*PHILIPPINES – TAXES ON DISTILLED SPIRITS*

**(WT/DS396/403)**

# EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES OF AMERICA

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# I. FACTUAL BACKGROUND

1. The Philippines protects its domestic production of distilled spirits by applying very low tax rates to spirits produced from a limited set of local raw materials, while applying much higher tax rates to other spirits which are largely imported. It does so despite the fact that there is a great deal of substitutability among all types of distilled spirits, and specifically between imported brands and Philippine domestic brands. By arbitrarily applying a very low tax rate to products produced from local raw materials and a much higher rate to imported spirits, the Philippine measures protect domestic spirits production, very much like the measures found to be WTO-inconsistent in the disputes *Japan – Alcohol*, *Korea – Alcohol*, and *Chile – Alcohol*.

2. The Philippine tax system for distilled spirits is set out in Section 141 of the National Internal Revenue Code, as enacted by Republic Act 8424 of 1997 and amended by Republic Act 9334 of 2004. Section 141 sets out the tax rates, the categories of products to which the rates apply, and procedures for calculation of the applicable tax for each product.

3. Section 141 divides spirits into two broad categories, reflected in sections 141(a) and 141(b) of the statute. A single low rate applies to all spirits under section 141(a) and one of three possible higher rates applies to spirits under 141(b), depending on the net retail price of a 750 milliliter bottle of the spirit. Section 141 further provides that the rates on spirits shall be adjusted upward over time.

4. The low tax rate under Section 141(a) applies to products distilled from nipa, coconut, cassava, camote, buri palm, or sugar cane. In addition, for a distilled spirit made from one of these materials to qualify for the low rate, the raw material must be produced commercially in the country where it is processed into the distilled spirit. All of the raw materials listed in Section 141(a) are produced in the Philippines.

5. In fact, the Philippines has acknowledged that lower taxes on products distilled from these raw materials means lower taxes on products from indigenous materials. The Department of Trade and Industry Development Plan 200[4] stated, "Excise taxes on distilled spirits impose a lower tax on products made from materials that are indigenously available (*e.g.*, coconut, palm, sugarcane)."

6. All spirits not produced from one of these typical Philippine raw materials fall into the second category under its tax system, provided for in Section 141(b) of the National Internal Revenue Code. Products in this second category are subject to one of three tax rates, depending on the retail price of a 750 milliliter bottle of the spirit. All of the rates under the second category are significantly higher than the low rate levied on products produced from indigenous materials. The lowest rate in the second category is 146.97 pesos/proof liter and the highest is 587.87 pesos/proof liter.

**Spirit Tax Category by Raw Material & Price (per proof liter)**

| | | Tax as of 1/1/2009 | Tax as of 1/1/2011 (8% scheduled increase) |
|---|---|---|---|
| 141 (a) – Local Raw Materials | | 13.59 | 14.68 |
| 141(b) – Other Raw Materials | Price for 750 ml bottle | | |
| | From P0 to P250 | 146.97 | 158.73 |
| | From P250 to P675 | 293.93 | 317.44 |
| | More than P675 | 587.87 | 634.90 |

7. All the rates are set in pesos per proof liter. The tax on a particular distilled spirit may be calculated using a standard formula. For example, the tax on a 750 ml bottle of local White Castle Whisky (80 proof, or 40% alcohol) with the 2009 tax rate of 13.59 pesos/proof liter, would be calculated as follows:

$$13.59 \times (40/100) \times 2 \times (750/1000) = 8.15 \text{ pesos}$$

The tax on a 750 ml bottle of imported Jim Beam black whiskey (86 proof, or 43% alcohol), with the 2009 tax rate of 293.93 pesos/proof liter, would be:

$$293.93 \times (43/100) \times 2 \times (750/1000) = 189.5 \text{ pesos}$$

8. In the Philippines, regulations promulgated under the distilled spirits tax law which specify a “net retail price” for each brand and the applicable tax. The regulations list brands sold in the Philippines, specifying for each brand the net retail price per bottle and resultant amount of applicable tax. These regulations separate products eligible for the low tax rate (“local” products) from those subject to the higher tax rate.

## II. LEGAL ARGUMENT

### A. The Philippine Measures Are Inconsistent with GATT 1994 Article III:2

9. Article III:2 of the GATT 1994 applies to internal taxes, such as the domestic excise tax at issue in this dispute. Article III:2 of the GATT 1994 provides that:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Paragraph 1 in turn states that:

> The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

10. An Ad note to paragraph 2 provides that "A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed."

11. The Philippine excise tax measures on distilled spirits are inconsistent with the obligations of both Article III:2, first sentence and Article III:2 second sentence, because they subject imported products to internal taxes in excess of those applied to like domestic products, and because they are applied to imported products so as to afford protection to domestic production. Article III:2, second sentence is examined first below, followed by the first sentence of Article III:2.

### B. Philippine Measures Are Inconsistent with GATT 1994 Article III:2, Second Sentence

12. The Philippine tax system on distilled spirits is inconsistent with the second sentence of GATT Article III:2. Consistent with the approach used by prior panels and the Appellate Body, to demonstrate that a measure is inconsistent with Article III:2, second sentence, a complaining party must show that:

- The imported products and the domestic products which are in competition with each other are "directly competitive or substitutable";
- The directly competitive or substitutable imported and domestic products are "not similarly taxed"; and
- The dissimilar taxation of the directly competitive or substitutable imported products is "applied . . . so as to afford protection to domestic production."

#### 1. Philippine Distilled Spirits Are Directly Competitive or Substitutable with Imported Distilled Spirits

13. Several previous panels and the Appellate Body have considered the issue of whether certain distilled spirits are "directly competitive or substitutable" within the meaning of the second sentence of Article III:2 of the GATT 1994. The WTO panels that examined this issue all used a similar approach, evaluating factors including physical characteristics, channels of distribution, and end-uses, and to determine whether the products at issue are "directly competitive or substitutable."

14. Philippine distilled spirits and imported spirits share similar physical characteristics, end uses, channels of distribution, substitutability, and tariff classification. Following the approach of prior WTO panels, these similarities demonstrate that Philippine distilled spirits are directly competitive or substitutable with imported distilled spirits in the Philippine market.

*Physical Characteristics*

15. Philippine and imported distilled spirits have similar physical characteristics, including attributes such as appearance, color, and alcohol content.

16. Exhibit US-38 contains pictures of Philippine and imported products, along with descriptions of these products drawn from advertising, other company representations, and consumer statements. As is evident from these materials, the Philippine products are similar in color to the imported products — for example, both Philippine whiskeys and imported whiskeys are brown spirits and Philippine vodkas and imported vodkas are clear.

17. Manufacturers, distributors, and retailers use similar terms to describe domestic and imported products in local advertising. For example, advertising for both imported and domestic brandies emphasizes the aroma and smoothness of the brands concerned.

18. Descriptions and photos by Philippine companies squarely place them as substitutes with international products, having similar attributes to their foreign competitors. Domestically produced Ginebra San Miguel is a "dutch-type" gin for which the "predominant flavor emanates from juniper berries that are imported from Europe." Gran Matador Solera Gran Reserva is made with "carefully selected Solera Gran Reserva brandy concentrates from Spain." St. George Premium Whisky "approximates the taste, aroma, and alcohol kick of imported whiskies."

19. Domestic and imported brands are not distinguishable from one another on the basis of alcohol content, which is another important physical characteristic. For example, under Philippines standards, all whiskies, regardless of raw material, must have an ethyl alcohol content of at least 32.5%.

20. Thus, based on physical attributes such as appearance, taste, color and alcohol content, distilled spirits made of indigenous materials in the Philippines are directly competitive or substitutable with imported distilled spirits.

*Channels of Distribution*

21. Philippine and imported brands are sold in the same channels of distribution. Rules and regulations concerning distribution and sales of spirits apply to all types of spirits, supporting the conclusion that they are sold by the same retailers and wholesalers in the same places of business. Regulations on sales and distribution do not distinguish between domestic and imported spirits, nor do they separate spirits products by the raw material used in production. For example, the "Checklist of Requirements for Food Establishments," though applicable widely to wholesalers, importers, and exporters, does not apply different rules for different products. Similarly, the authority to apply municipal taxes applies to all liquors, spirits, and wines regardless of the raw material, or whether products are imported or domestic.

22. In addition, photographs from stores in the Philippines show imported and domestic brands available to Philippine consumers side by side, frequently on the same shelves. Exhibit US-30 provides concrete examples of domestic and imported products sold in the same channels of distribution in the Philippines, including multiple examples of store displays showing domestic and imported distilled spirits sold side by side in the same stores.

23. As these examples demonstrate, domestic and imported brands are sold in the same channels of distribution, providing further evidence for the fact that they are directly competitive or substitutable.

*End Uses of Spirits*

24. The end uses of products produced from indigenous materials and those produced from non-indigenous materials also demonstrate that domestic distilled spirits are "directly competitive or substitutable" with imported distilled spirits. Data collected directly from consumers, as well as evidence depicting how products are presented to consumers in stores, restaurants, and bars, all support the conclusion that these products have similar end uses.

25. Euromonitor International undertook a study of consumers in the Philippines, in order to understand consumers' perceptions of different brands of distilled spirits, both domestic and imported. The resulting study provides detailed information on end uses of spirits in the Philippines, including end-use as it concerns the drink itself (*e.g.*, whether the spirit is consumed straight) and end-use as it concerns the setting for consuming drinks (*e.g.*, home or elsewhere).

26. The results of this study confirm that domestic and imported brands have comparable end uses. Survey respondents indicated that they consume both imported and domestic brands straight, with water, or in a mixed drink. Respondents also indicated that they consume both domestic and imported brands in a similar range of places, such as bars, discos, restaurants and sporting events. Consumers drink domestic versus imported brands at similar times and in similar settings (*e.g.*, both imported and domestic products are consumed after work, before dinner).

27. Photographs from stores and restaurants in the Philippines are consistent with consumers' responses to the Euromonitor Consumer Preference Survey, and confirm that end-uses for imported and domestic brands are the same. Domestic and imported brands are displayed together in bars and supermarkets, and they are sold together on drinks menus.

28. Thus, information from consumers as well as evidence from the marketplace demonstrates that the end uses of domestic and imported brands are the same.

*Price Substitutability*

29. Evidence also suggests that products produced from indigenous materials and products produced from non-indigenous materials are substitutable depending on price. If the Philippines removed the discriminatory aspects of its tax on imported spirits, the price difference between imported and domestic products would be reduced. The results of the Euromonitor Consumer Preference Survey of Philippine consumers regarding whether they would replace some purchases of domestic products with imported products if the difference in price between them were smaller demonstrate that price changes result in consumers purchasing more imported spirits and fewer domestic spirits.

*Harmonized Tariff System Classification*

30. Regardless of raw material, distilled spirits products are classified under heading 2208.

31. In summary, Philippine distilled spirits are "directly competitive or substitutable" with domestic distilled spirits. Philippine producers of distilled spirits produce spirits from local raw materials, which are then regulated, marketed, and sold side-by-side with imported products and consumed for similar reasons in the same types of places. These products are directly competitive or substitutable with the products produced by their international competitors, yet, are subject to a significantly lower tax rate.

### 2. Philippine Products and Imported Products Are Not Similarly Taxed

32. Under the second sentence of Article III:2 of the GATT 1994, a complaining party must show that the domestic products and the imported products are "not similarly taxed." In Philippine regulations listing brands of spirits and applicable taxes, products are divided into two groups: "local" and "imported." Products made from local raw materials and eligible for the low tax rate under Section 141 (a) are included in one list, and all other products — those subject to the higher tax rates — are another list.

33. Revenue Regulations 12-2004 is the most recent regulation listing products and the taxes applied to different brands. For "local" products taxed at the lower rate, listed at Annex A of the regulation, the tax per bottle (as adjusted for proof liters) is very low. As to 2009, taxes for 750

ml bottles range from 6.35 pesos (for a 750 ml bottle of Tanduay rum) to 9.24 pesos (for the same size bottle of local Gordan's gin).

34. By contrast, taxes are significantly higher for all products listed in Annex B, "Imported Distilled Spirits Brands Produced from Grains, Cereals and Grains covered by Section 141(b)." The products are divided by price into three categories, reflecting the three tax rates under Section 141(b). The maximum and minimum tax (in pesos) per 750 ml bottle for imported products, as listed in the Annex, are:

| | Maximum 2009 | Minimum 2009 | Maximum 2011 | Minimum 2011 |
|---|---|---|---|---|
| Premium | 379.17 | 352.72 | 409.51 | 380.94 |
| De-Luxe | 189.59 | 154.31 | 204.75 | 166.66 |
| Standard | 99.21 | 79.36 | 107.15 | 85.71 |

35. In other words, the minimum tax per 750 ml bottle for an Annex B product, P79.36, is nearly nine times the maximum tax per 750 ml bottle for an Annex A product.

### 3. The Taxation of Distilled Spirits Protects Domestic Philippine Production

36. The third element of the second sentence of GATT Article III:2 requires that the differential taxation is applied "so as to afford protection" to domestic production. In this case, the Philippines itself has acknowledged that the measures are structured to favor products made from local raw materials, and an objective examination of the measures' structure leads to the conclusion that they protect domestic products.

37. The sheer magnitude of difference in the tax rate for products made from typical local materials compared to that for all other products supports the conclusion that the measures operate to afford protection to domestic production.

38. The *lowest* tax rate in the Philippine system for products not made of typical local materials is 146.97 pesos/proof liter, *more than ten times* the rate applied to local products. The highest tax rate is *more than 40 times* the low rate. The extent of discrimination under the Philippine tax regime dwarfs the tax differentials found to afford protection to domestic production in prior disputes.

39. The Appellate Body in *Japan – Alcohol* noted that in some cases, the difference in taxation itself will be enough to establish the protection of the domestic industry. Given the magnitude of discrimination in the Philippines, this alone supports the conclusion that the measures "afford protection to domestic production."

40. Although the magnitude of the difference in taxation between domestic and imported brands is sufficient to show that the Philippine measures protect domestic industry, other facts also support this conclusion.

41. The Philippine measures divide distilled spirits into two broad categories, based on the raw material from which the individual spirits are distilled. As explained above the Philippine and imported products are substitutable, and the raw materials that are designated as inputs for products eligible for the low tax rate all thrive in the Philippines. The Philippine system, like the system analyzed in *Korea – Alcohol*, "operates in such a way that the lower tax brackets cover almost exclusively domestic production, whereas the higher tax brackets embrace almost exclusively imported products." Moreover, the Philippine law requires that for a product distilled from the typically local raw materials to receive the low tax treatment, not only must the raw material used to produce the spirit be among those on the select list of indigenous products, but also that raw material must be produced commercially in the country where the spirit is produced. This imposes an additional barrier to low tax treatment on par with Philippine products.

42. In summary, the Philippines measure is structured to favor domestic products, by virtue of the separation of products made from typical Philippine raw materials and all other products.

### C. First Sentence, GATT 1994 Article III:2: Imported Distilled Spirits Are Like Philippine Distilled Spirits and Taxed in Excess of Domestic Products

43. To establish that a Member's internal tax is inconsistent with the first sentence of Article III:2, one must demonstrate that (1) the taxed imported and domestic products are "like"; and (2) the taxes applied to the imported products are "in excess of" those applied to the like domestic products. As explained below, the measures in question are also inconsistent with the first sentence of Article III:2.

#### 1. Philippine Distilled Spirits Are "Like" Imported Distilled Spirits

44. As with determining whether products are "directly competitive or substitutable," in order to determine whether imported and domestic distilled spirits are "like products" previous panels have assessed factors such as the products' physical characteristics, channels of distribution, end uses, consumer tastes and habits, and tariff classification.

45. Rather than specifying a particular type of spirit for preferential treatment, the measures discriminate by specifying the raw materials used to produce the product — raw materials that are largely used to produce Philippine "local" spirits, not imported products. This is similar to the facts in *Mexico – Soft Drinks*, where both cane sugar and beet sugar were used to produce the soft drinks affected by Mexico's measure. These two materials were both used to manufacture the same products. Examining the characteristics and uses of the two materials, the panel determined that the downstream products were "like" products.

46. The Philippines produces a range of products from the local materials designated in the statute. The Ginebra San Miguel Company alone produces brandy, vodka, gin, tequila and whiskey. For the Philippines, the evidence supports the conclusion that local products made from typical local raw materials (e.g., gin, whiskey, vodka, brandy) compete with, and are "like," their imported counterparts.

47. For brandy, whiskey, and vodka, the Philippines has promulgated Standard Administrative Orders (SAOs) on product standards that very plainly state that different raw materials can be used to make the same "type" of spirit. This supports the conclusion that, for purposes of the Philippine measures, the "local" product is "like" the imported product.

48. With respect to whiskey and brandy, the SAOs explicitly provide that "whiskey" and "brandy" can be made from different raw materials. Specifically, "compounded" brandy and "compounded" whiskey can by made from "neutral spirits." The SAO for vodka does not mention raw material at all in the definition of vodka, but simply states that it is obtained from "neutral spirit" from "fermented grain, potato, or any other source." By the Philippines' own standards, Philippine vodkas, whiskeys, and brandies are "like" imported vodkas, whiskeys, and brandies.

49. Not only are Philippine products directly competitive or substitutable with imported products, based on both physical characteristics and how the products are marketed and sold, Philippine products are "like" domestic products

50. Each type of Philippine distilled spirit is virtually identical to its imported counterpart in terms of color, packaging, and alcohol content. For example, gin and vodka are clear, whether imported or domestic, and that whiskies and brandies are golden. Advertising uses similar terms to describe the color and taste of imported and domestic brands.

51. Other factors (end uses, channels of distribution, substitutability) also support the conclusion that the Philippine products subject to the lower tax rate are "like" imported products subject to the higher rate. For example, with respect to channels of distribution, imported and domestic brands of the same type are grouped together in stores and displays, demonstrating that the raw material is irrelevant to how the brands are sold. The second photograph in Exhibit US-30 depicts imported whiskies (Maker's Mark, Jack Daniel's, J&B) and domestic White Castle on the same set of shelves.

52. The labels of the individual brands also emphasize the "likeness" of Philippine and imported products. For example, the local White Castle whisky and imported Jim Beam whiskey both use red, gold, black and white in their label designs, as well as seals and natural images. Don Enrique tequila features a sombrero, signaling association with Mexico.

53. Evidence from the Philippine market (the survey results prepared by Euromonitor) shows that imports are no different – from a consumer perspective – than locally manufactured distilled

spirits made of local raw materials. In short, for every variety of distilled spirit available, the Philippine product — made from local raw materials — is "like" the imported product. As such, these products are "like" domestic products within the meaning of the first sentence of Article III:2 of the GATT 1994.

### 2. Imported Products are "Taxed in Excess" of Philippine Products

54. As noted above, a measure is inconsistent with the first sentence of GATT 1994 Article III:2 where (1) the domestic and imported products are "like" products; and (2) the imported like product is taxed in excess of the domestic product. The difference in taxation between domestic and imported products in the Philippines is so large that the lowest tax rate per bottle for imported products is nearly nine times above the highest rate per bottle applied to domestic products in recent regulations. Thus, imported products are clearly "taxed in excess" of domestic products.

## III. CONCLUSION

55. For the reasons set out above, the United States respectfully requests the Panel to find that the Philippine measures with respect to the taxation of distilled spirits are:

- inconsistent with Article III:2 of the GATT 1994, second sentence, as a tax applied on imported distilled spirits which are directly competitive or substitutable with domestic distilled spirits which are "not similarly taxed"; and

- inconsistent with Article III:2 of the GATT 1994, first sentence, as a tax on imported distilled spirits "in excess of those applied to like domestic products."