

PHILIPPINES – TAXES ON DISTILLED SPIRITS

(WT/DS396 and WT/DS403)

**Third Party Written Submission of Australia
Executive Summary**

1 November 2010

I. INTRODUCTION

1. The proceedings, initiated separately by the European Union and the United States in relation to the Philippines' distilled spirits excise tax regime, raise systemic issues concerning the application of the national treatment principles contained in Article III:2 of the General Agreement on Tariffs and Trade 1994 (GATT 1994).

II. THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT 1994)

A. ARTICLE III:2, FIRST SENTENCE

2. A key issue raised in the dispute is whether spirits which fulfil the raw materials requirement¹ and those that do not are 'like products' under the first sentence of Article III:2 of GATT 1994. The Appellate Body has previously construed the term 'like products' narrowly and undertaken a case-by-case analysis through the application of criteria such as the product's end-uses in a given market and its properties, nature, and quality². Australia notes that no one criterion is determinative and the evidence as a whole must be examined³.
3. The complaining parties' argument in respect of 'like products' raises three possibilities for the Panel to determine on the facts: firstly that all distilled spirits are 'like products'; secondly that distilled spirits falling within the same 'type' (i.e. imported and domestic vodka) are 'like products'; and lastly that spirits of a different 'type', but which utilise the same raw materials are 'like products' (e.g. would Philippines brandy be considered 'like' imported rum as both are made from the same raw material?⁴).
4. Australia notes that the Philippines' submission emphasises the differences in the physical characteristics of the distilled spirits under examination, primarily based on the different raw ingredients used in their production. Australia notes that the panel in *Japan-Alcoholic Beverages II* found that shochu and vodka were 'like products' although they contained 'similar' and not identical raw materials⁵. Australia observes that the present facts appear to indicate that the raw material used does not materially alter consumer perception of the product; rather such perception appears to be affected by the addition of flavouring and the marketing of the end products as brandy, gin, etc.
5. The qualifying issue is whether the taxes are applied to imported products 'in excess of' like domestic products. The Appellate Body has indicated that 'in excess of' is to be interpreted strictly and 'even the smallest amount of "excess" is too much' and that

¹ Section 141 of *National Internal Revenue Code of 1997* (Philippines) applies a lower rate of tax to spirits made from specified raw materials which are commercially produced in the same country where they are processed into distilled spirits. Australia refers to this requirement as the 'the raw materials requirement'.

² Appellate Body Report, *Japan-Alcoholic Beverages II*, pp. 20-22.

³ Appellate Body Report, *EC-Asbestos*, para. 109.

⁴ The Philippines claims that all rum would be afforded the lowest tax bracket under the excise tax measure (although presently this is not the case in practice) (see Philippines' First Written Submission, paras. 172-175). Australia notes that in addition to requiring that the distilled spirit be made from the specified raw materials, the raw material requirement requires that the raw ingredient be commercially produced in the same country in which the alcohol is distilled.

⁵ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.23. Similarly, the panel in *Mexico – Soft Drinks* found that beet sugar and cane sugar are 'like products' within the meaning of Article III:2 (para. 8.36).

further such an assessment is not conditional on a trade effects test or *de minimis* standard⁶.

6. Australia notes that the measures at issue do not directly discriminate between imported and domestic goods. However Australia submits that the Appellate Body in *Korea-Beef* confirmed that a measure which appears on its face to be origin-neutral may nevertheless give rise to *de facto* discrimination⁷. Australia submits that a measure which does not expressly apply different tax rates based on whether a product is imported or domestic may nevertheless be inconsistent with the first sentence of Article III:2 of GATT 1994 on the basis that the actual tax burden applied results in an economic impact on the competitive conditions for imported compared with like domestic products⁸.

B. ARTICLE III:2, SECOND SENTENCE

7. The second sentence of Article III:2 applies to a broader range of products than the first sentence⁹; however each panel must consider on a case-by-case basis how broad the scope is¹⁰. Previous panels have developed criteria which may be applied to determine whether products are ‘directly competitive’ under the second sentence of Article III:2 including ‘physical characteristics, end-uses, channels of distribution and prices’¹¹.
8. Australia’s view is that a ‘directly competitive’ relationship should be determined in the context of the particular market conditions. The Philippines submits that its consumer market is driven by price and is segmented into at least two different groups with different tastes, habits, perceptions and behaviour¹². Australia notes that previous panels have found that products with different net retail prices can be ‘directly competitive’ within the context of a segmented market driven by price, on the basis that the impact of the price on the market can be affected by the nature of the product itself as well as the relative competition within and across specific market segments¹³.
9. In contrast to the characterisation of ‘like products’ under the first sentence, Australia notes that the panel in *Japan- Alcoholic Beverages II* found that ‘the term “directly competitive or substitutable” does not suggest at all that physical resemblance is required... [T]he decisive criterion... is whether they have common end uses, *inter alia*, as shown by elasticity of substitution’¹⁴. Australia further notes the complaining parties’ assertions that domestically produced and imported spirits are marketed as the same ‘type’ of spirit, often using similar packaging and branding¹⁵ and that the nature and content of the products’ marketing strategies seem to indicate that they are competing for a similar market segment¹⁶. In assessing such assertions, the Panel may again wish to consider the relationship between all distilled spirits, between types of distilled spirits, or

⁶ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 23.

⁷ Appellate Body Report, *Korea-Beef*, para. 137.

⁸ Panel Report, *Argentina-Hides and Leather*, paras. 11.182-183.

⁹ Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.

¹⁰ Panel Report, *Korea –Alcoholic Beverages*, para. 10.38, citing EPCT/A/PV/9, p.7; E/Conf.2/C.3/SR.11.p. 1 and Corr.2; and E/Conf.2/C.3/SR.40, p. 2.

¹¹ Panel Report, *Korea–Alcoholic Beverages*, para. 10.43; Panel Report, *Chile-Alcoholic Beverages*, para. 7.30.

¹² Philippines’ First Written Submission, para. 179.

¹³ Panel Report, *Korea – Alcoholic Beverages*, para. 10.74; Panel Report, *Chile-Alcoholic Beverages*, para. 7.37.

¹⁴ *Japan-Alcoholic Beverages II*, Panel Report, para. 6.22; Appellate Body Report, p. 25.

¹⁵ US’s First Written Submission, para. 97.

¹⁶ EU’s First Written Submission, para. 77.

across types with different names, but made from the same raw materials¹⁷
(see paragraph 3 above).

10. The term ‘not similarly taxed’ in the second sentence of Article III:2 of GATT 1994, requires more than a *de minimis* standard¹⁸. Under the excise tax measure the lowest tax on spirits which do not meet the raw materials requirement amounts to more than ten times the tax which is applied to spirits which meet the requirement. Australia notes that while the determination must be made on a case-by-case basis¹⁹, the comparative difference in this dispute is in excess of what has been considered as reaching the *de minimis* standard in previous panel decisions²⁰.
11. The second sentence of Article III:2 of GATT 1994, also requires that the measure is not ‘applied... so as to afford protection to domestic products’. The Appellate Body has stated that ‘protective application can most often be discerned from the design, the architecture, and the revealing structure of the measure’²¹.
12. In Australia’s view such an analysis should include consideration of:
 - the legal and historical development of the excise tax measure;
 - comparison of the Philippines’ stated objective of the excise tax measure²² and the application of the measure;
 - the difference in the scale of the tax rates;
 - the growth in annual sales in domestic spirits in the Philippines compared with the decrease in imports of spirits into the Philippines²³;
 - that imported spirits account for less than four per cent of the market share in 2006, but accounted for 36 per cent of tax revenue raised from spirits;
 - some imported spirits made from the same raw material as domestic spirits are not afforded the lowest tax rate²⁴; and
 - the requirement that the raw materials be produced in the country in which the spirit is manufactured.

III. CONCLUSION

13. Australia considers that there are two critical questions in this dispute. First, whether spirits which meet the raw materials requirement and those that do not can be classified as ‘like products’ and/or ‘directly competitive or substitutable products’ (whether between or across types of spirits, or between all spirits). Second, whether the measure is ‘applied... so as to afford protection to domestic products’, for the purposes of the second sentence of Article III:2, based on a consideration of not only the application of the excise tax measure, but also its design and architecture.

¹⁷ In *Japan- Alcoholic Beverages II*, the panel found that the range of spirits ‘shochu, whisky, brandy, rum, gin, genever, and liqueurs were “directly competitive or substitutable products” for the purposes of Article III:2 (para. 7.1). See also Panel Report, *Korea –Alcoholic Beverages*, para. 10.67.

¹⁸ *Japan-Alcoholic Beverages II*, Panel Report, para. 6.33; Appellate Body Report, p. 27.

¹⁹ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 27.

²⁰ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.33.

²¹ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 29.

²² Philippines’ First Written Submission, para. 32.

²³ US’s First Written Submission, paras. 32-33.

²⁴ US’s First Written Submission, para. 30; Philippines’ First Written Submission, para. 175.