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Reports of the Appellate Body

PHILIPPINES – TAXES ON DISTILLED SPIRITS

(WT/DS396/AB/R; WT/DS/403/AB/R)
(Circulated on 21 DECEMBER 2011)

Parties:

<i>Appellant/Appellee:</i>	Philippines
<i>Other Appellant/ Appellee:</i>	European Union
<i>Appellee:</i>	United States
<i>Third Participants:</i>	Australia, China, Colombia, India, Mexico, Thailand, Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu.

Appellate Body Division:

Van den Bossche (Presiding Member), Hillman (Member), Ramirez-Hernandez (Member)

I. INTRODUCTION

This appeal concerns issues of law and legal interpretations developed in the Panel Reports, *Philippines – Taxes on Distilled Spirits*¹ (“Panel Reports”) and challenged by Philippines and the European Union (“EU”). The Panel was established to consider complaints by EU and the United States (“US”) who alleged that the excise tax regime imposed by Philippines, as applicable to distilled spirits, violated Article III:2, first and second sentences of the *General Agreement on Tariffs and Trade* (“GATT 1994”).

Under Section 141(a) of Philippines’ National Internal Revenue Code of 1997 (“NIRC”), distilled spirits are subject to a specific flat tax rate if two requirements are met:

- (i) if distilled spirits are produced from one of the designated raw materials that includes

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**This issue can also be accessed online at <http://wtocentre.iift.ac.in/DisputeAnalysis.asp> . Queries and comments are most welcome and may be directed to disputes_cws@iift.ac.in .

¹ WT/DS396/R (the EU Panel Report); WT/DS403/R (the US Panel Report), 15 August 2011

- (ii) sap of *nipa*, coconut, cassava, or juice, syrup or sugar of the cane, and the designated raw materials are produced commercially in the country where they are processed into distilled spirits

For all *other* distilled spirits that do not meet either of the above requirements, under Section 141 (b) of NIRC, these are subject to three different tax rates that apply depending on the net retail price of a 750 millilitre bottle of the spirit.

On a joint request of EU and US, the Panel circulated the Panel Reports on August 15, 2011, in the form of a single document containing two separate reports with common descriptive and analytical sections but separate conclusions and recommendations for each complainant. Same approach has been followed by the Appellate Body in its report as well.

The Panel found with respect to *EU's* complaint that Philippines had, through its excise tax regime, violated *Article III:2, first sentence* of GATT 1994, since it had subjected imported distilled spirits made from raw materials other than those designated in its legislation to internal taxes in excess of those applied to like domestic spirits made from designated raw materials. With respect to the complaint by the *US*, in addition to the above mentioned violation of the *Article III:2, first sentence*, the Panel also found Philippines to have violated the *second sentence of Article III:2* as it had applied dissimilar internal taxes on domestic distilled spirits made from designated raw materials and to directly competitive or substitutable imported distilled spirits made from other raw materials in a manner so as to afford protection to the Philippines domestic production of distilled spirits.

II. KEY ISSUES AND APPELLATE BODY FINDINGS

A. Article III:2, first sentence, GATT 1994

- a. Whether the Panel was wrong in holding that imported distilled spirit made from non designated raw materials is “like” the same type of distilled domestic spirit made from designated raw materials?

The Panel had found that imported distilled spirit made from non designated raw materials were “like” the same type of domestic distilled spirit made from designated raw materials. The Panel addressed the issue by considering evidence with respect to (i) products properties, nature and quality i.e. physical characteristics; (ii) end use in Philippines; (iii) Philippine consumers’ tastes and habits; (iv) tariff classification; and (v) relevant Philippine regulation. No claims were raised in the appeal with respect to Panel’s finding that all distilled spirits at issue in the dispute share the same end-uses of *inter alia* thirst quenching, socialisation, relaxation etc. Hence, the Appellate Body’s analysis was confined to the remaining four criteria, which are briefly summarised below:

(i) **Product’s Physical Characteristics**

Philippines claimed that the Panel was wrong in its interpretation of like products as the test of determining the same is whether the products are sufficiently close in nature that they can fit the narrow category of like products and any significant physical difference will be considered sufficient to disqualify a product from being like to another. EU and US argued that Philippines overstated the importance of physical characteristics, particularly differences in chemical composition in the likeness analysis. The Appellate Body rejected Philippines’ claim and upheld Panel’s findings stating:

“We understand that products that have very similar physical characteristics may not be “like”,

within the meaning of Article III:2, if their **competitiveness or substitutability** is low, while products that present certain physical differences may still be considered "like" if such physical differences have a limited impact on the competitive relationship between and among the products.” (Para 120)

Relevance of Raw Material Base in the determination of “Likeness”

On Panel’s assessment of physical characteristics of the distilled spirits, Philippines claimed that because of differences in chemical composition, which affects the taste, flavour and aroma, distilled spirits made from designated raw materials and non designated raw materials are not physically similar. The Appellate Body noted that the Panel had focused on the physical characteristics of distilled spirits as final products and not on those of raw materials or production process used to make the final products. It further held that “...in spite of differences in the raw materials used to make the products, if these differences do not affect the final products, these products can still be found to be "like" within the meaning of Article III:2 of the GATT 1994. Article III:2, first sentence, refers to "like products", not to their raw material base.” (Para 125)

The Appellate Body reiterated that Article III:2 is not **focused exclusively on the physical characteristics of the products**, but is concerned with the nature and the extent of the competitive relationship between and among the products. Therefore, as long as the “differences among the products, including a difference in the raw material base, **leave fundamentally unchanged the competitive relationship among the final products**, the existence of these differences does not prevent a finding of "likeness" if, by considering all factors, the panel is able to come to the conclusion that the competitive relationship among the products is such as to justify a finding of "likeness" under Article III:2.” (Para 125)

Further, the Appellate Body also noted that every effort was made from the production process to the sale of domestic distilled spirits made from designated raw materials to ensure they replicate as closely as possible the corresponding type of imported distilled spirit made from non designated raw materials, and are hence indistinguishable to the consumers.²

Application of “Perceptible Difference Test”

Philippines argued that the Panel was wrong in finding that there was no evidence of *perceptible difference* between the physical qualities and characteristics of the imported spirit and those of Philippine spirit, nor between the physical qualities and characteristics of the spirit made from the designated raw materials and those of spirit made from other raw material. It further argued that Panel applied a wrong standard because it relied on the ‘perceptible difference’ test from the perspective of a hypothetical consumer as the sole determinant. According to Philippines, in the ‘likeness’ analysis the perception of consumer is not related to physical characteristics of the product since those are empirical, physical attributes.

The Appellate Body rejected Philippines’ claim and upheld the Panel ruling stating that:

“While consumer perception of products is highly relevant to the overall determination of "likeness" under Article III:2, we believe that this element may reach beyond the products’

² While the Panel had addressed presentation and labeling under consumer tastes and habits, the Appellate Body observed that since distilled spirits are sold in labeled bottles, their presentation and labeling are also concerned with the physical characteristics of the products and not only with the perception of the consumers. (Para 128)

properties, nature, and qualities, which concern the objective physical characteristics of the products. Indeed, consumer perception of products may be more concerned with consumers' tastes and habits than with physical characteristics.

However, in light of the above, while the Panel refers to “perceptible” differences only in the context of the physical characteristics of the products, we do not consider that the Panel committed an error in its analysis of the products' physical characteristics by finding that, within each type, there is physical similarity between imported and domestic distilled spirits, irrespective of whether they are made from designated raw materials or from non-designated raw materials.” (Para 132-133)

(ii) Consumer Tastes and Habits

On the issue of consumer tastes and habits, a summary of the main Appellate Body findings are given below:

- (a) While the analysis of likeness under Article III:2, first sentence, and the analysis of direct competitiveness and substitutability under Article III:2, second sentence, require consideration of the competitive relationship between imported and domestic products, the former is a narrower category. The Appellate Body reiterated the findings in two previous Appellate Body Reports of *Canada Periodicals*³ and *Korea – Alcoholic Beverages*⁴, where it was observed that perfectly substitutable products fall within Article III:2, first sentence and imperfectly substitutable products can be assessed under Article III:2, second sentence. The Appellate Body however noted that, “We do not understand the statements by the Appellate Body in *Canada – Periodicals* and in *Korea – Alcoholic Beverages* to mean that *only* products that are perfectly substitutable can fall within the scope of Article III:2, first sentence. This would be too narrow an interpretation and would reduce the scope of the first sentence essentially to *identical products*. Rather, we consider that, under the first sentence, products that are close to being perfectly substitutable can be “like products”, whereas products that compete to a lesser degree would fall within the scope of the second sentence.” (Para 149)
- (b) The fact that domestic and imported distilled spirits in Philippines do not share *all* channels of distribution does not establish that the degree of substitutability is such that they are **not like products** within the meaning of Article III:2, first sentence. In particular, the fact that one channel of distribution is used only for domestic spirits (the *sari-sari* stores) and not the imported spirits, is not sufficient to establish that the products are not like. (Para 153)
- (c) The Panel did not commit error to the extent it found the degree of competition or substitutability between imported distilled spirits of a particular type made from non designated raw materials and domestic distilled spirits of the same type made from designated raw materials, supports the overall finding that these products are like within Article II:2, first sentence of GATT 1994. (Para 154)

³ Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997

⁴ Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999

(iii) Tariff Classifications

The Panel had observed that the fact that all distilled spirits at issue in the this dispute, irrespective of the raw materials from which they were made, fell under **HS⁵ heading 2208** and this was an indication of similarity. This was challenged by Philippines additionally also contended that the Panel acted inconsistently with Article 11 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”) in its assessment of **HS six digit subheadings** for brandy and whisky.

The Appellate Body relied on the finding in *Japan Alcoholic Beverages II*⁶, where the Appellate Body had stated that the tariff classification can be a helpful sign of similarity only if it is sufficiently detailed which was not the case in the present instance. In the present instance, all distilled spirits as well as liquors and unflavored neutral spirits for human consumption or industrial purposed were grouped together. (Para 161)

On the issue of HS six digit subheadings, the Appellate Body noted that the six digit HS subheading for whisky contained no reference to the raw material from which the spirit was produced; however, the HS Explanatory Notes (HSEN) to the six digit HS codes for both brandy and whisky specified the material from which the spirits were distilled. This provided an indication that tariff classification would not suggest that domestic brandies and whiskies made from designated raw materials were "like" imported brandies and whiskies made from non-designated raw materials.

Accordingly, it did not agree with the Panel's conclusion that at the six-digit level the HS classification provided no "conclusive guidance" as to the similarity of brandies and whiskies made from designated and non-designated raw materials.

The Appellate Body however observed that tariff classification is only one of the criteria that the Panel reviewed in its analysis of "likeness" under Article III:2 of the GATT 1994. It had already agreed with the Panel's conclusions that the criteria of products' physical characteristics and consumers' tastes and habits did support a finding that the products at issue were "like" within the meaning of Article III:2. (Paras 158 – 165)

(iv) Regulatory regimes

Philippines claimed that the Panel had erred in stating as ‘irrelevant’, the regulatory regimes of the EU and US which prohibited the marketing of whisky and brandy made from sugar cane molasses as “whisky” and “brandy”. The Appellate Body ruled that such a distinction existed in the EU and US indicated that the consumers in those countries would perceive these products as having quite distinct physical properties. In contrast, in Philippines not only domestically distilled spirits made from designated raw materials were marketed and sold as whisky and brandy, but also every effort was put to ensure that they replicated as closely as possible imported brandy or whisky made from non designated raw materials. Thus, determination of likeness is made on a case by case basis. If two products are ‘like’ in a given market, it does not necessarily mean that they would be considered as like product in another market as well. (Paras 167 - 168)

Thus, the Appellate Body upheld the overall conclusion of the Panel that each type of imported distilled

⁵ Harmonized Commodity Description and Coding System of the World Customs Organization

⁶ Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996

spirit at issue in this dispute—gin, brandy, vodka, whisky, and tequila—made from non-designated raw materials is "like" the same type of domestic distilled spirit made from designated raw materials, within the meaning of Article III: 2, first sentence, of the GATT 1994 and hence Philippines had acted inconsistently with Article III: 2, first sentence, of the GATT 1994 (Paras 172 -174)

- b. Whether the Panel, in finding that the products at issue were ‘like’ within the meaning of Article III:2, first sentence of GATT 1994, acted inconsistently with its duties under Article 11 of the DSU in its assessment of physical characteristics, Philippine market segment for distilled spirits (with respect to consumers’ tastes and habits) and tariff classification?

Philippines argued that the Panel had acted inconsistently with its duties under Article 11 of the DSU through its finding under Article III:2, first sentence. The Appellate Body rejected all the claims of Philippines on the issue and found the Panel did not act inconsistently with Article 11 of the DSU observing the following:

- (i) On *physical characteristics*, Philippines had argued that the Panel had disregarded critical portions of the Philippines’ evidence and substituted its own judgment for that of the expert testimony presented by Philippines, hence violating its duties under Article 11 of the DSU to make an objective assessment of the matters before it and consider all the evidence presented.

The Appellate Body noted that the Panel had indeed referred to the evidence provided by Philippines as well as the expert evidence submitted by it. However, as trier of facts the Panel had acted within the bounds of its discretion on weighing of the evidences and attaching less importance to them than Philippines. (Paras 134 - 141)

- (ii) On *market segment*, the Appellate Body noted that the Panel enjoys a margin of discretion in assessing the value and weight to be ascribed to the evidence before it and is not required to accord to factual evidence of the parties the same meaning and weight as do the other parties. The Panel’s consideration of Philippines’ evidence with respect to market segments was well within its discretion and hence there was no violation of Article 11 DSU as argued by Philippines. (Para 157)
- (iii) On *tariff classification*, the Appellate Body noted that the fact that the Panel overlooked the significance of HS six-digit level classification for brandy and whisky did not undermine its overall finding that the products at issue were "like". Therefore, this was not an error that rose to the level of a failure by the Panel to comply with its duties under Article 11 of the DSU. (Para 164)

- c. Whether all distilled spirits at issue whether imported or domestic and irrespective of their raw material base are like products?

The Panel’s finding that all distilled spirits irrespective of the raw material base or origin were “like products” was challenged by Philippines. The Appellate Body ruled that it was not clear from Para 7.77 of the Panel Reports whether the Panel concluded that *all* distilled spirits at issue were like products irrespective of raw material or origin *or* that distilled spirits at issue in this dispute *may* be like products, irrespective of raw material base and origin. To the extent that the Panel found the former, the Appellate Body held that it disagreed with the Panel’s rulings since the Panel’s own findings suggest that the degree of physical similarity and competition among all distilled spirits at issue in this dispute is not such as to fulfil the narrow definition of likeness in Article III:2, first sentence of GATT 1994.

Moreover, in respect of consumers’ tastes and habits, Appellate Body held that likeness under first sentence requires a degree of competition that is **higher than merely significant**, as was found by the Panel. The Appellate Body thus *reversed* the Panel’s findings. (Para 183)

B. Article III:2, second sentence, GATT 1994

European Union’s Other Appeal

The EU claimed that the Panel erred in characterizing its claim under Article III:2, second sentence, GATT 1994 as made in the "alternative" to its claim under the first sentence of Article III:2 and hence the Panel acted inconsistently with Articles 7.1, 7.2, and 11 of the DSU. The Appellate Body observed that the EU’s panel request clearly indicated that the EU had made separate and independent claims under first and second sentences of Article III:2 of the GATT 1994 and these were also specified by the EU in response to questioning by the Panel. Thus the Appellate Body concluded that claims of the EU were not only separate and independent but also involved in distinct product groupings. The Appellate Body however noted that EU’s statement in the first submission where it stated that if the Panel discovered a breach under the first sentence, it would not necessarily need to analyze a breach under the second sentence may have in part contributed to the Panel’s incorrect characterization. EU’s statement itself was however legally incorrect and thus EU’s claim could not have been understood as to have been made in the alternative. The Appellate Body thus reversed the findings of the Panel and held that the Panel had acted inconsistently with its obligations under Article 11 of the DSU.

Philippines’ Appeal

Two separate issues were addressed by the Appellate Body for assessing the consistency of Philippines’ internal tax measure with Article III:2, second sentence of GATT 1994 and in examining Philippines’ appeal against Panel’s findings in this regard. These issues are discussed below:

a. Whether the imported and domestic products are ‘directly competitive or substitutable’?

Philippines challenged Panel’s assessment of the *competitive relationship* between imported and domestic distilled spirits in the Philippines market. It however did not challenge any other factor taken into account by the Panel in its determination that imported and domestic distilled spirits were directly competitive or substitutable

The Appellate Body’s findings with respect to the three main claims of Philippines under this issue are summarized below:

(i) **Degree of Competition**

Philippines argued that in an analysis under Article III:2, second sentence, ‘*degree of competition*’ between domestic and imported distilled products should be the central enquiry and not the *quality or nature* of competition. The Appellate Body agreed with Panel’s analysis and held that Panel’s analysis sufficiently demonstrates that it appropriately addressed the degree of competition between the relevant products. The Appellate Body ruled that the Panel had followed the guidance provided by the Appellate Body in *Korea – Alcoholic Beverages*⁷ and the appropriate standard was determining whether competition between imported and domestic distilled spirits in Philippines was *sufficiently direct* so that

⁷ Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999

these products could be properly characterised as directly competitive or substitutable.

Further, the term ‘directly’ suggests a degree of proximity in the competitive relationship between the domestic and imported products and requisite degree of competition is met where the imported and domestic products are characterised by a high, but imperfect degree of substitutability which the Panel found in the present case. Philippines had challenged the statement of the Panel where it noted that the question before it was not so much as what the ‘degree of competition’ between the products at issue was but rather what was the ‘nature’ or ‘quality’ of their competitive relationship. The Appellate Body rejected Philippines’ claim and clarified that the Panel was only de-emphasizing the role played by quantitative analysis of substitutability and its statement on degree of competition related exclusively to a quantitative assessment of the competitive relationship between domestic and imported distilled spirits in marketplace. The Appellate Body noted that the Panel was following the ruling of the Appellate Body in *Korea – Alcoholic Beverages*⁸ where panels were cautioned against placing undue reliance on quantitative analyses of the competitive relationship. (Paras 205-208)

(ii) Market Segmentation

Philippines argued that that the imported and domestic distilled spirits were not directly competitive or substitutable in Philippines because they were sold in two separate markets due to general gap in prices between low-price domestic distilled spirits from designated raw materials and imported, high-price distilled spirits made from non designated raw materials.

The Appellate Body however agreed with the Panel finding of separate markets on the basis of evidence demonstrating overlaps in the prices of imported and domestic products and rejected Philippines’ claim. It did not agree with Philippines that Article III:2, second sentence requires identity in the ‘nature and frequency’ of consumer’s purchasing behaviour and hence purchase on ‘special occasions’ should not be taken into account as was done by the Panel. It also observed that competitive relationship between the imported and domestic products in a given market are not assessed only with reference to *current* consumer preferences. The requisite relationship may exist between products that are not at a given moment considered by the consumers as substitutes but which *are capable of being substituted* for one another taking into account both latent and extant demand for the imported distilled spirit. The possibility that many consumers may be able to purchase high priced distilled spirits at least on ‘special occasions’ provides additional support for the extant demand.

Further, the Appellate Body rejected Philippines’ claim that the Panel incorrectly found direct competition on the basis of a ‘narrow segment’ of the population having ‘access’ to imported distilled spirits and upheld the Panel’s finding stating:

“More importantly, we do not agree with the Philippines that Article III:2, second sentence, requires that competition be assessed in relation to the market segment that is *most representative* of the “market as a whole”. To the contrary, the Panel was correct in concluding that Article III of the GATT 1994 “does not protect just *some* instances or *most* instances, but rather, it protects *all* instances of direct competition.” This reading is consistent with the Appellate Body’s finding that the object and purpose of the GATT 1994, as reflected in Article III, is “requiring equality of competitive relationships and protecting expectations of equal competitive relationships.” (Para 221)

⁸ Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999

(iii) Potential Competition

Philippines further argued that the Panel erred in its application of Article III:2, second sentence of GATT 1994 in finding that instances of actual competition indicated potential competition between imported and domestic distilled spirits in Philippines' market. Philippines further challenged Panel's ruling that an Article III analysis should not depend on predicting income distribution patterns but rather whether there is evidence that consumers are willing or may be willing to use the different products to satisfy same or similar needs. The Appellate Body rejected Philippines' claim and agreed with the Panel finding stating that in the present case, instances of actual competition were a clear indication that the imported and domestic products at issue in the dispute were indeed *capable of being* directly competitive or substitutable in the *future*. The Appellate Body agreed with the Panel's ruling and said that excise tax system could have the effect of creating and even freezing preferences for domestic goods in Philippines. Further, the Appellate Body rejected Philippines' contention that an analysis of potential competition under Article III:2, second sentence is limited to an assessment of whether competition would otherwise occur if the challenged taxation were not in place since such a 'but for' test was an overly restrictive interpretation of directly competitive or substitutable products. (Paras 225 - 228)

(iv) Substitutability Studies

Philippines also claimed that the Panel failed to conduct an objective assessment of the facts in examination of the studies evaluating the substitutability between domestic and imported distilled spirits in the Philippine market and hence there was violation of Article 11 of the DSU. The Appellate Body noted that for a claim under Article 11 to succeed, the Appellate Body must be satisfied that the Panel has exceeded its authority as initial trier of facts, which requires it to provide "reasoned and adequate explanations and coherent reasoning", to base its finding on a sufficient evidentiary basis, and treat evidence with "even-handedness". The Appellate Body on consideration of relevant factors concluded that the Panel *did not* act inconsistently with its duties under Article 11 of the DSU, rejecting Philippines' claim.

Thus, in Appellate Body's views, studies showing a significant degree of substitutability in the Philippine market between imported and domestic distilled spirits, as well as instances of price competition and evidence of actual and potential competition between imported and domestic distilled spirits in the Philippine market, sufficiently supported the Panel's conclusion that there was "a direct competitive relationship in Philippines between domestic and imported distilled spirits, made from different raw materials."

b. Whether dissimilar taxation of the directly competitive or substitutable products is 'applied...so as to afford protection to domestic production'?

The Panel had, after reviewing the design, architecture and structure of the measure at issue, observed that all designated raw materials listed in Section 141 (a) of the NIRC were grown in Philippines and all domestic distilled spirits were produced from designated raw materials thus subject to a lower flat rate tax. The Panel thus concluded that this meant that *de facto* the measure resulted in all domestic distilled spirits enjoying the favourable low tax while the vast majority of the imported spirits were subject to taxes between 10 and 40 times higher. Philippines challenged the finding of the Panel which was rejected by the Appellate Body. The main findings of the Appellate Body are summarized below:

(i) The Appellate Body in the present matter relied on the previous finding of the Appellate

Body in *Japan Alcoholic Beverages II*⁹, where it was held that the question of whether dissimilar taxation affords protection is not of intent, but rather of application of the measure at issue. Further, dissimilar taxation must be more than de minimis and that in certain cases the very magnitude of dissimilar taxation may be evidence of protective application which has to be evaluated on a case by case basis.

- (ii) The Appellate Body observed that if the Panel had limited its analysis to the ruling articulated by *Korea Alcoholic Beverages*¹⁰ alone, it would have fallen short of an objective and comprehensive analysis of the case at hand. The Panel went further and reviewed the measure in detail and stated that while designated raw materials are grown in the Philippines and all domestic distilled spirits are produced from designated raw materials, the vast majority of imported distilled spirits are not made from designated raw materials.
- (iii) The Appellate Body also agreed with the Panel that the assessment of whether the excise tax could affect the competitive relationship between domestic and imported distilled spirits in the Philippine market pertains to the prong of analysis directed at determining whether the products are "directly competitive or substitutable". Having addressed—and rejected—the Philippines' arguments concerning pre-tax price differentials when determining whether the products at issue are "directly competitive or substitutable" in the Philippine market, it was not necessary for the Panel to revisit this argument in its assessment of whether the dissimilar taxation of such products afforded protection to domestic production. (Para 256)

III. DISPUTE NOTES

- Sources of International Law: The Appellate Body in its analyses has mainly relied on treaty text (GATT 1994 and DSU) and the previous relevant Panel / Appellate Body Reports.
- 'Like Product' Determination: The Four Border Tax Factors: The Appellate Body following the approach of the Panel undertook the 'like product' analysis on the basis of (i) products properties, nature and quality i.e. physical characteristics; (ii) end use; (iii) consumers' tastes and habits; (iv) tariff classification. These four factors after being first proposed in the Working Party Report of *Border Tax Adjustments*¹¹ have now formed part of a standard 'like product' analysis. Additionally, the Appellate Body also looked into issue of regulatory regimes in place in EU and the US on Philippines' request. The Appellate Body however rejected Philippines claim stating that if two products are 'like in' a given market, it does not necessarily mean that they would be considered a like products in another market as well, thus reiterating the established rule that determination of likeness is to be made on a case by case approach.
- 'Like Product' Determination: Competitive Relationship: The Appellate Body's analysis of the various factors establishing likeness confirms that for determining whether products are 'like' product under Article III:2, first sentence, competitive relationship between products is very crucial

⁹ Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996

¹⁰ Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999

¹¹ Report of the Working Party on *Border Tax Adjustments*, L/3464, 2 December 1970, B.I.S.D

and has to be taken into account. The Appellate Body looked into the competitive relationship while deciding upon physical characteristics and consumer tastes and habits. For instance, with respect to physical characteristics, products that have very similar physical characteristics may not be "like", within the meaning of Article III:2, if their competitiveness or substitutability is low, while products that present certain physical differences may still be considered "like" if such physical differences have a limited impact on the competitive relationship between and among the products.

- ‘Like Product’ Determination: Perfect Substitutability: While the Appellate Body in the matters of *Canada Periodicals* as well as *Korea – Alcoholic Beverages* had stated that perfectly substitutable products fall under the first sentence of Article III:2 and imperfectly substitutable products under second sentence of Article III:2, neither of these Reports clarified whether *only* products that are perfectly substitutable can fall under Article III:2, first sentence. The Appellate Body in the present dispute has clarified that under the first sentence even products that are *close* to being perfectly substitutable can be ‘like products’, whereas products that compete to a lesser degree would fall within the scope of the second sentence.