Philippines – Taxes on Distilled Spirits (WT/DS395 and WT/DS403)

Australia's Reponses to Questions of the Panel Following the First Substantive Meeting with the Panel

QUESTIONS TO ALL THIRD PARTIES

1. Can third parties identify and explain under which tariff subheading or subheadings they would classify sugar-based gin, sugar-based brandy, sugar-based vodka, sugar-based whisky, and sugar-based tequila, and explain why. Additionally, please identify the tariff subheadings under which they would classify the same types of spirits (gin, brandy, vodka, whisky and tequila), if instead of sugar they were based on any of the other raw materials designated in Section 141(a) of the Philippines' National Internal Revenue Code (nipa, coconut, cassava, camote or buri palm).

With the exception of subheading 2208.40 - 'Rum and other spirits obtained by distilling fermented sugar-cane products', and subheading 2208.20 – 'Spirits obtained by distilling grape wine or grape marc', Australia's tariff subheadings do not distinguish spirits on the basis of the raw materials used in the spirit's production.

Australia's view is that the sugar-based brandy, vodka, whisky and tequila would likely fall within the scope of tariff subheading, 2208.40 on the basis that they constitute 'spirits obtained by distilling fermented sugar-cane products'. In contrast Australia considers that spirits made from any other raw material designated in section 141(1) of the Philippines' *National Internal Revenue Code* (nipa, coconut, cassava, camote or buri palm) would be classified under the respective types of spirits (i.e. whisky - 2208.30.00, or gin - 2208.50.00 etc.). By way of illustration, Australian Customs Tariff Schedule 3 adopts the following tariff classifications:

Ref Number	Goods	Rate
2208	Undenatured ethyl alcohol of an alcoholic strength by volume of less that 80%; spirits, liqueurs and other spirituous beverages	
2208.2	Spirits obtained by distilling grape wine or grape marc:	
2208.20.10	- Brandy	5%, and A$66.92/L of alcohol
2208.20.90	- Other	5%, and A$71.67/L of alcohol
2208.30.00	Whiskies	5%, and A$71.67/L of alcohol
2208.40.00	Rum and other spirits obtained by distilling fermented sugar-cane products	5%, and A$71.67/L of alcohol
2208.50.00	Gin and Geneva	5%, and A$71.67/L of alcohol
2208.60.00	Vodka	5%, and A$71.67/L of alcohol
2208.70.00	Liquers and cordials	5%, and A$71.67/L of alcohol
2208.90	Other:	
2208.90.10	- Having an alcoholic strength by volume not exceeding 1.15% vol	5%
2208.90.20	- Having an alcoholic strength by volume exceeding 1.15% vol but not exceeding 10% vol	5%, and A$71.67/L of alcohol
2208.90.90	- Other	5%, and A$71.67/L of alcohol

2. In its first written submission, and referring to the Appellate Body's report on US – Cotton Yarn, the Philippines has argued that "products can only be regarded as 'directly competitive' if the 'degree of proximity' in the competitive relationship between the sugar-based and non-sugar-based products is such that they could be considered to be in 'complete, absolute, or exact' competition with one another. Thus the relationship described in Article III:2, second sentence is one that requires a very high degree of proximity".[1] *Can third parties comment on the Philippines' argument.*

Australia observes that the Appellate Body in *US – Cotton Yarn,* as cited in the Philippines' first written submission, considers that inclusion of the term 'directly' in relation to 'competitive' qualifies the competitive relationship between the imported and domestic products by 'suggesting a degree of proximity'. The Appellate Body found that the term 'directly' assisted in determining how close or remote competition needed to be in order for products to be 'directly competitive or substitutable' in relation to Article 6.2 of the Agreement on Textiles and Clothing.

Australia further notes that the Philippines extrapolates from the Appellate Body finding that the degree required by the use of the term 'directly' amounts to 'complete, absolute, or exact'[2] and requiring 'a very high degree of proximity'[3]. However, Australia notes that the panel in *Korea-Alcoholic Beverages* cautioned that in determining the necessary degree of proximity in the competitive relationship between products found to fall within the scope of Article III:2, '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'[4].

Australia also refers the Panel to paragraphs 28-30 of its third party submission which explores the scope of 'directly competitive or substitutable' for the purposes of the second sentence of Article III:2 of GATT 1994.

3. In its third party submission, Australia submits that "[i]n addition to considering whether particular types of spirits (i.e. domestic vodka compared with imported vodka, etc.) are 'directly competitive or substitutable', ... 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'."[5] *Can Australia elaborate on its statement. What is the view of other third parties on this statement?*

[1] The Philippines' first written submission, para 215 (emphasis added).
[2] Australia observes that this argument relies on the application of a dictionary definition of the term 'directly', to mean 'complete, absolute, or exact'.
[3] The Philippines' first written submission, para 215.
[4] Panel Report, *Korea –Taxes on Alcoholic Beverages ('Korea-Alcoholic Beverages'),* para 10.38.
[5] Australia's third party submission, para 39.

Australia's view is that the determination of whether imported or domestic spirits are 'like' products under the first sentence of Article III:2 and/or 'directly competitive or substitutable products' under the second sentence of Article III:2 of GATT 1994 may vary depending upon the products being compared. Australia summarised this issue in its executive summary to its third party written submission as follows:

> 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?[6])[7].

As Australia argued in its third party submission, the term 'directly competitive or substitutable' applies to a broader range of products than 'like'[8]. Thus, in Australia's view, a finding that different types of spirits are not 'like' products under the first sentence of Article III:2, would not exclude a finding that different types of imported and domestic spirits (whether as a whole, or within sub-groups) are 'directly competitive and substitutable' under the second sentence of Article III:2.

In its submission, Australia cites by way of example the panel report in *Korea-Alcoholic Beverages* which found that domestically produced soju was 'directly competitive or substitutable' with a range of imported spirits, 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 beverages described are not so important as to render the products non-substitutable... differences in colour do not render products non-substitutable.[9]

In the same dispute, the panel was 'unable to conclude that the imported products, or any subcategory of them, are like the domestic products'[10].

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[6] 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.

[7] Australia's third party written submission executive summary, para 3.

[8] Appellate Body Report, *Korea –Alcoholic Beverages*, para 118 (see also Australia's third party submission, para 28).

[9] 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- Taxes on Aloholic Beverages ('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).

[10] Panel Report, *Korea –Alcoholic Beverages*, para 10.104.

Similarly, the panel in *Japan-Alcoholic Beverages II* found that 'only vodka could be considered as like product to shochu... Substantial 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'[11]. In comparison, the panel also found that '[s]hochu, whisky, brandy, rum, gin, genever, and liqueurs are directly competitive or substitutable'[12].

4. What is the view of third parties on the Philippines' argument that "the concept of de minimis for the purposes of Article III:2, second sentence, is defined by the extent to which the tax burden affects the competition of products in the market in question [and that if] the taxation rate has little or no impact on consumer choice, it will be deemed to be de minimis."[13]

Australia observes that the Philippines finds support for this argument in the finding of the panel in *Chile-Alcoholic Beverages* that: '*de minimis* differences in taxation are permissible because it is not necessarily true that small differences in tax levels will have an effect'[14]. Australia's view is that the phrase 'small differences in tax levels' reflects that the determination of the *de minimis* standard involves a consideration of both the quantum of the difference in tax levels as well as its effect in the market.

While acknowledging the view of the panel in *Chile-Alcoholic Beverages* that 'the determination must be based on an examination of the market in question'[15], Australia also observes that the panel included in its analysis consideration of the scale of the tax differential in its application of Article III:2 to the facts in that dispute[16]. In Australia's view, to make such an examination without taking into account the scale of tax differentiation between imported and domestic like products would be at odds with the ordinary meaning of the second sentence of Article III:2 of GATT 1994[17].

Australia further notes that the panel in *Chile-Alcoholic Beverages* cautioned that in considering the effect of a differential tax measure on the market, 'the very taxes in question, as well as other governmental policies, may have an impact on the market resulting in difficulty determining whether a relatively small level of differentiation is *de minimis* or does indeed have a discernable effect on the market'[18].

Australia notes that the panel in *Japan-Alcoholic Beverages II* went further and stated that 'it is appropriate to conclude, as have other GATT panels..., that it is not necessary to

[11] Panel Report, *Japan-Alcoholic Beverages II*, para 6.23.
[12] Panel Report, *Japan-Alcoholic Beverages II*, para 7.1.
[13] The Philippines' first written submission, para 290.
[14] Panel Report, *Chile –Taxes on Alcoholic Beverages* ('*Chile – Alcoholic Beverages*'), para 7.90 (emphasis added).
[15] Panel Report, *Chile –Alcoholic Beverages*, para 7.91.
[16] Panel Report, *Chile –Alcoholic Beverages*, paras 7.93 and 7.98-7.100.
[17] Appellate Body Report, *Japan-Alcoholic Beverages II*, states that '[t]he terms of Article III must be given their ordinary meaning – in their context and in the light of the overall object and purpose of the *WTO* Agreement' (p 17).
[18] Panel Report, *Chile –Alcoholic Beverages*, para 7.91.

show an adverse effect on the level of imports, as Article III generally is aimed at providing imports with "effective equality of opportunities" in "conditions of competition" '[19]. That is, the effect on competition in the market could be measured by the loss of opportunity rather than a quantifiable loss of trade.

Australia's view is that the determination of whether a difference in taxation rates will meet the *de minimis* standard should be made on a case by case basis[20] taking into account a range of factors including: the scale of the differences in tax rates, the impact on product competition in the market, potential lost opportunity in the market, as well as the potential contribution of other government policies or external factors on market competition.

5. What is the view of third parties on the Philippines' argument that de minimis is a relative concept and that an assessment of what is more than de minimis ought to be based on the relative tax burden of the products being compared, which should be calculated based on the average tax/price ratio applied to these products?[21]

Australia supports the view that the determination of what amounts to a *de minimis* standard for the purposes of the second sentence of Article III:2 (and *Ad* Article III) of GATT 1994 is to be made on a case-by-case basis[22] and is therefore a concept which is 'relative' to the facts of each dispute.

Australia further notes that the question of how the 'relative tax burden' should be calculated was addressed by the panel in *Japan-Alcoholic Beverages II*. In that dispute, the panel stated that the indicators of whether the imported and domestic products at issue were 'similarly taxed' under *Ad* Article III were *inter alia*, 'tax per litre of product, tax per degree of alcohol *ad valorem* taxation, and the tax/price ratio'[23].

Accordingly, Australia considers that the 'average tax/price ratio' applied to the products in dispute could be one of a number of calculations used by a panel to determine the 'relative tax burden', dependent upon the facts of each particular dispute.

6. In its third party submission, Australia suggests that "there are a number of features of the Philippines' excise tax measure which should be considered as part of [the] analysis" of whether the measure is applied "so as to afford protection to domestic production", among which "the requirement that the raw materials be produced in the country in which the spirit is manufactured".[24] *Can Australia elaborate on its statement. What is the view of other third parties on this statement?*

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[19] Appellate Body Report, *Japan-Alcoholic Beverages II*, p 146, citing Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, para 5.1.9.
[20] Appellate Body Report, *Japan-Alcoholic Beverages II*, p 27.
[21] The Philippines' first written submission, para 287.
[22] Appellate Body Report, *Japan-Alcoholic Beverages II*, p 27.
[23] Panel Report, *Japan-Alcoholic Beverages II*, para 6.33.
[24] Australia's third party submission, para 43.

In its third party submission, Australia refers to the views of the Appellate Body in *Japan-Alcoholic Beverages II*, that a measure's 'protective application can most often be discerned from the design, the architecture, and the revealing structure of the measure'[25]. Australia's submission does not seek to undertake such analysis in respect of the tax measure at issue; rather Australia seeks to draw attention to particular aspects of the measure and its application which in its view could be considered as part of any such analysis by the Panel. This includes 'the requirement that the raw materials be produced in the country in which the spirit is manufactured'[26].

Australia does not draw any conclusions on this point in its submission; however in its view an examination of the 'design, structure and architecture' of the excise tax measure, would include consideration of both of the qualifying requirements for the lowest tax threshold, being that: (i) the spirit is made from a specified raw material (sap of the nipa, coconut, cassava, camote or buri palm, or from the juice, syrup of sugar of the cane); and (ii) that the raw ingredients are grown in the same country where they are processed into distilled spirits[27].

The construction of the measure would therefore exclude from the scope of the lowest tax threshold, not only spirits which are not made from the specified raw materials, but also those that are made with the specified raw materials which are sourced from another country. Effectively the measure means that any country which does not produce the raw material domestically cannot take advantage of the lowest tax rate. This is another layer in the architecture of the measure which, in Australia's view, should be considered in determining whether the measure is 'applied so as to afford protection'.

7. In its first written submission, the Philippines has argued that "[the] statements of certain individuals in the Philippines Congress and Government alleging the WTO-incompatibility of the excise tax regime... are simply the personal opinions of such individuals and do not reflect the official position of the legislative branch of the Philippines Government... The official view of the Government of the Republic remains as stated in this submission."[28] *What is the view of third parties on the value, if any, which should be accorded by WTO panels to the statements made by a Member's officials on measures at issue in a dispute and, most particularly, with respect to the alleged protective nature of the measure?*

Australia's view, as referred to above (see response to question 6), is that a measure's 'protective application can most often be discerned from the design, the architecture, and the revealing structure of the measure'[29]. Therefore, whilst broader evidence relevant to the implementation of a measure may be considered by the Panel in making this assessment, Australia considers that the starting point of the enquiry should be the text of

[25] Appellate Body Report, *Japan-Alcoholic Beverages II*, p 29.
[26] Australia's third party submission, para 44.
[27] Section 141(a), *National Internal Revenue Code of 1997* (Philippines).
[28] The Philippines' first written submission, para 308.
[29] Appellate Body Report, *Japan-Alcoholic Beverages II*, p 29.

the measure. This view is consistent with the Appellate Body Report in *US – Corrosion-Resistant Steel Sunset Review* which stated:

> When a measure is challenged "as such", the starting point for an analysis must be the measure on its face. If the meaning and content of the measure are clear on its face, then the consistency of the measure as such can be assessed on that basis alone[30].

The panel in *US-1916* made a similar observation in relation to the use of extrinsic material in the interpretation of domestic legislation, stating 'The understanding of a law the WTO-compatibility of which has to be assessed begins with an analysis of the terms of that law'[31]. However in contrast to the views of the Appellate Body in *US-Corrosion-Resistant Steel Sunset Review*, the panel in *US-1916* also stated that:

> …we consider that we should not limit ourselves to an analysis of the text of the 1916 Act in isolation from its interpretation by US courts or other US authorities, even if we were to find that text to be clear on its face. If we were to do so, we might develop an understanding of that law different from the way it is actually understood and applied by the US authorities. This would be contrary to our obligation to make an objective assessment of the facts of the case, pursuant to Article 11 of the DSU[32].

Specifically in respect of the statements of US officials, the panel considered whether 'the statements should be treated as admissions of facts or of the legal nature' of the Act in question[33]. The panel concluded that as the accuracy of the statements was disputed by the parties the statements 'should be used only to the extent that they confirm other established evidence'[34].

In the current dispute, Australia's view is that the analysis should be based on 'the design, the architecture, and the revealing structure <u>of the measure</u>'[35] therefore the primary focus of the investigation should be the text of the measure itself. Australia notes that, in the appropriate context, panels have looked to extrinsic materials such as statements by members of Congress or government officials to provide assistance in interpretation of domestic legislative measures. However, in Australia's view, in considering such material the Panel should exercise caution and assign weight to such evidence based on factors such as whether the representation can be held to be an interpretation of law by a government, or executive as a whole, or whether they it is merely expressing the views of individual members or government officials. In Australia's view the value of such statements should be considered on a case-by-case basis.

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[30] Appellate Body Report, *United States - Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan ('US-Corrosion-Resistant Steel Sunset Review')*, para 168.
[31] Panel Report, *United States –Anti-Dumping Act of 1916 (Complaint by the European Communities) ('US-1916')*, para 6.48.
[32] Panel Report, *US-1916*, para 6.48.
[33] Panel Report, *US-1916*, para 6.64.
[34] Panel Report, *US-1916*, para 6.65.
[35] Appellate Body Report, *Japan-Alcoholic Beverages II*, p 29 (emphasis added).

QUESTIONS TO AUSTRALIA

8. In its third party submission, Australia suggests 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."[36] *Can Australia elaborate on its statement.*

Australia's third party submission considers the issue of whether Philippines and imported spirits are 'like' products for the purposes of the first sentence of Article III:2. In doing so, Australia observes that if all Philippines spirits and all imported spirits are not found to be 'like' products by the Panel, the Panel may turn its consideration to a comparison between types of spirits. That is, the Panel might consider the question of whether Philippines vodka is 'like' imported vodka or whether Philippines whisky is 'like' imported whisky, and so on.

Australia notes in its submission that the criteria for determining whether products may be considered 'like' for the purposes of the first sentence of Article III:2 of GATT 1994 include: the product's end-uses in a given market; and the product's properties, nature and quality[37]. Australia's position as stated in its written submission at paragraph 2 is that no one criterion is decisive and all evidence should be examined.

In considering the evidence provided by the parties to the dispute, and its application to the criteria, Australia notes that the arguments by the parties appear to focus on the difference in the ingredients or 'raw materials' used in producing the distilled spirits. However Australia's understanding of the production process is that the 'raw materials' are simply used to produce ethanol with flavouring being substantially added by additives (e.g. the barrel, juniper berries etc). On the basis of this understanding, it may be less relevant whether Philippines 'gin' could be marketed as such under European Union laws or regulations; rather the focus should be on whether it is 'like' in terms of its other properties (i.e. the product's end-uses in a given market; and the product's properties, nature and quality).

9. In its third party submission, Australia suggests 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 competitive conditions and opportunities for imported compared with like domestic products."[38] *Can Australia elaborate on its statement.*

The tax measure at issue applies different tax rates dependent upon whether the product is made from specified raw materials and the raw materials are grown in the same country in which the spirits are distilled. Therefore, as Australia observes in its third party

[36] Australia's third party submission, para 16.
[37] Australia's third party submission, para 10.
[38] Australia's third party submission, para 25.

submission, it does not on its face apply differential tax rates based on whether the spirits are domestic or imported[39]. However, Australia notes in its submission that the Appellate Body has previously found that a measure which appears on its face to be origin-neutral may nevertheless give rise to *de facto* discrimination. The question to be considered in making such an assessment, according to the Appellate Body in *Korea-Beef*, is 'whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products'[40].

Australia's assertion 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 competitive conditions and opportunities for imported compared with like domestic products[41]

is an extrapolation of its view that a measure may result in *de facto* discrimination between imported and domestic products, even if on its face it applies equally to both products regardless of origin. In Australia's view such a determination requires an examination of how the measure is applied to domestic and imported products and whether such application impacts on the imported products' competitive opportunities in the market.

[39] Australia's third party submission, para 21.
[40] Appellate Body Report, *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef ('Korea-Beef')*, para 137.
[41] Australia's third party submission, para 25.