

PHILIPPINES – TAXES ON DISTILLED SPIRITS

(WT/DS396 and WT/DS403)

Third Party Written Submission of Australia

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Short Title	Full Case Title and Citation
<i>Argentina-Hides and Leather</i>	Panel Report, <i>Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather</i> , WT/DS155/R and Corr.1, adopted 16 February 2001
<i>Canada-Periodicals</i>	Panel Report, <i>Canada - Certain Measures Concerning Periodicals</i> , WT/DS31/R and Corr. 1, adopted 30 July 1997, as modified by Appellate Body Report WT/DS31/AB/R
<i>Chile-Alcoholic Beverages</i>	Panel Report, <i>Chile – Taxes on Alcoholic Beverages</i> , WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by Appellate Body Report WT/DS87/AB/R, WT/DS110/AB/R
<i>Dominican Republic – Cigarettes</i>	Panel Report, <i>Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes</i> , WT/DS302/R, adopted 19 May 2005, as modified by Appellate Body Report WT/DS302/AB/R
<i>EC-Asbestos</i>	Appellate Body Report, <i>European Communities - Measures Affecting Asbestos and Asbestos-Containing Products</i> WT/DS135/AB/R, adopted 5 April 2001
<i>Japan –Alcoholic Beverages II</i>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996
<i>Japan –Alcoholic Beverages II</i>	Panel Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by Appellate Body Report WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R
<i>Korea-Alcoholic Beverages</i>	Appellate Body Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999
<i>Korea-Alcoholic Beverages</i>	Panel Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by Appellate Body Report WT/DS75/AB/R, WT/DS84/AB/R
<i>Korea-Beef</i>	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161,169/AB/R, adopted 10 January 2001
<i>Mexico-Taxes on Soft Drinks</i>	Panel Report, <i>Mexico – Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/R, adopted 24 March 2006, as modified by Appellate Body Report WT/DS308/AB/R

I. INTRODUCTION

1. These proceedings initiated by the European Union and the United States separately under the *Understanding on Rules and Procedures Governing the Settlement of Disputes* raise systemic issues concerning the application of obligations of WTO Members under the General Agreement on Tariffs and Trade 1994 (GATT 1994). In particular, the European Union and the United States claim that the Philippines' excise tax regime with regard to distilled spirits is inconsistent with the principle of national treatment contained in Article III:2 of GATT 1994.
2. Based on evidence provided by the parties to the dispute in their first written submissions to the Panel, Australia has concerns that the Philippines' excise tax regime in respect of distilled spirits may be inconsistent with Members' obligations under GATT 1994. Further, Australian industry representatives have advised that in their view, as a result of the existing tax arrangements, Australian spirits producers are discouraged from participation in the Philippines market.
3. In this third party submission Australia addresses a number of key aspects relating to the application of Article III:2 of GATT 1994 including:
 - (a) the distinctions between the application of the first and second sentences of Article III:2 of GATT 1994;
 - (b) the appropriate test/s to be applied in determining 'like products' for the purposes of Article III:2 of GATT 1994 (first sentence);
 - (c) the appropriate test/s to be applied in determining 'directly competitive or substitutable products' for the purposes of Article III:2 of GATT 1994 (second sentence); and
 - (d) the analysis required under Article III:2 of GATT 1994 (second sentence) in determining whether a measure is applied 'so as to afford protection to domestic products'.
4. Australia reserves the right to raise other issues in the third party session with the Panel.

II. THE MEASURE AT ISSUE

5. At issue in the dispute are a number of Philippines legal provisions, and in particular the *National Internal Revenue Code of 1997* which sets out the product categories and applicable tax rates for distilled spirits¹. The European Union and the United States argue that the relevant provisions ('the excise tax measure') create a tiered system of taxation by applying a lower rate of tax to spirits made from specified raw materials (sap of the nipa, coconut, cassava, camote, or buri palm, or from juice, syrup of sugar of the cane) which are commercially produced in the same country where they are

¹ See section 141 of the *National Internal Revenue Code of 1997* (Philippines) as amended by the *Republic Act no. 9334*.

processed into distilled spirits (‘the raw materials requirement’)². Spirits which do not meet the raw materials requirement are further differentiated into three categories with differing and higher tax rates, determined by the net retail price of the spirit³.

6. Under the current rates, spirits meeting the raw materials requirement are taxed at 13.59 pesos/proof litre. Distilled spirits which do not meet the raw materials requirement are taxed at between 146.97 and 587.87 pesos/proof litre dependent on the retail price⁴.

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

A. ARTICLE III:2, FIRST SENTENCE

7. The European Union and the United States assert that the Philippines’ excise tax measure violates both the first and second sentences of Article III:2 of GATT 1994. Australia agrees with the view expressed by the parties to the dispute that the first and second sentences of Article III:2 of GATT 1994 are to be considered separately as autonomous obligations⁵. However, Australia notes that the term ‘like products’ in the first sentence can be used to assist in determining the scope of the application of the term ‘directly competitive or substitutable products’ under the second sentence (see paragraph 28 below).
8. Investigation of a measure’s consistency with Article III:2 firstly requires consideration of the national treatment principle in the first sentence. Australia submits that this investigation requires a determination of whether imported and domestic distilled spirits amount to ‘like products’ and also, whether the taxes applied directly or indirectly to the imported products are ‘in excess of’ the taxes applied to the domestic product. In the event that the measure does not meet these conditions, then analysis turns to consideration of the second sentence.

1. ‘like products’

9. The initial question for the Panel to consider is whether spirits which fulfil the raw materials requirement (predominantly domestic products) are ‘like products’ to spirits which do not meet the requirement (predominantly imported products). Australia agrees that the overarching approach taken by the Appellate Body and WTO dispute settlement panels is that the term ‘like products’ should be examined on a case-by-case basis⁶.
10. Australia further notes that the Appellate Body in *Japan - Alcoholic Beverages II* set out four criteria for determining whether a product may be considered a ‘like product’ for the purposes of Article III:2, first sentence, including: the product’s end-uses in a

² Section 141 (a), *National Internal Revenue Code of 1997* (Philippines).

³ Section 141 (b), *National Internal Revenue Code of 1997* (Philippines).

⁴ Section 141 of the *National Internal Revenue Code of 1997* (Philippines).

⁵ EU’s First Written Submission, paras. 51-52; US’s First Written Submission, para. 36; Philippines’ First Written Submission, paras. 56-58.

⁶ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 20 and Appellate Body Report, *Canada-Periodicals*, p. 21.

given market; and the product's properties, nature and quality⁷. Australia's view is that these criteria should be used as a guide only and should not be applied in a formulaic or inflexible manner so as to overlook context or subvert the objectives of the relevant provisions of the GATT 1994. With this in mind, Australia recalls the view of the Appellate Body in *Japan - Alcoholic Beverages II* that in the context of the first sentence of Article III:2 of GATT 1994, the term 'like products' is to be construed narrowly⁸.

11. Australia notes that the Philippines has emphasised both the narrow scope of the term 'like products' in the context of this provision, and the need for a case-by-case approach⁹. The Philippines' argument relies on the 'illustrative, not exhaustive' list¹⁰ of criteria for determining 'like products', and further contends that 'the key determinant for 'likeness' for the purposes of GATT Article III:2, first sentence, is the essential physical characteristics of the products in question'¹¹. Australia notes however that no one criterion is determinative and the evidence as a whole must be examined to determine whether the products at issue should be characterised as 'like products'¹².
12. Australia's view is that the examination of 'like products' when applied to the circumstances of the current dispute poses two questions. Firstly, whether the overarching commonalities of all distilled spirits (irrespective of type, i.e. vodka, rum etc.) would support a broad characterisation of the term 'like products'. Australia notes that consideration of similar issues was undertaken by the panel in *Japan-Alcoholic Beverages II*. In that dispute, the panel found that vodka and shochu were 'like products' for the purposes of Article III:2 on the basis that they were both clean spirits; made of similar raw materials; and their end-uses were virtually identical. The only difference was the media used in filtration. The panel further found that:

[s]ubstantial noticeable differences in physical characteristics exist between the rest of the alcoholic beverages at dispute, and shochu that would disqualify them from being regarded as like products. More specifically, the use of additives would disqualify liqueurs, gin and genever; the use of ingredients would disqualify rum; lastly, appearance (arising from the manufacture process) would disqualify whisky and brandy¹³.

⁷ Appellate Body Report, *Japan-Alcoholic Beverages II* adopted the approach for interpreting 'like or similar products' under GATT 1947 as set out in the Report of the Working Party on *Border Tax Adjustments*, adopted by the CONTACTING PARTIES in 1970, which provided:

...the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality (cited at p. 20).

The Appellate Body added that '[u]niform classification in tariff nomenclatures based on the Harmonized System (the "HS") was recognized in GATT 1947 practice as providing a useful basis for confirming "likeness" in products.' (at p. 22)

⁸ Appellate Body Report, *Japan-Alcoholic Beverages II*, pp. 20-22.

⁹ Philippines' First Written Submission, paras. 79-81.

¹⁰ Philippines' First Written Submission, para. 83.

¹¹ Philippines' First Written Submission, para. 85.

¹² Appellate Body Report, *EC-Asbestos*, para. 109.

¹³ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.23.

13. Australia notes that the Philippines' submission identifies differences in the physical characteristics of the distilled spirits under examination in this dispute, and in particular the different raw ingredients used to produce the spirits. In doing so, the Philippines' argument distinguishes between the broad range of spirits which do and do not meet the raw materials requirement, as well as different types of spirits (i.e. vodka, rum, whisky, etc.).
14. As noted by the parties to the dispute, the previous panel reports relating to disputes concerning the treatment of imported alcoholic beverages provide useful guidance and examples of how panels have applied Article III:2 of GATT 1994 in similar product circumstances. In doing so, the parties to the dispute have also identified that each dispute must be considered on a case-by-case basis. Australia too recognises the distinctions between the facts of those disputes and the facts in the current matter. In particular, Australia notes that previous disputes have compared a specified type of local spirit (i.e. shochu¹⁴, pisco¹⁵ and soju¹⁶) with specified types of imported spirits. In contrast, the present dispute compares the same types of imported and domestic spirits (i.e. imported whisky with domestic whisky, imported vodka with domestic vodka, etc.). The imported and domestic products are distinguished on the basis of the different raw materials used in the distillation process rather than the type of spirit.
15. With this in mind, Australia notes the complaining parties' secondary argument that distilled spirits falling within the same 'type' could amount to 'like products' for the purposes of the first sentence of Article III:2 of GATT 1994 (i.e. imported and domestic vodka, imported and domestic rum, etc.)¹⁷. The primary issue in such analysis, in Australia's view, is whether the difference in the raw materials used in the production of these spirits is enough to distinguish the imported and domestic products such that they cannot be considered 'like' for the purposes of GATT Article III:2.
16. Australia considers the finding in the panel report in *Mexico – Soft Drinks*¹⁸ that beet sugar and cane sugar are 'like products' within the meaning of Article III:2 to be of particular relevance. We would further note that the panel in *Japan-Alcoholic Beverages II* found that shochu and vodka were 'like products' although they contained 'similar' and not identical raw materials. Further Australia notes that present facts appear to indicate that the use of cane sugar instead of other inputs in the creation of alcohol does not materially alter consumer perception; rather consumer perception appears to be most affected by the addition of flavouring and the fact that the end products are marketed as brandy, gin, vodka or rum.
17. In the alternative, if the Panel considers that on the facts the distilled spirits are not 'like products' within the same type of spirits, due to the different raw materials used

¹⁴ *Japan-Alcoholic Beverages II*.

¹⁵ *Chile-Alcoholic Beverages*.

¹⁶ *Korea-Alcoholic Beverages*.

¹⁷ EU's First Written Submission, states that:

[i]t is the opinion of the European Union that – at the very least – and irrespective of the type and origin of the raw materials used for their production, all gins sold in the Philippines are like products, all brandies sold in the Philippines are like products... and so on' (para. 62).

(See also US's First Written Submission, para. 82).

¹⁸ Panel Report, *Mexico – Soft Drinks*, para. 8.36.

in their production, the Panel might also consider whether a product would be ‘like’ a spirit marketed under a different name, but which utilises the same raw materials (e.g. would Philippines brandy be considered ‘like’ imported rum as both are made from the same raw material?¹⁹). Such an argument would be consistent with the finding by the Appellate Body in *Japan-Alcoholic Beverages II*, which overlooked differences in name and alcohol strength and focused instead on the physical characteristics of each product.

2. ‘in excess of’

18. The qualifying issue is whether taxes applied to imported products are ‘in excess of’ those applied to the like domestic products. Australia submits that any difference in taxes applied to ‘like products’ will be considered to be ‘in excess’ of taxes applied to like domestic products. The panel in *Japan - Alcoholic Beverages II* found that the phrase ‘should be interpreted to mean at least identical or better tax treatment’²⁰. The Appellate Body in the same dispute confirmed this view, stating that ‘[e]ven the smallest amount of “excess” is too much. The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a ‘trade effects test’ nor is it qualified by a *de minimis* standard’²¹.
19. Further, the panel in *Argentina-Hides and Leather* stated that:

Article III:2, first sentence, is not concerned with taxes or charges as such or the policy purposes Members pursue with them, but with their economic impact on the competitive opportunities of imported and like domestic products.²²
20. Therefore, Australia’s view is that the application of this term involves an analysis of the economic impact of the measure and the effect on competition between imported and domestic products, not on the Philippines’ stated policy objectives in respect of the measure²³.
21. Australia notes that the Philippines’ excise tax measure applies tax rates based on whether the product meets the raw materials requirement, not whether the product is domestic or imported. Both the European Union and the United States claim that because the specified raw materials are indigenous to the Philippines and principally used in the manufacture of domestic distilled spirits, the lower tax threshold is in practice almost exclusively applied to domestic products. Conversely, with very

¹⁹ 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). However, Australia notes that in addition to requiring that the distilled spirit be made from the specified raw materials, the raw materials requirement also requires that the raw ingredient be grown in the same country in which the alcohol is distilled. The evidence provided by the parties to the dispute does not clarify whether all imported rum would meet this criterion.

²⁰ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.24.

²¹ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 23.

²² Panel Report, *Argentina-Hides and Leather*, paras. 11.182-183.

²³ The Philippines states that the excise tax measure is ‘structured in a way that minimizes the regressive effects of the tax by distinguishing between lower-priced goods... and high-priced goods...’ (see Philippines’ First Written Submission, Para. 32).

limited exceptions²⁴, imported products do not meet the raw materials requirement and are therefore taxed at the higher level²⁵. The complainants argue that even if the excise tax measure did not explicitly apply different tax rates to imported and domestic products, the application and operation of the measure results in *de facto* discrimination. That is, the measure in practice applies higher tax rates, and therefore a greater economic burden, on imported than domestic 'like products'.

22. In response, the Philippines submits that:

The country of origin of the distilled spirit is irrelevant to determining whether it is eligible for the lower tax rate under Section 141(a). Moreover, given the global availability of all these materials, particularly sugar, the measure does not favour domestic producers. Thus even on a *de facto* basis the measure is origin-neutral²⁶.

23. Australia notes that a measure which appears on its face to be origin-neutral may nevertheless give rise to *de facto* discrimination. For example, in the context of consideration of Article III:4 of GATT 1994, the Appellate Body in *Korea-Beef* found that:

A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated "less favourably" than like domestic products should be assessed instead by examining whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products²⁷.

24. Similarly, in *Japan – Taxes on Alcoholic Beverages II*, the Appellate Body looked to the broader legal purpose of Article III of GATT 1994 stating:

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production'". Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. "[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they have been cleared through customs²⁸.

25. Applying such a view to Article III:2, Australia submits that a measure which does not expressly apply different tax rates based on whether a product is imported or domestic may still be inconsistent with the principles of Article III:2, on the basis that the actual tax burden results in the measure having an economic impact on the

²⁴ Bacardi white rum is currently the only imported brand of spirits which is taxed under the lowest tax rate under section 141(a) *National Internal Revenue Code of 1997* (see EU's First Written Submission, para. 41; and Philippines' First Written Submission para. 39).

²⁵ EU's First Written Submission, para. 15 and US's First Written Submission, paras. 23-24.

²⁶ Philippines' First Written Submission, para. 25.

²⁷ Appellate Body Report, *Korea-Beef*, para. 137. A similar approach was applied in *Dominican Republic – Cigarettes* in which the panel stated:

The Panel thus considers that the fact that the tax stamp requirement is applied equally – i.e. in a formally identical manner – to domestic and imported cigarettes does not automatically make it compatible with Article III:4. The Panel then needs to look at whether that formally equal measure results in a treatment that is less favourable for imported cigarettes.

²⁸ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 16.

competitive conditions and opportunities for imported compared with like domestic products.

B. ARTICLE III:2, SECOND SENTENCE

26. In addition to submitting that the excise tax measure is inconsistent with the first sentence of Article III:2 of GATT 1994, the European Union and the United States argue that the measure is inconsistent with the second sentence of Article III:2.
27. Australia notes that three elements must be considered: whether the domestic and imported products are ‘directly competitive or substitutable’; whether the products are ‘similarly taxed’; and whether the measure is ‘applied... so as to afford protection to the domestic product’²⁹. Australia addresses each of these elements in turn.

1. ‘directly competitive or substitutable products’

28. The second sentence of Article III:2 applies to a broader range of products than the first sentence. Australia notes in support of this position the Appellate Body’s finding in *Korea-Alcoholic Beverages* that:

The first sentence of Article III:2 also forms part of the context of the term. ‘Like’ products are a subset of directly competitive or substitutable products: all like products are, by definition, directly competitive or substitutable products, whereas not all ‘directly competitive or substitutable’ products are ‘like’. The notion of like products must be construed narrowly but the category of directly competitive or substitutable products is broader. While perfectly substitutable products fall within Article III:2, first sentence, imperfectly substitutable products can be assessed under Article III:2, second sentence³⁰.

29. Therefore, the question to be determined by the Panel on a case-by-case basis is how broad the scope is in respect of the category of ‘directly competitive or substitutable products’. This question was considered in detail by the panel in *Korea-Alcoholic Beverages* which observed that:

A review of the negotiating history of Article III:2, second sentence and the *Ad Article III* language confirms that the product categories should not be so narrowly construed as to defeat the purpose of the anti-discrimination language informing the interpretation of Article III. The Geneva session of the Preparatory Committee provided an explanation of the language of the second sentence by noting that apples and oranges could be directly competitive or substitutable³¹.

30. The panel went on to identify that:

[A]n assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste³².

²⁹ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 24. See also *Ad Article III* of GATT 1994.

³⁰ Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.

³¹ 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.

³² Panel Report, *Korea – Alcoholic Beverages*, para. 10.40.

31. As the United States identified in its submission, WTO panels have used comparable approaches to develop criteria that may be applied in determining whether such a directly competitive relationship exists³³. For example, in *Korea-Alcoholic Beverages* the panel considered evidence of a direct competitive relationship to include ‘comparisons of their physical characteristics, end-uses, channels of distribution and prices’³⁴.
32. A key aspect of the Philippines’ submission which cuts across a number of the issues addressed in this dispute is the argument that the complaining parties have failed accurately to represent, or perhaps understand, the Philippines’ spirits market and the key factors affecting consumer tastes and behaviour in that market. The Philippines argues that the majority of Philippine consumers have a limited disposable income and are therefore primarily driven by price. This, the Philippines argues, has resulted in a highly segmented market reflecting ‘the existence of at least two different groups of ‘consumers’ in the Philippines, each with a different set of tastes, habits, perceptions and behaviour’³⁵.
33. Australia shares the view that the application of the term ‘direct competitive relationship’ under the second sentence of Article III:2 of GATT 1994 must be considered in the context of the particular geographical market conditions. Australia further recognises that, consistent with the market for many consumer products, a price differential exists across the range of domestic and imported spirits reflecting numerous factors such as quality, production costs, material costs, demand and tax differentials.
34. Australia notes that the impact of price differential and market segmentation on the determination of whether products are ‘directly competitive’ was considered in part by the panel in *Chile-Alcoholic Beverages*. In that dispute, Chile argued that the end-uses of the local spirit pisco and imported whisky differed because ‘pisco is a more popular spirit in Chile than the imported spirits, such as whisky, which tend to be more expensive and, consequently, are consumed by the wealthier segment of the population’³⁶. The panel considered competing evidence related to the Chilean spirits market, concluding that ‘consumers have an increased willingness to shift between domestic and imported spirits for at least some purchases and some occasions. The current actual overlap in end-uses plus the evidence of potential overlap, is supportive of a conclusion that pisco and the imported distilled spirits are directly competitive or substitutable’³⁷.
35. The Philippines also argues that the price differential between imported and domestic spirits supports the view that the products are not ‘directly competitive’. In a similar context, the panel in *Korea-Alcoholic Beverages* considered that the nature of the product can affect the relative impact of differences in price on the consumer. The panel distinguished alcoholic beverages as frequently purchased consumer goods,

³³ US’s First Written Submission, para. 43.

³⁴ Panel Report, *Korea – Alcoholic Beverages*, para. 10.43. A similar approach was taken by the panel in *Chile-Alcoholic Beverages* (Panel Report, para. 7.30).

³⁵ Philippines’ First Written Submission, para. 179.

³⁶ Panel Report, *Chile-Alcoholic Beverages*, para. 7.37.

³⁷ Panel Report, *Chile-Alcoholic Beverages*, para. 7.47.

finding that even a lower income earner ‘can afford to purchase a bottle of a more expensive beverage at least occasionally. The ratios between \$10 and \$100 products may be the same as between \$10,000 and \$100,000 products, but the purchasing decisions of ordinary consumers in the two situations are quite distinct’³⁸.

36. Thus in applying Article III:2 second sentence, to a measure in the context of a particular market, previous panels have found scope for products with different net retail prices to be ‘directly competitive’ even within the context of a market driven by price. That is, the extent of the price difference and its impact on the market could be affected by the nature of the product itself as well as by looking at the relative competition within specific market segments.
37. Australia notes that the difference in the physical characteristics of domestic and imported spirits (being primarily the difference in raw materials used to make the distilled spirit) might prevent the products from being considered ‘like’ for the purposes of the first sentence of Article III:2. In contrast, in considering the second sentence of Article III:2, the panel in *Japan- Alcoholic Beverages II* found that ‘the wording of the term “directly competitive or substitutable” does not suggest at all that physical resemblance is required... [T]he decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end uses, *inter alia*, as shown by elasticity of substitution’³⁹.
38. Australia notes the European Union and United States’ assertions that domestically produced and imported spirits are marketed as the same ‘type’ of spirit, often using similar packaging and branding⁴⁰ while the nature and content of the products’ marketing strategies seem to indicate that the products are competing for a similar market segment⁴¹.
39. In addition to considering whether particular types of spirits (i.e. domestic vodka compared with imported vodka, etc.) are ‘directly competitive or substitutable’, Australia notes that the broad scope of the application of the term under the second sentence of Article III:2 might also lend itself to consideration of whether *all* distilled spirits (or larger groups thereof) are ‘directly competitive or substitutable’.
40. For example, in *Korea-Alcoholic Beverages* the panel held that domestically produced soju was ‘directly competitive or substitutable’ with a range of imported spirits subject to the dispute, being: whisky, brandy, general distilled liquors, liqueurs and other liquors (to the extent that they contain other distilled spirits or liqueurs). In that case the panel explained:

[T]he products presented to the Panel have the essential feature of being distilled alcoholic beverages... In our view, the differences due to the filtration or aging processes of the

³⁸ Panel Report, *Korea – Alcoholic Beverages*, para. 10.74. In this case the panel was considering the purchasing behaviour of a consumer comparing cars (Renault Clio and Ferrari) and comparing spirits.

³⁹ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.22. See also Appellate Body Report, *Japan-Alcoholic Beverages II*, pp. 25.

⁴⁰ US’s First Written Submission, para 97.

⁴¹ EU’s First Written Submission, para 77.

beverages described are not so important as to render the products non-substitutable... differences in colour do not render products non-substitutable.⁴²

2. ‘not similarly taxed’

41. Unlike the application of the term ‘in excess of’ in the first sentence of Article III:2 of GATT 1994, the term ‘not similarly taxed’ in *Ad Article III* has been found to require more than a *de minimis* standard⁴³. The Appellate Body in *Japan-Alcoholic Beverages II* further determined that whether this standard was reached was a matter to be determined on a case-by-case basis⁴⁴.
42. Australia notes that under the current excise tax measure⁴⁵ the lowest tax on spirits which do not meet the raw materials requirement amounts to more than ten times the tax on spirits that is applied to spirits which meet the raw materials requirement. By way of comparative example, the panel in *Japan - Alcoholic Beverages II* considered that a difference between the taxes applied to vodka at 377,230 Yen per kilolitre and shochu A which was taxed at 155,700 Yen per kilolitre resulted in those products being ‘not similarly taxed’⁴⁶.

3. ‘applied... so as to afford protection to domestic products’

43. In considering the application of the last component of the second sentence of Article III:2 of GATT 1994, Australia recalls the Appellate Body’s statement in *Japan - Alcoholic Beverages II*:

We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of the measure⁴⁷.

44. In Australia’s view there are a number of features of the Philippines’ excise tax measure which should be considered as part of this analysis, including:

⁴² Panel Report, *Korea –Alcoholic Beverages*, para. 10.67. In that dispute, the panel was asked to consider whether the local distilled spirit soju was a ‘directly competitive or substitutable product’ to whisky, brandy, general distilled liquors, liqueurs, and other liquors (to the extent that they contain other distilled spirits or liqueurs). Similarly, in *Japan- Alcoholic Beverages II*, the panel found that ‘shochu, whisky, brandy, rum, gin, genever, and liqueurs are “directly competitive or substitutable products”’ for the purposes of Article III:2 (Panel Report, para. 7.1.).

⁴³ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.33; Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 27.

⁴⁴ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 27.

⁴⁵ Under the current rates, spirits meeting the raw materials requirement are taxed at 13.59 pesos/proof litre. Distilled spirits which do not meet the raw materials requirement are taxed at between 146.97 and 587.87 pesos/proof litre dependant on the retail price (Section 141 of the *National Internal Revenue Code of 1997* (Philippines)).

⁴⁶ Panel Report, *Japan-Alcoholic Beverages II*, para. 6.33

⁴⁷ Appellate Body Report, *Japan-Alcoholic Beverages II*, p. 29.

- the legal and historical development of the excise tax measure⁴⁸;
 - the difference in the scale of the tax rates⁴⁹;
 - that annual sales in domestic spirits in the Philippines grew by 23 per cent between 2003 to 2008, while imports of spirits into the Philippines have dropped by 38 per cent (by volume) and 17 per cent (by value) in the same period⁵⁰;
 - that imported spirits accounted for less than four per cent of the market share in 2006, but accounted for 36 per cent of tax revenue raised from spirits;
 - that even though some imported spirits are made from the same raw material as domestic spirits they have been denied the application of the lowest tax rate⁵¹; and
 - the requirement that the raw materials be produced in the country in which the spirit is manufactured.
45. The Philippines argues that the excise tax measure is ‘structured in a way that minimizes the regressive effects of the tax by distinguishing between lower-priced goods... and high-priced goods...’⁵², and therefore fulfils a legitimate tax policy. This assertion is made on the basis of the Philippines’ contention that spirits meeting the raw materials requirement are primarily consumed by the lowest income consumers.
46. The design and architecture of sub-section 141(b)⁵³ may indeed lend itself to such an objective, as it comprises a three-tiered tax rate, based on the net retail price of the spirits. However, Australia notes that sub-section 141(a) establishes the lowest tax rate, not on the basis of retail price, but rather on the raw material used in production of the spirits.
47. The Philippines emphasises that the excise tax measure does not expressly distinguish between imported and domestic products⁵⁴ and that imported products are also eligible to be subject to the lowest tax rate provided they meet the raw materials requirement. However, Australia notes that the parties to the dispute agree that to date only one imported product has been classified under the Philippines’ revenue regulations at the lowest tax rate. In contrast, ‘[a]ll distilled spirits currently commercially produced in the Philippines market are sugar-based distilled spirits’⁵⁵.

⁴⁸ Philippines’ First Written Submission, paras. 27-33.

⁴⁹ Under the current rates, spirits meeting the raw materials requirement are taxed at 13.59 pesos/proof litre. Distilled spirits which do not meet the raw materials requirement are taxed at between 146.97 and 587.87 pesos/proof litre dependant on the retail price (Section 141 of the *National Internal Revenue Code of 1997* (Philippines)).

⁵⁰ US’ s First Written Submission, paras. 32-33.

⁵¹ US’ s First Written Submission states that this is, ‘presumably because they do not meet other conditions for eligibility for the lower tax’ (para. 30). In response, the Philippines’ First Written Submission claims that, ‘[i]f the importers of these rums were to file the proper sworn declaration and excise tax return indicating that the raw materials used to produce these spirits are classified within section 141(a), they would receive the tax treatment set out in that paragraph’ (para. 175).

⁵² Philippines’ First Written Submission, para. 32.

⁵³ Section 141 (b), *National Internal Revenue Code of 1997* (Philippines).

⁵⁴ Philippines’ First Written Submission, para. 298.

⁵⁵ Philippines’ First Written Submission, para. 23. Note that for ease of reference, the Philippines’ submission refers to all spirits which fulfil the raw materials requirement as ‘sugar-based’.

IV. CONCLUSION

48. In this submission, Australia has considered a number of issues relating to the application of Article III:2 of GATT 1994, and in particular sought to draw attention to specific aspects which in its view should be taken into account in analysing a Member's obligations under this provision of the GATT 1994.
49. In this dispute Australia considers there are two critical questions. First, whether spirits which meet the raw materials requirement and those that do not can be classified as 'like products' under the first sentence of Article III:2, or whether they are more properly characterised as 'directly competitive or substitutable products' under the second sentence and *Ad* Article III. As a related issue, the Panel may also consider whether this analysis is limited to comparison within particular types of spirits, or extends to a comparison between different types of spirits.
50. The second key question is whether the measure is 'applied... so as to afford protection to domestic products'. Australia has identified some of the aspects of the evidence provided by the parties to the dispute which may contribute to determining this question. In particular, Australia notes the importance of considering not only the application of the excise tax measure, but also its design and architecture.