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# THE NOTION OF TAXES ON PRODUCTS-LESSONS FROM THE *SOFT DRINKS* DISPUTE

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Sumario: I. *Introduction*. II. *The WTO rules*. III. *Taxes on products*. IV. *Final comments*.

## I. Introduction

The WTO dispute over soft drinks between the United States and Mexico was one element of long-running controversy between the two countries regarding trade in sugar and other sweeteners. The main product as far as the United States was concerned was high fructose corn syrup (HFCS), which is produced from corn (known in many countries as 'maize'), but is a sugar that, when used as a sweetener for soft drinks, is virtually indistinguishable from conventional sugars. Mexico also had substantial HFCS production, but its main and traditional source of sweetener was cane sugar, a product of considerable political sensitivity because of the large numbers of people engaged in its production.

The *Soft Drinks* case was not the first occasion on which this controversy had come to the attention of the WTO. In 1998 Mexico imposed anti-dumping duties against HFCS from the United States at rates of up to 175 US dollars per ton. The United States instituted dispute proceedings in the WTO and in 2000 a panel found that the Mexican investigation had failed to respect several of the requirements of the Anti-Dumping Agreement notably as regards the finding of injury and a number of procedural issues.[1] Following this ruling Mexico issued a revised final resolution which maintained the finding of injury and the United States returned to the WTO arguing that this failed to implement the recommendations and rulings of the

[1] Panel report, Mexico-Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States, WT/DS132/R, 2000, DSR 2000: III, 1345.



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panel. This complaint was also upheld by the panel,[2] and Mexico's appeal was rejected by the Appellate Body.[3] These rulings were made in parallel with proceedings under Chapter XIX of the North American Free Trade Agreement (NAFTA) in which a binational panel, applying Mexican law, reached a similar conclusion and gave similar rulings regarding the injury finding of the Mexican authorities.[4]

It was following these actions that, in 2002, Mexico introduced the legislation that gave rise to the *Soft Drinks* litigation. The *Ley del Impuesto Especial sobre Producción y Servicios* (Law on the Special Tax on Production and Services, LIEPS), created a peculiarly complicated system of taxes and regulations.[5] It comprised two main elements, a complex system of taxes on transactions involving sweeteners, and a set of measures imposing book-keeping requirements on those dealing in soft drinks containing those sweeteners.

The taxes were of two types, called here the 'soft drink tax' and the 'distribution tax'. They were applied, at 20% *ad valorem*, at different points in time.

First, at the time of importation, the soft drink tax was applied to all imported soft drinks,[6] regardless of the sweetener used.[7]

Second, once the imported soft drinks had cleared customs and entered into the Mexican market, the soft drink tax was applied to soft drinks sweetened with non-cane sugar sweeteners upon each internal transfer (with the exception of public sales).

[2] Panel report, *Mexico*-Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States-Recourse to Article 21.5 of the DSU by the United States, WT/DS132/RW, 2001, DSR 2001:XIII, 6717.

[3] Appellate Body report, Mexico-Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States-Recourse to Article 21.5 of the DSU by the United States, WT/DS132/AB/RW, 2001, DSR 2001:XIII, 6717.

[4] Review of the final determination of the antidumping investigation on imports of high fructose corn syrup, originating from the United States of America, case: MEX-USA-98-1904-01, 15 April 2001; Review of the final determination of the antidumping investigation on imports of high fructose corn syrup, originating from the United States of America, case: MEX-USA-98-1904-01, 3 Aug. 2001.

[5] The legislation was amended a number of times, and had several implementing regulations. For convenience these measures are referred to here collectively as the LIEPS.

[6] The measures were also applied to the syrups from which soft drinks are made, but, for the sake of simplicity that aspect of the legislation is overlooked in this account.

[7] The legislation was later amended to exempt from the tax imports of soft drinks made from cane sugar. However, this amendment came too late to be considered by the panel.

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Third, the distribution tax was applied to the provision of certain services within Mexico in regard to soft drinks sweetened with non-cane sugar sweeteners. The level of the tax on distribution was 20 percent of value of the transaction.

## II. The WTO rules

The *Soft Drinks* case in the WTO fell into two main parts.[8] In the first part the complainant United States sought to establish that the Mexican measures infringed important guarantees of national treatment that are contained in Article III of GATT 1994. The second part of the case concerned Mexico's efforts to defend its actions on the basis of the general exception provided in Article XX(d) of GATT 1994 as measures necessary to secure compliance with a law or regulation that is itself GATT-consistent.[9]

In simple terms, the national treatment rule in Article III of GATT 1994 requires WTO Members not to treat imported products worse than domestic products. The rule is spelt out in detail in the paragraphs 1, 2 and 4 of Article III in particular, and, as always with WTO rules, the precise terms of these provisions have received close attention from dispute bodies.

Article III distinguishes between discriminatory taxation and discriminatory measures in general. The former is dealt with in paragraph 2 and the latter in paragraph 4.

Furthermore, there are two rules about taxation in paragraph 2, contained the first and second sentences respectively. The first sentence is straightforward, at least in form. It states 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.

The sense of the rule in the second sentence is less obvious because it uses terms for which meanings must be sought in the Notes attached to Article III. Taking these into account the prohibition created by the second sentence exists when three conditions are satisfied. First, the products whose tax treatment is being compared must be 'directly competitive or substitut-

[8] Mexico also sought to persuade the Panel not to exercise jurisdiction in the case because of the existence of the arrangements for trade in sweeteners that had been included in the North American Free Trade Agreement.

[9] In this paper the term GATT should be taken to refer to GATT 1994 unless otherwise indicated.

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able'. Secondly, the situation must be one where the products concerned are not 'similarly taxed'. Thirdly, the dissimilar taxation of these products must be being applied so as to 'afford protection to domestic production'.

Turning to the rule in paragraph 4 of Article III, regarding discriminatory measures in general, one can again identify three elements in the prohibition. First, the products whose treatment is being compared must be 'like'. Secondly, the measure in question must be a law, regulation or requirement affecting the internal sale, offer for sale, purchase, transportation, distribution or use of such products. Thirdly, the rule requires that the treatment accorded to imported products be 'no less favourable' than that accorded to the like products of national origin.

In the *Soft Drinks* case the United States claimed that the LIEPS infringed each of these provisions of Article III. However, the peculiar nature of the LIEPS forced the United States, and in turn the Panel, to apply those provisions in previously unthought-of ways.

The Panel's consideration of these matters suffered from the unwillingness of Mexico to argue the matter in the perspective of Article III. Mexico explained its attitude as follows:

In light of the unique circumstances of this dispute and the arguments discussed above, Mexico will not respond to the United States' claims that the measures at issue are inconsistent with GATT 1994 Article III.[10]

On another occasion, in answer to a question from the Panel, Mexico said that

The only conclusion that the Panel should draw from Mexico's decision not to respond on the United States claims under GATT Article III is that (assuming that the Panel takes jurisdiction) Mexico has no objection to the Panel proceeding with consideration of its defence on the basis of the presumption that the measures at issue are inconsistent with Article III of the GATT 1994. This does not mean that Mexico agrees that its measures are in effect inconsistent. [11]

Although Mexico did not adhere rigidly to this strategy of non-participation,[12] its overall effect was that the Panel, facing a dispute which,

[10] Panel report, *Mexico-Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R, DSR 2006: I, 43 (Panel report *Mexico-Taxes on Soft Drinks)*, para. 4.115.

[11] Panel report *Mexico-Taxes on Soft Drinks*, Annex C-1, Responses by Mexico to Questions posed by the Panel after the First Substantive Meeting, page C-7, Answer to Question 9.

[12] See, e.g, paragraph 8.13 of the Panel report which records Mexico's views on the respective application to taxes and regulations of paragraphs 2 and 4 of Article III.

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because of the unusual nature of the LIEPS, was inevitably going to draw it into uncharted legal waters, was deprived of some of the help it would normally have expected. This paper concentrates on the light which the Panel's voyage into these waters cast on one particular aspect of GATT law — the notion of a tax on a product. Since Mexico did not take the findings regarding Article III to the Appellate Body we have only the Panel's views on these matters.

## III. Taxes on products

### 1. *Soft Drink Panel's conclusions*

A notable feature of the LIEPS taxes was that at all points at which the taxes were charged the sweeteners were integral parts of the soft drinks; they were never collected prior to the inclusion of the sweeteners in the drinks. The trigger for the imposition of the taxes was the presence of certain sweeteners, but the rate at which the taxes were imposed was based on the value of the soft drinks rather than on that of the sweeteners that they incorporated. Faced with these complex arrangements the Panel found that, for the purposes of Article III, the taxes had been imposed both on the sweeteners and on the soft drinks.

Specifically, as regards taxes 'imposed on sweeteners' the Panel made three findings.

First, it found that imported *beet sugar* was subject to internal taxes in excess of those applied to like domestic sweeteners, in a manner inconsistent with GATT Article III:2, first sentence.

Second, it concluded that imported *HFCS* was being taxed dissimilarly compared with the directly competitive or substitutable products, so as to afford protection to the Mexican domestic production of cane sugar, in a manner inconsistent with Article III:2, second sentence.

Finally, it found that imported *beet sugar and HFCS* were accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4.

As regards taxes 'imposed on soft drinks' the Panel's conclusions were apparently straightforward. It found that imported soft drinks sweetened with non-cane sugar sweeteners (including HFCS and beet sugar) were subject to internal taxes in excess of those applied to like domestic products, in a manner inconsistent with Article III:2, first sentence

The notion that taxes collected on the final product, the soft drink, could be at the same time taxes on that product and on the inputs to that product

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gives rise to interesting questions. The Panel's explanation for its conclusion that taxes had been imposed on the sweeteners was fairly short. The Panel found it 'significant that: (a) it is the presence of non-cane sugar sweeteners that provides the trigger for the imposition of the tax; and, (b) the burden of the tax can be expected to fall, at least in part, on the products containing the sweetener, and thereby to fall on the sweetener.'[13]

## 2. *The notion of taxes on products*

The *Soft Drink* Panel's conclusions on the effect of the LIEPS taxes call for a consideration of what is meant by a tax on products.

The notion is touched on in many provisions of the General Agreement, and it is expressed in a variety of terms. Article III:2 and its Note speak of a 'taxed product', of products being 'subject, indirectly or directly to internal taxes or other internal charges', and of a Member that might 'apply' such measures 'to … products'.[14] Elsewhere the GATT speaks of a charge 'in respect of' a product (Article II:2(a)), of a duty that a Member may 'levy on any … product' (Article VI:2) as well as of duties or taxes 'borne by the … product' (Article VI:4, Article XVI, Note).[15]

Although the use of different terms can often be taken to indicate that the drafter intended different concepts, the sheer degree of variety of terms used for this concept tends to refute such a conclusion since there could hardly be a corresponding degree of conceptual variety in the way that financial charges are linked to products. Rather, one is inclined to think that the drafters did not intend to establish a set of precise meanings but expected the concept of taxes imposed on products to be elucidated as appropriate circumstances arose. Be that as it may, little such elucidation has occurred, and the notion of a tax imposed on a product is relatively undeveloped in GATT law.

Certain matters are clear. Products do not have wallets or bank accounts. Taxes are paid not by products but by people and companies. Broadly speaking, it would seem that the notion of a tax imposed on a product comes into play when liability for the tax is linked to a person's dealing with a pro-

[13] Panel report *Mexico-Taxes on Soft Drinks*, para. 8.44.

[14] Article III: 1 is concerned with taxes as well as other measures that are 'applied' to products.

[15] As regards Articles VI and XVI a working party observed that they had not led to any differences in interpretation, Report of working party on border tax adjustments, L/3464, BISD 18S/97, (1972), para. 10.

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duct. For example, excise duties are often charged on the manufacturer of a product at the point of manufacture or sale. They may be *ad valorem* or specific (e.g. by unit or volume, as is common for duties on the manufacture of alcohol or cigarettes). In *Argentina – Hides and Leather* the Panel said that a tax applied to particular goods because it was based on their value.[16]

The situation is complicated by the fact that the person whom the law requires to make payment of a tax might not be the person who bears the burden of that tax. Arrangements of this kind are now an everyday experience because many countries use value added taxes as their principal form of indirect taxation. Payments of these taxes are made by all of those involved in the production and sale of products in respect of the value that they have added, but each such payment is recompensed by the person to whom the product is sold. The only exception is the consumer, the final purchaser in the chain, who pays (via the seller) tax on the whole value of the product, but gets no recompense and consequently is the one who bears the burden of the tax. The movement of the burden of indirect taxes to the consumer is sometimes known as the destination principle.

As long as there is no discrimination in the rates applicable to competing products the burden of taxes such as value added tax can, by their very nature, be expected to pass through to ultimate consumers since no competitive disadvantage will arise by allowing this to happen. Conversely, a discriminatory tax, for example one that is imposed only (or more heavily) on products containing foreign inputs, will tend to be absorbed by producers because the sellers will want to avoid a price disadvantage compared to untaxed products.

Thus, the *Soft Drinks* Panel observed that 'Taxes *directly* imposed on finished products can *indirectly* affect the conditions of competition between imported and like domestic inputs'.[17] But one can be rather more explicit. The burden of the tax will tend to follow the criterion on which the discrimination is based. For example, if the discriminatory tax is associated with the use of an input of a particular kind, such as foreign sweetener, the supplier of that input will be under pressure to reduce its price in an amount corresponding to the level of the discriminatory tax. Failure to make such a reduction would encourage the user of the sweetener to buy from a source that did not lead to the tax being incurred.

16 Panel Report, *Argentina-Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R, DSR 2001: V, 1779 (Panel report *Argentina-Hides and Leather*), para. 11.158. The issue was whether the tax was on goods or on income.

17 Panel report *Mexico-Taxes on Soft Drinks*, para. 8.44.

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Not every tax imposed in relation to a product finds its way forward to the ultimate purchaser or backward to the supplier. Under the second LIEPS tax examined by the *Soft Drinks* Panel, the distribution tax, anyone providing a service (transportation, for example) in the provision of soft drinks had to pay a tax when those drinks were sweetened with something other than cane sugar. Such a person would no doubt like to recoup that cost by increasing the usual level of his fee by the amount of the tax. However, he is not necessarily in as strong a position as a buyer of soft drinks, and may not be able to threaten to shift his services in directions that do not lead him having to pay the tax. The market for services in connection with sales and transport of soft drinks may be less well developed than that for the soft drinks themselves. At any rate, in this situation the assumption, which may have been made by the Panel, that all of the burden of the tax would pass to the person presently owning the product, and from him (following the logic described above) back to the supplier of the sweetener, is at least questionable. On the other hand, it is also unlikely that *none* of the burden could be transferred in this way, and in so far as the transfer took place there would be discrimination against the sweetener whose use led to the tax being imposed.

The LIEPS taxes examined in the *Soft Drinks* case had one additional level of complexity. Whereas the *trigger* for the imposition of tax was the presence of a foreign-origin sweetener, the *amount* of the tax was proportional not to the value of the sweetener but to that of the whole soft drink. However, while this factor adds complexity it does not seem to change the basic analysis. Assuming that the level of sweetener in soft drinks is fairly constant, a calculation could be made of the effective rate of tax vis-à-vis the units of sweetener that are used, and consequently a reduction could be determined in the price paid for the sweetener that would off-set the tax that would be payable by the soft-drink maker.

The basic argument made here that the burden of a discriminatory tax related to the presence of particular inputs is borne by the suppliers of those inputs is no doubt a simplification of economic reality. Thus, in practice the supplier of foreign sweetener might find that the price reduction demanded of him made sales unprofitable and decline to sell at that level. The absence of competition might encourage suppliers of non-foreign sweeteners to raise their prices, thereby altering the competitive situation and making a deal involving the foreign sweetener once more attractive.

Nevertheless, in the absence of other evidence, the *Soft Drinks* Panel's assumption that the burden of the tax falls where the trigger is located seems to be a reasonable one.

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This conclusion is not the end of the story. In addition to the direct burden created by the tax, which will usually be equal (or at least closely correlated) to the amount of the tax, there may well be indirect effects that cause distortions of trade. An example is provided by the distribution tax contained in the LIEPS. While the burden of the tax may not have fallen on the sweeteners the tax would nevertheless constitute a disincentive to trade in the imported product, since persons providing services in respect of those products would gain less than they would in acting with respect to domestic goods.

These considerations provide a convenient base on which to examine the ways in which GATT looks at these concepts.

### 3. *GATT 1994 recognition of location of tax burden*

#### A. *Remission of taxes on export – subsidy rules*

Nearly all WTO disputes about discriminatory taxes are pursued under GATT Article III. Most of them are straightforward in character and do not require any analysis of the location of the ultimate burden of the tax of the type suggested above. To have the impugned measure ruled illegal is usually all that the complainant wishes. As a consequence the issue has received little attention from dispute bodies. However, the need to identify the proper location of the burden of taxes has arisen in the context of some other provisions in the General Agreement. These are examined in the following paragraphs.

The most significant of these provisions are the GATT rules on subsidies. These rules reflect the important principle that the burden of (non-discriminatory) taxes on products is borne by purchasers. Thus, as explained above, value added taxes are collected at all stages of the production of a product, but it is the eventual consumer that bears their burden. As a consequence, taxes that have been collected in the production of a particular product are remitted if it is exported (before passing to the consumer). The rationale is that consumer taxes (if any) will be charged in the country where the consumer is located. If that country has a value added tax system it will collect tax at the import value of the goods, and on any further transactions, so that, once again, the burden of the tax is passed on to the consumer.

The principle is expressed in the Note to GATT 1994 Article XVI

The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of

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such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

Item (g) of the Illustrative List of Export Subsidies that is annexed to the Agreement on Subsidies and Countervailing Measures explicitly addresses the topic of indirect taxes:

g) The exemption or remission in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

In other words, the remission of indirect taxes, such as value added taxes, is not a subsidy unless it exceeds the level of the tax that has been collected.[18]

This principle applies both to the prohibition on export subsidies that is found in Article 3 of the Agreement, and to the rules governing the use of countervailing measures against subsidized imports that are found in Part V of the Agreement and in GATT Article VI. It should be said, however, that the GATT rules on determining the movement of the benefit of subsidies (which can for many purposes be regarded as negative discriminatory taxes) do not always show great sophistication. To be specific, in the application of countervailing measures it is usual practice simply to assume that the benefit of an export subsidy moves with the product and is entirely absorbed in lowering the price of that product.[19]

B. *Article II:2(a)*

Turning to the GATT rules on internal taxes, although the principal rules are all contained in Article III the provision that comes closest to addressing the situation which arose in the *Soft Drinks* dispute is found in Article II, which concerns duties and other charges imposed at the border. Paragraph 2(a) of Article II states that a tax may be imposed on an imported product

[18] Since value added tax systems include a mechanism for making transfers to exporters, Governments wishing to subsidize exports, or to discourage them, commonly make use of it for these purposes by overpaying or underpaying the sums that are due.

[19] However, if there is an arm's-length sale and the product has undergone a transformation, such as incorporation into another product, there should be an investigation of whether the benefit has passed through: Appellate Body Report, *United States — Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, 2004, adopted 17 February 2004 . DSR 2004:II, 587, para. 140; Panel report *Mexico-Definitive Countervailing Measures on Olive Oil from the European Communities*, WT/DS341/R, para. 7.144.

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that corresponds to an internal tax that is imposed "in respect of an article from which the imported product has been manufactured or produced in whole or in part". An illustration given during the negotiation of the General Agreement was that of imported perfume being taxed on the basis of its alcohol content rather than its whole value, in line with a domestic tax on alcohol.[20]

Applying this principle, the panel in the *Superfund* case found that a United States tax on certain imported substances complied with Article III:2 in so far as it did not in principle exceed the amount of the tax which would have been imposed under the legislation on the chemicals used in the manufacture or production of the imported substance if these chemicals had been sold in the United States for use in the manufacture or production of that substance.[21]

This case confirms that, in accordance with Article II:2(a), when a tax has been collected from a person dealing with the input article (for example, on its sale) the burden of the tax would pass with the article into the product which is manufactured or produced from it. The burden would thereafter pass to the purchaser of that product. In the same way, a tax charged on the imported product in an amount equivalent to the tax charged domestically on the input product would also be assumed to pass through to the ultimate purchaser.

As a consequence, in the *Soft Drinks* dispute the LIEPS tax would have been found to be GATT-compliant if a corresponding tax, at an appropriate level, had been placed on internal sweeteners prior to their inclusion in soft drinks.

C. *Article III*

The location of the burden of indirect taxation has occasionally been addressed by dispute bodies applying GATT Article III. In one instance where a panel was examining imports that were subject to an additional tax it observed that no *a priori* statements are possible as to who bears the financial burden. "Depending on the market situation, the taxable person may have to bear that burden and suffer lower profit margins. Alternatively, where the

20 Doc. EPCT/TAC/PV/26, p. 21. It was emphasised that the tax should not be based on the total value of the imported perfume.

21 Panel Report, *United States-Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136 (1988), para. 5.2.8.

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market situation allows a taxable person to sell a product at a higher price, the burden may be borne by the purchaser of the product."[22]

No doubt the particular market situation is always an important factor in locating where a tax burden falls. Nevertheless, subject to that qualification, a presumption that the burden of a discriminatory tax falls on producers rather than purchasers would not be unreasonable. As the above analysis makes clear, which of the various producers that are successively involved in a bringing a product to market will bear the cost will normally depend on the criterion used for imposing the tax. The need to meet the competition coming from those (domestic) producers that are not subject to the tax will tend to ensure that the sale price will not be affected.[23]

## 2. *Article III*

This concluding section will attempt to fit the notions of taxes and the burdens that they create into the framework of Article III. The scope of the relevant provisions, paragraphs 2 and 4, has already been described.

### A. *Article III:2 – first sentence*

The GATT provision that most explicitly deals with taxation of products is Article III:2. The first sentence of this provision is based on the notion of taxes on imports that are "in excess" of those applied to like domestic products, and for this purpose any level of excess is sufficient to qualify.[24]

Implicit in this interpretation is the assumption that the level of taxation can be calculated, even if such a calculation will not normally be necessary in order to determine whether one tax is "in excess" of another. In the measurement of subsidies the predominant rule is that the benchmark is provided by the benefit that is conferred rather than the cost to the government.[25] By analogy with the subsidy rules a tax should be measured by its burden

22 Panel report *Argentina-Hides and Leather*, para. 11.188, footnote 474.

23 However, it should be said that if the tax is imposed that is linked to sales volume or turnover (as in an *ad valorem* tax) the seller will tend to maximize his profits by increasing prices (even if that reduces sales volume). The issue will depend on the price elasticity of the product in the particular market.

24 Appellate Body report *Japan-Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 1996, p. 22. DSR 1996: I, 97 (Appellate Body report *Japan-Alcoholic Beverages II*).

25 E.g., Agreement on Subsidies and Countervailing Measures, Art. 14.

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on the taxpayer rather than by what is received by the government. In any event, there is unlikely to be much difference between the two amounts.

The burden of tax can be borne only once. As already explained, the fact that under some systems, such as value added tax, the burden passes through more than one person's hands does not mean that it falls on all such persons. This is not to say that other prejudicial effects of the system are irrelevant (they are discussed below), but those effects are distinguishable from the actual burden of the tax. The analysis of taxes on inputs, such as the LIEPS tax, carried out above suggests that a tax based on the presence of a particular input will usually be borne by the provider of that input if there is an alternative source. At any rate, that burden cannot be borne both by the input provider and by the producer of the finished soft drink (unless it is shown to be split between them). Consequently, a finding of infringement of the rule in the first sentence of Article III:2 is limited in the same way.

### B. *Article III:2 – second sentence*

The second sentence of Article III:2 is also concerned with taxation, but it establishes criteria that are at the same time both broader and less demanding than those of the first sentence. The range of products whose treatment can be compared is broader since it includes all those that are "directly competitive or substitutable". On the other hand, whereas under the first sentence any degree, no matter how small, of excess taxation will be illegal, under this provision the dissimilar taxes must be such as to "afford protection to domestic production".

This provision concerns internal taxes that "apply" to imported or domestic products. In that respect it would seem that it is limited to those tax arrangements where the burden of the tax is associated with the product, and cannot be used in respective of collateral harm.

The rule in Article II:2(a) (above) concerning taxation of imported products that is equivalent to an internal tax imposed in respect of an article from which the imported product has been made applies to "like" products. No mention is made of products that are "directly competitive or substitutable", but the question whether such products are governed by the same principle is an irrelevant one. Because of Article III:2, a Member would be effectively prevented from according different tax treatment to two articles that were "directly competitive or substitutable". Consequently, if the "directly competitive or substitutable" article was being taxed in a particular way that tax would also have to be applied to the domestic article that was

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"like" the article incorporated in the import product which was the basis for the tax being imposed on that import.

### C. *Article III:4 – other effects of taxes*

The obligation in paragraph 4 of Article III might be regarded as existing separately, albeit in parallel, to paragraph 2, so that a measure would fall within the scope of either one or the other. However, although paragraph 2 is directed at tax measures, paragraph 4 does not explicitly exclude them. Taken in isolation, the words 'laws, regulations and requirements' do not exclude tax laws, and one could hardly deny that a law which imposes a tax when goods are sold falls within the notion of 'laws … affecting [the] internal sale' of such products. Dispute bodies have generally assumed that where two provisions govern a situation they should first address the one that is more specific, and in these cases they rarely need to proceed to consider the other provision.[26] However, that principle is one of judicial practicality, and there is no interpretative principle of WTO law that says that a specific rule necessarily excludes the application of a general rule.

Once it is accepted that paragraph 4 may be invoked even where the measure in question is a tax, the main point of interest is its application with respect to the indirect prejudicial effects arising from discriminatory taxes on products (since any discrimination associated with the direct burden can be dealt with using paragraph 2, first sentence). The nature of such effects has already been described

As already explained, for there to be an infringement of paragraph 4 three conditions must be satisfied. Firstly, the products must be 'like', a term that in this context has been accorded a broad meaning by the Appellate Body.[27] The second condition, that there must be a law, regulation or requirement affecting the sale, etc., of such products, will invariably be satisfied by a tax measure. The final condition is 'less favourable treatment' for products of the territory of another WTO Member. Such treatment could arise because of imposition of a tax on that product (as discussed above, that would usually mean that a tax was being applied to a person

[26] Appellate Body report, *EC-Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, 1998, adopted 13 February 1998. DSR 1998:I, 135, para. 204.

[27] Appellate Body report, *Japan-Alcoholic Beverages II*, p. 21. Cane sugar, beet sugar and HFCS were found to be like products for the purpose of this provision in Panel report *Mexico-Taxes on Soft Drinks*, paras. 8.105, 8.106.

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because he was dealing with the product, typically by buying or selling it). However, the circumstances of the *Soft Drinks* case illustrate how less favourable treatment can occur as a consequence of the imposition of a tax, but in ways other than through the burden of paying that tax. As the panel in one case observed: "Regardless of who bears the burden [of the tax], it has an immediate impact on the competitive opportunities of the products affected."[28] For example, the producer of soft drinks in Mexico who wished to use HFCS, although he would not bear the burden of the soft drink tax (which, as explained above, would be borne by the producer or seller of the HFCS) would have the inconvenience of transferring to the government the amount of the tax, and of seeking to recoup this amount in the form of a correspondingly lower price paid to the seller of the HFCS. Negotiating such an arrangement would involve real or apprehended problems that would not exist in regard to purchases of (Mexican) cane sugar.

Drawing a distinction between situations where the burden of the tax falls on the product and those where the disadvantage that arises is not part of that burden is not always a straightforward matter. The difficulties were illustrated in *Argentina – Hides and Leather* where the tax rates charged on imported and domestic products were the same but where the tax on imported products had to be paid earlier. The cost of the tax on imported products was therefore higher by the amount of interest lost by the taxpayer (or paid by him) in respect of the period between his tax payment in respect of the imported goods and the tax payment in respect of the domestic goods. The panel was correct in identifying this cost as a part of the tax payment.[29] What it could also usefully have made explicit was that the burden to the tax-payer corresponded to the benefit to the government that arose from the earlier payment of the tax.

Nevertheless, whatever difficulties of classification arise from time to time, one may reasonably conclude that a particular indirect tax may infringe Article III:2 in respect of one product (such as an input product) at the same time as infringing Article III:4 in respect of another (such as the finished product).

## IV. Final comments

The aim of this paper has been to examine the notion of a tax on a product under GATT rules. The issue is not one that generally attracts much

28 Panel report *Argentina-Hides and Leather*, para. 11.188, footnote 474.

29 Panel report *Argentina-Hides and Leather*, para. 11.188.

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attention, and it has taken fairly uncommon circumstances, such as the complicated arrangements of Mexico's LIEPS taxes, for it to be examined closely by a WTO panel.

One reason for the small number of disputes is probably the relative scarcity of taxes relating to inputs, of the kind as envisaged in Article II:2(a). This situation may change as pressure to protect the environment encourages attempts to use taxes on imports as a way of penalizing industrial processes or products that are prejudicial to the environment. Concerns of an environmental character were the explanation for the United States' measures examined in the *Superfund* case (above). As is well known, GATT rules limit what may be done in this respect, at least without resorting to justification under the General Exceptions provisions of Article XX. The limit arises because Article III is focussed on discrimination between products, and only physical characteristics are taken into account in deciding whether the products are sufficiently comparable for the rule to be applied.[30] In other words, different processing will not render the resulting products non-comparable unless it results in them having significant physical differences. Nevertheless, as the *Superfund* case demonstrates, in some circumstances such environmental objectives can be achieved within the limits set by Article III.

This paper has shown that in applying the notion of taxes on products the WTO still has some way to go in elucidating the concepts that lie behind its rules. An increasing use of environmental taxes on imports would encourage consideration of the issues, and that consideration will in any case come about sooner or later through one-off cases like *Soft Drinks*. In any event, that case has shown once again that 60 years after they were drafted some of the basic provisions of the GATT are still giving rise to important problems of interpretation.

30 The notion that the purpose of a tax could be taken into account in considering likeness of products was rejected by GATT: Panel report *United States-Measures Affecting Alcoholic and Malt Beverages*, BISD 39S/206 (1993), paras. 5.25 et seq. and 5.71 et seq, Panel report *United States-Taxes on Automobiles*, DS31/R, 1994, (unadopted) paras. 5.8 et seq. However, there has recently been a suggestion that a non-discriminatory purpose may negate *de facto* discrimination: Appellate Body report *Dominican Republic-Import and Sale of Cigarettes*, para. 96.

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