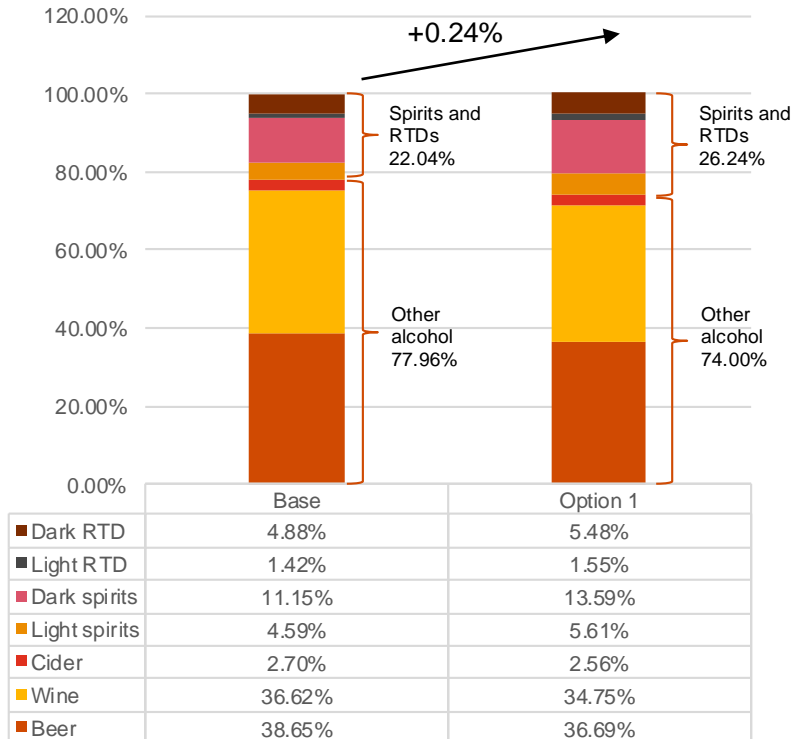
Total government revenue related to alcohol (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	Four year total
Option 1							
Spirits and RTDs excise	3,313	3,475	3,943	4,079	4,243	4,397	16,663
Other alcohol excise and WET	3,532	3,685	3,591	3,704	3,836	3,915	15,046
<i>All excise and WET sub-total</i>	<i>6,845</i>	<i>7,160</i>	<i>7,534</i>	<i>7,783</i>	<i>8,079</i>	<i>8,312</i>	<i>31,709</i>
GST on spirits and RTDs	762	795	903	914	925	935	3,677
GST on other alcohol	2,459	2,527	2,424	2,432	2,444	2,457	9,757
<i>All GST sub-total</i>	<i>3,221</i>	<i>3,322</i>	<i>3,327</i>	<i>3,346</i>	<i>3,369</i>	<i>3,392</i>	<i>13,434</i>
Total revenue	10,065	10,482	10,860	11,129	11,448	11,704	45,142
Base							
Spirits and RTDs excise	3,313	3,475	3,553	3,670	3,807	3,934	14,964
Other alcohol excise and WET	3,532	3,685	3,777	3,900	4,043	4,131	15,851
<i>All excise and WET sub-total</i>	<i>6,845</i>	<i>7,160</i>	<i>7,330</i>	<i>7,570</i>	<i>7,850</i>	<i>8,065</i>	<i>30,815</i>
GST on spirits and RTDs	762	795	805	815	824	832	3,276
GST on other alcohol	2,459	2,527	2,549	2,560	2,575	2,591	10,276
<i>All GST sub-total</i>	<i>3,221</i>	<i>3,322</i>	<i>3,354</i>	<i>3,375</i>	<i>3,399</i>	<i>3,423</i>	<i>13,552</i>
Total revenue	10,065	10,482	10,684	10,945	11,249	11,488	44,366
Difference							
Spirits and RTDs excise	0	0	390	409	436	463	1,699
Other alcohol excise and WET	0	0	-186	-196	-207	-216	-805
<i>All excise and WET sub-total</i>	<i>0</i>	<i>0</i>	<i>204</i>	<i>213</i>	<i>229</i>	<i>247</i>	<i>894</i>
GST on spirits and RTDs	0	0	97	99	101	103	401
GST on other alcohol	0	0	-125	-128	-131	-135	-519
<i>All GST sub-total</i>	<i>0</i>	<i>0</i>	<i>-28</i>	<i>-29</i>	<i>-30</i>	<i>-32</i>	<i>-118</i>
Total revenue	0	0	176	185	199	216	776
% change (excise)	0.00%	0.00%	2.78%	2.82%	2.92%	3.07%	2.90%
% change (all revenue)	0.00%	0.00%	1.65%	1.69%	1.77%	1.88%	1.75%

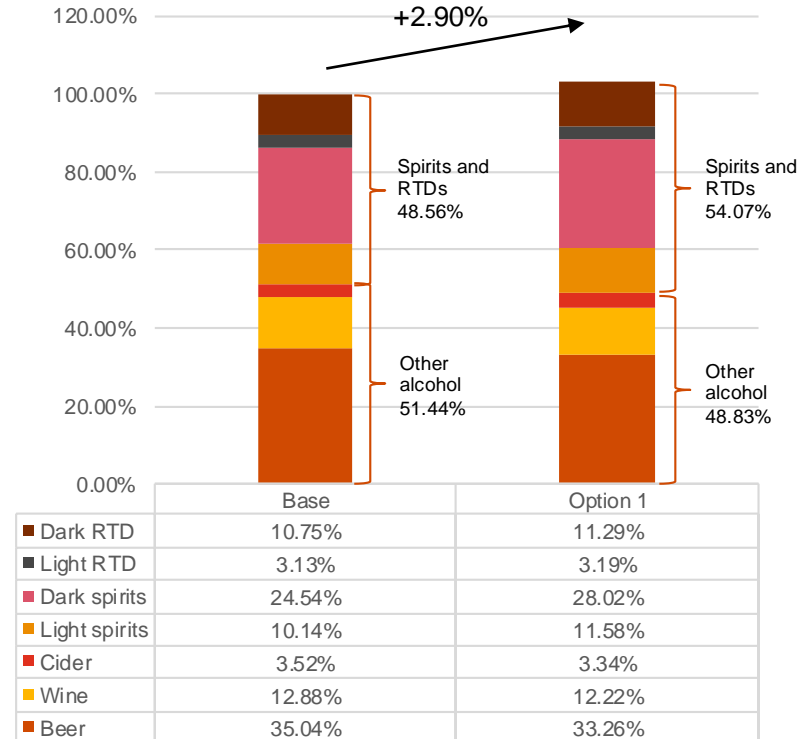
Option 1 detailed consumption results

Under Option 1, pure alcohol consumption increases by 0.24 per cent. Alcohol volumes within the spirits and RTD categories increase, but this is offset by decreases in other categories. As a result of these changes, the proportion of excise revenue generated by spirits and RTD categories increases from 48.56 per cent to 54.07 per cent (as a percentage of excise revenue in the base case).

Pure alcohol consumption by category, proportion of base total (sum of four years)



Excise revenue by category, proportion of base total (sum of four years)



Option 2 detailed revenue results

The table below shows detailed revenue impacts from freezing CPI on brandy, other spirits and RTDs from 1 July 2020 for three years.

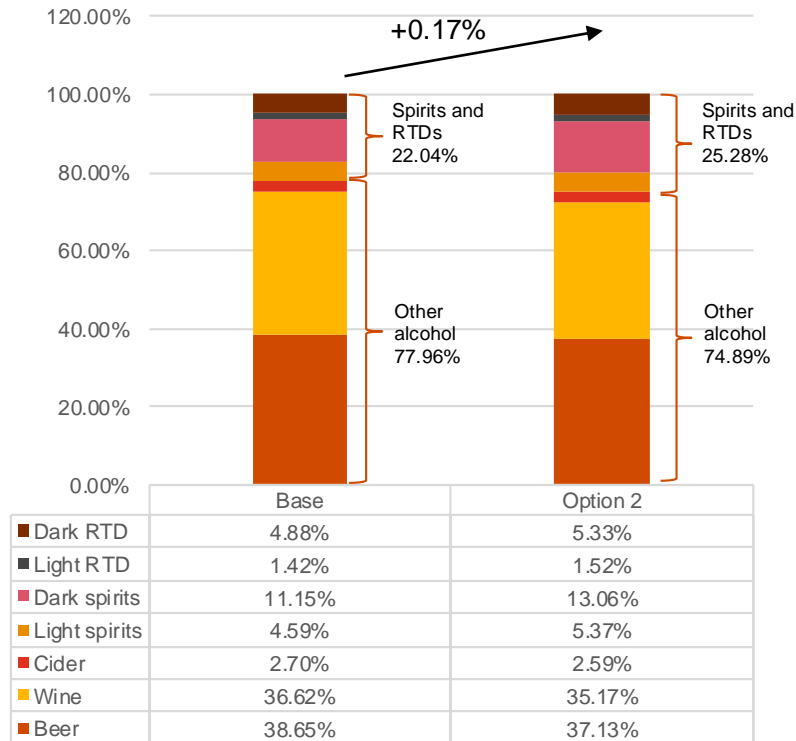
Total government revenue related to alcohol (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	Four year total
Option 2							
Spirits and RTDs excise	3,313	3,475	3,672	3,945	4,249	4,437	16,303
Other alcohol excise and WET	3,532	3,685	3,723	3,771	3,832	3,893	15,219
<i>All excise and WET sub-total</i>	<i>6,845</i>	<i>7,160</i>	<i>7,395</i>	<i>7,716</i>	<i>8,081</i>	<i>8,330</i>	<i>31,522</i>
GST on spirits and RTDs	762	795	834	881	927	945	3,586
GST on other alcohol	2,459	2,527	2,513	2,475	2,442	2,443	9,873
<i>All GST sub-total</i>	<i>3,221</i>	<i>3,322</i>	<i>3,347</i>	<i>3,356</i>	<i>3,369</i>	<i>3,388</i>	<i>13,459</i>
Total revenue	10,065	10,482	10,741	11,072	11,450	11,719	44,981
Base							
Spirits and RTDs excise	3,313	3,475	3,553	3,670	3,807	3,934	14,964
Other alcohol excise and WET	3,532	3,685	3,777	3,900	4,043	4,131	15,851
<i>All excise and WET sub-total</i>	<i>6,845</i>	<i>7,160</i>	<i>7,330</i>	<i>7,570</i>	<i>7,850</i>	<i>8,065</i>	<i>30,815</i>
GST on spirits and RTDs	762	795	805	815	824	832	3,276
GST on other alcohol	2,459	2,527	2,549	2,560	2,575	2,591	10,276
<i>All GST sub-total</i>	<i>3,221</i>	<i>3,322</i>	<i>3,354</i>	<i>3,375</i>	<i>3,399</i>	<i>3,423</i>	<i>13,552</i>
Total revenue	10,065	10,482	10,684	10,945	11,249	11,488	44,366
Difference							
Spirits and RTDs excise	0	0	119	275	443	503	1,339
Other alcohol excise and WET	0	0	-54	-129	-211	-237	-632
<i>All excise and WET sub-total</i>	<i>0</i>	<i>0</i>	<i>65</i>	<i>146</i>	<i>232</i>	<i>266</i>	<i>707</i>
GST on spirits and RTDs	0	0	29	66	103	113	310
GST on other alcohol	0	0	-36	-84	-134	-148	-403
<i>All GST sub-total</i>	<i>0</i>	<i>0</i>	<i>-7</i>	<i>-18</i>	<i>-31</i>	<i>-35</i>	<i>-93</i>
Total revenue	0	0	57	127	200	231	615
% change (excise)	0.00%	0.00%	0.88%	1.93%	2.95%	3.29%	2.29%
% change (all revenue)	0.00%	0.00%	0.53%	1.16%	1.78%	2.01%	1.39%

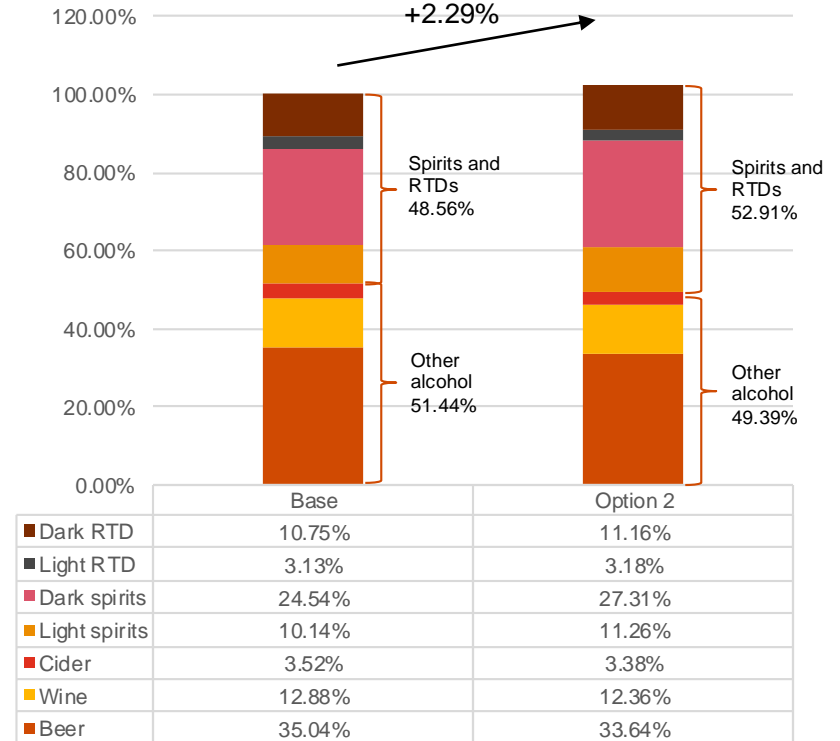
Option 2 detailed consumption results

Under Option 2, pure alcohol consumption increases by 0.17 per cent. Alcohol volumes within the spirits and RTD categories increase, but this is offset by decreases in other categories. As a result of these changes, the proportion of excise revenue generated by spirits and RTD categories increases from 48.56 per cent to 52.91 per cent (as a percentage of excise revenue in the base case).

Pure alcohol consumption by category, proportion of base total (sum of four years)



Excise revenue by category, proportion of base total (sum of four years)



Option 3 detailed revenue results

The table below shows detailed revenue impacts from combining options 1 and 2 above. Because indexation is frozen at the brandy rate, rather than the existing spirits rate in option 1, the revenue impact of this option is less than the sum of the parts.

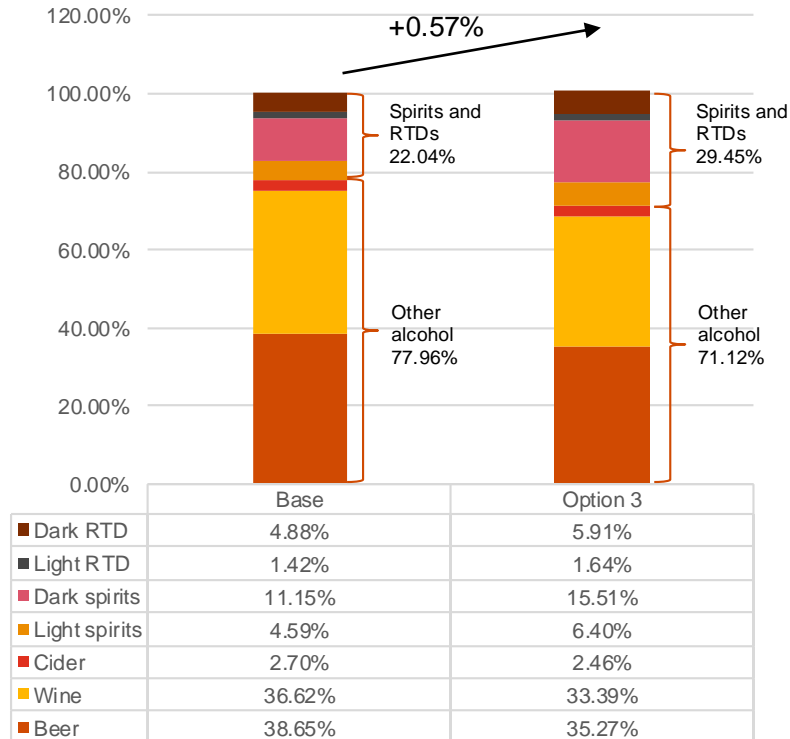
Total government revenue related to alcohol (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	Four year total
Option 3							
Spirits and RTDs excise	3,313	3,475	4,041	4,305	4,605	4,809	17,760
Other alcohol excise and WET	3,532	3,685	3,540	3,584	3,639	3,693	14,455
<i>All excise and WET sub-total</i>	<i>6,845</i>	<i>7,160</i>	<i>7,581</i>	<i>7,889</i>	<i>8,244</i>	<i>8,502</i>	<i>32,215</i>
GST on spirits and RTDs	762	795	928	972	1,016	1,036	3,953
GST on other alcohol	2,459	2,527	2,390	2,353	2,319	2,318	9,380
<i>All GST sub-total</i>	<i>3,221</i>	<i>3,322</i>	<i>3,318</i>	<i>3,325</i>	<i>3,335</i>	<i>3,354</i>	<i>13,333</i>
Total revenue	10,065	10,482	10,899	11,214	11,579	11,856	45,548
Base							
Spirits and RTDs excise	3,313	3,475	3,553	3,670	3,807	3,934	14,964
Other alcohol excise and WET	3,532	3,685	3,777	3,900	4,043	4,131	15,851
<i>All excise and WET sub-total</i>	<i>6,845</i>	<i>7,160</i>	<i>7,330</i>	<i>7,570</i>	<i>7,850</i>	<i>8,065</i>	<i>30,815</i>
GST on spirits and RTDs	762	795	805	815	824	832	3,276
GST on other alcohol	2,459	2,527	2,549	2,560	2,575	2,591	10,276
<i>All GST sub-total</i>	<i>3,221</i>	<i>3,322</i>	<i>3,354</i>	<i>3,375</i>	<i>3,399</i>	<i>3,423</i>	<i>13,552</i>
Total revenue	10,065	10,482	10,684	10,945	11,249	11,488	44,366
Difference							
Spirits and RTDs excise	0	0	488	635	798	874	2,796
Other alcohol excise and WET	0	0	-237	-316	-405	-437	-1,396
<i>All excise and WET sub-total</i>	<i>0</i>	<i>0</i>	<i>251</i>	<i>319</i>	<i>393</i>	<i>437</i>	<i>1,400</i>
GST on spirits and RTDs	0	0	123	157	193	204	677
GST on other alcohol	0	0	-159	-207	-256	-273	-895
<i>All GST sub-total</i>	<i>0</i>	<i>0</i>	<i>-36</i>	<i>-50</i>	<i>-63</i>	<i>-69</i>	<i>-218</i>
Total revenue	0	0	215	269	330	368	1,182
% change (excise)	0.00%	0.00%	3.43%	4.21%	5.01%	5.42%	4.54%
% change (all revenue)	0.00%	0.00%	2.01%	2.46%	2.93%	3.20%	2.66%

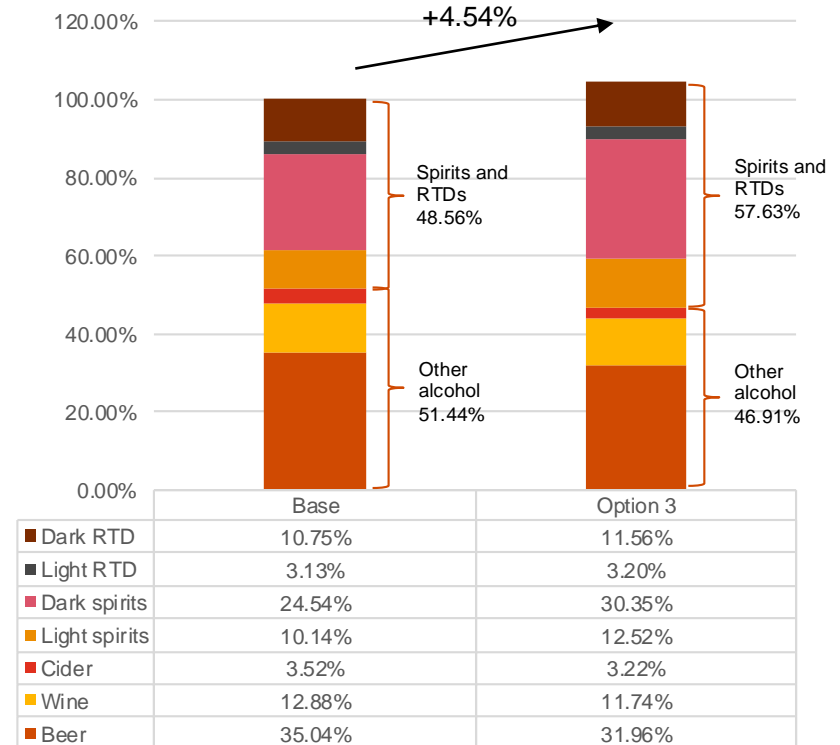
Option 3 detailed consumption results

Under Option 3, pure alcohol consumption increases by 0.57 per cent. Alcohol volumes within the spirits and RTD categories increase, but this is offset by decreases in other categories. As a result of these changes, the proportion of excise revenue generated by spirits and RTD categories increases from 48.56 per cent to 57.63 per cent (as a percentage of excise revenue in the base case).

Pure alcohol consumption by category, proportion of base total (sum of four years)



Excise revenue by category, proportion of base total (sum of four years)



Amend and broaden the current craft distillers' refund scheme

Separate to the options examined above, analysis of amending and broadening the current craft distillers refund scheme has also been conducted. Currently, eligible craft brewers and distillers can claim a refund on up to 60 per cent of the excise duty paid on their products – capped at \$30,000 per financial year in 2018-19 and previous years, increasing to \$100,000 per financial year in 2019-20.

This analysis examines the increase in refund scheme expenditure if this cap was extended to \$350,000 for craft distillers in 2019-20 and 2020-21 at a full 100 per cent of excise duty paid on their products. Analysis shows expenditure on the refund scheme would increase by \$33 million over those two years, a 47 per cent increase from current arrangements over the same period.

This analysis, unlike the options presented above, calculates the impact of government revenue assuming no price or behaviour change. As a refund scheme that is back dated and designed to address current cash flow issues, it is assumed to not be incorporated in to prices, and therefore assumed to have no consumer response (in terms of consuming more/less or substituting between products).

Total government refund scheme expenditure to craft distillers and brewers (2018-19 to 2023-24, \$ millions)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	Two year total (2019-20 and 2020-21)
Current refund scheme arrangements							
Distillers	2	9	9	10	11	11	17
Brewers	8	26	26	30	34	34	53
Total	10	35	35	40	45	45	70
Proposed refund scheme arrangements							
Distillers	2	25	25	10	11	11	50
Brewers	8	26	26	30	34	34	53
Total	10	51	51	40	45	45	103
Net increase in refund payments	0	16	16	0	0	0	33

Note: Totals may not sum due to rounding. These are refund estimates, but they are presented on an accrual basis (i.e. the year in which the excise is paid) and not when the cash refund is received, which may be delayed. On a cash basis, the vast majority of the net increase in refunds will occur in 2020-21 (delayed lump sum for 2019-20 and then monthly payments for 2020-21), with a small amount in 2021-22 (any delayed monthly payments from 2020-21).

Appendix approach - general

Key assumptions and sources are set out below.

- Baseline and forecast total volume consumption and retail value are taken from industry IWSR data provided by Spirits and Cocktails Australia. These forecasts were taken as given and not tested.
- Government revenue current and forecast were based on this consumption data provided, but has been adjusted to ensure that excise (and the level of pure alcohol implied by that excise) aligns with the forecast in Mid-Year Economic and Fiscal Outlook 2019-20.
- However, the specifics of the headline budget figures have been disaggregated to divorce brandy from other spirits and cider from RTD and WET. It has been assumed that 18.9 per cent of cider is included in other alcohol excise with RTDs (proportion of market that is flavoured cider from IBIS World *Cider Production in Australia*).
- Implied volume of pure alcohol is also sense checked against ABS *Apparent Consumption of Alcohol*, and typical alcohol by volume (ABV) percentages of various products on a desktop exercise.
- GST cannot be adjusted to specific budget forecasts, so is based on retail values in IWSR.
- The categorisation of baseline data is important to the results, especially in terms of assigning elasticities (as more categories can mean more responsiveness across categories, rather than own price adjustments within a category). Our modelling is built on the categories shown to the right, discussed and agreed with Spirits and Cocktails Australia.
- Price points for the full bottled spirits (FBS) have been aligned to IWSR data, where our budget category means IWSR low-price, value and standard (i.e. under \$47.49), our mid means ISWR premium (\$47.50 to \$65) and our high means all other categories. It should be noted that the vast majority of IWSR data is in their Value and Standard categories for FBS, which is why they are in different categories for our modelling.

Description	Product	Sub-product	Price point
Low strength beer	Beer	Low	All
Mid strength beer	Beer	Mid	All
Full strength beer	Beer	Full	All
Red wine	Wine	Red	All
White wine	Wine	White	All
Other wine	Wine	Other	All
Cider	Cider	All	All
Brandy	FBS	All	All
Budget light spirits	FBS	Light	Budget
Mid light spirits	FBS	Light	Mid
High light spirits	FBS	Light	High
Budget dark spirits	FBS	Dark	Budget
Mid dark spirits	FBS	Dark	Mid
High dark spirits	FBS	Dark	High
Light RTD	RTD	Light	All
Dark RTD	RTD	Dark	All

- Our model is built on half years (as indexing happens twice a year). We have assumed seasonality based on IRI data provided by Spirits and Cocktails Australia which shows that approximately 46 per cent of consumption occurs in the January to June half year.

Appendix approach - elasticities

Elasticities are the assumption our modelling is the most sensitive to.

Our key source, discussed and agreed with Spirits and Cocktails Australia, has been Srivastava, P. et al (2014) *Econometric Modelling of Price Response by Alcohol Types to Inform Alcohol Tax Policies*, Monash University.

This has been reviewed against international examples and meta analysis and found to be the most appropriate for the Australian context. We note that the own price elasticities are higher than other analysis (i.e. Fogarty, J. (2004) *The Own-Price Elasticity of Alcohol: A Meta-Analysis*, University of Western Australia and Fogerty (2010) *The demand for Beer, Wine and Spirits*), but this can be due to the level of product detail in the Monash paper (compared to a single own price elasticity for spirits).

We have taken the Morishma elasticities of substitution from the Monash paper for cross product, and taken own price elasticity as given, with disaggregation across price points as below.

For disaggregating the Monash elasticities across price points, we have used one standard deviation of Australian estimates as shown in Fogerty (2010) *The demand for Beer, Wine and Spirits*. We have assumed lower own price elasticity for lower price points, to avoid a crowding to the bottom of the price points as price reduce, but have also allowed for a 0.3 price reaction to move up a price point (although as all are within the same taxation rate, this will not impact excise revenues).

For pass through of option price changes for the market to respond to with these elasticities, we have assumed that all costs except excise and profit are fixed, and profit margin stays consistent as a percentage on top of fixed costs and revised excise. In essence, the full excise cut is passed through to prices for consumers, with mark up proportions staying consistent.

Description	Own price	Substitution of products	Within category
Low strength beer		1.529	
Mid strength beer		1.666	
Full strength beer		1.483	
Red wine		1.490	
White wine		1.546	
Other wine		1.621	
Cider		1.494	
Brandy	-1.519	1.728	
Budget light spirits	-1.51	1.577	0.3
Mid light spirits	-1.26	1.577	0.3
High light spirits	-1.01	1.577	0.3
Budget dark spirits	-1.769	1.728	0.3
Mid dark spirits	-1.519	1.728	0.3
High dark spirits	-1.269	1.728	0.3
Light RTD	-1.164	1.534	
Dark RTD	-1.831	1.277	

Note – simplified structure for options where all spirits and RTD have a price movement.

Appendix - sensitivities

Alcohol excise modelling is most dependent on the choice of elasticities.

To test these sensitivities, we have modelled six sensitivity scenarios for each option, as follows:

- **A** – assume zero own price elasticity (i.e. current consumers of a product will have no volume reaction to a price change) and zero cross price elasticity (i.e. consumers will not move their expenditure between products, regardless of price movements)
- **B** – assume low own price elasticity (i.e. current consumers of a product will have a low volume reaction to a price change – we have used average elasticities for all spirits, rather than detailed product own price) and zero cross price elasticity (i.e. consumers will not move their expenditure between products, regardless of price movements)
- **C** – assume detailed own price elasticity (i.e. current consumers of a product have nuanced reactions to a price change dependent of the particular product that has a price change) and zero cross price elasticity (i.e. consumers will not move their expenditure between products, regardless of price movements)
- **D** – assume zero own price elasticity (i.e. current consumers of a product will have no volume reaction to a price change) and detailed cross price elasticity (i.e. consumers will move their expenditure between products in reaction to price change)
- **E** – assume low own price elasticity (i.e. current consumers of a product will have a low volume reaction to a price change – we have used average elasticities for all spirits, rather than detailed product own price) and detailed cross price elasticity (i.e. consumers will move their expenditure between products in reaction to price change)
- **F** – assume detailed own price elasticity (i.e. current consumers of a product have nuanced reactions to a price change dependent of the particular product that has a price change) and detailed cross price elasticity (i.e. consumers will move their expenditure between products in reaction to price change)

Our recommended set of assumptions is F, for the following reasons:

- Although A is the most conservative, it shows no consumer response which is unrealistic, given several decades of Australian literature that at a minimum shows an own price reaction for all categories of alcohol. Similarly, D is not recommended as it does not leverage the strong evidence base of own price reactions.
- B and E are also not recommended because although they do show an own price response, they have a single spirits own price reaction (which is most prevalent in the literature) which understates individual category movements that are relevant for the options presented (i.e. options modelled above separate movements for brandy, bottled spirits and RTDs, for example option 1 has no movement for brandy). This is because estimates of own price elasticity that only have a single spirits category are lower as they treat cross substitutions between products as own price, instead of the substitution reaction they actually are.

Sensitivity tests for each of the three options are presented on the following pages. These show that without any cross product substitution, the net excise is always net negative, as without consumers moving into the now more attractively priced product, a discount applies only to current consumers, even if they increase consumption of that product. Change in pure alcohol consumption is generally higher with no cross price as there is no substitution out of non-spirits products which are both lower excise per litre alcohol and generally (though dependent on other factors) also higher all inclusive retail price higher per litre of pure alcohol. With lower own price elasticity, revenue responses are generally negative as there is not the increase in consumption to offset the discount effect.

Appendix - sensitivities

Sensitivity tests for option 1 – sums across four budget years

	No own price elasticity	Low own price elasticity (general spirits from Fogerty 2010)	Detailed own price elasticity (detailed categories from Monash)
No cross price elasticity	Spirits and RTD excise change (\$ million)	A -971	B -584
	Other alcohol excise and WET change (\$ million)	0	0
	Total taxation revenue – excise and GST (\$ million)	-1,089	-40
	Pure alcohol % change	0.00%	0.61%
Monash substitution elasticities	Spirits and RTD excise change (\$ million)	D 733	E 1,174
	Other alcohol excise and WET change (\$ million)	-805	-805
	Total taxation revenue – excise and GST (\$ million)	-379	149
	Pure alcohol % change	-1.28%	-0.59%

Sensitivity tests for option 2 – sums across four budget years

	No own price elasticity	Low own price elasticity (general spirits from Fogerty 2010)	Detailed own price elasticity (detailed categories from Monash)
No cross price elasticity	Spirits and RTD excise change (\$ million)	A -756	B -450
	Other alcohol excise and WET change (\$ million)	0	0
	Total taxation revenue – excise and GST (\$ million)	-848	-482
	Pure alcohol % change	0.00%	0.47%
Monash substitution elasticities	Spirits and RTD excise change (\$ million)	D 588	E 931
	Other alcohol excise and WET change (\$ million)	-632	-632
	Total taxation revenue – excise and GST (\$ million)	-283	128
	Pure alcohol % change	-0.99%	-0.46%

Appendix - sensitivities

Sensitivity tests for option 3 – sums across four budget years

	No own price elasticity	Low own price elasticity (general spirits from Fogerty 2010)	Detailed own price elasticity (detailed categories from Monash)
No cross price elasticity	Spirits and RTD excise change (\$ million)	A -1,678	B -1,042
	Other alcohol excise and WET change (\$ million)	0	0
	Total taxation revenue – excise and GST (\$ million)	-1,882	-1,116
	Pure alcohol % change	0.00%	1.05%
Monash substitution elasticities	Spirits and RTD excise change (\$ million)	D 1,069	E 1,857
	Other alcohol excise and WET change (\$ million)	-1,396	-1,396
	Total taxation revenue – excise and GST (\$ million)	-888	58
	Pure alcohol % change	-2.29%	-0.98%

Appendix – refund scheme amendments

Analysis of the refund scheme amendment was conducted separately to the other options in this report.

The other options have an excise change that can directly impact the price paid by the customer, so have been analysed incorporating consumer behaviour and elasticities. However, as a refund that is back dated and designed to address current cash flow issues, this is assumed to not be incorporated into prices and therefore have no consumer response.

Therefore, estimates of government impact incorporate just the cost of increased refund on activity that was already occurring.

The approach to that estimate was as follows:

- The cost of current excise refund scheme arrangements were taken from Treasury's *Tax Benchmarks and Variations 2019*.
- The components of that current costs that is paid to craft distillers and craft brewers was estimated using the following sources:
 - ATO data on the number of excise claimants across level of current excise paid
 - ABS *Count of Businesses* data on the number of business (by turnover size range) in the industry classes of 'Beer Manufacturing' and 'Spirits Manufacturing)
 - The relative proportions of excise to total turnover by alcohol type from base case modelling of excise scenarios above.
- That allowed for a profile of current excise claimants to be built over across the level of current excise paid, with craft brewers separate from craft distillers.
- Amendments were then modelled based on the profile of current excise paid across different bands for just craft distillers.

It should be noted that this approach requires each entry claiming the refund to be classed as either a brewer or a distiller and does not recognise that some organisations may be claiming refunds for excise charged on both beer and spirits. It is assumed for the craft component of the industry, which this analysis examines, this will be a negligible amount but it is still a caveat to note. This distinction is drawn using ABS *Count of Business* data which assigns businesses to an industry based on 'main activity'.

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