CANADIAN
VINTNERS
ASSOCIATION

ASSOCIATION
DES VIGNERONS
DU CANADA

Submission to the House of Commons Standing Committee on Finance

Pre-Budget Consultations Budget 2012

August 2012

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EXECUTIVE SUMMARY

The Canadian Vintners Association (CVA) is the national association of the Canadian wine industry representing wineries across Canada responsible for more than 90% of annual wine production. CVA members are engaged in the entire wine value chain from grape growing, farm management, grape harvesting, wine production, bottling, retail sales, research and tourism.

Canada's wine industry is growing significantly, offering the highest valued-added contribution to agricultural production in six provinces across Canada. It is vital that the recommendations in this pre-budget submission be implemented to support the ongoing growth and prosperity of Canada's domestic wine industry.

This pre-budget submission contains three recommendations for consideration with a view to attaining higher levels of job growth and business investment:

1. Amend the federal *Importation of Intoxicating Liquors Act (1928)* to establish a limited personal exemption to permit adult consumers to purchase Canadian wines directly from wineries (eg., tasting room, wine club, internet, phone, etc.) and have it legally shipped/transported across provincial boundaries for personal consumption.

2. Initiate a Wine Quality Enhancement Program for blended wine producers, with annual program funding based on the value of the federal excise tax collected on the Canadian content used in blended wines produced in Canada for the domestic market.

3. Increase the small business tax deduction qualifying asset base thresholds to reflect inflation dating back to its implementation date of July 1994, while indexing future asset test thresholds for inflation annually.

INTRODUCTION

The CVA welcomes this opportunity to provide comments to the House of Commons Standing Committee on Finance as part of the pre-budget consultation process for Budget 2012. As Canada emerges onto a stronger financial position and strives to move back to a balanced fiscal framework, it is timely for the federal government to consider and implement measures which will position the Canadian wine industry to expand markets across Canada and beyond our borders, create a better environment for private sector investment and enhance the long-term drivers of growth in Canada.

A SNAPSHOT OF CANADA'S WINE INDUSTRY

The wine sector is a prime example of high valued-added small and medium-sized enterprises, generating extensive spin-offs in related sectors such as rural agricultural services, manufacturing, tourism and hospitality. Recent analysis prepared by KPMG for the Wine Council of Ontario concluded that the wine industry generates $11.50 for every litre of VQA/100% Canadian wine and $7.72 for every litre of blended wine produced and sold, compared to $0.67 per litre generated through the sale of imported wine products. This is a remarkable multiplier illustrating the economic benefits of domestic wine production and sales in regional economies across Canada.

Currently, the Canadian marketplace is dominated by imported wine products, with imports representing 68% of total wine sold to Canadian consumers. Canadian wines represent 32% of total wine sales across Canada (only 6% of which is VQA/100% Canadian wines). This is a poor comparison to our foreign competition where domestic wine products represent 99% of wine consumption in Argentina, South Africa, and Chile, 96% in Spain, 94% in Italy and 87% in Australia, to name just a few. It is vital that a favourable economic climate be created for this important segment of our domestic value-added agriculture industry.

The Canadian wine industry has experienced tremendous growth and investment over the past decade. More than 12,500 hectares (31,000 acres) are planted in wine grapes by almost 1,000 grape growers. Canada's

annual wine production comes from more than 400 grape-based wineries, while new wineries are being established by small grape growers or newcomers to the world of wine-growing, bringing increased investment and a whole new dimension to the Canadian wine industry experience. The industry is expanding, not only in the traditional wine regions of British Columbia and Ontario, but also in emerging wine producing provinces such as Nova Scotia and Quebec. Although the industry has expanded, it could make further contributions to jobs and economic growth if the recommendations being made in this submission are implemented.

Continuous growth and large untapped markets hold a promising future for the Canadian wine industry compared to many other agricultural commodities. Canadian wine sales (2010) are valued at $1.85 billion of Canada's $5.8 billion wine sales market, offering significant potential for growth and greater economic benefits through higher sales volumes.

Wineries capture more of the revenue stream by not only crushing grapes and producing wine, but also by packaging, marketing and sales to wholesalers or foreign importers. 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.

While the industry has faced its challenges, it remains a major contributor to the local, regional and national economy. Canadian wines contribute $1.06 billion in economic multiplier benefits (excluding tourism) to the Canadian economy, which is almost 6 times greater than the $183 million economic contribution provided by the sale of imported wines in Canada. Further, this economic contribution is based on 133 million litres of Canadian wine sales which is less than half the 285 million litres of imported wines sold in Canada.

With annual wine sales of 466 million litres, Canada is one of the fastest growing wine retail markets in the world, with per capita wine consumption increasing by more than 37% over the past seven years. However, the market share of Canadian wine sales must continue to increase across Canada to create jobs and economic prosperity. Supportive federal government policy can assist the domestic grape and wine industry increase its share of retail wine sales in Canada.

PRIORITY MEASURES FOR CONSIDERATION

The CVA is tabling three measures for review by the Finance Committee and suggests that these form part of the Committee's recommendations to the Minister of Finance for Budget 2012.

1. Direct-to-Consumer Wine Delivery

Over the past decade the Canadian wine industry has grown significantly, with millions of dollars invested in vineyards, wineries, equipment and wine tourism. Each new winery produces new wine products adding more wine into the market for Canadians to purchase. However, potential sales opportunities are limited because the only available sales channels for most wineries are liquor boards, on-site winery retail stores and direct sales to consumers and restaurants **within** their home province.

Liquor boards are a key retail channel for domestic wineries, but VQA/100% Canadian wine sales represent less than 3% of total wine sales in 8 of 13 provincial-territorial liquor boards. It is physically impossible for any liquor board to carry the growing selection and diversity of regional Canadian wines given physical shelf space limitations. Most small - and medium-sized wineries do not have national distribution, and liquor boards are not obligated to sell Canadian wine products. In short, winery retail sales options are drastically constrained by market restrictions.

Under the current system, prohibition-era federal legislation *Importation of Intoxicating Liquors Act* (*IILA 1928*), requires that wine intended for consumption can only move across provincial borders if it is purchased by or consigned to the province. It is technically illegal to buy wine while on vacation in another province and take it home to a different province or have wine delivered on your behalf from an out-of-province tasting room, internet or wine club purchase. Movement of wine across provincial borders is a violation of the Criminal Code punishable by monetary fines and/or a prison sentence.

Based on a 2005 US Supreme Court decision, 38 US states have now modernized their prohibition era laws and regulated some form of direct delivery, representing 83% of US wine production. Total direct sales represent 2% of total US wine production -- 1% represents wine purchased directly at the winery and 1% represents some form of direct delivery (tasting room shipment, wine club, internet, phone).

Amending the *Importation of Intoxicating Liquors Act* by establishing a personal adult wine exemption (12 – 24, 9 litre cases of wine per year), would impose no financial costs on the federal government. Rather it would represent significant sales opportunities for Canadian wineries, support higher margin sales from Canadian wineries, increased investment in improved wine quality, equipment, infrastructure and jobs, and additional tax revenues. Direct sales are estimated to represent only 1% of VQA-100% Canadian wine sales over $15 per bottle (11,000 cases per year), with limited, if any, impact on liquor board revenues (eg., only 7% of LCBO VQA wine sales exceed $15 per bottle). The wines in question are not readily available in provincial retail stores.

Direct-to-consumer sales are directly connected to winery visits and wine tourism. According to a recent Canadian Tourism Commission study, wine and culinary tourism generated more than 1.8 million domestic tourist visits in 2005, generating more than $500 million, with forecast growth of 50% over the period 2005-2025. Almost 20% of leisure travellers engage in wine and culinary tourism, and they typically stay longer and spend more money than any other type of tourist. Further, close to 40% of those visitors plan to make repeat visits thus adding to the economic contribution.

Recommendation #1

- ***The CVA recommends that the federal government amend the federal Importation of Intoxicating Liquors Act (1928), to establish a limited personal exemption to permit adult consumers to purchase Canadian wines directly from wineries (eg., tasting room, wine club, internet, phone, etc.) and have it legally shipped/transported across provincial boundaries for personal consumption.***

2. Wine Quality Enhancement Program

Budget 2006 exempted Canadian wineries from paying excise tax on VQA/100% Canadian wine products, providing an economic annual benefit of approximately $15 million (2010). The excise exemption measure applies to 18% of domestic wine sales representing less than 6% of total retail wine sales across Canada. The remaining 82% of domestically produced wines, which include a blend of foreign and domestic wines, were exposed to the 2006 Budget measure of a 21% excise rate increase. This excise increase currently represents an annual tax burden of approximately $11 million for Canadian blended wine producers.

The net impact of the flat excise tax increase created a benefit for imported wines, since 96% of Canadian produced blended wines sell below $10 per bottle, compared to only 40% of imported wines. In effect, the GST tax reduction (based on retail price) which was meant to neutralize the majority of the excise tax increase, actually benefitted imports since 60% of imports sell for greater than $10 a bottle, compared to only 4% of Canadian blended wine products -- 99% of Canadian blended wines sell below $12 a bottle.

Canadian blended wine producers are large buyers of Canadian grapes, supporting grape growers across Canada. With fierce competition in value wines, Canadian produced blended wines are the Canadian wine industry's best means to compete in the value price wine segment, thus providing significant economic opportunities for grape growers, wineries and related jobs. Canadian produced blended wines provide an $812 million multiplier benefit to the Canadian economy, and provide a market for 74% of independent Canadian grape growers.

To ensure the competitiveness of domestic blended wine producers, enhance the quality of grapes grown in Canada, and safeguard the future long term markets for Canadian grape growers, the CVA recommends the implementation of a Wine Quality Enhancement Program (WQEP). A WQEP would provide blended wine producers with the equivalent value of the excise tax paid on the Canadian content in blended wine products

sold in the Canadian market. Such a program would support Canadian blended wine producers by helping them improve the quality of their products at a competitive price, take advantage of Canadian grape content, and continue to play a vital role in the success of the overall Canadian grape and wine industry.

The estimated cost of the WQEP based on current Canadian wine content and blended wine sales would approximate $11 million per year.

Recommendation #2

- ***The CVA recommends that the federal government implement a Wine Quality Enhancement Program for blended wine producers, with annual program funding equivalent to the value of excise tax collected on the Canadian content used in blended wines produced in Canada for the domestic market.***

3. Small Business Tax Deduction

The special small business tax deduction fosters greater investment in Canada by nurturing smaller business and providing access to a reduced federal corporate income tax rate of 11% on the first $500,000 of eligible income.

The problem facing many wineries is that only those businesses with assets valued below $10 million receive the full benefit of this tax measure. Wineries with assets between $10 and $15 million qualify for the deduction on a straight line sliding scale, and those with assets in excess of $15 million are ineligible for the small business tax deduction. The qualifying asset test penalizes wineries with large holdings of high cost farmland, processing facilities, cellars, retail stores and ancillary tourist attractions such as restaurants and showrooms.

Winery assets can reach high levels given the level of vertical integration in the value-added wine business, keeping in mind that the wineries are typically small- and medium-sized family businesses with low profit margins. Adjusting the asset thresholds would benefit wineries and support higher levels of business investment and job creation.

In support of small business growth, the federal government should adjust the qualifying asset test thresholds for inflation. While other parts of the income tax system are regularly adjusted for inflation, the small business tax deduction asset thresholds have not been changed since the measure was implemented in July 1994. Inflation indexation would increase the threshold limits by 36% to approximately $14 and $20 million, with indexation adjustments annually going forward. The cost to the federal government would be limited to the new asset thresholds in line with inflation.

Recommendation #3

- ***The CVA recommends that the federal government increase the small business tax deduction qualifying asset base thresholds to reflect inflation dating back to 1994, while indexing future asset test thresholds for inflation annually.***