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[redacted]
on behalf of the undersigned distillers

Committee Secretary
House Standing Committee on Industry, Science and Resources
PO Box 6021
Parliament House
Canberra ACT 2600

By email: isr.reps@aph.gov.au

30 April 2024

Dear Chair,

We welcome the opportunity to submit to the *Inquiry into Food and Beverage Manufacturing in Australia*.

We are a group of medium-sized spirits manufacturers facing a unique set of challenges that we have decided to address in a separate submission to those tabled by the other industry bodies representing the spirits manufacturing sector.

Our submission responds to the following Terms Of Reference for this inquiry:

- mechanisms for the Australian Government to support further innovation and sustainable growth in the sector.

It provides specific context in support of Recommendation 7.2 contained in the Australian Distillers Association submission, which calls on the Federal Government to:

- Conduct a periodic review of the implementation of the *Excise Remission Scheme for Manufacturers of Alcoholic Beverages* to ensure efficiency and alignment with the original intent of the policy.

Medium-sized spirits manufacturers
Our cohort of spirits manufacturers are typically businesses that have been in operation for five or more years; have undertaken considerable capital investment in their businesses; and are significant employers and contributors to the Australian economy.

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Most relevantly to this submission, we are already paying spirits excise, which sets us apart from more than two thirds of the 700-plus spirits manufacturers currently operating in Australia (according to the Deloitte Spirits Industry Survey 2023).

This is because we have already invested to grow our businesses well beyond the $350,000 excise remission threshold that came into effect in 2022.

This grouping includes some of Australia's best known craft spirits producers, such as Starward Whisky, Patient Wolf and Four Pillars Gin (Victoria), Archie Rose, Manly Spirits, Cape Byron Distillery and Poor Toms Distillery (NSW), Husk Distillers (Qld), Great Southern Distilling, Old Young's and West Winds (WA), Prohibition and Never Never Distilling (SA), and Lawrenny Distilling (Tasmania).

Excise remission: Unintended consequences
The intention of the excise remission scheme was to create conditions that would allow small distilleries to grow and thereby create more jobs and investment.

Unfortunately, the 100% remission of excise up to $350,000 is having precisely the opposite effect, by effectively encouraging producers to remain under this threshold.

Based on a 700ml bottle of spirits at 42% ABV at the current excise rate of $101.85, each bottle attracts approximately $30 in excise. This means a producer can sell 11,666 bottles per year, or 972 bottles per month, excise free.

They can set up a very lucrative business on this basis. It would actually be foolhardy to expand beyond the cap, as they then have to pay almost $30 in excise on every bottle they produce.

The result is that our cohort of medium-sized manufacturers is now competing with hundreds of small distillers that can undercut our pricing by up to $30 a bottle.

Some of the more cynical operators have even started openly advertising their cheaper products to consumers as excise free.

This situation poses an existential threat for medium-sized distillers, especially in the current economic environment where consumers are extremely price sensitive.

We are being squeezed, not only by the non-excise paying distillers, but also the large multinational spirits companies.

These international businesses have far better economies of scale, established routes to market and higher marketing budgets.

They also benefit from enjoying higher profits in other countries where excise is lower, which they are able to amortise against the higher operating costs that apply in Australia.

Australian Distilling Ltd (ACN 160 037 249) trading as Old Young's, Juniper Society and Gingin Gin
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Growing local manufacturing of spirits
In stark contrast to beer and wine, the vast majority of full-strength bottled spirits consumed in Australia is currently manufactured offshore.

This presents a huge opportunity for Australian-made spirits to grow domestic market share, which would provide huge economic benefits in terms of job creation, company tax, etcetera.

Once this is achieved, Australian spirits producers could then follow the example of Australian wine by conquering export markets.

However, the government must support medium-sized distillers if it wants to build a sustainable and profitable spirits manufacturing industry that can grow domestically and internationally.

Only medium-sized distillers have the potential to progress towards a situation where they can sell *hundreds **of** thousands* of bottles, which is the necessary scale to take meaningful share away from imported brands and potentially build a lucrative export industry.

The current regime supports producers who only desire to produce *hundreds **or** thousands* of bottles.

Rorts and abuse
The ease with which businesses are able to access the full remission of $350,000 in tax is incentivising people to enter the industry for the wrong reasons.

Across Australia, pub groups are installing cheap stills to produce spirits tax-free, with vastly superior profit margins than they could ever get by sourcing products from tax-paying distillers.

Worse, there are numerous schemes being dreamt up to rort the system:

1. A pub group uses up its excise remission, so it encourages a business next door to install a still and buys all the spirit at excise-free pricing – ie double dipping.
2. A business is split into two separate entities with different directors to claim two lots of excise remission.
3. Liquor wholesalers are approaching small distillers to buy their excess 'remission volume' and sell tax-free spirits direct to bars for use as first pour spirits.

These rorts and abuse will surely have a noticeable impact on the government's tax revenues if we continue to see 200-plus small distilleries opening in Australia every year.

There is no 'one size fits all' solution for beer/wine/spirits
When the full remission of $350,000 was introduced in 2022, the Federal Government stated that the intention was to align the scheme with the existing Wine Equalisation Tax (WET) producer rebate for wine producers.

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“This ensures all alcohol manufacturers are placed on an equal footing and provides additional tax relief to Australia’s craft brewing and distilling industries,” the Government said.

However, it is extremely misguided to suggest these categories are on equal footing when the headline rates of tax we pay are so vastly different.

Small producers in the wine and beer industries can produce far higher volumes of product before surpassing the $350,000 threshold, simply due to their lower tax rates.

The tax per standard drink on wine is 24c, versus 41c for draught beer, and $1.29 for spirits. So, the impact of the $350,000 remission threshold is significantly different when applied to these three sectors.

Further, a ‘one-size-fits-all’ approach to these three categories would be unwise for the following reasons:

1) The wine and beer industries are both in completely different stages of their life cycle as compared to spirits, which is the only alcohol category in Australia that is currently in growth. As mentioned above, the vast majority of full-strength spirits sold in Australia are imported, whereas the opposite is true for the other categories. Only spirits offers the economic growth upside for the Australian economy by converting consumption to locally manufactured product.
2) Further to the above point, the associated distillery tourism growth is only just beginning, whereas winery cellar doors and craft brewery taprooms have likely already peaked. We note that the recent *Spirits Industry Sector Competitiveness Plan* by research firm Mandala found that between 2019 and 2022, distillery visits were the fastest-growing tourist activity for overnight domestic visitors in Australia, up 16% year-on-year. This significantly outpaced visitation growth for wineries and breweries, which grew at 5% and 9% per year respectively between 2019 and 2022.
3) Trying to paint all three categories with the same brush ignores the fact that the barriers to entry are completely different. You won’t see a pub group buying a vineyard to make their own wine, and breweries are also a more capital intensive, unwieldy operation. In contrast, there are minimal barriers for people to venture into tax-free spirits manufacturing, and exploit the $30 per bottle differential versus tax-paying distillers.

Possible solutions

The current situation whereby small distilleries pay no tax, and medium-sized distilleries pay $101.85 per litre on most of the bottles they produce, is untenable.

We propose the Federal Government consider reverting to a model where remission occurs in the form of a rebate on tax already paid, and reduce the rebate to somewhere in the realm of 25-50%.

Depending on the level of rebate, this would mean that to get the full $350k remission, you would need to sell between 2,000 to 4,000 bottles per month (at a 50% and 25% rebate respectively), not circa 1,000.

At 4,000 bottles per month, you are tending towards to be a decent size, thinking about maybe employing staff, investing a little more in equipment and maybe thinking about selling wholesale.

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With this system, all distillers – big or small – would pay some excise, meaning the difference in excise COGS between a mid-tier and a under the cap distiller would be between $15 and $7.50, not $30.

This differential is manageable, where economies of scale can further level the playing field.

Bigger distillers should be able to offer better customer service and leverage their brand to get pull through.

It is worth noting that at a 50% rebate, you would need to pay $350,000 to the ATO to receive the full benefit of $350k. At a 25% rebate, you would pay $1,050,000.

Market entrants such as pub groups that never intended to distil, but were lured by a $350,000 windfall, would then need to produce between double and quadruple the volume to receive this benefit.

They would also have to pay some tax, so there is an associated administration burden as well. The allure to operate a still purely to game the excise remission would therefore be diminished.

Yours sincerely,

[redacted]

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