Diageo Submission to the Productivity Commission *Pillar #1 Inquiry: Creating a more dynamic and resilient economy*

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DIAGEO – Submission to Productivity Commission Pillar #1 Inquiry: Creating a more dynamic and resilient economy

Spirits industry proposals to reduce the impact of regulation on business dynamism and to reduce the alcohol tax gap

Overview

Diageo Australia (Diageo) is the leading spirits company in Australia. Diageo's global brands include *Johnnie Walker*, *Tanqueray, Baileys*, *Smirnoff, Gordon's* etc. Diageo is the parent company of the iconic *Bundaberg Rum Company*, which owns and operates the world-renowned Bundaberg Rum Distillery in Bundaberg, Queensland. Diageo has also invested in other local spirits producers (such as *Starward* in Melbourne).

Diageo commends the Government for pursuing improvements in business dynamism and resilience in all sectors of the Australian economy, including the spirits sector. Diageo particularly commends the Productivity Commission for the *Interim Report* on its Pillar #1 Inquiry into *Creating a more dynamic and resilient economy* in Australia. Diageo responded to the on-line questionnaire, with a focus on reducing excessive and inappropriate regulation on the spirits sector.

Lost excise revenue on alcohol (the alcohol tax gap) is estimated to cost the Federal Government approximately $798m in 2022-23. [1]

Diageo has developed 3 detailed proposals (excluding changes to spirits excise duty taxation rates) that will reduce the alcohol tax gap and enhance business dynamism and thus improve productivity in the spirits sector. The recommendations for progressing these proposals include:

Recommendation 1: That the *Uniform Business Experience* (ie the single administration) for imported spirits be re-examined. This reform has the potential to allow legitimate businesses in the downstream supply chains to compete fairly and to develop their dynamism and resilience capabilities;

Recommendation 2: That the *Excise Remission Scheme for Alcohol Manufacturers* be amended to:

1. Strengthen the definition of an eligible *'alcohol manufacturer'*;
2. Strengthen the definition of *'legally and economically independent'*; and
3. Introduce a packaging and branding requirement.

Recommendation 3: That the findings of the *Spirits Sector Blockchain Pilot* should form the basis of a renewed investigation of the potential for blockchain technology to assist transform firms in the spirits sector to become more dynamic and resilient.

[1] ATO 2022-23 Alcohol Tax Gap (published Nov 2024)

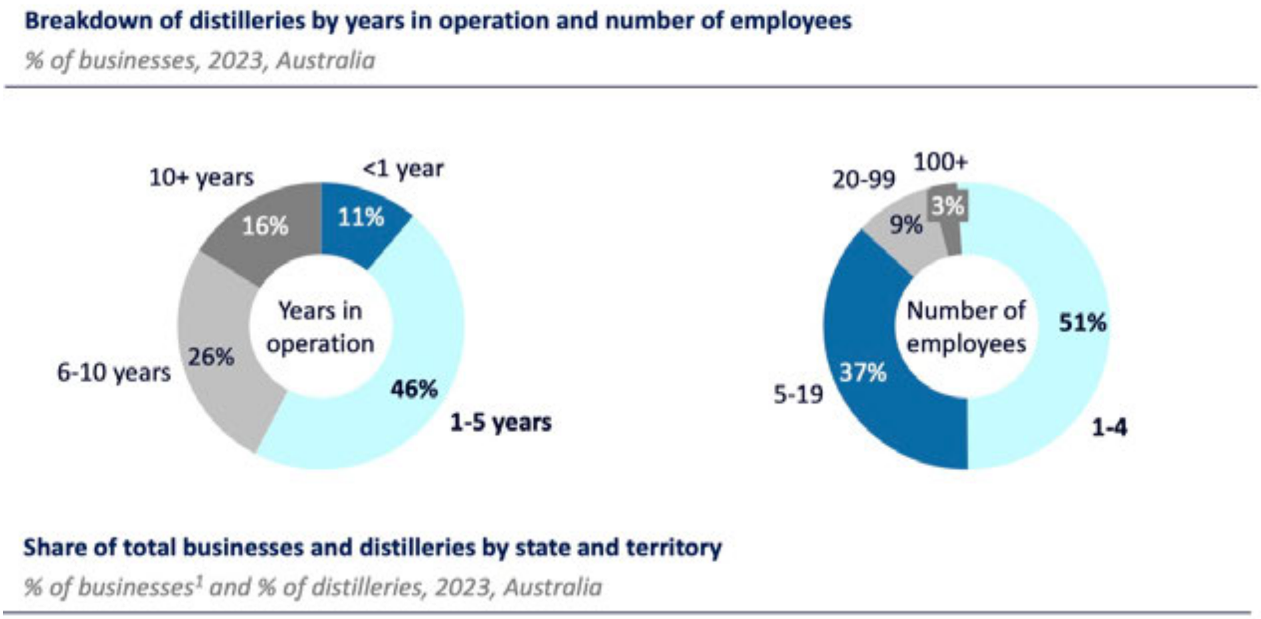
Opportunities for growth in the spirits sector and reductions in the tax gap

Spirits industry sector Competitiveness Plan

A *Spirits industry sector competitiveness plan* (the *Competitiveness Plan*) was commissioned by Bundaberg Rum/Diageo and the *Australian Distillers Asso*ciation (ADA) in 2024. [2] The *Competitiveness Plan* estimated that the spirits industry supports almost $1.2 billion in economic activity and over 7,600 FTE jobs and contributes to many national economic priorities. [3] Spirits exports were valued at $210m in 2022.

The *Competitiveness Plan* estimated that there are 5,700 manufacturing FTE jobs in distilling, and approximately 57% of the firms in distilling are less than 5 years old. [4] See *Figure 1*.

Figure 1: Breakdown of distilleries by years in operation



Frontier firms in the spirits industry

Diageo is aware of the 2022 *Treasury Working Paper* [5] in which the authors compare '*frontier firms*' and '*laggard firms*' in the context of falling productivity in the Australian economy.

A *'frontier firm'* is an agile, competitive firm which is an early adopter of new technology. These firms have low margins and undercut less competitive, established businesses. Frontier firms have higher levels of productivity and are dynamic businesses. These characteristics are referred to as *'business dynamism'*.

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[2] *Spirits industry sector competitiveness plan*, Mandala, March 2024.

[3] Ibid., pg. 3.

[4] Ibid., pg. 4.

[5] Andrews et al, *Reaching for the stars: Australian firms and the global productivity frontier,* Treasury Working Paper, 2022-01 (the views are those of the authors not the Treasury nor the Government).

A *'laggard firm'* is a slower adopter of new technology. It is less agile, longer established, has higher margins and is slow to respond to new competitors. These firms have lower levels of productivity.

The authors of the *Treasury Working Paper* compare Australian 'frontier' firms and 'laggard' firms with global 'frontier' firms in different industries. The analysis shows that Australian 'frontier' firms are falling behind their global counterparts, with the gap between the two groups widening, as Australian productivity levels decline.

The authors make the point that firms in industries with higher entry, exit and turnover rates catch up to the global frontier firms more quickly (pg 1).

Diageo considers that there are already many examples of 'frontier firms' in the spirits sector, especially in distilling/spirits manufacturing activities. In particular, the fact that 57% of distilling firms are less than 5 years old corroborates this view.

The authors reach conclusions about the extent to which new (regulatory) policies are needed in Australia to create more dynamic businesses. It is expected that such policies would reduce the extent to which Australian frontier firms have fallen behind global frontier firms. In particular, the Paper concludes:

> *" … **policies to address barriers to business dynamism** and competitive pressures can improve Australia's productivity performance, by increasing incentives for firms to adopt, innovate and improve."* [6] *(Emphasis added).*

The *Competitiveness Plan* estimated that there are several policy and regulatory barriers currently preventing the industry achieving $1 billion in spirits exports by 2035. [7]

Diageo believes that the regulatory reform proposals in this submission are examples of regulatory policies which can reduce existing barriers to business dynamism amongst firms in the spirits industry supply chain.

Potential revenue gains from regulatory reforms in the spirits sector

Lost excise revenue on alcohol is estimated to cost the Federal Government approximately $798m in 2022-23. [8] According to the ATO, the arrangements which result in these revenue losses include:

- Unauthorised manufacture and unpaid excise duty;
- Authorised manufacture with under-reported or unpaid excise duty;
- Product diversion;
- Cross-border transactions (smuggling or export diversion); and
- Deliberate fraud and evasion.

[6] Ibid., Abstract

[7] Ibid., pg 3. This estimate includes assumptions of some freeze on spirits excise indexation, broader alcohol tax reforms and establishing 'Spirits Australia'.

[8] ATO 2022-23 Alcohol Tax Gap (published Nov 2024)

Around $709 million of the unreported alcohol duty is due to illicit activity in the shadow economy. The alcohol tax gap has remained steady, at around 9% of total alcohol duty ($7.5 billion) in the last 6 years. [9]

Diageo has prioritised 3 proposals for regulatory reform (excluding any changes to excise duty taxation rates) as set out below. Each of these will contribute to reducing the alcohol tax gap and to improving the economic dynamism and resilience amongst firms participating in the spirits sector supply chain in Australia.

Proposal #1: Uniform business experience (the single administration) for imported spirits

Background

In the March 2022–23 Budget, the then Coalition government announced a package of measures to streamline the administration of alcohol (and fuel) excise. The *Streamlining excise administration for fuel and alcohol package* was the culmination of the work of the *Deregulation Taskforce* which undertook a comprehensive consultation process with the spirits (and other) industries.

The companies involved in the consultation (through their respective industry associations) included both local spirits manufacturers (such as *Bundaberg Rum*) as well as the importers of major spirits brands (such as *Diageo*).

The work of the Taskforce identified a range of priorities for amending or removing archaic regulations in the sector to reduce compliance costs and thus enhance business dynamism and resilience.

The *Deregulation Package* was intended to deliver $1.6 billion in savings over 4 years, with annual savings of $20 million in compliance costs for around 1,200 alcohol and fuel businesses. The package was expected to lift productivity and produce other economic benefits.

Unfortunately, the most significant measure in the package has not been implemented, *'at this time'*. See further discussion below.

Several measures of the Package were legislated in the *Treasury Laws Amendment (Refining and Improving our Tax System) Act 2023*. These measures included aligning excise and customs reporting with other indirect taxes.

There were a range of other technical amendments and repeal of regulations enacted subsequently in the *Excise and Customs Legislation Amendment (Streamlining Administration) Act 2024*. These deregulation measures will enhance the business dynamism and resilience of many firms in the downstream supply chains of local spirits producers and spirits importers.

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[9] Ibid.

The Government is to be commended for implementing the majority of the recommendations of the former *Deregulation Taskforce* and for proceeding with these technical regulatory amendments.

The growing regulatory burden on the spirits industry

The growing regulatory burden of dealing with 2 Government regulators, (the Australian Border Force (ABF) and the Australian Taxation Office (ATO)), in relation to imported spirits has been causing increasing compliance and regulatory challenges for spirits importers for many years. Australia's Constitution requires that excises payable on locally produced goods, such as spirits, collected by the ATO, cannot be applied to imported goods. Consequently, Australia imposes customs duty on imported spirits, collected by the ABF, at equivalent rates as the excise that applies to the similar products when locally produced. These customs duties are referred to as *"excise-equivalent duties".*

The spirits industry has been alarmed by the accelerating levels of parallel imported branded spirits products whose retail selling prices are well below similarly branded legitimately imported spirits products paying their legal duties. A parallel imported bottle of *Johnnie Walker* scotch whisky may have been purchased in another market (e.g. in the European Union) and then transported to Australia and imported by a competitor of Diageo, which has the distribution rights in Australia for the brand. This is not an illegal practice. However, when the retail price of the parallel imported bottle is lower than could be possible if the correct excise-equivalent duty had been paid on importation, this is clearly a case of duty evasion.

It is evident that these parallel imported branded spirits products may be evading excise-equivalent customs duty on importation.

All of the warehousing, distribution, transport and retail businesses in the legitimate downstream supply chains of the major spirits importers are being disadvantaged by the existence of competitor firms dealing with products which are not paying their legal taxation liabilities. This unfair competition prevents legitimate businesses from developing the dynamism characteristics of a 'frontier firm' in the sector and also impedes the development of truly resilient legitimate firms.

The *Deregulation Package* specifically referred to its aim of *"removing overlapping administration at the border".* (See the then Minister's press release of 31 March 2022.)

The recommendations of the *Deregulation Taskforce* also included, arguably, the most significant recommendation, which is referred to as the *"Uniform Business Experience"* or *'the single administration'.* This referred to the proposed transfer from the ABF to the ATO of the legal and administrative responsibility for the excise-equivalent duty regime. This was a significant future regulatory reform which had the potential to reduce the increasing regulatory burden on spirits importers and their downstream supply chain firms. It would have created a single administrator (ie the ATO) in place of the current 2 administrators in relation to imported spirits.

Diageo and the entire spirits industry strongly welcomed the potential reform at the time. In particular, the move to a 'single administration' for imported spirits would create increased leverage for the ATO, as the primary regulator of the spirits industry, to take concerted action against parallel importers of branded spirits who were not paying the legal amounts of excise-equivalent duty on the parallel imports.

Diageo and the spirits industry believe that the *Uniform Business Experience* reforms, as announced, still have the potential to address this issue of unfair competition in pricing of competitor spirits products.

However, in the *2023–24 MYEFO* the government announced the *Uniform Business Experience* component of the *Deregulation Package* would no longer proceed due to design complexities identified during implementation of that component and that *" … the original policy intent cannot be achieved **at this time**."* (Emphasis added)

Ideally, an *Impact Analysis* study should be undertaken of the potential regulatory benefits and alcohol tax gap reductions which would flow from implementation of the *Uniform Business Experience* (the single administration) for imported spirits.

Recommendation

Diageo strongly recommends it is now time for the *Uniform Business Experience* (ie the single administration) for imported spirits to be re-examined. This reform has the potential to allow legitimate businesses in the downstream supply chains in the spirits sector to compete fairly and to be allowed to develop their dynamism and resilience capabilities.

Proposal #2: Amendments to the *Excise Remission Scheme for Alcohol Manufacturers*

Background

Distilleries make an important contribution to local and regional economies across Australia. However, alcohol beverage production can be operationally complex, with onerous licensing requirements, capital costs and on-going cashflow implications of regular excise duty payment obligations. Despite this, legitimate distilleries and their downstream distribution supply chains employ thousands of Australians and support countless jobs, from suppliers in Australia's agricultural sector to the burgeoning regional hospitality sector.

Jurisdictions around the world have enacted various measures to reduce the excise duty burden on small-scale domestic producers. The Australian Government (via the ATO) administers the *Excise Remission Scheme for Alcohol Manufacturers* (the Remission Scheme). From July 2021, the Remission Scheme:

> *" … provides eligible alcohol manufacturers with a full (100%) automatic remission of excise duty, up to a maximum of $350,000 per financial year, on alcoholic beverages they manufacture and enter into the Australian domestic market for home consumption."*

By targeting the first $350,000 of excise payable, the policy intent of the Remission Scheme has been to support legitimate small-scale distilleries and breweries – acknowledging the economic benefits and jobs they provide for Australia's regional communities.

The Government has announced that the maximum ceiling for automatic remission will be increased to $400,000 from 1 July 2026. A similar increase will apply to the wine producer rebate for small wineries under the separate Wine Equalisation Tax (WET).

Unfortunately, the regulation changes since 2021 have had the unintended consequence of incentivising commercial arrangements to 'game' the Remission Scheme. By aggregating supply of alcohol from multiple Remission Scheme recipients, large on-trade retailers (with significant sales of 'generic' spirits for mixed drinks) are able to effectively utilise multiple $350,000 excise remissions.

This issue was highlighted in a submission to the Federal parliamentary Inquiry into *Food and Beverage Manufacturing in Australia* (the Parliamentary Committee) by Adam Carpenter from *Prohibition Liquor Co.* in South Australia:

> *"… spirit(s) makers are walking into venues all over Australia, with drums of gins or vodkas, selling to bars at $25-$35 per litre, a product which should cost more than $43/L in excise value alone. This completely renders distilleries which pay excise, employ staff, generate exports and build the economy, unable to compete on price in such a price-sensitive market."*

On face value these business models may, to all intents and purposes, meet the Remission Scheme's literal independence and 'small ownership' requirements. However, it is evident that their overwhelming purpose can be to produce spirits for a large single entity which, when aggregated, can easily lead to avoiding the payment of millions of dollars of excise duty and undercutting legitimate distillers.

The Parliamentary Committee's final report, *Food for Thought*, included the comment that the Committee felt that its Terms of Reference " *… did not enable it to give full consideration to (such) complex (technical) issues …* " as these. [10]

However, the overall impact of the current administrative interpretations of the Remission Scheme legislation and *Excise Regulations* is to constrain the business dynamism and resilience of legitimate distilleries and the firms in their downstream supply chains. This issue is relevant to the current Productivity Commission inquiry.

Ideally, an *Impact Analysis* study should be undertaken of the potential regulatory benefits and alcohol tax gap reductions which would flow from tightening the Remission Scheme regulations to achieve their original intended purpose.

Recommendations

Diageo recommends that the Remission Scheme be urgently reviewed and, at least, that the *Excise Regulations* be amended to:

1. **Strengthen the definition of an eligible 'alcohol manufacturer'**, to require the selling of excisable beverages (whether wholesale or retail) on which excise has been paid, directly from the

[10] *Food for Thought*, House of Representatives, House Standing Committee on Industry, Science and Resources, pg 130

manufacturing premises – reintroducing a condition of the original Microbreweries Rebate that was removed in a later expansion of the scheme.

2. **Strengthen the definition of 'legally and economically independent'** to explicitly clarify that a manufacturer cannot be deemed independent if its sole or primary purpose is to supply a third party which aggregates/pools purchases from multiple suppliers that are eligible for the Remission Scheme.
3. **Introduce a packaging and branding requirement**, for eligible products to be sold in recognisable retail units (e.g. 700ml/1 litre bottles or not bulk over 5 litres) and be clearly branded with the eligible manufacturer's registered trademark (akin to WET Rebate requirements).

Proposal #3: Blockchain technology to be applied to the spirits industry's provenance

Background

The former *Department of Industry, Energy and Resources* (DISER) was very insightful in understanding how blockchain technology could reduce the regulatory burden on businesses in the spirits sector and enhance the business dynamism and resilience of those firms. DISER released the *National Blockchain Roadmap in* 2020 (the Roadmap). It quickly became a catalyst for a national conversation about Australia's blockchain strategy, helping to highlight the enormous opportunities for the technology across the economy.

A *Spirits Sector Blockchain Pilot* (the Pilot) was funded by the *Blockchain Pilot Grants Program* established as a result of the *Roadmap*. DISER effectively commissioned a report on how blockchain could be used to improve the controls and administrative efficiency of excise duty on spirits.

The Pilot's objectives were to demonstrate the potential for blockchain to reduce the regulatory compliance burden for spirits businesses, develop blockchain solutions for government and showcase to industry the viability of the regulatory efficiencies.

Convergence.Tech, a global technology company and leading blockchain solution provider, led the Pilot, working closely with the regulator (the ATO) and the spirits industry. The Pilot assessed key administrative and compliance burdens impacting the regulator and industry. *Convergence.Tech* addressed these challenges through the design and development of the *Blockchain Excise Platform*.

In the platform, the *Selecting and Engaging Procedures* (SEP) connects industry (i e. distillers/producers and distributors/wholesalers) and the regulator via a private permissioned blockchain. The blockchain provides a real-time ledger, digitising and tracking the excisable commodity (alcohol/spirits) as it is produced, matured and distributed across the supply chain. *Convergence.Tech's* revolutionary platform also enables a *Global and Domestic Trusted Distiller Program* to be introduced that could lead to privileged trading benefits and a significant reduction in the excise tax administrative burden.

Whilst the Pilot focused on spirits, the capability can be extended and applied to other excisable commodities (e.g beer, fuel, tobacco) and supply chains (e.g hydrogen) which deliver significant benefits for regulators, industry and taxpayers.

At that time, the application of blockchain technology to the spirits sector had the potential to recover at least $45m annually in lost excise duty revenue (based on KPMG analysis). [11]

Diageo and the spirits industry agree that the application of blockchain technology has the potential to reduce the alcohol tax gap in relation to spirits. Burdened with administrative oversight, cashflow impediments and fighting a market burdened with illicit activity, bona fide local spirits producers wish to be released from the current excise and production constraints in order to compete more equally in this market.

The Pilot concluded in 2022 [12] and was widely recognised as a success by government and industry, with significant interest from overseas regulators.

Unfortunately, the opportunity to further develop the blockchain insights from the Pilot has not been pursued.

Diageo believes that blockchain technology has a significant potential to be used to turbocharge business dynamism and resilience in the spirits sector and to assist in reducing the alcohol tax gap.

Ideally, an *Impact Analysis* study should be undertaken of the potential regulatory benefits and alcohol tax gap reductions which would flow from further developing blockchain technology for the spirits sector.

Recommendation

Diageo recommends that the findings of the *Spirits Sector Blockchain Pilot* should form the basis of a renewed investigation of the potential for blockchain technology to assist transform firms in the spirits sector to be more dynamic and resilient.

Conclusion

These 3 regulatory reform proposals (which exclude changes to spirits excise duty taxation rates) have the potential to reduce the alcohol tax gap and to enhance business dynamism and thus improve productivity in the spirits sector.

15 September 2025

[11] See *To Excise and Beyond*, the National Blockchain Pilot Report, Convergence.Tech, 2022

[12] Ibid.