FINA Pre-Budget 2019 Consultation Submission

Solutions to Advance the Competitiveness of the Canadian Wine Sector

August 1, 2018

Recommendation 1: That the federal government prioritize the removal of interprovincial barriers for both personal transport and direct-to-consumer delivery of wine across the country.

Recommendation 2: That the government amend the *Excise Tax Act* to eliminate the annual inflation indexation of the excise duty on wine to ensure that any federal tax increase is subject to a vote in Parliament.

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SUMMARY

Canada is the second most attractive market in the world for wine sales, with growth in wine consumption twice that of the rest of the world. Canada is also the fifth largest wine importer in the world by value, and imported bottled and bulk wine represents roughly 85% of all wine volume sold across Canada. Today, based on free trade agreements which Canada has with various trading partners, including some of the largest wine producing nations in the world, 91% of all wine imports enter Canada tariff free.

By global standards, Canadian vintners are subject to a high excise tax load and have little import tariff protection. Excise duty on wine sold in Canada ranks amongst the highest globally, while tariffs are the lowest of any major wine importing country.

Canadian wine provides the highest value added contribution of any agri-food, delivering an annual economic impact of $9 billion[1], which is a fraction of its potential value. Regulatory reforms to liberalize interprovincial market access is critical for industry growth and sustainability as is excise duty relief to support jobs and competitiveness.

INTRODUCTION

As the federal government aims to achieve its 2025 target of increasing agri-food exports to $75 billion annually[2], it is timely to address barriers to trade and tax measures which impede the growth of the Canadian wine industry. This would enable this growing agri-food sector to seize upon opportunities arising from rapidly expanding markets across Canada and beyond our borders; create an improved environment for private sector investment; and enhance long-term drivers for jobs and economic growth.

Canada's 700 grape wineries and 1,800 grape growers are not only tied to Canadian soil, but support more than 37,000 jobs across Canada. Wine is the highest value-added agricultural product in the world, and our investments are completely rooted in Canada, and cannot be transplanted to another country. We are the model of a vertically integrated family farm.

CANADIAN WINE INDUSTRY

Our industry produces premium 100% Canadian and value-priced quality wines made from a blend of international and domestic grapes to meet the demands of all consumers. On average, every bottle of domestic wine produced and sold in Canada

[1] Frank, Rimerman + Co. LLP., The Economic Impact of the Wine and Grape Industry in Canada, 2015
[2] Advisory Council on Economic Growth, "Unleashing the Growth Potential of Key Sectors", February 2017

generates $36.54 in economic impact, while premium 100% Canadian wines generate $89.99 per bottle, compared to only $15.73 for imported wine.

The vertical integration of the Canadian wine industry captures greater revenue than any other value-added agri-food product, by not only crushing grapes and producing wine, but also through packaging, marketing and sales. From vineyard development and grape cultivation to the final sale, wine is a highly complex process that involves numerous suppliers, distributors and service providers throughout the value chain, compounding the economic benefits.

THE CHALLENGE

Canadian efforts to capture increasing consumer demand have been impressive, with investment in over 300 new grape wineries over the past decade. Still, Canadian wines do not capture their fair share of wine sales across Canada, with provincial liquor retailers supporting less than 5% VQA wine sales market share in 8 of 10 provinces. In total, wines produced and sold in Canada have a mere 33% share of the market, with imports not only owning the remaining two-thirds of the sales market, but have also captured 75% of total wine sales growth in Canada over the past decade.

The level of government financial support extended to Canadian wine producers is modest considering the industry's stage of development, and less generous than that in place in other wine producing countries. The sheer level of public financial support extended to other more mature wine producing industries allows these larger competitors to better leverage this support to deliver significant added economic benefits to industry.

A younger, smaller agri-food sector such as the Canadian wine industry, with high import competition, requires higher relative levels of public support to compete and grow compared to the competitors whose infrastructure, including intangible assets such as brands and reputation, is already well established.

OPPORTUNITY & RECOMMENDATIONS

Global wine experts Rabobank and Vinexpo have identified Canada as one of the most attractive wine markets in the world, with percentage growth in wine consumption double that of the rest of the world. This offers an enormous opportunity to expand the growth of wines produced in Canada, in all available sales channels from coast-to-coast.

Every $1 million increase in Canadian wine sales will lead to a minimum $3.4 million increase in gross output – revenues, taxes, jobs and wages across the wine industry value chain. Growth in sales across Canada will help ensure the future growth of wine exports, allowing the Canadian wine industry to take advantage of the opportunities that free trade agreements have to offer.

To compete in an intensely competitive market and improve our future growth prospects and the sustainability of the wider industry, our 2019 pre-budget submission strongly recommends the following:

Recommendation 1: That the federal government prioritize the removal of interprovincial barriers for both personal transport and direct-to-consumer delivery of wine across the country.

Before Exporting Abroad we need to Win at Home First

Despite the June 2012 passage of Bill C-311, *An Act to Amend the Importation of Intoxicating Liquors Act (interprovincial importation of wine for personal use)*, only three provinces (British Columbia, Manitoba and Nova Scotia), representing 19% of the Canadian population, amended their laws to allow for the personal transport and delivery of wine from another province.

All other provinces imposed personal use exemption limits allowing for a small amount of wine to be personally transported across a border. Exceeding these volume limits, or having the wine couriered, remains punishable with a maximum fine (as high as $100,000 in Ontario) and/or imprisonment (up to 6 months in Ontario).

In July 2018, provincial-territorial Premiers proposed significantly increasing (e.g., doubling) the quantity of wine, beer and/or spirits that a consumer can transport across a provincial border for personal use. Taking steps to reduce these barriers by doubling the exemption means that the exemption is a measure aimed at interprovincial trade rather than being a measure aimed at regulating internal control of alcohol that merely has an incidental effect on trade. Therefore, the decision to double the provincial exemption is a measure that, in essence and purpose, is aimed at restricting trade in alcoholic beverages and, as per *R. vs Comeau*, likely violates Section 121 of the Constitution.

Since 2005, 45 of 51 U.S. states have amended their laws and regulations to permit some form of interstate direct-to-consumer wine delivery. Over the years, U.S. direct wine delivery has supported the growth of wineries of all sizes by using modern computer technology to reach consumers in states where these wines are not readily available. While direct delivery has increased in value and volume, and stimulated economic growth in all sized wineries, it is important to recognize that 99 % of U.S. wines continue to be sold in traditional retail stores.

Given the sales and exposure resulting from direct delivery sales, these U.S. wineries are investing in their vineyards and wineries, increasing production, and are now looking at the Canadian market to export their wines.

To support the growth of Canadian wines across Canada, the CVA has turned to the Canadian Free Trade Agreement, and submitted a direct-to-consumer legislative proposal to the federal-provincial-territorial Alcoholic Beverages Working Group (ABWG). While this is the top internal barrier to alcohol trade in Canada, the ABWG failed to support direct-to-consumer delivery in its recommendations to government.

The objective of our legislative proposal is to allow Canadian producers to sell direct to consumers in other provinces. This could be achieved without undermining government authority to regulate alcoholic beverages and to continue to control prices and collect taxes, in a way that i is fully consistent with international and internal trade rules, and complements provincial/territorial liquor sales systems, without creating retail competition.

The proposal would establish the legal requirements that provides producers with the right to sell, thus allowing them to decide whether or not to participate in interprovincial trade by marketing, selling and delivering direct to consumers in all other provinces direct from their winery. Establishing the legal requirements will support inter-provincial purchases of small production premium wines using three key options for out-of-province consumers:

- Winery wine clubs – offerings of limited release wine delivery;
- Online purchase and delivery; and,
- Cellar door purchase and delivery.

In July 2018 provincial-territorial Premiers recognized that there are barriers to interprovincial trade, but failed to demonstrate immediate progress by not removing barriers to direct-to-consumer wine delivery, a long-standing concern of industry and something which 87% of Canadians want to see rectified. Without support from individual provinces and territories prior to the First Ministers' Conference in fall 2018, the only remaining alternative is for the federal government to lead by example and take every measure possible to implement interprovincial direct-to-consumer delivery of our highest value-added agri-food, wine. This will benefit all of Canada, increasing interprovincial commerce.

Recommendation 2: That the government amend the *Excise Tax Act* to eliminate the annual inflation indexation of the excise duty on wine to ensure that any federal tax increase is subject to a vote in Parliament.

In 2017, the federal government legislated annual inflation indexation of the excise duty on wine which has, and will continue to negatively impact Canada's value-added wine chain. Not only do economic circumstances vary across Canada, but producers cannot pass on these additional costs to consumers due to a lack of pricing power, resulting in an unintended government imposed producer tax.

In June 2018, inflation reached a 6-year high of 2.5%, which will create severe economic consequences for domestic producers who compete against some of the largest wine import producers in the world.

Recent economic analysis of an estimated 2% annual inflation on Canadian blended wines over the 5-year period 2018-2022, concluded the following average annual impact on International Canadian blended wines produced in Canada:

- Sales value decline of $28.4 million
- Sales volume decline of 3.14 million litres
- Excise duty collected increase of $8.45 million
- Federal tax collected decline of $7.97 million
- Provincial tax collected decline of $7.01 million
- National economic impact decline of $87.3 million

In effect, the legislated annual inflation adjusted excise increase was found to generate an average $480,000 in additional annual federal revenue, but created an $87 million loss to the Canadian economy. In recognition of the toll an inflation adjusted excise escalator can have on both industry and the economy, the UK government froze excise indexation in their March 2018 budget.

The excise duty on wine in Canada (C$0.64 per litre) is double the rate of our largest trading partner, the U.S. Yet, the 2017 *U.S. Tax Cuts and Jobs Act*, included support for the growth of their wine sector through the implementation of excise tax credits which decreased the rate of excise from C$0.368 per litre to:

(i) C$0.024 per litre on the first 113,550 litres of wine;
(ii) C$0.058 cents per litre between 113,551 litres and 492,000 litres; and,
(iii) C$0.184 cents per litre between 492,001 litres and 2.35 million litres

The full U.S. excise rate of C$0.368 per litre is only applied beyond 2.35 million litres of wine sales, greatly supporting the competitiveness of U.S. wines in the Canadian market.

The impact of inflation indexation and changes to competition tax policy is why Parliamentarians should have final say on any tax increase. Given the broad economic implications of legislated excise duty indexation on the entire wine agri-food value chain from producer to restauranteur, the CVA recommends that the government amend the *Excise Tax Act* to remove the legislated annual excise duty inflation adjustment, with any future tax change subject to a vote in Parliament.