CANADIAN VINTNERS ASSOCIATION — ASSOCIATION DES VIGNERONS DU CANADA

FINA Pre-Budget 2018 Consultation Submission

A Solution to Advance the Canadian Value-Added Wine Sector

EXECUTIVE SUMMARY

Canada is ranked as the second most attractive market in the world for wine sales, with growth in wine consumption twice that of the rest of the world. With a strong market and increasing number of free trade agreements, wines from Europe, United States, New Zealand and Australia will continue to muscle into the Canadian market in coming years. Roughly three quarters of wine volume[1] consumed in Canada comes from other countries.

The Canadian wine industry provides an annual economic benefit of $9 billion[2], which is a fraction of its potential value when recognizing that wines produced in Canada account for roughly one-third of total wine sales in Canada. The industry is growing appreciably in six provinces, offering one of the highest value-added contributions of any agricultural product and providing enhanced rural economic opportunities.

With home advantage and growing wine sales, the industry is well-positioned to increase its competitiveness and seize greater market share with the implementation of the Canadian Vintners Association's (CVA) Budget 2018 recommendations.

CVA Recommendations:

- ✓ Review the excise duty structure on wine, including the legislated annual inflation adjusted excise duty increase
- ✓ Implement the Wine Industry Innovation Program (WIIP) to foster investment in growth infrastructure
- ✓ Eliminate the small business tax deduction qualifying asset test for the agriculture and agrifood industry

INTRODUCTION

CVA welcomes the opportunity to provide input to the House of Commons Standing Committee on Finance, as part of the pre-budget consultation process for Budget 2018.

As government aims to achieve its target of increasing agrifood exports to $75 billion annually by 2025, while striving to implement a robust growth strategy supporting sustainability and innovation, it is timely for the federal government to implement

[1] Volume includes import content in International Canadian Blend (ICB) wines.
[2] Frank, Rimerman _+ Co. LLP., The Economic Impact of the Wine and Grape Industry in Canada, 2015

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competitive programs and tax measures which will enable the Canadian wine industry to seize: rapidly expanding markets across Canada and beyond our borders; create a better environment for private sector investment; and, enhance the long-term drivers for jobs and economic growth.

By their very nature, wine and grapes provide long-term employment and investments that are inherently tied to Canadian soil. We produce among the highest value-added agricultural products in Canada, but unlike manufacturing or service enterprises, our wineries and vineyards cannot be transplanted to another country, which ensures that federal investments in the industry are maximized to benefit the Canadian economy, communities and labour force.

CANADIAN WINE INDUSTRY

Our industry produces 100% Canadian (VQA and other Product of Canada) wines, as well as International Canadian Blended (ICB) wines[3]. Both are significant economic drivers. A 2015 national economic impact study concluded that the Canadian wine industry contributes $9 billion to the Canadian economy – 100% Canadian wines contribute $4.5 billion (including tourism) and wines blended in Canada from imported and domestic content contribute an additional $4.5 billion. This study determined that each bottle of Canadian produced wine generates an average of $36.54 in economic impact[4]. The economic impact also includes more than $1.7 billion in contributions to government revenue through tax and liquor board mark-ups.

Canadian wineries capture greater revenue than any other value added agrifood products, by not only crushing grapes and producing wine, but also by 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.

Unlike beer and spirits, the Canadian wine industry is directly connected to the family farm. We are reliant upon Canadian soil and are firmly rooted in rural economies. However, its impact extends well beyond direct sales and employment of Canada's almost 700 grape wineries and 1,770 independent grape growers, with strong linkages to tourism, retail sales, bars and restaurants supporting more than 37,000 jobs.

THE CHALLENGE

[3]International Canadian Blended wines are produced in Canada using a blend of domestically grown grapes and imported bulk wine to create a value-priced quality wine to meet the demands of Canadian who consume wine at a price points below $10 per bottle.

[4] 100% Canadian wines provide a national average economic impact of $89.99 per bottle.

Canadian efforts to capture increasing consumer demand have been impressive, with investment in roughly 400 new grape wineries focused on premium wines over the past decade. Still, Canadian wines do not represent a fair share of domestic market sales, as Canadian wine industry sales account for only 33% of total wine sales. This makes Canada the reverse of most wine producing countries, which appreciate strong domestic sales, such as 69% market share in the United States, 78% in Australia and 99% in South Africa, Argentina and Chile. Even China enjoys 64% of its domestic wine sales market.

Foreign governments provide billions of dollars in direct payments to their domestic grape growers and winemakers to increase their competitiveness. Virtually every country producing grape wine in any significant quantity maintains more robust programs supporting its wine industry than that of Canada. These programs include grape growing and production grants to support domestic and export growth, as well as export promotion funding to support market growth. For example, in 2016, total program support (including promotion) specifically allocated to the European Union wine sector amounted to approximately $US1.41 (€1.2) billion.

THE OPPORTUNITY

Global wine expert Rabobank said Canada ranks amongst the most attractive markets in the world for wine sales, while Vinexpo concluded that growth in wine consumption in Canada is twice that of the rest of the world. The industry must be in a position to take advantage of these market conditions and our primary objective is to grow the sale of Canadian produced wines in all available sales channels from coast-to-coast.

In December 2016, the FINA committee's 11th Report, *Creating the Conditions for Economic Growth: Tools for People, Businesses and Communities,* recommendation 54 states that the Government support innovation in the Canadian wine sector through improved operational and infrastructure investments**.** Canadian vintners agree, with proper support, the industry will build its market share beyond 33% back towards its pre-NAFTA market share of 50%.

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 – an excellent investment in our economy. In building greater market share and domestic consumer support, wineries will be in a better economic position to pursue greater export sales and take advantage of the opportunities that trade agreements have to offer.

To achieve this ambitious, yet attainable goal, our 2018 pre-budget submission strongly recommends the following:

Excise Tax Review

The recent introduction of a legislated annual excise duty increase aligned with the Consumer Price Index (CPI), will restrict future investments in our business and impact our competitiveness at a time when import tariffs are being eliminated under CETA, NAFTA is being renegotiated and the U.S. plans to cut taxes and regulations. Further, the EU has threatened that our 100% Canadian wine excise exemption is at risk, should Canada proceed with the inflation adjusted excise duty policy on wine. This poses a significant risk for our premium 100% Canadian wine businesses.

To support the growth and competitiveness of the all wines produced in Canada, the CVA recommends that the government review the excise duty structure on wine, including the legislated annual excise duty increase, with the goal of growing the Canadian wine industry, making our sector more competitive, while ensuring federal tax revenue growth.

Wine Industry Innovation Program – *A solution to grow the value-added wine sector*

The introduction of a directed **Wine Industry Innovation Program** (WIIP) should be immediately implemented to provide strategic support to increasing wine competitiveness. The program would be delivered via grants designed to support initiatives to develop the industry through improved operational and infrastructure investments, thereby benefitting environmental sustainability through clean-technology, productivity and competitiveness.

Program elements:

- Implementation for a period of five years (2018-2023), with an extension based upon an economic review
- Restriction to grape-based wine
- Implementation on a per winery basis, with no corporate ownership restrictions
- Maximum $2.5 million annual investment per qualified grape winery

The key objectives:

- Develop and grow the Canadian grape wine industry
- Support the use of clean-technology in developing sustainable wine production
- Support business development including innovation, skills and training
- Increase wine tourism and cellar door sales
- Foster domestic and export markets

Areas for funding priorities:

- Projects that contribute to the development of domestic and export markets
- Projects that improve sustainability, clean-technology and production
- Marketing and tourism development

			$Million

The program would apply to qualified tangible or intangible investments in the winery business, related to products, processes, clean-technology, infrastructure and capital assets (buildings, roads, retail and tourism, production equipment, environmental improvements, water treatment, vineyards, etc.) intended to increase the marketability and competitiveness of the wine sector, while helping the industry transition towards reducing its carbon footprint.

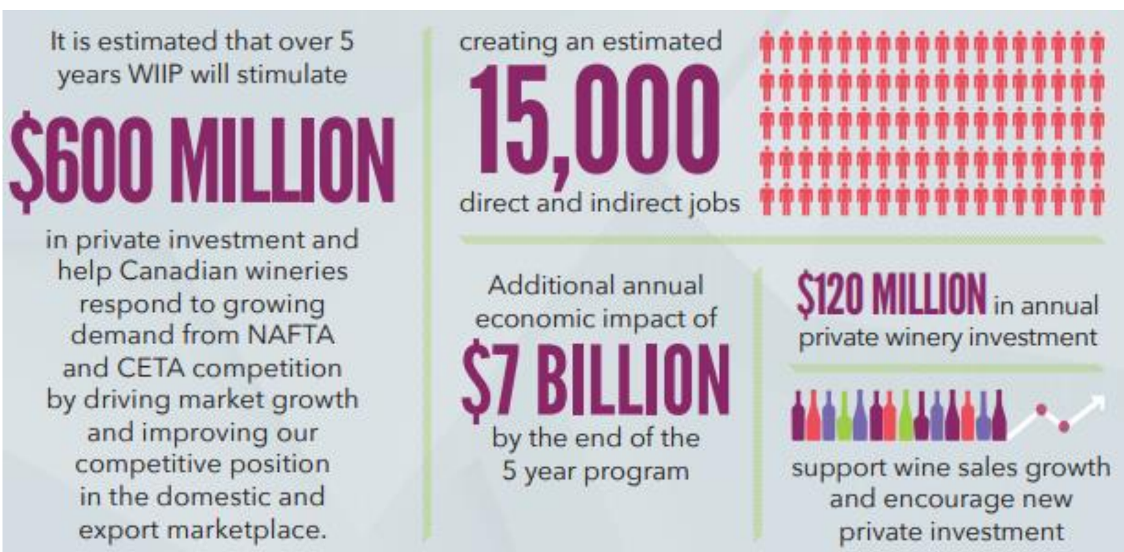
The program would result in increased clean-technology investments, transfers of expertise and technology through the registration of intellectual property, higher levels of employment, a more highly skilled workforce, improved economic conditions in wine regions, more economic activity resulting in increased tax revenues.

WIIP Cost

WIIP would benefit every winery in Canada, regardless of size, with an estimated 77% of the benefits directed to small-and-medium-sized wineries producing less than 50,000 cases of wine per year.

The industry is highly motivated to seize the current and growing market opportunities and through this supportive program, the industry will grow substantially, benefitting rural economies, as well as the greater national economy.

WIIP is estimated to stimulate $119 million in annual winery investments with a federal cost of $36 million per year, stimulating $600 million in total investment over five years.



Annual Winery Production	Number of Wineries	Average use of Maximum Annual Investment	Average Annual Industry Investment	Annual Federal Cost @ 30% WIIP	5-Year Federal WIIP Cost
> 1 million litres	7	100%	$17.5	$5.3	$26.3
500,000 to 1 million litres	8	50%	$10.0	$3.0	$15
250,000 to 500,000 litres	16	25%	$10.0	$3.0	$15
< 250,000 litres	654	5%	$81.8	$24.5	$122.6
Total	685		$119	$36	$179

Based on an average annual revenue growth of 11.5% for 100% Canadian wines and 8.5% for International Canadian Blended wines, the growth program would provide a **38 fold return on the federal government investment** and double direct and indirect employment. Ultimately, the program would help grow the wine industry's national economic contribution by $7 billion over the period 2018-2023.

Small Business Tax Deduction

The small business rate and threshold are beneficial tax policies that nurture smaller firms, fostering greater investment in Canada.

The problem facing many wineries is that the small business tax deduction benefits are phased out on straight-line basis for businesses with taxable capital between $10 million and $15 million. The federal government recognized the importance of increasing the small business income threshold to $500,000 in Budget 2009. However, the economic benefits of this improvement are presently overshadowed by the qualifying asset test/threshold, which restricts the availability of the small business rate to most Canadian wineries. High asset levels in the wine industry is reflective of large holdings of high cost land, processing facilities, cellars, retail stores and often, ancillary tourist attractions such as restaurants and showrooms.

The margins for small and medium-sized wineries are very low, yet they are restricted access to the lower tax rates by virtue of a large asset base which is a prerequisite to a successful wine business. The CVA recommends that the federal government eliminate the qualifying asset test for the agriculture and agrifood industry. Any loss to the Treasury based on this exemption would be more than made up over time by increased investments in the wine and grape and other agrifood businesses that would result in increased business revenues and thus increased tax revenue for the government.