



Mr John Williams
Rules of Origin Study
Productivity Commission
PO Box 80,
Belconnen, ACT 2616

7 April 2004

Dear Mr Williams

Rules of Origin (RoO) Review – CER Agreement

Thank you for providing the Distilled Spirits Industry Council of Australia (DSICA) with a copy of the Productivity Commission's Interim Research Report on the above Project. DSICA has reviewed the document and intends to make several observations, rather than proceeding to a full submission.

DSICA is the peak body representing the interests of the major distilled spirits manufacturers and importers in Australia.

In summary, DSICA wishes to raise the following two issues with the RoO study team in relation to the CER Agreement:

Interim Recommendation 1

Interim Recommendation 1 proposes (among other things) that:

“A standard definition of manufacturing be adopted, based on the Australian and New Zealand Standard Industrial Classification.”

DSICA agrees that the lack of a definition of “manufacture” in the CER agreement creates a problem of uncertainty for the spirits industry.

Issue: Is reducing in strength a bulk container of spirits from 75% alcohol by volume (abv) to 40% abv, and packaging into retail containers considered “manufacture” and/or “substantial transformation” in terms of the RoO?

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Background: To save on freight costs, over 70% of spirits are transported in this over-strength bulk form. These bulk spirits are then ‘watered down’ and repackaged into saleable units (‘reduction/packaging’).

There have been periods of time in which bulk spirits such as Scotch, Bourbon, and Rum have been imported into New Zealand for reduction and packaging, and subsequently exported to Australia. DSICA is aware that some operators engaged in these reduction/packaging activities have claimed tariff exemption under the RoO. There have been significant concerns within the industry as to why such products should be able to take advantage of the CER agreement benefits of tariff free entry as goods of “New Zealand” origin. Pricing advantages do accrue to those who can avail themselves inappropriately of the CER provisions, through tariff free entry and flow on effects to GST, etc.

DSICA is concerned that the *Australian and New Zealand Standard Industrial Classification* (ANZSIC) system does not contain a sufficiently specific technical definition of “manufacture” relevant to the spirits industry. Should *Interim Recommendation 1* be implemented and ANZSIC-based definitions be utilised in determining the definition of “manufacture”, DSICA believes that it is arguable that this reduction/packaging process would not constitute ‘manufacture’. However, a more precise definition should be used to place this beyond doubt. See below.

ANZSIC Division C provides:

“In a broad sense manufacturing relates to the physical or chemical transformation of materials or components into new products...”

It then determines the Class of different types of manufacture by a more specific definition. *Spirits Manufacturing* is defined in *Class 2184*:

“This class consists of units mainly engaged in *manufacturing* or *blending* fortifying spirits, or potable spirits.” (Our emphasis).

It is unclear whether the reduction/packaging process is “blending” for these purposes, as blending commonly means blending different spirits.

DSICA notes that, when interpreting the ANZSIC codes, reference can be made to the *International Standard Industrial Classification of All Economic Activities* (ISIC) codes. These provide an international standard which is generally followed in ANZSIC.

ISIC provides a further perspective on the definition of ‘manufacture’, under the explanatory notes to *Section: D – Manufacturing*:

“The boundaries of manufacturing and other sectors of the classification system can be somewhat blurry. As a general rule, the units in the manufacturing sector are engaged in the transformation of materials into new products. Their output is a new product. However, the definition of what constitutes a new product can be somewhat subjective”

ISIC further provides for certain industry or good specific circumstances in the same explanatory notes:

“Conversely, there are activities that though sometimes considered *manufacturing*, are classified in another section of ISIC (in other words, they are not classified as manufacturing) they include:...

- Activities of breaking of bulk and redistribution in smaller lots, including packaging, repackaging, or *bottling products, such as liquors*” (Our emphasis).

It is DSICA’s view that under this interpretation, reduction and packaging of bulk spirits would not be considered “manufacture” for the purposes of the RoO, as there is no transformation of the materials into a new product. The explanatory notes to ISIC Section D seem to expressly preclude this activity from being defined as ‘manufacturing’.

This view is also supported by the analysis of possible definitions of ‘manufacture’ considered in the Interim Report, which generally defined ‘manufacture’ to occur where the item made is essentially different in character, identity, form, function etc. to its component parts (See Interim Report pp.70-72).

DSICA further submits that, in comparison with spirits, the ANZSIC *Class 2182: Beer and Malt Manufacturing*, specifically includes in its definition the *bottling or canning* of beer. Arguably, the absence of such a phrasing in *Class 2184* is significant and would preclude reduction/packaging from being considered ‘manufacture’ should an ANZSIC-based definition be adopted.

It should be noted that the reduction and packaging of bulk spirit is not considered to be either manufacture or substantial transformation by the industry, or within the terms of the *Customs Act*, the *Trade Practices Act* or the *Food Standard Codes* published by Food Standards Australia New Zealand (FSANZ).

Recommendation: The definition of ‘manufacture’, in relation to spirits, should specifically preclude the reduction and packaging of bulk spirits. This will remove any opportunity for this ambiguity to be exploited by some operators.

Section 5.5 Compliance and enforcement

Issue: DSICA shares the concerns of a number of participants in the review that there is a significant non-compliance problem with the RoO. In particular, DSICA would agree with the statements made by the Plastics and Chemicals Industries Association (PACIA) in this regard, and would note a number of relevant experiences within the distilled spirits industry, as set out below.

Is the Australian Customs Service (Customs) appropriately resourced and supported to ensure compliance with the RoO, in particular, for these sorts of complaints raised by the industry above in Issue 1?

Comments: The experience of DSICA is that Customs may not be appropriately resourced for these enforcement activities. DSICA would imagine that it would require considerable review of the relevant “value add” transactions occurring within the bottling plants of New Zealand to verify origin status within the RoO. Protocols reviewed for referring and investigating these types of issues appear limited to complaints within the Textile, Clothing and Footwear industry.

There are also concerns around the veracity of a system where New Zealand manufacturers with operations in Australia can and do issue Origin Certificates to themselves for spirits bottled in New Zealand intended for the Australian market.

Because of the high rates of like customable (excise equivalent) duties still payable on distilled spirits imported from New Zealand, it is common for such spirits to be bonded in a licensed customs warehouse. From the importer’s bond store there is a real possibility that the spirits are subsequently sold on an under-bond basis, and sometimes there may be two or three under-bond sales before the goods are delivered into home consumption and the duty then paid. In these cases, the correct origin status must be transferred with the spirits so that the eventual party clearing/entering the goods to home consumption can calculate the tariff at the appropriate rate. Again, DSICA is uncertain whether Customs has the capability of properly “tracking” those goods entitled (or not entitled) to duty free status under CER, after several under-bond sales.

Recommendation: A review should be undertaken of the adequacy of Customs resources allocated to RoO enforcement activities.

Conclusion

DSICA looks forward to reviewing the Study’s final Report. However, if in the interim you should have any queries relating to this correspondence, please do not hesitate to contact me on (03) 9696 4466.

Yours sincerely



Gordon Broderick
Executive Director