*PHILIPPINES – TAXES ON DISTILLED SPIRITS*

**(WT/DS396/403)**

# FIRST WRITTEN SUBMISSION OF THE UNITED STATES OF AMERICA

**September 2, 2010**

## TABLE OF CONTENTS

**TABLE OF REPORTS CITED**

| **Short Form** | **Full Citation** |
|---|---|
| *Canada – Periodicals (AB)* | Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997 |
| *Chile – Alcohol (Panel)* | Panel Report, *Chile – Taxes on Alcoholic Beverages,* WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by the Appellate Body Report, WT/DS87/AB/R, WT/DS110/AB/R |
| *Chile – Alcohol (AB)* | Appellate Body Report, *Chile – Taxes on Alcoholic Beverages,* WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000 |
| *Japan – Alcohol (Panel)* | Panel Report, *Japan – Taxes on Alcoholic Beverages,* WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November, 1996, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R |
| *Japan – Alcohol (AB)* | Appellate Body Report, *Japan – Taxes on Alcoholic Beverages,* WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November, 1996 |
| *Korea – Alcohol (Panel)* | Panel Report, *Korea – Taxes on Alcoholic Beverages,* WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by the Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R |
| *Korea – Alcohol (AB)* | Appellate Body Report, *Korea – Taxes on Alcoholic Beverages,* WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999 |
| *Mexico – Soft Drinks (Panel)* | Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R, adopted 24 March 2006, as modified by the Appellate Body Report, WT/DS308/AB/R |
| *Mexico – Soft Drinks (AB)* | Appellate Body Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/AB/R, adopted 24 March 2006 |

## I. INTRODUCTION

1. The Philippines protects its domestic production of distilled spirits[1] 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 Philippines maintains its measures despite its acknowledgment that the tax is inconsistent with the Philippines' international obligations. In fact, the Philippines Department of Trade and Industry stated as recently as May 2009 that the taxes on distilled spirits violate the national treatment obligation of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"). In its comments on proposed measures to reform its tax system, it stated that the Philippine law providing for taxation of distilled spirits "is inconsistent with GATT 1994 as it gives preferential treatment to domestic alcohol products produced from indigenous or locally sourced raw materials ... Since the indigenous materials mentioned are not likely grown in commercial quantities in temperate countries, and are levied higher taxes, the existing law and the proposed amendments are inconsistent with the national treatment principle under GATT 1994."[2]

## II. PROCEDURAL BACKGROUND

3. On July 29, 2009, the European Union ("EU") requested consultations with the Philippines under Article XXII:1 of the GATT 1994 and Article 4 of the *Understanding on Rules*

---

[1] Distilled spirits are alcoholic beverages made "from wine or other fermented fruit or plant juice or from a starchy material (such as various grains) that has first been brewed." By heating the fermented or brewed material, the alcohol is evaporated and captured. This alcohol is the "distilled spirit." Distilled spirits are distinguished from other alcoholic beverages, such as beer and wine, by the higher alcohol content. Exhibit US-12, Encyclopedia Britannica Article on Distilled Spirits. Distilled spirits fall under Heading 2208 of the Harmonized Tariff System, and they include many types of spirits, such as gin, vodka, brandy, whiskey, tequila, rum, and liqueurs. *See, e.g.,* Exhibit US-13, Harmonized Tariff System.

[2] Exhibit US-11, Department of Trade and Industry, Position on Proposed Measures Restructuring the Excise Tax on Alcohol and Tobacco Products, 11 May 2009. The Philippines Department of Finance also has shared the view that the tax regime on distilled spirits is inconsistent with WTO commitments. *See also* Exhibit US-14, Department of Finance discussion of proposed reforms, stating that the current tax system has the problem of "unfair competition between manufacturers of locally-produced and of imported products" (accessed from Department of Finance website at: http://www.dof.gov.ph/report/explanatory%20note.pdf).

*and Procedures Governing the Settlement of Disputes* (the "DSU").[3] The United States requested to be joined in those consultations pursuant to Article 4.11 of the DSU on August 10, 2009 and the Philippines accepted that request on August 17, 2010. Consultations were held in Manila on October 8, 2009.

4. On January 14, 2010, the United States requested consultations with the Philippines under Article XXII of the GATT 1994 and Article 4 of the DSU with respect to the taxation of distilled spirits by the Philippines. The EU requested to be joined in those consultations pursuant to Article 4.11 of the DSU on January 27, 2010, and the Philippines accepted that request on January 29, 2010.[4] Consultations were held in Geneva on February 23, 2010. The parties were unable to resolve the dispute during consultations.

5. On December 10, 2009, the EU requested establishment of a panel pursuant to Article 6.1 of the DSU.[5] The Dispute Settlement Body (DSB) agreed to this request at its meeting on January 19, 2010.

6. On March 26, 2010, the United States submitted a request for the establishment of a panel pursuant to Article 6 of the DSU.[6] The DSB agreed to this request at its meeting on April 20. The DSB established under Article 9.1 of the DSB a single panel to consider the disputes brought by the United States and the EU.

7. On June 25, 2010, the United States and the EU jointly requested the Director-General to determine the composition of the panel, pursuant to Article 8.7 of the DSU. On July 5, the Director-General composed this Panel. Australia, China, Colombia, India, Mexico, Thailand, and Chinese Taipei reserved their rights as third parties to this dispute.

## III. FACTUAL BACKGROUND

### A. Structure of Philippine Tax System for Distilled Spirits

8. 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

[3] WT/DS396/1.

[4] WT/DS403/2.

[5] WT/DS396/4.

[6] WT/DS403/4.

9334 of 2004.[7] 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.

9. Other laws and regulations provide further detail on the implementation of the tax regime. These include regulations subsequent to the 2004 Act, concerning updates to the rates as provided for in Section 141 and the taxes applicable, under those rates, for brands of distilled spirits later introduced in the Philippine market. In addition, laws and regulations predating the 2004 Act remain applicable to the extent they provide the most current classifications of distilled spirits products sold in the Philippines. The product's classification (raw material and net retail price ("NRP")), determine the tax on the product under the 2004 Act and under the earlier law, both of which were structured in the same way.

10. In addition to Republic Acts 8424 and 9334, specific legal instruments include:

- Republic Act No. 8240 (1996), setting out the tax rates for distilled spirits (then codified at Article 138 of the National Internal Revenue Code) and setting out the classification for products sold in the Philippines at that time;[8]

- Revenue Regulations No. 02-97 (1997), setting out the classification (still applicable) for products sold in the Philippines at that time;[9]

- Revenue Regulations No. 17-99 (1999), setting out the tax rates applicable to products, including designated increases;[10]

- Revenue Regulations No. 9-03 (2003), setting out procedures for classification of new brands sold in the Philippines;[11]

---

[7] Exhibit US-1, Republic Act No. 8424, *an Act amending the National Internal Revenue Code as amended and for other purposes* ; Exhibit US-2, Republic Act 9334, an Act *increasing the excise tax rates imposed on alcohol and tobacco products, amending for the purpose Sections 131, 141, 142, 143, 144, 145 and 288 of the National Internal Revenue Code of 1997, as amended*.

[8] Exhibit US-3, Republic Act No. 8240, *an Act amending Sections 138, 139, 140 and 142 of the National Internal Revenue Code, as amended*.

[9] Exhibit US-4, Revenue Regulations No. 02-97, *Governing Excise Taxation on Distilled Spirits, Wines and Fermented Liquors.*

[10] Exhibit US-5, Revenue Regulations No. 17-99, *Implementing Sections 141, 142, 143 and 145(A) and (C)(1),(2) and (4) of the National Internal Revenue Code of 1997 relative to the Increase of the Excise Tax on Distilled Spirits, Wines, Fermented Liquors and Cigars and Cigarettes Packed by Machine by Twelve Per Cent (12%) on 1 January 2000.*

[11] Exhibit US-6, Revenue Regulations No. 9-2003, *Amending Certain Provisions of Revenue Regulations No. 1-97 and Revenue Regulations No. 2-97 Relative to the Excise Taxation*

- Revenue Regulations No. 23-03 (2003), setting out the classification of new brands sold in the Philippines;[12]

- Revenue Regulations No. 12-2004 (2004), setting out classification for new brands sold in the Philippines;[13] and

- Revenue Regulations No. 03-06 (2006), setting out the procedures for classification of new brands sold in the Philippines and the applicable tax rates.[14]

### 1. Section 141 of the Internal Revenue Code

11. Section 141 of the Internal Revenue Code, as amended by Section 1 of Republic Act 9334,[15] 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 states:

> Sec. 141. *Distilled Spirits.* – On distilled spirits, there shall be collected, subject to the provisions of Section 133 of this Code, excise taxes as follows:
>
> (a) If produced from the sap of nipa, coconut, cassava, camote, or buri palm or from the juice, syrup or sugar of the cane, provided such materials are produced commercially in the country where they are processed into distilled spirits, per proof liter, Eleven pesos and sixty-five centavos (P11.65);

---

*of Alcohol Products, Cigars and Cigarettes for the Purpose of Prescribing the Rules and Procedures To Be Observed in the Establishment of the Current Net Retail Price of New Brands and Variants of New Brands of Alcohol and Tobacco Products.*

[12] Exhibit US-7, Revenue Regulations No. 23-2003*, Implementing the Revised Tax Classification of New Brands of Alcohol Products and Variants Thereof Based on the Current Net Retail Prices Thereof as Determined in the Survey Conducted Pursuant to Revenue Regulations No. 9-2003.*

[13] Exhibit US-8, Revenue Regulations No. 12-2004, *Providing for the Revised Tax Rates on Alcohol and Tobacco Products introduced on or before December 31, 1996, and for those Alcohol and Tobacco Products Covered by Revenue Regulations No. 22-2003 and 23-2003, Implementing Act No. 9334*.

[14] Exhibit US-9, Revenue Regulations No. 3-2006, *Prescribing the Implementing Guidelines on the Revised Tax Rates on Alcohol and Tobacco Products Pursuant to the Provisions of Republic Act No. 9334, and Clarifying Certain Provisions of Existing Revenue Regulations Relative Thereto.*

[15] Exhibit US-2.

(b) If produced from raw materials other than those enumerated in the preceding paragraph, the tax shall be in accordance with the net retail price per bottle of seven hundred fifty mililiter (750 ml.) volume capacity (excluding the excise tax and the value-added tax) as follows:

(1) Less than Two hundred and fifty pesos (P250.00) – One hundred twenty-six pesos (P126.00), per proof liter;

(2) Two hundred and fifty pesos (P250.00) up to Six hundred and seventy-five pesos (P675.00) – Two hundred fifty-two pesos (P252.00), per proof liter; and

(3) More than Six hundred and seventy five pesos (P675.00) – Five hundred four pesos (P504.00) per proof liter. . ..”

12. Section 141 further provides that the rates on spirits shall be adjusted upward, stating:

The rates of tax imposed under this Section shall be increased by eight percent (8%) every two years starting on January 1, 2007 until January 1, 2011.

13. Because it is calculated as a percentage of the statutory rates, each biannual adjustment results in an even greater disparity between the tax rate on distilled spirits produced from typical local raw materials and the rates for other distilled spirits.[16]

[16] See Figure 1.

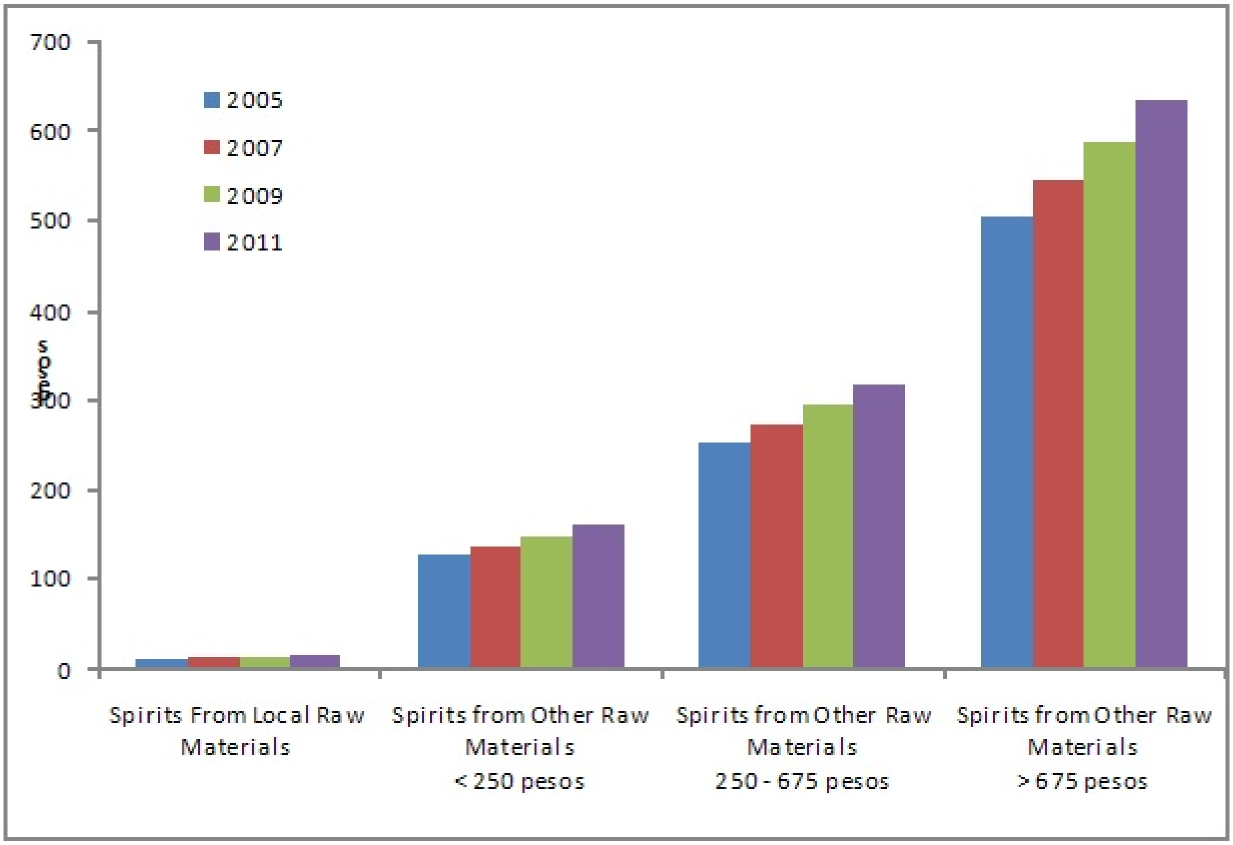


**Figure 1. Tax rates on distilled spirits, 2005-2011.**

14. All the rates are set in pesos per proof liter. A "proof liter" is a standard industry term, referring to a liter with 50% alcohol content at a standard temperature, or the amount (by volume) of a given spirit with the same amount of alcohol.[17] To determine the tax rate applicable by proof liter to a product under the Philippine excise tax system, the following formula applies: Tax Rate x % Alcohol x 2 x Bottle Volume= Tax.[18] 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, would be calculated as follows:

13.59 x (40/100) x 2 x (750/1000)= 8.15 pesos

[17] The Philippine law defines "proof liter." "'Proof spirits' is liquor containing one-half (½) of its volume of alcohol of a specific gravity of seven thousand nine hundred and thirty-nine ten thousandths (0.7939) at fifteen degrees centigrade (15°C). A 'proof liter' means a liter of proof spirits." Exhibit US-2, Republic Act 9334, section 1, page 3.

[18] An alternative formula, yielding the same result, is: tax rate x proof x bottle size = tax.

Similarly, 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:

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

15. In the Philippines, retailers do not calculate the tax per proof liter or determine the classification of a brand based on its price, but instead refer to regulations promulgated under the distilled spirits tax law which specify a “net retail price” for each brand and the applicable tax. As explained in further detail below, the regulations list brands sold in the Philippines, specifying for each brand the net retail price per bottle and resultant amount of applicable tax. The Philippine Bureau of Internal Revenue is authorized under the law to verify the retail price designations; the law also specifies how the Bureau of Internal Revenue is to determine net retail price for new brands in the Philippine market.

16. Regulations that predate the current law set forth the net retail price for some brands of distilled spirits; when the 2004 law came into effect, it retained the net retail price designations for these brands. These classifications can only be changed by law. (The law in place before 2004 also divided spirits between those made with the same typical raw materials, which were taxed at a low rate, and other products, which were taxed at one of three higher rates.)[19]

17. The net retail price determined for the purpose of tax assessment is defined in Section 141 as follows:

> “Net retail price”, as determined by the Philippine Bureau of Internal Revenue through a price survey conduced by the Bureau of Internal Revenue itself, or by the National Statistics Office when deputized for the purpose by the Bureau of Internal Revenue, shall mean the price at which the distilled spirits is sold on retail in at least ten (10) major supermarkets in Metro Manila, excluding the amount intended to cover the applicable excise tax and the value-added tax. For brands which are marketed outside Metro Manila, the ‘net retail price’ shall mean the price at which the distilled spirits is sold in at least five (5) major supermarkets in the region excluding the amount intended to cover the applicable excise tax and the value-added tax.

18. If a new brand is introduced for which such price information is not available, that new brand would be classified according to its suggested retail price until after the brand has been sold in the Philippines and the Philippine Bureau of Internal Revenue can validate the brand’s classification.[20]

---

[19] *See* Republic Act 8424, Section 3, amending Section 141 of the National Internal Revenue Code. Exhibit US-1.

[20] *See* Republic Act No. 9334, amending Section 141 of the National Internal Revenue Code, at page 4. Exhibit US-2.

### 2. Implementing Regulations

19. Revenue Regulations No. 3-2006 implements the tax rates and period increases required by Section 141. While the classification of new brands for the purposes of the tax law would require new information on suggested or actual retail prices, the regulation provides that retailers should rely on regulations that predate the law for classification, pricing, and tax information of spirits included therein. In Section 4 on "Prohibition Against Reclassification," Revenue Regulations No. 3-2006 states:

> The tax classification of the following brands of alcohol and tobacco products shall remain in force until revised by Congress:
>
> (a) Brands enumerated in Annexes "A", "B", "C" and "D" of R.A. No. 8240;
> (b) Brands listed in RR Nos. 1-97 and 2-97; and
> (c) New brands introduced in the domestic market between January 1, 1997 and December 31, 2003.[21]

20. Revenue Regulations No. 02-1997[22] and No. 23-2003[23] list brands that had been classified under the predecessors to current Section 141(a) or (b) at the time of enactment of the 2004 law enacting the current tax rates.[24] Revenue Regulations No. 12-2004[25] lists brands introduced on or before December 31, 1996, and those included under Revenue Regulations No. 23-2003.

21. Although the regulations implementing the Philippine measures are complex, the essentials of the measures are quite simple, beginning with the division of products into two categories, consistent with the categories set forth in sections 141(a) and 141(b). All of the relevant regulations divide products in this manner. Revenue Regulations 3-2006, which followed the 2004 law, sets out the different rates in a table in Section 3. Part A.1 of the table covers distilled spirits, and is divided between A.1.a, distilled spirits "produced from the sap of nipa, coconut, cassava, camote, or buri palm or from the juice, syrup or sugar of the cane," and A.1.b, covering distilled spirits "produced from raw materials other than those enumerated in [A.1.a]."

---

[21] See Exhibit US-9.

[22] Exhibit US-4.

[23] Exhibit US-7.

[24] *Revenue Regulations 9-2003* amends *Revenue Regulations* 2-97 and provides for a pricing survey of new brands, the results of which were published in *Revenue Regulations 23-2003. See Revenue Regulations 9-2003*, section 3, Exhibit US-6.

[25] *Revenue Regulations No. 12-2004, Providing for the Revised Tax Rates on Alcohol and Tobacco Products introduced on or before December 31, 1996, and for those Alcohol and Tobacco Products Covered by Revenue Regulations No. 22-2003 and 23-2003, Implementing Act No. 9334* (Exhibit US-8).

### 3. Categories of Distilled Spirits

22. Under Section 141(a) of the National Internal Revenue Code, products falling within the first category of distilled spirits have the lowest tax rate, currently 13.59 pesos/proof liter.[26]

23. The statute, as well as the implementing regulations, specify that the low tax rate 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.[27] All of the raw materials listed in Section 141(a) are significant crops produced in the Philippines.[28] Sugar cane historically has been a significant crop — the Philippines reached the status of the world's third largest producer by 1880. It continues to have significant production of sugar cane, reaching over 2 million metric tons annually over the past several years.[29] The Philippines is one of the top producers of coconut, ranking second in the world by volume and value in 2008.[30] Nipa palm grows in brackish areas throughout the Philippines, and has been characterized as "one of the most important of Philippines crops, economically speaking."[31] Cassava, a starchy tuber found in warm, humid climates, "grows throughout the Philippines except in very cool areas and high altitudes."[32] For sweet potato (camote), the Philippines was the 15th largest producer, by volume, in 2008.[33] Buri palm is a large palm that is "found throughout the Philippines, in most islands and provinces."[34]

24. 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)."[35] Moreover, in the regulations setting out the taxes for brands of spirits sold in the

---

[26] In 2011, the last of the rate adjustments required by law will occur, and the tax will increase 8% (to 14.68 pesos/proof liter).

[27] *See* Section 141(a) of the National Internal Revenue Code. (Exhibit US-2).

[28] Exhibits US-10 and 16-21.

[29] Exhibit US-21, Sugar Cane Information.

[30] Exhibit US-16, Coconut Information.

[31] Exhibit US-17, Nipa Palm Information.

[32] Exhibit US-18, Cassava Information.

[33] Exhibit US-20, Camote Information.

[34] Exhibit US-19, Buri Palm Information.

[35] Exhibit US-35, Philippines Department of Trade and Industry Development Plan

Philippines, the list of brands subject to the low tax rate is labeled "local" and the list of brands subject to the higher rates is labeled "imported."[36]

25. 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.[37] 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.[38]

**Figure 2. 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 |

26. As with the "local" products subject to the low tax rate, the taxes applicable to products subject to these higher rates are also listed in Philippine regulations by brand. The regulations describe the list of brands subject to the higher rate as "*Imported* Distilled Spirits Brands Produced from Grains, Cereals, and Grains covered by Section 141(b)."[39]

---

[36] *See*, *Revenue Regulations No. 02-97*, *Section 4* (Exhibit US-4); *Revenue Regulations No. 23-2003, Annex A* (Exhibit US-7); *Revenue Regulations 12-2004, Section 2* (Exhibit US-8); *Republic Act No. 8240, Annexes A-1 and A-2* (Exhibit US-3); Republic Act No. 8424, Annexes A-1 and A-2 (Exhibit US-1).

[37] *See* Section 141(b)(1)-(b)(3), enacted by Section 1 of Republic Act 9334 and Section 3 of Revenue Regulations 3-2006. Exhibits US-2 and US-9.

[38] In 2011, the rate on spirits produced from indigenous raw materials will increase to 14.68 pesos/proof liter, and the higher rates on other spirits will range from 158.73 pesos/proof liter to 634.90 pesos/proof liter.

[39] Emphasis added. *See* Exhibit US-4, Revenue Regulations No. 02-97, Section 4; Exhibit US-7, Revenue Regulations No. 23-2003, Annex A; Exhibit US-8, Revenue Regulations No. 12-2004, Section 2.

27. In addition to the laws and regulations implementing the tax system itself, other regulations govern the sales of distilled spirits in the Philippines. These regulations include Standard Administrative Orders ("SAO") detailing the standards that products must meet in order to be sold in the Philippines as, for example, "whiskey" or "vodka", as well as generally applicable laws and regulations concerning licensing of businesses to sell distilled spirits and for payment of taxes.

28. The Philippines has issued SAOs for "brandy," "whiskey," "vodka," and "rum."[40] These orders set out in detail the requirements a product must meet to be sold in the Philippines with each of these designations. The SAOs provide that products may use these designations depending on attributes such as raw materials, chemical composition, alcohol content, appearance, additives, packaging, and marking. The following describes the provisions of the SAOs specifying the raw materials that must be used for a product to be sold with a given designation, which are of particular significance because the amount of tax applied to a distilled spirit brand in the Philippines depends on the raw material used to produce the brand.

29. With respect to whiskey, brandy, and vodka, the SAOs provide that these spirits may be produced from different raw materials. Thus, for example, two products equally eligible to be designated as "whiskey" in the Philippines may be subject to different tax rates, merely owing to the fact that one is comprised of indigenous raw materials. Likewise, products designated as "brandy" (or "vodka") could be subject to very different tax rates, notwithstanding the fact that the Philippines consider them the same type of distilled spirit under the applicable Philippine SAO. [41]

30. Unlike the SAOs for whiskey, brandy, and vodka, the SAO for rum provides that products may only be designated as "rum" if they are distillates from sugarcane, sugarcane molasses, or other sugarcane by-products.[42] Regarding taxation of rum products, the Philippine law specifies sugarcane as a local raw material from which a product can be distilled and qualify for the lowest tax rate. While the regulations designate certain imported and domestic rum products as eligible for lower taxes, the regulations designate other — imported — rums as subject to the higher tax rate. Despite the fact that all of these products are rums, and all are made from sugarcane, presumably because they do not meet other conditions for eligibility for the lower tax — such as the requirement that the raw material used for a spirit be "commercially

[40] Exhibit US-24, Standards Administrative Order No. 358 Series of 1978 (Brandies); Exhibit US-25 , Standards Administrative Order No. 259 Series of 1976 (Whiskies); Exhibit US-23, Standards Administrative Order No. 258 Series of 1976 (Vodka); Exhibit US-27, Standards Administrative Order No 257 Series of 1976 (Rum).

[41] Exhibit US-24, SAO (Brandies).

[42] Exhibit US-27, SAO (Rum).

produced" in the country where a spirit is distilled — they are subject to the higher tax.[43] Accordingly, even where imports are made from one of the indigenous materials listed in the statute, imported products remain subject to discriminatory taxation.

### B. Overview of the Philippine Distilled Spirits Market

31. The Philippines has a strong market for distilled spirits. Annual sales of distilled spirits ranged from just over 400 million liters to just under 600 million liters over the past ten years, with the highest figures (in value as well as volume) in 2009.[44] Filipino consumers purchase a wide variety of types of spirits. Top selling products include gins, brandies, and rums. [45]

32. Distilled spirits sales in the Philippines have increased over the past several years. From 2003 to 2008, annual sales in the Philippine market for distilled spirits grew from 448 million liters to 551 million liters, an increase of 23%.[46] In addition to the increase in distilled spirits sales overall, sales increased for each type of spirit (*e.g.* whiskey, gin). Brandy — a product which has only recently begun to be produced domestically — experienced the largest increase in sales.[47] Such changes in consumption demonstrate that Philippine consumers are open to consuming different types of distilled spirits and changing patterns of consumption.[48]

33. According to Philippines' import data from the WTO Integrated Data Base, over the same period, however, imports of distilled spirits actually decreased 38% by volume and 17% by value. Notwithstanding the increase in overall sales of distilled spirits, imports of distilled spirits to the Philippines represent a tiny percentage of the market (2.4% of sales in 2008).[49]

## IV. LEGAL ANALYSIS

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

---

[43] *See*, *e.g.* Lemon Hart Rhum and Lemon Hart Jamaican Rhum, listed at page 10 in Annex A to Revenue Regulations No. 23-2003. (Exhibit US-7).

[44] Exhibit US-41, Consumer Perceptions Regarding Substitutability in the Philippines Distilled Spirits Market ("Euromonitor Consumer Preference Survey").

[45] Exhibit US-40, Spirits – Philippines, Euromonitor International: Country Sector Briefing.

[46] Exhibit US-40, Spirits – Philippines, Euromonitor International: Country Sector Briefing, Table 1.

[47] Exhibit US-40, Spirits – Philippines, Euromonitor International: Country Sector Briefing, Table 1.

[48] Exhibit US-41, Euromonitor Consumer Preference Survey, p. 11.

[49] Exhibit US-15.

34. 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.

35. 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."

36. Article III:2 prohibits discrimination (1) against imported products that are "like products" to domestic products; and (2) against imported products that are "directly competitive or substitutable" with domestic products. The first sentence of Article III:2 addresses nondiscriminatory treatment of imported products that are "like" domestic products. The second addresses the treatment of imported products that are "directly competitive or substitutable" with domestic products.[50]

37. As explained below, in the case of the Philippines, domestically produced distilled spirits are both "directly competitive or substitutable" with and "like" imported products. Furthermore, the Philippine excise tax measures on distilled spirits are inconsistent with both of these obligations, 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.

---

[50] *See Korea – Alcohol (Panel)*, paras. 10.34-10.35; *Japan – Alcohol (Panel)*, paras. 6.11-6.12.

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

38. Three WTO panels addressing discriminatory taxes applied to distilled spirits have concluded that distilled spirits are "directly competitive or substitutable" under the second sentence of Article III:2, and the evidence demonstrates that the Panel should draw the same conclusion here. "Directly competitive or substitutable" denotes a broader category of products than "like product," requiring relatively less similarity among products.[51] For that reason, it is discussed first below, and the discussion of the first sentence of Article III:2 follows in the next section.

39. The Philippine tax system on distilled spirits is inconsistent with the second sentence of GATT Article III:2, which states that "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, when read in conjunction with the ad note, provides in relevant part that internal taxes affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products should not be applied to an imported product that is in competition with a "directly competitive or substitutable" domestic product that is "not similarly taxed," so as to "afford protection to domestic production."

40. 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: [52]

- 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." [53]

41. As explained below, the Philippine measures meet each of these elements, and thus are inconsistent with GATT 1994 Article III:2, second sentence.

---

[51] *Japan – Alcohol (AB)*, pp. 19-21; Panel Report, *Mexico – Soft Drinks (Panel)*, para. 8.29.

[52] *Chile – Alcohol (AB)*, para. 47; *Korea – Alcohol (AB)*, para. 107.

[53] *Japan – Alcohol (AB)*, p. 24.

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

42. 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.[54] As the Appellate Body noted, products may be directly competitive or substitutable if they are "interchangeable or if they offer … 'alternative ways of satisfying a particular need or taste.'"[55]

43. The WTO panels that examined this issue for distilled spirits 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."[56] For example, in the *Chile– Alcohol* dispute, the panel stated it would examine "end-uses of the products, their physical characteristics, the channels of distribution, price relationships (including cross-price elasticities), and other relevant characteristics."[57] In *Korea – Alcohol*, the characteristics the panel identified in assessing whether imported and domestic products were directly competitive or substitutable were "physical characteristics, end-uses including evidence of advertising activities, channels of distribution, price relationships including cross-price elasticities, and any other characteristics."[58] In addition, panels have looked to tariff classification in assessing substitutability of distilled spirits.[59]

44. As the following sections demonstrate, Philippine distilled spirits and imported spirits share similar physical characteristics, end uses, channels of distribution, substitutability, and tariff classification, such that Philippine distilled spirits are directly competitive or substitutable with imported distilled spirits in the Philippine market.

---

[54] *Japan – Alcohol (AB)*; *Korea – Alcohol (AB)*; *Chile – Alcohol (AB).*

[55] *Korea – Alcohol (AB)*, at para. 115.

[56] *Japan – Alcohol (Panel)*, at para. 7.1 (In *Japan – Alcohol*, the Panel found that the domestic distilled spirit at issue, shochu and imported products (whisky, brandy, rum, gin, genever, and liqueurs) were directly competitive or substitutable with shochu.); *Korea – Alcohol (Panel)* at para. 10.57-10.60, 10.98, (finding domestic products (Korean soju, a distilled spirit variant similar to shochu, which has been classified by Japanese authorities as the same product as shochu for tax purposes) directly competitive or substitutable with whisky, brandy, cognac, rum, gin, vodka, tequila, liqueurs, and ad-mixtures.); *Korea – Alcohol (AB)*, at para. 169(a); *Chile – Alcohol (Panel)*, at para. 8.1 (finding that pisco, a local spirit distilled from grapes, was directly competitive or substitutable with products falling under HS 2208).

[57] *Chile – Alcohol (Panel)*, para. 7.30.

[58] *Korea – Alcohol (Panel)*, para. 10.61.

[59] *Japan – Alcohol (AB)*, pp. 21-22.

### a. Philippine Distilled Spirits Are "Directly Competitive or Substitutable" with Imported Distilled Spirits Based on Their Physical Characteristics

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

46. 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.[60]

47. The SAOs reinforce the fact that domestic and imported brands have similar physical characteristics. For both whiskey and brandy, the SAOs provide that products carrying these designations shall have the characteristic "taste" and "aroma" and be "free from added coloring matters except caramel prepared from sugar."[61] Conversely, vodkas "shall be free from color and odor and possess the characteristics generally attributed to vodka."[62] Thus, the Philippines itself appears to recognize that these physical characteristics — shared by both domestic and imported products alike — determine whether a product is a whiskey, brandy or vodka, and under the terms of the Philippines SAO, a producer may use different raw materials.[63]

48. Manufacturers, distributors, and retailers use similar terms to describe domestic and imported products in local advertising.[64] For example, advertising for both imported and domestic brandies emphasize the aroma and smoothness of the brand. The Philippine producers of local Gran Matador describe it as having a rich distinct aroma, smoothness and overall taste that is on par with that of international brands.[65] This is comparable to the "overall smooth taste" and "warm finish" of imported Fundador, and the "smooth taste" of imported Tres Cepas.[66]

---

[60] Note that Gilbey's Gin, included in this exhibit, is produced in the Philippines and also in other countries.

[61] Exhibit US-25, Standards Administrative Order (SAO) No. 259 Series of 1976. (Whiskies), 4.2 and 4.4; Exhibit US-24, Standards Administrative Order No. 358 Series of 1978 (Brandies), 4.2-4.3.

[62] Exhibit US-23, Standards Administrative Order No. 258 Series of 1976 (Vodka), 3.1.

[63] As discussed in Section C.1.a below, brandies or whiskies produced from different raw materials may be described as "compound" type brandy or whiskey.

[64] See Exhibit US-22.

[65] Exhibit US-22.

[66] Exhibit US-38.

49. 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."[67]

50. Alcohol content is another important physical characteristic of distilled spirits. Domestic and imported brands are not distinguishable from one another on this basis. The Philippines prescribes minimum alcohol standards for types of spirits. All whiskies, regardless of raw material, must have an ethyl alcohol content of at least 32.5%.[68] The minimum alcohol content for brandies is also 32.5%,[69] but for vodka a higher alcohol content is prescribed, from 37.15% to 42.85%.[70]

51. These standards are reflected in the alcohol content of specific brands. Below are some examples of typical Philippine and imported brands. The range of alcohol content is narrow, from 32.5% for domestic Gran Matador brandy to 40% for several imported and domestic brands (including whiskies, vodkas, tequila and rum), with a somewhat higher figure for two gin examples noted. For each type of spirit and across the types of spirits, alcohol content is very similar.

**Figure 3. Alcohol Content of Domestic and Imported Spirits** [17]

| Brand | Type | % Alcohol |
|---|---|---|
| Fundador | Imported Brandy | 36.00% |
| Gran Matador | Domestic Brandy | 32.5% |
| Emperador | Domestic Brandy | 36% |
| Napoleon | Domestic Brandy | 36-40% |
| Jack Daniels | Imported Whiskey | 40% |
| White Castle 69 | Domestic Whiskey | 34.5% |

---

[67] Exhibit US-22.

[68] Exhibit US-25, Standards Administrative Order (SAO) No. 259 Series of 1976 (Whiskies).

[69] Exhibit US-24, Standards Administrative Order No. 358 Series of 1978 (Brandies),

[70] Exhibit US-23, Standards Administrative Order No. 258, Series of 1976 (Vodka), 3.3.

[71] Triple Excellence Marketing Services; Revenue Regulations 12-2004.

| | | |
|---|---|---|
| Antonov | Domestic Vodka | 40% |
| Absolut | Imported Vodka | 40% |
| Finlandia | Imported Vodka | 40% |
| Ginebra San Miguel | Domestic Gin | 40% |
| Tanqueray | Imported Gin | 47.3% |
| Bombay | Imported Gin | 47% |
| El Hombre | Domestic Tequila | 40% |
| Jose Cuervo | Imported Tequila | 38% |
| Patron | Imported Tequila | 40% |
| Bacardi | Imported Rum | 40% |
| Tanduay | Domestic Rum | 40% |

52. 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.

#### b. Philippine Distilled Spirits Are "Directly Competitive or Substitutable" with Imported Distilled Spirits Based on Their Channels of Distribution

53. 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.

54. 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.[72]

[72] Exhibit US-33, Section 143, of Republic Act 7160, Local Government Code of the Philippines.

55. Ordinance No. 066 of 2007, from the City of Valenzuela (an area of Metropolitan Manila), offers a good demonstration of how distilled spirits are regulated in the Philippines. It concerns sale, dispensation, and distribution of alcoholic beverages,[73] and prescribes in detail requirements on where spirits may be sold, licensing of retail establishments, minimum age for purchase, and when spirits may be purchased. None of these requirements distinguish between imported and domestic products or among spirits based on raw material.[74] In fact, for the purposes of this ordinance, the range of covered products is even broader than distilled spirits under HS 2208. "Intoxicating Liquor or Alcoholic Beverage" is defined to include:

> Any and all alcoholic drinks containing a specific percentage of alcohol by volume or weight, which may be in the form of, but not limited to ale, basi, beer, brandy, champagne, cocktails, cream, gin, liquor, rum, sake, tuba, vermouth, wine and all other similar drinks.[75]

56. 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.[76]

57. 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. In the second photograph, both imported and local brandies and whiskies are visible on sale together. Photograph 3 provides another example, depicting tequila, whiskey, and brandy together, including domestic and imported brands, as does photograph 5, which includes vodkas and tequilas. In this photograph, an imported vodka (Smirnoff) is sold next to a domestic tequila (El Hombre). Photograph 4 shows that, as in retail establishments, imported and domestic spirits are also sold side by side in bars. The photograph depicts imported and domestic brandies sold side by side, with imported whiskeys on the shelf directly below.

---

[73] Exhibit US-33, Ordinance No. 066, Series of 2007, An Ordinance Unifying and Consolidating the Provisions of all City Ordinances Regulating the Sale, Dispensation and/or Distribution of Alcoholic Beverages, Codifying the Same into one Common and Unified Regulatory Measure, Including the Regulation of the Establishments Dispensing the Same and Providing Penalties for Violations Thereof, Republic of the Philippines, City of Valenzuela, Metropolitan Manila.

[74] Exhibit US-28, Ordinance No. 066, Section 16. There is one limited exception, concerning spirits of domestic manufacturers, which provides that the city mayor may revoke the license to sell products at the recommendation of the local health department based on its opinion that a product is adulterated or otherwise injurious to health.

[75] Exhibit US-30.

[76] Exhibit US-30.

58. 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.

#### c. Philippine Distilled Spirits Are Directly Competitive or Substitutable with Imported Distilled Spirits Based on End Uses

59. 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.

60. 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).

61. 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.[77] 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).[78]

62. 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. Exhibit US-30 shows domestic and imported brands displayed together in bars and supermarkets. In addition, on menus for mixed drinks, imported and domestic products are sold side by side.[79] Menus do not specify the raw material used to produce the product. Rather, menus divide distilled spirits into types — such as "vodka" and "brandy" — and do not distinguish domestic and imported brands. Both imported products and domestic products include a different types, with a variety of spirits available to consumers from

---

[77] Exhibit US-41, Euromonitor Consumer Preference Survey, p. 8-9.

[78] Exhibit US-41, Euromonitor Consumer Preference Survey, p. 8-9. *See also*, Excerpt from Ginebra San Migual Annual Report 2004 (Exhibit US-26); Study on "Manner of Drinking Different Alcoholic Beverage Types" (Exhibit US-32).

[79] Exhibit US-31, Sample Menus.

both domestic and imported sources. Similarly, the descriptions for mixed drinks do not indicate any difference between a cocktail made with a domestic distilled spirit compared to an imported distilled spirit.

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

**d. Philippine Products Are Directly Competitive or Substitutable with Imported Products Based on Price Substitutability**

64. 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.[80]

**e. Philippine and Other Distilled Spirits Are Classified Under the Same Heading of the Harmonized Tariff System**

65. In determining whether products are directly competitive or substitutable, previous panels have referred to the tariff classification of imported and domestic products. In the case of distilled spirits, all products — regardless of raw material — are classified under heading 2208.[81]

66. In summary, as the above demonstrates, Philippine distilled spirits are "directly competitive or substitutable" with domestic distilled spirits in terms of their physical characteristics, channels of distribution, end uses, price substitutability, and HS classification. 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, as explained in the section that follows, are subject to a significantly lower tax rate.

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

---

[80] Exhibit US-40, Euromonitor Consumer Preference Survey, p. 30.

[81] Exhibit US-13.

67. Under the second sentence of Article III:2 of the GATT 1994, in addition to demonstrating that products are directly competitive or substitutable, a complaining party must show that the domestic products and the imported products are "not similarly taxed." As discussed in section III.A, the Philippines has promulgated laws and regulations listing brands sold in the Philippines, along with net retail price and taxes on each brand. In each regulation listing brands, and in the laws prior to 2004 that include such lists, the products are divided into two groups: "local" and "imported." Products made from local raw materials and eligible for the low tax rate under paragraph (a) of section 141 of the National Internal Revenue Code are included in one list, and all other products — those subject to the higher tax rates — are included in a separate list.

68. Revenue Regulations 12-2004 is the most recent regulation listing products and the taxes applied to different brands. Annex A of Revenue Regulations 12-2004, entitled "Local Distilled Spirits Brands Produced from the Sap of Nipa, Coconut, etc. covered by Section [141(a)],"[82] lists a range of types of spirits, including gin, rum, whiskey, and brandy. The tax per bottle (as adjusted for proof liters) is low for all products in this annex. Tax rates for 750 ml bottles range as of 2009 from very low levels like 6.35 pesos (for Tanduay ESQ) to 9.24 pesos (for the same size bottle of local Gordon's gin).

69. Annex B, entitled "Imported Distilled Spirits Brands Produced from Grains, Cereals and Grains covered by Section 141(b)," likewise includes a variety of types of spirits, including whiskey, brandy, vodka, and gin. The products are divided by price into three categories, "Premium (High-Priced)"; "De-Luxe (Medium-Priced)"; and "Standard (Low-Priced)," 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:[83]

| | 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 |

70. 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

[82] The copy of this regulation submitted as Exhibit US-8 references "141(b)" in Annex A. "141(b)" is apparently a typographical error; it should read "141(a)."

[83] There was no change in tax rate for 2010.

71. 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. With respect to establishing whether dissimilar taxation of directly competitive or substitutable products is applied "so as to afford protection to domestic production," the Appellate Body stated in *Japan Alcohol* that:

> . . . we believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. We believe it is possible to examine objectively the underlying criteria used in a particular 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, architecture and revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such protective application . . . Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the circumstances in any given case.[84]

72. 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. Moreover, consistent with the reasoning of the Appellate Body in *Japan – Alcohol*,[85] 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.

**a. The Magnitude of the Dissimilar Taxation of Distilled Spirits in the Philippines Demonstrates that the Measures Operate to "Afford Protection to Domestic Production"**

73. 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.[86] The highest tax rate is *more than 40 times* the low rate .[87] The extent of discrimination under the

---

[84] *Japan – Alcohol (AB)*, page 29.
[85] *Japan – Alcohol (AB)*, page 29.

[86] 146.97/13.59 = 10.81.

[87] 587.87/13.59 = 43.26.

Philippine tax regime dwarfs the tax differentials found to afford protection to domestic production in prior disputes.[88]

74. 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.[89] Given the magnitude of discrimination in the Philippines, this alone supports the conclusion that the measures "afford protection to domestic production."

#### b. The Structure of the Philippine Measures Favors Domestic Industry

75. 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.[90]

76. In *Korea – Alcohol*, the panel stated that the Korean measure included a "very broad generic definition" for the local product, with specific exceptions that resulted in exclusion of imported products from the category of "sochu" that benefited from the lower tax rate. Similarly, the Philippine measures are structured in a way that results in the favorable tax treatment applying to Philippine products. The Philippine measures divide distilled spirits into two broad categories, based on the raw material from which the individual spirits are distilled. As explained in section IV.B.1, the Philippine and imported products are substitutable. And, as explained in section III.A.3 above, the raw materials that are designated as inputs for products eligible for the low tax rate all thrive in the Philippines. Like the Korean tax system, the Philippine system "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."[91]

---

[88] *Chile – Alcohol (Panel)*), para. 7.100 (imported products taxed about 50% more per degree of alcohol than the typically Chilean product (pisco); *Japan – Alcohol (Panel)*, para. 6.24 (Japanese product, sochu, taxed at a little less than 2/3 of the tax on vodka); *Korea – Alcohol (Panel)*, paras. 2.20, 10.100 (typically Korean products were subject to a tax rate between 35%-50%, while other products were taxed between 50-100%). Korea also applied a 30% surtax to several imported distilled alcoholic beverages.

[89] *Japan – Alcohol (AB)*, page 29-30; *see also Korea – Alcohol (Panel)*, para. 10.101 (referring to the *Japan – Alcohol* dispute), stating that "the Panel and the Appellate Body found that the very magnitude of the dissimilar taxation supported a finding that it was applied so as to afford protection. In the present case, the Korean tax law also has very large differences in levels of taxation, large enough, in our view, also to support such a finding."

[90] *Japan – Alcohol (AB)*, page 29, stating that panels should take account of the specific circumstances in each case.

[91] *Korea – Alcohol (AB)*, para. 147-150; *Korea – Alcohol (Panel)*, para. 10.101-10.102.

77. In addition, a producer could not gain the benefit of the low tax just by switching raw materials. The 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. The law states that the product will receive low tax treatment "if produced from the sap of nipa, coconut, cassava, camote, or buri palm or from the juice, syrup or sugar of the cane, *provided such materials are produced commercially in the country where they are processed into distilled spirits*" (emphasis added).[92] Unless it can base its production in a country with a climate and market conditions similar to those in the Philippines, a producer simply cannot take advantage of the low tax bracket no matter what raw materials it uses.

78. 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

79. As set out by the *Appellate Body* in *Japan – Alcohol*,[93] in order 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.[94] 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

80. 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. As the panel in *Japan – Alcohol* noted in determining that Japanese sochu was "like" imported vodka,[95] earlier panels (under the GATT 1947) "agreed that 'like product' should be interpreted on a case-by-case basis" and "[p]revious panels had used different criteria in order to establish likeness, such as, such as the product's properties, nature and quality, and its end-uses, consumers' tastes and habits, which change from

---

[92] Exhibit US-2.

[93] *Japan – Alcohol (AB)*, at p. 18-19. *See also Canada – Periodicals (AB)*, p. 20.

[94] *See also, Canada – Periodicals (AB)*, pp. 22-23.

[95] *Japan – Alcohol (Panel)*, at paras. 6.21-6.23 (concluding that the domestic distilled spirit at issue, shochu, and imported vodka were like products). The panel stated that, except for filtration, vodka, and shochu were virtually identical with regard to their physical characteristics.

country to country; and the product's classification in tariff nomenclatures."[96] Similarly, the panel in *Mexico – Taxes on Soft Drinks and Other Beverages* analyzed "likeness" using evidence on "the products' end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality," as well as tariff classification.[97]

81. 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.[98]

82. 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.[99] Therefore, for purposes of the like product analysis, the domestic product to be compared with the imported product is distilled spirits produced from local raw materials compared to those produced from other raw materials. 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.

#### a. The Philippine Standards Demonstrate that Local and Imported Spirits Are "Like Products"

83. For brandy, whiskey, and vodka, the Philippines has promulgated SAOs 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.

84. With respect to whiskey and brandy, the SAOs explicitly provide that "whiskey" and "brandy" can be made from different raw materials. The brandy SAO defines several "brandies." "Brandy" is produced from grapes and "fruit" brandy from other fruits, while "compounded brandy" can be produced from any other raw material. Compounded brandy is:

> A product obtained by mixing neutral spirits or alcohol with brandy essences, with permissible coloring and flavoring materials.[100]

---

[96] *Japan – Alcohol (Panel)*, para. 6.21.

[97] *Mexico – Soft Drinks (Panel)*, para. 8.28.

[98] *Mexico – Soft Drinks (Panel)*, para. 8.36.

[99] Exhibit US-22.

[100] Exhibit US-24, Standards Administrative Order No. 358 Series of 1978 (Brandies).

85. Similarly, the SAO for whiskey includes "compound whiskey", which is:

> The product obtained by mixing neutral spirits or alcohol distilled from any material at above 190° proof, with whiskey or whiskey essence, permissible flavoring and coloring materials, and reduced at the time of bottling to not less than 65 proof.[101]

86. The SAO for vodka does not mention raw material at all in the definition of vodka. It states:

> Vodka is the distilled liquor obtained from neutral spirit filtered through activated carbon (charcoal) so as to render the product without distinctive character, aroma, or taste.

87. Raw materials are mentioned under "General Requirements," but only to clarify that vodka may be distilled from different raw materials. It states:

> Vodka shall be the distilled alcoholic beverage made from neutral spirit which may be obtained from fermented grain, potato, or any other source from fermented grain, potato, or any other source of fermentable carbohydrates in such a manner that the distillate is free from color and odor and possess the characteristics generally attributed to vodka.[102]

88. The SAOs demonstrate that, by the Philippines' own standards, Philippine vodkas, whiskeys, and brandies are "like" imported vodkas, whiskeys, and brandies.

89. As discussed in Section III.A.3 the SAO for rum presents a somewhat different situation, in that the standard for "rum" requires that a product be produced from a sugar cane product.[103] Setting aside whether a rum made from another raw material may be "like" a rum made from sugar cane, it is notable that while some imported rums are eligible for the low tax rate, others — produced from the same input — are not. Even if the producer of an imported rum product uses sugar cane, just as a domestic rum producer, and thereby meets the standard for "rum" set forth in the SAO, its products may nonetheless be subject to a higher tax rate because the requirement that the "materials are produced commercially in the country where they are processed into distilled spirits" is not met.

#### b. Physical Characteristics and Presentation in the Marketplace Show that Philippine and Imported Distilled Spirits Are "Like Products"

---

[101] Exhibit US-25, Standards Administrative Order No. 259 Series of 1976 (Whiskies).
[102] Exhibit US-23, Standards Administrative Order No. 258 Series of 1976 (Vodka).
[103] Exhibit US-27, Standards Administrative Order No. 257 Series of 1976 (Rum).

90. 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. While all distilled spirits at issue – imported and domestic – are directly competitive or substitutable, the similarities between imported and domestic brands of the same type (*e.g.*, whiskey, vodka, etc.) are even greater with almost the same physical characteristics and similar packaging. As such, these products are "like" domestic products within the meaning of the first sentence of Article III:2 of the GATT 1994.

91. Of the different attributes discussed, physical characteristics are particularly significant for the "like product" analysis. The panel in *Japan – Alcohol* emphasized the physical characteristics of vodka and sochu in its conclusion that the two products were like, stating that "the term 'like products' suggests that for two products to fall under this category they must share, apart from commonality of end-uses, essentially the same physical characteristics."

92. With respect to physical characteristics, the evidence described in section IV.B.1 supports the conclusion that Philippine and imported distilled spirits are "essentially the same." Each type of Philippine distilled spirit is virtually identical to its imported counterpart in terms of color, packaging, and alcohol content. For example, Exhibit US-38 shows that gin and vodka are clear, whether imported or domestic, and that whiskies and brandies are golden. Advertising uses the same type of terms to describe the color and taste of imported and domestic brands.

93. Furthermore, the alcohol content for Philippine vodka, gin, brandy, whiskey, rum and tequila is essentially the same as the alcohol content of imported products of that type.

- Whiskey: Imported Jack Daniels and Jim Beam White have alcohol content of 40% compared to domestic White Castle 69 at 34.5%.

- Vodka: Domestic vodka Antonov has the same 40% alcohol content as imports like Absolut and Finlandia.

- Gin: In the gin category, Ginebra San Miguel has similar alcohol content (40%) to imported Bombay (47%) and Tanqueray (47.3%).

- Tequila: Domestic brand El Hombre has an alcohol content of 40%, similar to Jose Cuervo at 38% and Patron at 40%.

- Rum: Imported Bacardi has the same 40% alcohol content as local Tanduay.

- Brandy: The import Fundador has alcohol content of 36%, which is in the same range as domestic products like Gran Matador (32.5%), Emperador (36%), Generoso (32.5%), and Napoleon (36-40%, depending on subtype).

94. In short, for every variety of distilled spirit available, the Philippine product — made from local raw materials — is "like" the imported product.

95. Similarly, other factors (end uses, channels of distribution, substitutability) support the conclusion that the Philippine products subject to the lower tax rate are "like" imported products subject to the higher rate.

96. 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. In Exhibit US-30, the first photograph features three types of brandy, two imported (1877 and Tres Cepas) and domestic Gran Matador grouped in the same display. The second photograph depicts whiskies, with imported brands (Maker's Mark, Jack Daniel's, J&B) and domestic White Castle on the same set of shelves.

97. The labels of the individual brands also emphasize the "likeness" of Philippine and imported products.[104] 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. Gran Matator brandy has a matador, reminiscent of Spanish brandies. Local brands Emperador and Generoso feature coats of arms with crested helmets on their labels, like imported Fundador. Antonov vodka is sold in a clean, clear bottle with a modernist edge similar to brands like Absolut and Skyy.

98. Evidence from the Philippine market (the survey results prepared by Euromonitor)[105] shows that imports are no different – from a consumer perspective – than locally manufactured distilled spirits made of local raw materials. Gin made from wheat and gin made from local sugar are essentially the same: the difference is that only one is eligible for low taxes under the Philippine tax regime. Accordingly, Philippine and imported distilled spirits are "like products."

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

99. As noted in section IV.C, 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. There is no *de minimis* threshold; any amount by which taxation of imported products exceeds taxation of domestic products fulfills this requirement.[106] 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

[104] Exhibit US-34. *See also* Exhibit US-36.

[105] Exhibit US-40.

[106] *Japan – Alcohol (AB)*, p. 23.

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.

## V. CONCLUSION

100. 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."

**List of Exhibits**

| Number | Exhibit |
|---|---|
| US-1 | Republic Act No. 8424, *an Act amending the National Internal Revenue Code as amended and for other purposes* |
| US-2 | Republic Act 9334, *an Act increasing the excise tax rates imposed on alcohol and tobacco products, amending for the purpose Sections 131, 141, 142, 143, 144, 145 and 288 of the National Internal Revenue Code of 1997, as amended* |
| US-3 | Republic Act No. 8240, an Act amending Sections 138, 139, 140 and 142 of the National Internal Revenue Code, as amended |
| US-4 | Revenue Regulations No. 02-97, *Governing Excise Taxation on Distilled Spirits, Wines and Fermented Liquors* |
| US-5 | Revenue Regulations No. 17-99, *Implementing Sections 141, 142, 143 and 145(A) and (C)(1),(2) and (4) of the National Internal Revenue Code of 1997 relative to the Increase of the Excise Tax on Distilled Spirits, Wines, Fermented Liquors and Cigars and Cigarettes Packed by Machine by Twelve Per Cent (12%) on 1 January 2000* |
| US-6 | Revenue Regulations No. 9-2003, *Amending Certain Provisions of Revenue Regulations No. 1-97 and Revenue Regulations No. 2-97 Relative to the Excise Taxation of Alcohol Products, Cigars and Cigarettes for the Purpose of Prescribing the Rules and Procedures To Be Observed in the Establishment of the Current Net Retail Price of New Brands and Variants of New Brands of Alcohol and Tobacco Products* |
| US-7 | *Revenue Regulations No. 23-2003, Implementing the Revised Tax Classification of New Brands of Alcohol Products and Variants Thereof Based on the Current Net Retail Prices Thereof as Determined in the Survey Conducted Pursuant to Revenue Regulations No. 9-2003* |
| US-8 | Revenue Regulations No. 12-2004, *Providing for the Revised Tax Rates on Alcohol and Tobacco Products introduced on or before December 31, 1996, and for those Alcohol and Tobacco Products Covered by Revenue Regulations No. 22-2003 and 23-2003, Implementing Act No. 9334.* |
| US-9 | *Revenue Regulations No. 3-2006, Prescribing the Implementing Guidelines on the Revised Tax Rates on Alcohol and Tobacco Products Pursuant to the Provisions of Republic Act No. 9334, and Clarifying Certain Provisions of Existing Revenue Regulations Relative Thereto* |

| | |
|---|---|
| US-10 | Excerpts from "Selected Statistics on Agriculture 2008" |
| US-11 | Letter of the Filipino Department of Trade and Industry to the Chairman of the Committee on Ways and Means recommending adoption of House Bill No. 6079 |
| US-12 | Encyclopedia Britannica Article on Distilled Spirits (excerpt) |
| US-13 | Harmonized Tariff System, Heading 2208 |
| US-14 | Department of Finance Comments on Excise Tax |
| US-15 | Excerpts from the 2010 Report on the Philippines published by the International Wine and Spirit Record (ISWR) |
| US-16 | Coconut Information |
| US-17 | Nipa Palm Information |
| US-18 | Cassava Information |
| US-19 | Buri Palm Information |
| US-20 | Camote Information |
| US-21 | Sugar Cane Information |
| US-22 | Ginebra San Miguel Advertising |
| US-23 | Standards Administrative Order No. 258 Series of 1976 (Vodka) |
| US-24 | Standards Administrative Order No. 358 Series of 1978 (Brandies) |
| US-25 | Standards Administrative Order No. 259 Series of 1976 (Whiskies) |
| US-26 | Excerpts from Ginebra San Miguel 2004 Annual Report |
| US-27 | Standards Administrative Order No 257 Series of 1976 (Rum) |
| US-28 | Local Tax Information – Section 143, of Republic Act 7160 |
| US-29 | Valenzuela Local Ordinance |
| US-30 | In Store Marketing and Displays |
| US-31 | Philippines Menus |
| US-32 | Study on "Manner of Drinking Different Alcoholic Beverage Types" by IDP/Taylor Nelson |

| | |
|---|---|
| US-33 | Checklist of Requirements for Food Establishments |
| US-34 | Product Labels |
| US-35 | Philippines Department of Trade and Industry Development Plan (excerpt) |
| US-36 | Comparison of “VAT 69 Scotch Whisky” and “White Castle Calibre 69 Whisky” |
| US-37 | Table Reporting Value and Volume of Exports of the Philippines of distilled spirits for years 2000-2008 |
| US-38 | Comparison of different types of spirits with regard to appearance, colour, taste and smell |
| US-39 | Statistical Data on US Exports to Philippines |
| US-40 | Spirits – Philippines, Euromonitor International: Country Sector Briefing |
| US-41 | Consumer Perceptions Regarding Substitutability in the Philippines Distilled Spirits Market (Euromonitor) |