

# **EXPLANATORY STATEMENT**

## **Issued by authority of the Minister of Revenue and Financial Services**

### *Excise Act 1901*

#### *Excise Amendment (Refund Scheme for Alcohol Manufacturers) Regulations 2017*

The *Excise Act 1901* facilitates the imposition of excise duty on excisable goods produced in Australia. Excisable goods are goods produced or manufactured in Australia including alcohol (other than wine), tobacco, fuel, crude oil, condensate and lubricants.

Section 164 of the *Excise Act 1901* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The *Excise Amendment (Refund Scheme for Alcohol Manufacturers) Regulations 2017* (the Regulations) extend the brewery refund scheme in place prior to 1 July 2017 to Australian-based distilleries and producers of low strength fermented beverages with effect from 1 July 2017. The changes are intended to provide support to domestic distillers of beverages such as whisky, vodka, gin and liqueurs, and domestic producers of excisable low strength fermented beverages such as non-traditional cider.

The purpose of the Regulations is to amend the *Excise Regulation 2015* to extend the existing brewery refund scheme to apply to more alcohol manufacturers in the excise system and remove the on-premises sale requirement. Alcohol manufacturers can claim a refund of 60 per cent of the excise paid, up to a maximum of \$30,000 each financial year. To be eligible they must be legally and economically independent of any other entity that is an alcohol manufacturer that has received a refund of excise under the refund scheme. They must also have fermented or distilled at least 70 per cent by volume of the alcohol content of the alcoholic beverage and, for refunds of excise paid for distilled alcoholic beverages, have a still and satisfy the still ownership test (unless the exception applies).

Targeted consultation on the regulations and explanatory material has been undertaken with industry stakeholder representative groups and industry participants.

Details of the Regulations are set out in Attachment A.

The regulation impact statement for this measure is included in Attachment B.

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The Act does not specify any conditions that must be met before the power to make the Regulations may be exercised.

The Regulations commence on the day after registration on the Federal Register of Legislative Instruments.

## **Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

### **Excise Amendment (Refund Scheme for Alcohol Manufacturers) Regulations 2017**

This legislative instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview of the Legislative Instrument**

The purpose of the Regulations is to amend the *Excise Regulation 2015* to extend the existing brewery refund scheme to apply to more alcohol manufacturers in the excise system and remove the on-premises sale requirement. Alcohol manufacturers can claim a refund of 60 per cent of the excise paid, up to a maximum of \$30,000 each financial year. To be eligible they must be legally and economically independent of any other entity that is an alcohol manufacturer that has received a refund of excise under the refund scheme. They must also have fermented or distilled at least 70 per cent by volume of the alcohol content of the alcoholic beverage and, for refunds of excise paid for distilled alcoholic beverages, have a still and satisfy the still ownership test.

#### **Human rights implications**

This legislative instrument does not engage any of the applicable rights or freedoms.

#### **Conclusion**

This legislative instrument is compatible with human rights as it does not raise any human rights issues.

## Attachment A

### **Details of the Excise Amendment (Refund Scheme for Alcohol Manufacturers) Regulations 2017**

#### Section 1 – Name of Regulations

This section provides that the name of the Regulations is the *Excise Amendment (Refund Scheme for Alcohol Manufacturers) Regulations 2017* (the Regulations).

#### Section 2 – Commencement

This section provides that the Regulations commence on the day after registration on the Federal Register of Legislative Instruments.

#### Section 3 – Authority

This section provides that the Regulations are made under the *Excise Act 1901*.

#### Section 4 – Schedule

This section provides that each instrument that is specified in a Schedule to this instrument is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this instrument has effect according to its terms.

#### **Schedule 1 - Excise refund scheme for alcohol manufacturers**

The Regulations extend the brewery refund scheme that applied before 1 July 2017 to more categories of alcohol manufacturers in the excise system. This includes Australian-based distillers of beverages such as whisky, vodka, gin and liqueurs and domestic producers of excisable low strength fermented beverages such as non-traditional ciders. It excludes wine producers producing wine for which the *A New Tax System (Wine Equalisation Tax) Act 1999* applies.

Under the Regulations an alcohol manufacturer is an entity that is licensed to manufacture alcoholic beverages.

To be eligible an alcohol manufacturer must have paid the excise duty for which the refund is being claimed.

Only one alcohol manufacturer in a group of manufacturers that are not legally and economically independent is entitled to receive the refund. This ensures that the group as a whole is in the same position as they would be if all of the manufacturing activities were undertaken by one entity. An alcohol manufacturer is entitled to a refund of excise duty paid if it is legally and economically independent of any other alcohol manufacturer that has received a refund of excise under the refund scheme as follows:

- if the claim for the refund is made after the end of the financial year in which the excise duty was paid – the alcohol manufacturer must have been legally and economically independent for the whole of the financial year in which the excise duty was paid; or
- if the claim for the refund is made before the end of the financial year in which the excise duty was paid – the alcohol manufacturer must have been legally and economically independent from the first day of the financial year in which the

excise duty was paid to the day when the claim for the refund was made and must have a reasonable expectation that this will be the case for the remainder of that financial year.

Alcohol manufacturers are legally and economically independent of one another if they have the capacity to take business decisions independently. While no one factor is decisive, indicators that they may be legally and economically independent of one another include:

- each manufacturer pays for their use of manufacturing facilities, even if they share use of the same facility (jointly owned premises would not qualify as one party could not act without consent of the other or would be subject to the direction of the other);
- each manufacturer supervises the production, testing and bottling of its own product without the other alcohol manufacturer being involved in these activities; and
- each manufacturer develops, labels and sells its own product and uses its own sales network without relying on the other alcohol manufacturer to undertake any of these activities on its behalf.

An alcohol manufacturer that is a subsidiary of another entity (parent entity) that is also an alcohol manufacturer is not legally and economically independent of the parent entity. This is because the subsidiary entity is subject to the control of and is generally financially dependent upon the parent entity. Entities that are alcohol manufacturers may also not be legally and economically independent of one another, even if they do not have common ownership between them.

An alcohol manufacturer is entitled to a refund of 60 per cent of the excise duty they pay, up to a maximum refund of \$30,000 each financial year. The \$30,000 maximum refund amount applies on an entity basis, not on a manufacturing facility basis. Therefore an alcohol manufacturer is able to claim a refund for excise it paid for one or multiple kinds of alcoholic beverages. For example it may brew beer and claim a refund for excise paid on the beer and also distil spirits and claim a refund in respect of excise paid on those spirits (assuming the other requirements are satisfied), but the total refund paid in any financial year cannot exceed \$30,000. A pro-rata refund applies if an alcohol manufacturer only commenced being an eligible alcohol manufacturer part-way through a financial year.

While the eligible alcohol manufacturer has to have undertaken some fermentation or distillation activities to qualify for a refund for an alcoholic beverage, it is not necessary to have undertaken the whole of those activities. For example, a liqueur or vodka manufacturer could purchase a base spirit, further distil that spirit (and any other things required) to turn it into liqueur or vodka, pay excise on it (and provided that the other requirements are met) qualify for an excise refund under this scheme.

The requirement that the alcohol manufacturer ferments or distils at least 70 per cent by volume of the alcohol content of the alcoholic beverage ensures that the measure applies only to entities that are alcohol manufacturers. They do this by fermenting or distilling the part(s) of the alcoholic beverage that contain the alcohol. The remaining alcohol content in the final beverage can come from alcohol which the manufacturer has not themselves fermented or distilled, such as purchased spirits, gin, or other

alcoholic beverages. The alcohol manufacturing requirement prevents entities that primarily mix alcoholic beverages they acquire from other manufacturers, but that only do a limited amount of manufacturing themselves, from qualifying. For example, most domestically produced ready-to-drink (RTD) beverages would not qualify as most of these products are produced from spirits that are imported in bulk, and then blended with soda.

If the claim for a refund is for excise paid on a beverage that has been distilled, the alcohol manufacturer of the distilled beverages must also have one or more stills and satisfy the still ownership requirement other than for the first or second financial year in which it is entitled to claim a refund of excise under this scheme. The still must have a capacity of at least five litres and a still must have been installed ready for use at the beginning of the financial year in which the excise was paid. One or more of those stills must also have been used to manufacture an alcoholic beverage at some time during the financial year. However the test can be satisfied by different stills. Accordingly, the still that satisfies the installed ready for use test at the beginning of the financial year does not have to be the same still that satisfies the alcoholic beverage manufacturing requirement.

An alcohol manufacturer of distilled beverages satisfies the still ownership test (which applies from the third and later financial years in which they are entitled to claim a refund under this scheme) as follows:

- if the claim for the refund is made after the end of the financial year in which the excise duty was paid – the alcohol manufacturer must have had sole ownership of at least one still at all times for the whole of the financial year in which the excise duty was paid; or
- if the claim for the refund is made before the end of the financial year in which the excise duty was paid – the alcohol manufacturer must have had sole ownership of at least one still at all times for the part of the financial year in which the excise duty was paid from the day the financial year started to the day when the claim for the refund was made and must have a reasonable expectation that this will be the case for the remainder of that financial year.

Alcohol manufacturers of distilled beverages must own at least one still at all times during the financial year in which the still ownership test applies, however this does not have to be the same still for the whole financial year. For example if an alcohol manufacturer makes their refund claim for a distilled beverage after the end of the financial year, they could own one still at the beginning of the financial year, then purchase another still which they then own for the balance of the financial year. They could dispose of the first still before the end of the financial year and still satisfy the still ownership test. For the purposes of this requirement sole ownership requires the manufacturer to fully own the still. Therefore a leased or rented still would not meet the still ownership test.

Under the Regulations the financial year for which the refund is claimed is aligned with the year in which the duty is paid. There is no longer a need to have also manufactured the excisable product in the same year, a requirement some distilled products would not be able to satisfy as they take a number of years to manufacture. While the alcohol manufacturer must have manufactured the alcoholic product

themselves, this can have occurred in a prior year. However, the application for the refund must be made within 12 months after the day when the excise duty is paid.

To qualify for a rebate under the brewery refund scheme in operation prior to 1 July 2017, manufacturers could only qualify for a refund of excise duty paid if they sold some product directly from the manufacturing premises of the brewery. This requirement to sell product directly from the manufacturing premises no longer applies under the excise refund scheme for alcohol manufacturers. This allows small start-up manufacturers that may not have the capital to invest in their own manufacturing facility to produce alcohol at an established manufacturer's facilities.

The Regulations also make consequential changes to definitions to align them with the refund scheme applying from 1 July 2017. This means that the definitions of brewery and brewing days respectively are replaced with definitions of alcohol manufacturer and eligible days and the definition of eligible brewery is repealed as it is no longer required. References to brewing have also been removed as brewing is a type of fermentation and therefore specific references to brewing are no longer required.

The Regulations apply where excise has been paid on alcoholic beverages by the alcohol manufacturer on or after 1 July 2017.

Section 12 of the *Legislation Act 2003* provides that a legislative instrument may apply retrospectively where this will not affect the rights of a person (other than the Commonwealth or an authority of the Commonwealth) to the extent that it disadvantages them and where no liabilities would otherwise be imposed on a person prior to the commencement of the instrument.

The Regulations apply retrospectively from 1 July 2017. However this will not adversely affect a person's rights or impose liabilities retrospectively. This is because the Regulations provide a refund of excise paid and therefore do not impose any liability on any entity (other than the Commonwealth or an authority of the Commonwealth).

The Regulations also do not impose any new requirements for entities to which the former brewery refund scheme applied when they claim a refund under the alcohol manufacturers refund scheme. This means that all entities that received refunds of excise paid under the brewery refund scheme that applied prior to 1 July 2017 are eligible to receive a refund of excise paid after 30 June 2017 under the alcohol manufacturers refund scheme.

## **Attachment B**

### **Regulation impact statement - Excise refund scheme for alcohol manufacturers**

#### **Background**

In the 2016-17 Budget, the Government undertook to provide targeted support to all small Australian alcohol producers that undertake distillation or fermentation.

The Government announced that it would extend the brewery refund scheme to domestic spirit producers including producers of whisky, vodka, gin and liqueur as well as producers of low strength fermented beverages such as non-traditional cider from 1 July 2017.

The scheme would not be extended to:

- most ready-to-drink (RTD) producers (i.e. those who merely purchase the spirits and add the soda and other flavours), and
- wine producers who benefit from the wine equalisation tax (WET) rebate.

#### **Background on the domestic spirit industry**

There are around 120 spirit producers and producers of low strength fermented beverages in Australia. The industry comprises of mostly small distilleries and a small number of big international producer groups that produce a wide range of alcoholic beverages including spirits, non-traditional cider, beer, RTDs and wine.

#### **1. The problem**

Currently, small Australian breweries are able to access the brewery refund scheme which provides refunds of excise of up to \$30,000 per financial year on goods sold. Tax concessions are also targeted to small wine producers through the WET producer rebate. However, there is no refund scheme available for small spirit producers, such as producers of whisky, gin, vodka, liqueur and other spirits and producers of other low strength fermented beverages.

The discrepancy in tax concessions creates an uneven playing field, and makes it difficult for spirit producers to compete with competitors whose product is covered under the brewery refund scheme. All else being equal, the tax concessions available under the brewery refund scheme increase the returns that can be earned by breweries, which they can use to reinvest in infrastructure and their other business activities. This encourages the development of breweries rather than distilleries. Providing concessions more evenly would decrease distortions in the market and allow market forces to determine the success of small alcohol producers.

Without change, domestic spirit producers and producers of low strength fermented beverages would continue to be disadvantaged by their exclusion from current alcohol tax concession schemes. The problem is material and affects many regions across Australia. There are around 120 affected distilleries and producers of low strength fermented beverages (other than beer or wine) that are not entitled to any tax concessions. In 2015, Australia had 29 whisky distilleries, most of which were located in Tasmania and New South Wales, with the rest spread throughout Victoria, Queensland and Western Australia. More recently, there has been growth in the

manufacture of white spirits, such as vodka and gin in Australia<sup>1</sup>. These distilleries employ people in their regions, including by supporting local tourism. In 2015-16, Australia's domestic spirit exports were valued at \$195.5 million or 39.4 per cent of industry sales revenue<sup>2</sup>, with a number of Australian spirit exporters winning international awards.

## **2. Case for government action / Objective of reform**

The Government is seeking to reduce inequity in the tax concessions between different types of small Australian alcohol producers to better achieve its policy intent of providing targeted support to the domestic alcohol production industry.

As the Government determines alcohol tax concessions, government action is needed to address the inequity in the current schemes.

## **3. Policy options**

The following options were considered to achieve the Government's policy intent:

- Option 1 (proposed): targeted concession: by extending the brewery refund scheme to spirit producers and producers of low strength fermented beverages (other than beer or wine) that ferment or distil their own product.
- Option 2: wide concession: by introducing an alcohol concession scheme available for all alcohol producers with a uniform and generous cap.
- Option 3: no change: under this option no action would be taken by the Government with the existing brewery refund scheme continuing on unchanged.

## **4. Impact analysis**

### **Option 1 (proposed): targeted concession**

Costs

#### *Compliance costs*

Extending the brewery refund scheme to spirit producers will marginally increase compliance costs for businesses. The aggregate impact has been estimated at \$10,700 per year (\$107,000 over ten years). This includes implementation costs in the first year of \$39,000, related to education and training, and ongoing compliance costs of \$7,000 per year. Option 1 would add some complexity to the tax system due to the new rules governing eligibility for the scheme.

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<sup>1</sup> Ledovskikh, A., 2015, *Refill: Growing demand for bottled spirits and new products has offset alcopop tax pressures*, IBISWorld.

<sup>2</sup> Ledovskikh, A., 2015, *Refill: Growing demand for bottled spirits and new products has offset alcopop tax pressures*, IBISWorld.



| Potential compliance costs             | Total     | Per client |
|--|-----------|------------|
| Implementation                         | \$39,000  | \$180      |
| Ongoing (p.a)                          | \$7,000   | \$30       |
| Aggregate impact over 10 year duration | \$107,000 |            |
| Per year (10 years)                    | \$11,000  |            |

It is unlikely that the compliance costs on business associated with the measure will be passed onto consumers, as the costs will be more than offset by the tax benefit eligible businesses will receive. The extended excise refund scheme will be administered through the existing excise system, with which producers already comply and therefore would be well equipped to receive refunds under the scheme.

#### *Social costs*

The extended scheme provides modest excise relief and therefore, would have negligible impacts on prices of domestically produced spirits and other low strength beverages and on social costs.

As the cap is low at \$30,000 per financial year, the scheme has very low risk of being exploited and having broader impacts on prices. Therefore, it is unlikely to cause an increase in the social costs associated with alcohol consumption. In addition, it provides a proportional refund of 60 per cent of excise paid meaning that a net amount of excise will always be paid on a particular excisable beverage. Producers would also need to comply with their obligations under their excise manufacturer's licence (which includes record keeping, maintaining control over the goods at all times, and operating a licenced manufacturing premises) which provides a robust mechanism of ensuring that integrity is instilled in the scheme.

#### *Cost to revenue*

This option is estimated to have a cost to revenue of \$9 million over the forward estimates period.

| 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---------|---------|---------|---------|
| -       | -3.0    | -3.0    | -3.0    |

#### Benefits

##### *Levelling the playing field*

This option would level the playing field between domestic spirit producers, producers of low strength fermented beverages and breweries.

Under the change, domestic spirit producers and producers of low strength fermented beverages would have access to the same tax concessions as the breweries with which they compete. From an economic efficiency perspective, more even concessions would also decrease market distortions and allow market forces to determine the allocation of resources between the industries.

The changes may also improve competition within the spirits industry by encouraging new entrants. For example, most new entrants to the beer industry have been smaller craft breweries. New entrants can be a source of innovation, and can provide competition in terms of price, quality and variety.

#### *Benefits to local economies*

Extending the tax concessions to spirit producers would assist them to grow their businesses, support the creation of new businesses, and take advantage of the growing popularity of craft spirits, (and other alcoholic products covered by the extension of the scheme). As with the growth in craft breweries this is expected to provide economic benefits to local economies. Spirit producers have indicated that excise relief would allow them to invest in export marketing, local tourism, and infrastructure to grow and compete on the world stage.

The design of the scheme (due to the \$30,000 concession cap and the requirement for producers to ferment or distil their own product) ensures that the scheme is targeted to small producers that have significant investment in the manufacturing process.

#### *Efficient and effective form of assistance*

Broadening the existing brewery refund scheme to spirit producers and producers of other low strength fermented beverages would provide the most efficient and effective form of assistance. The extended scheme uses established systems within the excise regime, with which producers already comply, and effectively targets the scheme to provide a refund of excise paid.

An alternative approach would be to implement a new direct grant payment to alcohol producers. However, this approach would have higher compliance costs on producers with no additional benefits. Producers would need to comply with a new system in addition to meeting their obligations under the excise regime.

### **Option 2: Wide concession**

#### Costs

This option would not require producers to ferment or distil their own products. Compared with Option 1, Option 2 would have a considerably higher revenue cost as eligibility for the tax concession would include producers that blend products giving RTDs access to the scheme. A more generous assistance cap would also involve considerably higher costs to revenue.

A wider concession with a higher cap may open the scheme to some integrity risks. A larger cap would make the scheme more attractive for businesses to structure their affairs so they can maximise the amount of refunds they can claim. The looser eligibility criteria would undermine the objectives of the alcohol excise regime. For example, it would reduce the effective excise rate of RTDs, undermining the objectives of the 2008 excise increase on RTDs of reducing alcohol related harm.

Option 2 would have similar compliance costs as Option 1 as it would impact the same population of taxpayers.

| Potential compliance costs             | Total     | Per client |
|--|-----------|------------|
| Implementation                         | \$39,000  | \$180      |
| Ongoing (p.a)                          | \$7,000   | \$30       |
| Aggregate impact over 10 year duration | \$107,000 |            |
| Per year (10 years)                    | \$11,000  |            |

#### Benefits

Extending the brewery refund scheme to spirit producers and producers of low strength fermented beverages would level the playing field for small producers, as in Option 1.

However, unlike Option 1, the benefits would also extend to producers which do not ferment or distil their own products, and as such may not have a significant investment in the domestic alcohol industry. We anticipate there would be little additional benefit from including these types of producers, which includes those that blend products from imported or purchased manufactured spirit to make RTDs.

A higher assistance cap would mean the concession would be less targeted to small producers, delivering additional benefits to larger producers.

It would also be more efficient and effective to provide the wider scheme through the excise system than implementing a new grant program for the same reasons outlined under Option 1.

#### **Option 3: No change**

##### Costs

Implementing no change, with the existing brewery refund scheme carrying on as is, would not impose any additional compliance costs on business.

##### Benefits

This option would have no additional benefits compared with the status quo as it makes no changes to the current system. However, compared with Options 1 and 2, it has the benefit of not having any additional costs to revenue.

Under this option, spirit producers and producers of other low strength beverages would continue to be relatively disadvantaged by the favourable tax concessions available to other domestic alcohol producers. It would not address the distortive impacts of the current system which incentivises the production and consumption of beer over spirits and other low strength products.

### **5. Consultation plan**

The Government invited the Australian community to contribute their thoughts on potential reform to the tax system, including the alcohol tax concession schemes, through the Re:think Tax discussion paper.

Industry canvassed support for an excise refund scheme noting that excise relief is needed to help the industry to grow. Industry raised that refunds of excise could be used to invest in export marketing, local tourism, and in additional infrastructure.

The latest round of consultation on the draft regulation confirmed support for extending the brewery refund scheme to spirit producers and producers of low strength fermented beverages. Feedback concerning technical changes has been incorporated into the final regulation.

## **6. Conclusion**

The current alcohol tax concession schemes for domestic producers disadvantage small spirit producers and producers of other low strength fermented beverages (other than beer or wine).

Three options were considered in the context of addressing this problem. These were:

- Option 1: Targeted concession: Extend the brewery refund scheme to spirit producers and producers of low strength fermented beverages that ferment or distil their own product.
- Option 2: Wide concession: by introducing an alcohol concession scheme available for all alcohol producers with a uniform and generous cap.
- Option 3: No change.

Option 1, extending the brewery refund scheme to spirit producers and producers of low strength fermented beverages would address the regulatory failures of the current system. It would level the playing field between spirit manufacturers and producers that have access to the brewery refund scheme, reduce the distortive impacts of the current concessions, and improve the fairness and efficiency of the tax system. It would provide targeted excise relief to small domestic producers which would allow effected businesses to invest in new infrastructure, grow their brand domestically and internationally, and contribute to local economies through increased investment and employment. It would be the most effective and efficient form of assistance, compared with alternative forms such as direct grant payments. Treasury's assessment is that the additional compliance cost of the measure is small compared with the benefits that it would provide to the domestic alcohol manufacturing industry and the Australian economy. It would have negligible impacts on prices of domestically produced alcohol and have negligible social costs. The cost to revenue is estimated to be \$9 million over the forward estimates. Industry has expressed broad support for this option.

Option 2 would have similar benefits to Option 1 in terms of providing a benefit to small producers. The compliance cost impact would also be similar as it would impact the same population of taxpayers. However, this option would be expected to have a considerably higher cost to revenue compared with Option 1 due to the higher cap and wider eligibility. In addition, it would not as effectively target the scheme to genuine small domestic producers that are invested in the manufacturing process. It may be open to integrity risks, and may increase the risk of harmful alcohol consumption.

Option 3, no change, would have no additional benefits compared with the status quo. However, compared with Options 1 and 2, it has the benefit of having no any additional costs to revenue. This option would add no additional complexity to the tax system, or create any new administrative costs. It would leave unresolved the difference in tax concessions available to breweries compared with distilleries.

Overall, the option with the highest net benefit is Option 1.

## **7. Implementation and evaluation**

The *Excise Regulation 2015* would require amendment.

The Australian Taxation Office (ATO) would be responsible for administering the excise alcohol manufacturer refund. The ATO will monitor compliance and will advise Treasury if any problems are identified so remedial action, if appropriate, can be considered.