KIEP Working Paper 08-01

National Treatment on Internal Taxation: Revisiting GATT Article III:2

Sherzod Shadikhodjaev

KIEP Korea Institute for International Economic Policy

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KIEP Working Paper 08-01
Published May, 2008 in Korea by KIEP

Executive Summary

This paper examines GATT Article III:2 on national treatment on internal taxation. The fact that as of 1 January 2008, national treatment violations in the goods sector have been challenged in nearly 29% of the WTO complaints points to the great importance of the national treatment principle in the multilateral trading system on the one hand, and temptation of WTO Members to protect domestic production through internal taxes and regulations on the other. Cases involving *de facto* discrimination against foreign goods will increase in number given the sophistication of governments' protectionist policy.

The examination of a claim on a discriminatory internal tax requires a multi-tiered test of several issues including likeness, discriminatory threshold and protective application of the tax measure. This test applies differently depending on what sentence of Article III:2 is at issue. The controversial "aim-and-effect" approach is not relevant to the determination of likeness, but can still be utilized, to some extent, in examining the protective application of the measure concerned. Some discrepancy in the Appellate Body's approach to the subjective intent issue seems to leave some room for referring to government statements in future analyses of protective application.

Korea and its FTA partners have affirmed their adherence to GATT Article III. When the FTA parties enter into a dispute over national treatment, a problem as to the jurisdiction of WTO panels over FTA's GATT-plus provisions on national treatment may arise. Irrespective of what dispute settlement forum is resorted to, GATT-plus provisions, as a *lex posterior*, would prevail over the corresponding

provisions of Article III. Another problem is that FTA panels are not legally constrained by WTO jurisprudence. In this regard, it is suggested that FTA panels, wherever possible, follow the WTO interpretations of Article III to secure consistent and predictable application of the national treatment rule.

Keywords: Non-discrimination, National Treatment, Internal Taxation, Like Product, Directly Competitive or Substitutable Product

국문요약

본 연구는 GATT 제3조 2항에 규정되어 있는 내국세의 내국민대우에 대한 것이다. WTO 출범 이후 2008년 1월 1일 현재까지 제소된 약 29%의 분쟁은 내국민대우와 관련되어 있다. 이는 한편으로 내국민대우 원칙이 다자무역제도에서 차지하는 중요성을 나타내며 또 한편으로는 많은 국가들이 내국세와 국내법규를 통해 국내생산을 보호하고자 하는 동향을 보여주고 있다. 내국민대우 위반은 주로 두 가지 형태, 즉 법률상의 차별(de jure discrimination)과 사실상의 차별(de facto discrimination)로 나타나는데, 향후 외국산 상품에 대한 사실상의 차별과 관련된 사례가 많아질 것으로 예상된다.

GATT 제3조 2항과 관련된 차별적 내국세 부과여부 사안을 다룰 때 동종상품, 차별적 대우 및 보호주의적 적용(protective application)의 여부를 확인해야 한다. 이러한 3가지 요소의 검토는 GATT 제3조 2항의 어떤 내용(first sentence or second sentence)에 위반되느냐에 따라 다르게 이루어진다. 비록 소위 '목적・효과분석법('aim-and-effect' approach)'이 동종상품의 범위를 결정하는 데 적용될 수는 없으나, 내국세의 보호주의적 적용 여부 확인시에는 이용될 수 있다.

GATT 제3조는 모든 한국 FTA에 포함되어 있으며 그 협정의 일부를 구성한다. 하지만 GATT 제3조에 존재하지 않은 내국민대우에 관한 추가적 내용, 즉 'GATT-plus' 규정은 향후 WTO에서 제소대상이 되어 패널에 의해 판정될 경우에 적용 가능한 법(applicable law) 문제가 발생할 수 있다. 이 문제는 '신법 우선의 원칙(*lex posterior*)'을 바탕으로 해결할 수 있다. FTA 패널은 WTO 패널과 상소기관의 판정에 의존할 의무가 없지만 FTA의 한 구성부분으로서의 GATT 제3조를 일관성 있게 적용하기 위해 FTA 패널들은 WTO의 해당 평결이나 해석에 따라야 한다.

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Всемирная торговая ор ганизация и развивающиеся страны: вопросы разреш ения споров (2005) / “Cessation and Reparation in the GATT/WTO Legal System: A View from the Law of State Responsibility” (공저, 2007) /「미국 - 1916년 반덤핑법에 대한 WTO 중재판정 (WT/DS136/ARB)에 관한 법적 고찰」(2007) 외 지필

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National Treatment on Internal Taxation: Revisiting GATT Article III:2

Sherzod Shadikhodjaev*

I. Introduction

The principle of non-discrimination which comprises national treatment and most-favored-nation (MFN) treatment is an important pillar of the multilateral trading system. The World Trade Organization (WTO) has separate disciplines on these two components with respect to the goods, services and intellectual property sectors. As to trade in goods, the MFN principle requires equal treatment of all WTO Members' products, while the national treatment rule precludes discrimination between domestic and imported products.

National treatment has a long history dating back to ancient Hebrew Law. It was introduced in various commercial agreements concluded in Europe in the Middle Ages, in a number of shipping treaties between European countries in the 17th and 18th centuries, and became quite a common part of many trade agreements since the late 19th century.[1] National treatment appeared in the Havana

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Charter for an International Trade Organization and subsequently in the General Agreement on Tariffs and Trade (GATT) of 1947, though it started to play greater role in restraining protectionism in the 1980s when trade tariffs were substantially reduced.[2)]

Since the WTO creation in 1995, national treatment violations in the goods sector have been challenged in 106 out of 369 disputes, *i.e.* nearly 29% of all complaints brought as of 1 January 2008.[3)] The fact that quite a big portion of the WTO complaints has dealt with Article III claims may lead to two conclusions. First, it stresses the profound importance of national treatment in the multilateral trading system. Second, it reveals the temptation of WTO Members to protect domestic production through internal taxes and regulations as their importation regimes are becoming more liberalized.

National treatment has been the subject of many academic writings discussing a wide range of issues, such as the "like product" standard, the "aim-and-effect" test, discriminatory regulatory measures, the "product-process" doctrine and many others.[4)] Unlike those studies, the purpose of the present paper is to examine the national treatment principle as applied to internal taxation only. Taxation is a significant economic instrument of each country and is subject to domestic laws

1) Trebilcock (2004), p. 1.
2) *Ibid*., p. 2.
3) See Appendix.
4) For instance, the incomplete list of publications on national treatment not cited in this paper includes *e.g.* Srinivasan (2005), pp. 69-95; Roessler (2003), pp. 771-781; Regan (2003), pp. 737-760; Verhoosel (2002); Ehring (2001); Hudec (2000), pp. 101-123; Howse and Regan (2000), pp. 249-289; Zedalis (1994), pp. 33-134.

and regulations. However, GATT Article III:2 as an international rule sets forth certain requirements for domestic taxes so as to ensure non-discriminatory treatment *vis-à-vis* foreign goods. In the light of expanding regionalism in recent years, national treatment is becoming important not only on the multilateral, but also regional plane. In this respect, this paper supplements the existing literature with some observations on the application of this principle in the regional context, namely under Free Trade Agreements (FTAs) concluded by the Korean government.

For the purpose of this study, the paper will examine GATT Article III:2 and corresponding FTA provisions. In addition, subject-related GATT/WTO jurisprudence, preparatory work and critique will be referred to in the discussion of legal issues and interpretations.

It is believed that the issue of non-discriminatory internal taxes is of particular interest to policy makers, including legislators and government officials who are in charge of national taxation. In addition, a detailed overview and analysis of case law would also be helpful in identifying and challenging a foreign country's illegal tax measure in the future. This study would also be useful to all those who are interested in legal aspects of international trade.

The remainder of this paper is organized as follows. Section II explains general concepts of national treatment, such as *de jure* and *de facto* discrimination, internal taxes and charges, and the structure of Article III:2. Sections III, IV and V examine the likeness standard, discriminatory threshold and protective application of a tax measure respectively. Section VI discusses national treatment clauses of Korea FTAs, and Section VII concludes the paper.

II. National Treatment and Internal Taxation: General Observations

GATT Article III on national treatment targets two types of discrimination, namely: (1) tax discrimination and (2) discrimination by laws, regulations or other requirements. In addition, paragraph 5 of the said Article deals with the local content requirement. Paragraph 2 specifically addresses the issue of national treatment on internal taxation. The sections bellow provide some general observations on the nature of discriminatory treatment, measures and substantive issues covered by Article III:2.

1. *De Jure* and *De Facto* Discrimination

An origin-specific internal tax or regulation which explicitly discriminates against imported products is a typical example of *de jure* discrimination. In contrast, internal measures which are facially neutral but apply to the disfavor of foreign goods constitute *de facto* discrimination. Although Article III is silent on the *de jure/de facto* distinction, GATT/WTO case law has, on a number of occasions, recognized illegality of both types of discrimination.

De jure discrimination on internal taxes took place in the GATT case on *Brazil – Internal Taxes*, where a Brazilian law of 1948 set forth higher taxes on imported liqueurs (36 cruzeiros per liter) and lower taxes on domestic liqueurs (18 cruzeiros per liter). The *US – Superfund* case was concerned with a tax on petroleum which was levied at the rate of 11.7 cents a barrel on imported products and 8.2 cents a barrel on domestic products. The source-specific measures in these two

instances accorded less favorable treatment *vis-à-vis* imported goods in violation of GATT Article III.[5)]

Due to its implicit character, *de facto* discrimination against imported products is a more challenging aspect of national treatment. As John H. Jackson once assumed, the cases of *de facto* discrimination will increase in number, as "sophistication about GATT rules has increased among various national officials".[6)] Indeed, while mostly *de jure* discrimination was targeted in GATT cases, origin-neutral measures have more frequently been contested in WTO disputes.[7)] The first GATT ruling which satisfied a complaint regarding *de facto* discrimination was adopted just in 1987.[8)] As to the WTO period, in *e.g. Chile – Alcoholic Beverages*, the new Chilean tax system, which was applicable as of 1 December 2000, charged all distilled spirits – both domestic and imported – with taxes based on the degree of alcohol content. The rate escalated in increments of 4% per additional degree of alcohol. The lowest rate of 27% was imposed on spirits with an alcohol content of 35° or less, while the highest rate of 47% was set

5) See GATT Working Party Report, *Brazilian Internal Taxes*, GATT/CP.3/42 (First Report), adopted 30 June 1949, BISD II/181; GATT/CP.5/37 (Second Report), adopted 13 December 1950, BISD II/186; Hudec (1990), pp. 123-133; GATT Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances (US – Superfund)*, L/6175, adopted 17 June 1987, BISD 34S/136, para. 5.1.

6) Jackson (1989), p. 212.

7) Trebilcock, *supra* note 1, p. 4.

8) GATT Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (Japan – Alcoholic Beverages I)*, L/6216, adopted 10 November 1987, BISD 34S/83 cited in Hudec (1998), p. 622.

out for all spirits over 39°. This is a typical example of an origin-neutral measure. Both the Panel and the Appellate Body confirmed discriminatory treatment by Chile's measure, finding that about 75% of all domestic products had an alcohol content of 35° or less and thus taxed at the lowest rate.[9]

2. The Scope of Fiscal Measures

GATT Article III:2, first sentence requires non-discrimination concerning "internal taxes or other internal charges of any kind". Furthermore, the drafters made it clear that even if fiscal measures are collected in the case of the imported product at the time of importation, they nevertheless fall within the scope of Article III:2.[10] Tariffs and other charges related to importation or exportation are not subject to this provision. Article III:2 is confined to taxes on products (indirect taxes) including sales taxes, excise taxes and value-added taxes, and does not apply to direct taxes, such as income or corporate taxes.[11] Nevertheless, direct taxes may be challenged

9) WTO Appellate Body Report, *Chile – Taxes on Alcoholic Beverages (Chile – Alcoholic Beverages)*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, paras. 62-76.

10) Ad Article III of the GATT.

11) During discussions in Sub-Committee A of the Third Committee at the Havana Conference, it was agreed that "neither income taxes nor import duties came within the scope of Article 18 [on national treatment] since this Article refers specifically to internal taxes on products." E/CONF.2/C.3/A/W/32, pp. 1-2, cited in GATT (1995), p. 144 (hereinafter "GATT Analytical Index"). See also, WTO Panel Report,

under Article III:4.[12)]

It is noteworthy that taxes for the purposes of Article III:2 are applied not only "directly", but also "indirectly" to the like product. During preparatory work on the GATT drafting, it was stated that the word "indirectly" would indicate even a tax imposed not on product *per se* but on the processing of the product.[13)] The 1955 Review Working Party II on Tariffs, Schedules and Customs Administration noted the divergence of opinion among the GATT contracting parties as to whether the national treatment principle allows taxation of imported products at a rate equivalent to the taxes levied at the various stages of production of the like domestic product or only at the rate of the tax levied at the last stage – *i.e.* on the final product. Eventually, it refrained from recommending the insertion of an interpretative note on this point.[14)] Nevertheless, the GATT Panel in *Japan – Alcoholic Beverages I* appears to have clarified

Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather (Argentina – Hides and Leather), WT/DS155/R, adopted 16 February 2001, para. 11.159 ("…income taxes, because they are taxes not normally directly levied on products, are generally considered not to be subject to Article III:2.").

12) See WTO Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, paras. 8.142-8.146. For the direct tax issue, see also Daly (2005).

13) UN, EPCT/A/PV/9, p. 9; EPCT/W/181, p. 3, cited in GATT (1995), *supra* note 11, p. 141.

14) GATT, Review Working Party II on Tariffs, Schedules and Customs Administration: Report to the Contracting Parties, L/329, 24 February 1955, para. 10.

this issue by stating that:

> [I]n assessing whether there is tax discrimination, account is to be taken not only of the rate of the applicable internal tax but also of the taxation methods (*e.g.* different kinds of internal taxes, direct taxation of the finished product or *indirect taxation by taxing the raw materials used in the product during the various stages of its production*) and of the rules for the tax collection (*e.g.* basis of assessment).[15] (emphasis added)

This passage seems to recognize taxes on foreign goods with respect to various stages of production provided that they are not less favorable compared to those on domestic products.

Fiscal measures covered by Article III:2 consist of both "taxes" and "charges of any kind." With respect to the latter, the Panel in *Argentina – Hides and Leather* found that even the internal measure which is not a tax as such, but a mechanism for the collection of certain taxes – a "tax administration" measure – can still fall within Article III:2. In this case, two government resolutions provided for the imposition of charges. Specifically, they imposed a pecuniary burden and created a liability to pay money. The Panel concluded that these resolutions qualified as measures covered by Article III:2.[16] In this respect it should be noted that all internal taxes are set forth in laws or regulations. When a complaining party initiates a dispute settlement procedure over a particular tax measure, it actually challenges

15) GATT Panel Report, *Japan – Alcoholic Beverages I*, *supra* note 8, para. 5.8.

16) WTO Panel Report, *Argentina – Hides and Leather*, *supra* note 11, paras. 11.143-11.144.

the law or regulation which introduces this measure. This should be differentiated from the case of "laws, regulations and requirements" covered by Article III:4, as the latter deals with discrimination other than tax discrimination.

The issue of border tax adjustments is also relevant to Article III:2, since it "reflects a desire to equalize domestic tax treatment on goods consumed domestically, whether domestically produced or imported, and a desire to relieve other goods (exports) of that burden."[17] A GATT working party dealing with this issue defined border tax adjustments as "any fiscal measures which put into effect, in whole or in part, the destination principle (*i.e.* which enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market and which enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products)."[18] A border tax adjustment should be provided on a non-discriminatory basis in accordance with the national treatment rule. The working party pointed to the "convergence of views" that only indirect taxes are eligible for tax adjustment.[19] In support, most of the GATT contracting parties argued that "indirect taxes by their very nature bear on internal consumption and were consequently levied, according to the principle of destination, in the country of consumption, while direct taxes – even assuming that they were partly passed on into

17) Jackson (1969), p. 295.

18) GATT, Report of the Working Party on Border Tax Adjustments, L/3464, adopted 2 December 1970, para. 4.

19) *Ibid.*, para. 14.

prices – were borne by entrepreneurs' profits or personal income."[20]

3. Multi-Tiered Test under Article III:2

GATT Article III:2 reads:

> 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.*

The asterisk at the end of the second sentence refers to an interpretative note Ad Article III, paragraph 2 which provides:

> 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.

The accompanying interpretative note clarifies Article III:2, second

20) *Ibid.*, para. 21.

sentence, and must thus be read together with the latter in order to ascertain the proper meaning of the provision.[21] In addition, Article III:1 which the second sentence refers to states:

> 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.

The two sentences of Article III:2 are closely related through the same subject matter (national treatment on internal taxes) and the words "moreover" and "otherwise." However, the conformity of a contested measure with either of these sentences is checked on the basis of different legal standards. In particular, the first sentence requires a two-tiered test of (1) whether the taxed imported and domestic products are "like," and (2) whether the taxes applied to the imported products are "in excess of" those applied to the like domestic products.[22] In contrast, the second sentence deals with three issues of whether: (1) the imported and domestic products are "directly competitive or substitutable products" which are in competition with each

21) WTO Appellate Body Report, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II)*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 24.

22) *Ibid.*, pp. 18-19.

other; (2) these products are "not similarly taxed"; and (3) the dissimilar taxation of the products is "applied ... so as to afford protection to domestic production."[23] It is for the complaining party to establish a rebuttable *prima facie* case, under the first or second sentence, with respect to each covered issue.[24] Consequently, one can point to three elements of national treatment on internal taxation which apply in each sentence differently: the likeness standard, discriminatory threshold and protective application of the measure.

Table 1. The Structure of Article III:2

Elements	Article III:2, first sentence	Article III:2, second sentence
Likeness Standard	"like product"	"directly competitive or substitutable product"
Discriminatory Threshold	"in excess of"	"not similarly taxed"
Protective Application	-	"so as to afford protection"

When a WTO Member disputes another Member's tax, in a panel request it normally indicates what sentence of Article III:2 it believes the tax violates. Depending on the product coverage, the complainant may refer to two sentences when both like, and directly competitive or substitutable products are at issue, or either of the sentences.

23) *Ibid.*, p. 24.

24) See WTO Panel Report, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II)*, WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, para. 6.14 and 6.28; WTO Appellate Body Report, *Korea – Taxes on Alcoholic Beverages (Korea – Alcoholic Beverages)*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, para. 156.

Although in *Korea – Alcoholic Beverages*, the claim was raised under both sentences, given that "like products" are a subset of "directly competitive or substitutable products," the Panel found it "more logical" to consider first the broader product category under the second sentence.[25] This "more logical" approach is not applicable to cases where the complainant's claim is raised under the first sentence only. Accordingly, a panel considering this claim should concentrate solely on the first sentence. Otherwise, turning directly to the second sentence based on the approach above would breach the panel's mandate.[26]

Under certain circumstances, the Appellate Body may complete the panel's analysis of Article III:2. Notably, in *Canada – Periodicals*, the Panel found a violation of Article III:2, first sentence and thus refused to consider the US claim under the second sentence. But the Appellate Body reversed the Panel's finding on the first sentence and went on to examine the consistency of the measure with the second sentence. Despite Canada's argument that the Appellate Body lacked jurisdiction to do so, the Appellate Body responded that it "can, and should, complete the analysis of Article III:2" as a "part of a logical continuum" as two sentences are "closely related." In *EC – Asbestos*, the Appellate Body specified several conditions which would allow it

25) WTO Panel Report, *Korea – Taxes on Alcoholic Beverages (Korea – Alcoholic Beverages)*, WT/DS75/R, WT/DS84/R, adopted 17 February 1999, para. 10.36.

26) See WTO Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, para. 156 ("Panels are inhibited from addressing legal claims falling outside their terms of reference").

to complete the analysis of a panel, such as:[27]

(1) Factual findings of the panel and undisputed facts in the panel record should provide a sufficient basis for such analysis.

(2) Furthermore, the additional analysis should be "closely related" to the panel's analysis.

(3) Finally, the rules to be examined in the additional analysis should previously have been interpreted or applied by panels or the Appellate Body.

27) WTO Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paras. 78-81.

III. The Likeness Standard

Treatment no less favorable than that to a domestic product is accorded to such an imported product with which it shares some common features. In this regard, how alike these products are is a matter of crucial importance. As a matter of fact, the degree of likeness varies in WTO law. It is even different in different provisions of GATT Article III. Paragraph 2 of the said Article speaks of "like product" and "directly competitive and substitutable product."

1. "Like Product"

The concept of "like product" in the context of international trade in goods was originally inserted in the MFN clause of the 1794 "Jay Treaty" between the US and the UK. Since then, many bilateral agreements providing for MFN and national treatment *vis*-à-*vis* products have used such terms as "same articles," "same merchandize," "like articles," "articles of like nature, the growth," "similar goods" or "same goods."[28)]

As regards the multilateral trading system, more than 50 provisions under WTO agreements deal with the likeness standard.[29)] The term "like or similar products" occurs some sixteen times in the GATT only.[30)] At first, the national treatment provision as drafted at the London Conference had been linked to "identical and similar products." In the final version, the reference was made simply to

28) See Choi (2003), pp. 158-160.
29) *Ibid.*, p. xi.
30) GATT, L/3464, *supra* note 18, para. 18.

"like products." However, the negotiating records suggest that the drafters wanted to see some flexible wording for the likeness standard. This led to the inclusion in 1947 of the words "directly competitive or substitutable." Under the proposed text, this standard would, however, apply only if "there is no substantial domestic production of like products of national origin." Ad Article III introduced in 1948 excluded the prerequisite of "substantial domestic production" ensuring broader applicability of the category of "directly competitive or substitutable" products.[31)]

GATT Article III does not define the term "like product." Neither does case law give a uniform definition. In fact, the Appellate Body compared the concept of likeness to an accordion which "stretches and squeezes" depending on the provision in which this concept appears as well as the specific circumstances of each individual case where this provision is invoked.[32)] Accordingly, imported and domestic products do not need to be identical in all respects in order to be "like." Nevertheless, the degree of likeness is subject to certain limitations imposed by relevant rules. As regards the first sentence of Article III:2, the term "like product" should be construed narrowly, whereas how narrowly is a matter that is determined for each tax measure separately.[33)] For instance, while the Panel in the GATT case on *Japan – Alcoholic Beverages I* had qualified as "like products" the goods which shared similar qualities or served substantially identical end-uses, the Panel and the Appellate Body in the WTO case on

31) See Choi, *supra* note 28, pp. 107-108.

32) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, pp. 21-22.

33) *Ibid.*, pp. 19 and 21.

Japan – Alcoholic Beverages II interpreted this term more narrowly by stressing substantially the same physical characteristics.[34]

The "like product" standard has been construed based on numerous criteria. Referring to the 1970 Working Party Report on "Border Tax Adjustments," the adjudicatory bodies have mainly relied on (1) the product's end-uses in a given market; (2) consumers' tastes and habits; and (3) the product's properties, nature and quality.[35] This approach has been followed in almost all adopted panel reports.[36] In addition, the Appellate Body in *Japan-Alcoholic Beverages II* also acknowledged the relevance of the product's tariff classification based on the Harmonized System (HS). On the other hand, it doubted the reliability of tariff bindings which "include broad ranges of products that cut across several different HS tariff headings." Only tariff bindings which are sufficiently precise with respect to product description may provide some "significant guidance" for the likeness test.[37] The suggested criteria are by no means an exhaustive list and should be applied on a case-by-case basis taking into account the particularities of each case context. As to the process or production method (PPM) by which a product is made, it is not relevant to the likeness test, since the national treatment obligation under Article III is confined to measures which apply to or affect the product as such.[38] Accordingly, two products satisfying the criteria above cannot be

34) See Zhou (2007), pp. 11-12.
35) GATT, L/3464, *supra* note 18, para. 18.
36) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, p. 20.
37) *Ibid.*, p. 22.
38) See Matsushita *et al.* (2006), pp. 240-241.

qualified as not "like" merely on the grounds that their PPMs are different.

The likeness test requires a comparison between an imported product and a domestic product. However, discriminatory treatment may be found even in the absence of actual imports. The reason is that the rationale for the Article III obligation is to protect *expectations* of the Members as to the competitive relationship between their products and those of other Members.[39] In the *Indonesia – Autos* case on an origin-based distinction with respect to internal taxes, the Panel found that such distinction "suffices in itself to violate Article III:2, without the need to demonstrate the existence of actually traded like products."[40] In the *Canada – Periodicals* case, the Panel took one step further comparing domestic and hypothetical imported goods. The Panel considered whether imported split-run periodicals and domestic non-split-run periodicals were like products. The measure at issue was a prohibitive tax on advertising revenues from Canadian edition of split-run periodicals, *i.e.* periodicals produced for the Canadian market and containing advertisements directed at this market and additional pages for local editorial content. As there were no imports of split-run editions because of the import prohibition in Tariff Code 9958, which was found to be inconsistent with GATT Article XI,

39) GATT Panel Report, *US – Superfund*, *supra* note 5, para. 5.2.2; WTO Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, para. 36.

40) WTO Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry (Indonesia – Autos)*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998, para. 14.113.

hypothetical imports of split-run periodicals were considered. The Appellate Body recognized the possibility of using hypothetical imports to determine whether a measure violates Article III:2, but it rejected the hypothetical example used by the Panel.[41]

2. "Directly Competitive or Substitutable Products"

Even if an imported product is not a "like product" within the meaning of Article III:2, first sentence, it can still be eligible for national treatment *vis-à-vis* a directly competitive or substitutable domestic product. This is the case for *e.g.* products with different origins, contents and tariff rates but competitive in terms of price or substitutable in terms of their end-use, such as apples and oranges, or skimmed milk and vegetable protein products.[42] On the other hand, the "directly competitive or substitutable" standard is applicable even if an imported product has a domestic "like" counterpart. Suppose Member A levies a sales tax of 50% on apples and 5% on pears without distinguishing their origin. The tax in question fully conforms to Article III:2, first sentence because it equally treats like products, *i.e.* domestic and imported apples, and domestic and imported pears. But Member B, the main exporter of apples to Member A, can challenge the 50% tax under Article III, second sentence on the grounds that apples and pears are directly competitive

41) WTO Panel Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/R, adopted 30 July 1997, paras. 5.22-5.26; WTO Appellate Body Report, *Canada – Certain Measures Concerning Periodicals (Canada – Periodicals)*, WT/DS31/AB/R, adopted 30 July 1997, pp. 20-22.

42) GATT Panel Report, *Japan – Alcoholic Beverages I*, *supra* note 8, para. 3.4.

and substitutable, as this tax has provoked a decrease of consumption of apples and a simultaneous increase of consumption of pears in Member A. Indeed, Ad Article III, paragraph 2 provides a legal basis for such an allegation by stipulating that a tax consistent with the first sentence may be found in breach of the second sentence.

Two products are "competitive or substitutable" if they are interchangeable or offer "alternative ways of satisfying a particular need or taste."[43] The words "competitive or substitutable" are preceded with the word "directly" which narrows the scope of competitive/ substitutable products. Accordingly, *indirectly* competitive or substitutable products do not fall within Article III:2, second sentence. It is understood that the word "directly" refers to both "competitive" (*i.e.* "directly competitive") and "substitutable" (*i.e.* "directly substitutable"). Although adjudicatory bodies normally examine the product coverage in the single "competitive/substitutable" category, the word "competitive" is used from a producer's perspective while "substitutable" is a term used from the consumer's point of view.[44]

The notion of "directly competitive or substitutable products" is a broader concept than that of "like product." The scope of "broadness" is a matter for a panel to determine in each particular case based on the relevant factors.[45] Furthermore, according to the Appellate Body, while perfectly substitutable products fall within Article III:2, first sentence, imperfectly substitutable products can be assessed under Article III:2, second sentence.[46] Unfortunately, the Appellate Body

43) WTO Appellate Body Report, *Korea – Alcoholic Beverages*, *supra* note 24, para. 115.

44) For details, see Choi (2003), *supra* note 28, pp. 14-17.

45) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, p. 25.

has not elaborated on the "(im)perfectly" criterion, nor has it provided a sensible reasoning for its decision to differently treat perfectly and imperfectly substitutable products under the two sentences. It appears that the term "perfectly substitutable" is absolute, that is all perfectly substitutable products are "like" in the sense of the first sentence. In contrast, not all imperfectly substitutable products fall within the second sentence, as they must be *directly* substitutable. This is probably why the Appellate Body stated that these products "*can* be assessed" under the second sentence.[47)]

Article III:2, second sentence involves an examination of competitive conditions in the relevant market. In addition to the basic criteria of "like product" (physical characteristics, common end-uses, consumers' tastes and habits, and tariff classifications), several other factors may be examined. These factors include but are not limited to the cross-price elasticity, advertising activities or channels of distribution.[48)]

A comparison of imported and directly competitive or substitutable domestic products is normally carried out on an item-to-item basis when each imported product is compared to a domestic product concerned. However, in *Korea – Alcoholic Beverages*, the Panel grouped

46) WTO Appellate Body Report, *Canada – Periodicals*, *supra* note 41, p. 28; WTO Appellate Body Report, *Korea – Alcoholic Beverages*, *supra* note 24, para. 118. For a critique of the "perfectly substitutable" criterion, see also 이재형 (2002), pp. 19-20.

47) WTO Appellate Body Report, *Korea – Alcoholic Beverages*, *ibid.*, para. 118, emphasis added.

48) See WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, p. 25; WTO Panel Report, *Korea – Alcoholic Beverages*, *supra* note 25, para. 10.61.

together all of the imported products and compared this group with Korean alcoholic beverage called "soju." The Appellate Body found this approach appropriate, because the grouping of imported products was an "analytical tool" to minimize repetition in this comparison, and the Panel took account of individual product characteristics where appropriate.[49] The same rationale may be applied in the likeness test under Article III:2, first sentence. While a proper grouping of imported products is acceptable, the omission of some products in the Article III analysis is not allowed. The Appellate Body in *Japan – Alcoholic Beverages II* found that the Panel erred in law in limiting its conclusions to some beverages only ("shochu, whisky, brandy, rum, gin, genever, and liqueurs") while the range of products mentioned in the panel request ("all other distilled spirits and liqueurs falling within HS heading 2208") was broader.[50]

3. The "Aim-and-Effect" Test

In certain cases, GATT panels developed the so called "aim-and-effect" test which produced additional standards for a likeness determination. The proposed approach examined whether a contested measure has the protectionist intent and effect. In *US – Malt Beverages*, the Panel examined Canada's claim that the state of Mississippi applied, contrary to Article III, a lower tax to wines made from a certain variety of grape growing only in the Southeastern US

49) WTO Appellate Body Report, *Korea – Alcoholic Beverages*, *supra* note 24, paras. 139-145.

50) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, p. 26.

and the Mediterranean and thus discriminated against Canada's "like" products, and that some US states differentiated between beers based on their alcohol contents. The most controversial aspect of the Panel's findings was the consideration of the regulatory purpose of the measure in the context of the likeness determination. In particular, the Panel stated:

> Specifically, the purpose of Article III is not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production. [···] [T]he limited purpose of Article III has to be taken into account in interpreting the term "like products" in this Article. Consequently, in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made "so as to afford protection to domestic production."[51]

The "aim-and-effect" approach was further followed in the unadopted GATT report on *US – Taxes on Automobiles*. The EC's complaint was mainly about the imposition by the US of a luxury excise tax and gas-guzzler tax on domestic and imported automobiles on the basis of their value and gasoline consumption per mile. According to the EC, these measures imposed heavier burden on larger and more expensive automobiles that were predominantly represented by European cars. The US contended that the key factor in the likeness

51) GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages (US – Malt Beverages)*, DS23/R, adopted 19 June 1992, BISD 39S/206, para. 5.25.

determination was whether the measure was applied "so as to afford protection to domestic industry." The Panel ruled in favor of the US, finding that the product differentiation was not implemented for the protectionist purpose and thus despite their physical similarities the cars at issue were not like products in the sense of Article III:2, first sentence.[52] With respect to the EC's argument that statements by legislators pointed out the protectionist nature of the measure, the Panel held that:

> [A]n assessment of the aim of the legislation could not be based solely on such statements or on other preparatory work. The aim of the legislation had also to be determined through the interpretation of the wording of the legislation as a whole.[53]

This passage suggests that although the demonstration of a subjective intent by legislators is not irrelevant for the likeness test, it is still not sufficient, so the evidence should be inferred from the text of the legislation. The Appellate Body provided some support for this standpoint in *Chile – Alcoholic Beverages*.[54]

In *Japan – Alcoholic Beverages II*, both Japan and the US took the view that Article III:2, first sentence requires an examination of the aim and effect of the contested legislation. The Panel rejected their arguments and considered that while the effect of a particular measure is generally discernible, the examination of its aim is very

52) GATT Panel Report, *United States – Taxes on Automobiles*, DS31/R, 11 October 1994, unadopted, paras. 5.11-5.15, and 5.21-5.36.

53) *Ibid.*, para. 5.12.

54) See Section V of this paper.

difficult as the aim is sometimes "indiscernible." Because a contested measure may have multiple aims, it could be problematic to show which aim is relevant for the "aim-and-effect" test. It is also not clear what kind of evidence would be pertinent. In addition, the list of exceptions in GATT Article XX could become redundant or useless if the aims specified there were considered under the Article III analysis. Specifically, if adjudicatory bodies were required to consider the aim of the measure in the context of Article III, "all of the regulatory justifications provided in Article XX would already have been considered and disposed of in the first-stage determination of violation, leaving no reason to conduct the same inquiry again under Article XX."[55] While recognizing that the "aim-and-effect" test was utilized by GATT panels in two cases, the Panel in *Japan – Alcoholic Beverages II* could not find any textual justification for this approach under Article III:2, first sentence.[56] The Appellate Body upheld the Panel's conclusion on this issue.[57]

Despite the rejection of the "aim-and-effect" test in WTO jurisprudence, Robert E. Hudec suggested that it offers two "principal improvements" to the traditional analysis:

> First, it consigned the metaphysics of "likeness" to a lesser role in the analysis, and instead made the question of violation depend primarily on the two most important issues that

55) Hudec, *supra* note 8, pp. 628-629.

56) WTO Panel Report, *Japan – Alcoholic Beverages II*, *supra* note 24, paras. 6.16-6.18.

57) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, p. 18.

> separate bona fide regulation from trade protection – the trade effects of the measure, and the bona fides of the alleged regulatory purpose behind it. Second, by making it possible for the issue of regulatory justification to be considered at the same time the issue of violation itself is being determined, the "aim and effects" approach avoided both the premature dismissal of valid complaints on grounds of "un-likeness" alone, and excessively rigorous treatment given to claims of regulatory justification under Article XX whenever the two products were ruled "like."[58)]

The "aim-and-effect" test could be said to be useful at least in the context of *de facto* discrimination. The proposition is that unlike the case of an origin-specific measure which arguably does not require a thorough likeness analysis, the case of the origin-neutral measure requires a "substantive inquiry into the relevant meaning of 'likeness'" which may include the "aim-and-effect" test.[59)] This thesis is controversial

58) Hudec, *supra* note 8, p. 628.

59) For example, Donald H. Regan states that:

> [I]n order to decide whether products which are treated differently by an origin-neutral measure are "like," we must first find some specific content for "likeness." We must decide what particular properties are relevant. But it turns out that we can skip over that step when we are dealing with an origin-specific measure. The reason is that an origin-specific measure treats differently (or is potentially capable of treating differently) products that are identical in every respect except for their origin. But products which are identical in every

because there is no formal distinction of *de jure/de facto* discrimination in Article III, and GATT/WTO jurisprudence does not seem to indicate different likeness standards based solely on this distinction. Without going into all details of the "aim-and-effect" debate, this paper concludes that according to the WTO practice the approach in question is still relevant, to some extent, to Article III:2, second sentence with respect to "so as to afford protection" – a stage which is independent of and separate from the determination of likeness.

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respect except for their origin must be "like" whatever the specific content of "likeness" in the context.

Regan (2002), pp. 455-456. See also, p. 474 ("It remains true that in dealing with an origin-neutral measure such as the measure involved in *Japan – Alcohol*, we must somehow attend to the 'so as to afford protection' policy, even under Article III:2, first sentence. If there is no separate step, then the 'so as to afford protection' policy must be part of the inquiry into 'likeness.'").

IV. Discriminatory Threshold

Once the likeness standard is met, the next step is to determine whether the product at issue has (not) been discriminated against. With respect to internal taxation, unequal treatment of domestic and imported products normally takes the form of imposing different tax rates. This also includes situations where domestic products are granted exemption or remission of taxes while like or directly competitive/substitutable imported products are not. In 1950, the Netherlands filed a complaint about the "utility" system of the UK which exempted from a purchase tax some domestic products. Two years later, the UK notified that such tax exemption was extended to imported products.[60] In *Canada – Gold Coins*, South Africa raised a claim that an exemption of Canadian gold coins from retail sales tax was a violation of national treatment. The Panel found that the tax imposed on South African gold coins was in excess of that applied to a like domestic product.[61]

Under certain circumstances, tax breaks may be qualified as a "subsidy" within the meaning of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). Regarding the subsidy issue, GATT Article III:8(b) provides:

> The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal

60) GATT Analytical Index, *supra* note 11, p. 152.

61) GATT Panel Report, *Canada – Measures Affecting the Sale of Gold Coins*, L/5863, 17 September 1985, unadopted, para. 51.

> taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

It is important to note that not all subsidies are exempted from the national treatment rule. First, the words "the payment of subsidies" point to direct subsidies involving actual payments, *i.e.* not tax credits or tax breaks. Moreover, the "payments to domestic producers derived from the proceeds of internal taxes or charges" refer to payments made after taxes have been collected.[62] Second, the passage above refers to the subsidies which are paid exclusively to *domestic producers*, rather than *products*. The word "exclusively" suggests that a payment must be made *solely* and *directly* to producers.[63] To put it differently, the provision in question is about producer subsidies. In *e.g. EEC – Oilseeds I*, a subsidy to processors of oilseeds was conditional upon purchase of domestic oilseeds, thus it provided indirect incentives for oilseed producers. The Panel did not consider the subsidy as an exception to the national treatment rule because it was not paid directly to the producers of oilseeds. Moreover, this subsidy benefited not only the producers, but also the processors of oilseeds.[64] Since Article III:8(b) subsidies are allocated to *producers*, a reduction or exemption of taxes on a *product* is not a

62) GATT Panel Report, *US – Malt Beverages*, *supra* note 51, para. 5.8.

63) GATT Panel Report, *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, L/6627, adopted 25 January 1990, BISD 37S/86, paras. 136-137.

64) *Ibid*.

"subsidy" in the sense of this provision, and is subject to the requirements of Article III.[65]

Article III:8(b) is without prejudice to the SCM Agreement.[66] Thus, subsidies adversely affecting international trade are subject to provisions of the SCM Agreement irrespective of whether they violate or not GATT Article III. In fact, the obligations under the national treatment and subsidy disciplines are different and complementary, so that even subsidies to producers are subject to the provisions of Article III when they discriminate between imported and domestic products.[67]

In determining whether a tax measure discriminates against foreign goods, it is essential to set the boundaries of latitude within which differential treatment is permissible. A threshold beyond which any Member's action would be inconsistent with Article III:2 is reflected in the words "in excess of" (the first sentence) or "not

65) At least four GATT panel reports cited by the US support this proposition. See WTO Appellate Body Report, *Canada – Periodicals*, *supra* note 41, p. 33.

66) See Interim Commission for the International Trade Organization, Reports of the Committees and Principal Sub-Committees: ICITO I/8, Geneva, September 1948, p. 66, cited in WTO Appellate Body Report, *ibid.*, p. 34.

This sub-paragraph was redrafted in order to make it clear that nothing in Article 18 [on national treatment] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 would override the provisions of Section C of Chapter IV [on subsidies].

67) WTO Panel Report, *Indonesia – Autos*, *supra* note 40, para. 14.45.

similarly taxed." (the second sentence)

1. "In Excess of"

Discrimination under Article III:2, first sentence exists when internal taxes or charges on imported products are "in excess of" those on like domestic products. In *Japan – Alcoholic Beverages II*, the Appellate Body held that even the smallest amount of "excess" – *de minimis* – is too much, thus not allowed in this context.[68] To put it differently, the permissible level of burden from fiscal measures imposed on imported goods is either the same as or lower than the tax burden borne by domestic like products.

The comparison of fiscal measures on imported and domestic products is not limited to the applicable tax rates only. Even equal tax rates may impose different tax burden on the products in question, for example, when different methods of computing tax bases are employed. Should imported goods be faced with heavier tax burden, the rule of national treatment is violated. Thus, Article III:2, first sentence requires a comparison of actual tax burdens rather than merely of nominal tax burdens.[69] Moreover, national treatment is to be accorded to each individual import transaction concerned, and to be evaluated on a transaction-to-transaction basis. For example, in *Argentina – Hides and Leather*, the tax rate of 3% for imports as compared to corresponding tax rates of 2% or 4% for

68) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, p. 23.

69) WTO Panel Report, *Argentina – Hides and Leather*, *supra* note 11, paras. 11.182-11.184.

internal sales was found inconsistent with Article III:2, first sentence. Although the burden on imports was lower in some cases (3% vs. 4%), it was higher in others (3% vs. 2%). The Panel concluded that Members are not permitted to "balance more favourable tax treatment of imported products in some instances against less favourable tax treatment of imported products in other instances."[70]

2. "Not Similarly Taxed"

In contrast to the very strict standard of "in excess of", the "not similarly taxed" standard means excessive taxation which is over the *de minimis* level. The *de minimis* margin varies from case to case.[71] This means that in some cases a tax difference of 1% would be said to be permissible under the second sentence, while in others it would be considered unjustifiable. It seems that the decisive factor for the *de minimis* determination would be the question of to what extent the tax differential affects the competitive relationship between imported and domestic products. If it is found that the tax burden on imports is heavy enough to move on to the final stage of the three-tiered test of Article III:2, second sentence, the remaining element is to establish the protective application of the tax.

70) *Ibid.*, paras. 11.257-11.263.

71) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, pp. 26-27.

V. Protective Application

The fundamental purpose of Article III is to "avoid protectionism in the application of internal tax and regulatory measures" by requiring equality of competitive conditions between imported and domestic products.[72] However, this is not a ground for justifying the "aim-and-effect" test in the context of the likeness assessment. In addition, Article III also ensures that domestic measures do not undermine tariff commitments of WTO Members under GATT Article II, though the purpose of Article III is broader, given that the national treatment obligation covers both bound and unbound products.[73] As stated in the GATT preparatory documents, the national treatment clause was aimed not only to protect scheduled concessions but also to prevent the use of internal taxes and regulations as a system of protection.[74]

Article III:1 stipulates that internal taxes and charges "should not be applied to imported or domestic products so as to afford protection to domestic production." This "general principle" informs the rest of Article III and constitutes part of the context of each paragraph of this Article. As for paragraph 2 of Article III, the general principle informs the first sentence and the second sentence in different ways because of the textual difference between them.[75]

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72) *Ibid.*, p. 16; WTO Appellate Body Report, *Canada – Periodicals*, *supra* note 41, p. 18.

73) WTO Appellate Body Report, *Japan – Alcoholic Beverages II*, *supra* note 21, pp. 16-17.

74) UN, EPCT/TAC/PV.10 (1947), p. 3, cited in Jackson, *supra* note 17, p. 277.

As there is no specific reference in the first sentence of Article III:2 to the general principle of Article III:1, the Appellate Body in *Japan – Alcoholic Beverages II* considered that the protective application of a contested measure does not need to be established separately from the specific requirements of the first sentence, though the first sentence is "in effect" an application of this general principle.[76] This appears to suggest that the anti-protectionism principle is incorporated into the first sentence through the strict standards of "like" and "in excess of" so that an affirmative conclusion with respect to both criteria would implicitly indicate the protectionist nature of the measure.

In contrast, Article III:2, second sentence explicitly refers to the general principle of Article III:1. The issue of protective application requires "a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products." In some cases, a substantially high tax differential itself may suggest that dissimilar taxation has been employed so as to afford protection. In most cases, however, there are other relevant factors to be considered in this context.[77] For example, in *Japan – Alcoholic Beverages II*, it was found that Japanese "shoju" was effectively protected from foreign competition through a combination of high import duties and dissimilar internal taxes.[78] Accordingly, the tariff may serve as a pertinent factor. In the same case, the Appellate

75) WTO Appellate Body Report, *Japan – Alcoholic Beverages II, supra* note 21, p. 18.
76) *Ibid.*
77) *Ibid.*, p. 33.
78) *Ibid.*, p. 31.

Body held that the subjective intent of legislators and regulators in the drafting and the enactment of a particular measure is irrelevant for establishing the protective application of the tax measure.[79] In *Chile – Alcoholic Beverages*, it further observed that "[t]he *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters." At the same time, while these "subjective" intentions are not relevant, the statutory purposes – that is, the purposes of a Member's legislature and government as a whole – are pertinent "to the extent that they are given *objective* expression in the statute itself". According to the Appellate Body, this objective expression can be discerned from the design, the architecture, and the revealing structure of a measure.[80] However, what each of these factors means is not clear from the existing jurisprudence. The "design" probably refers to a policy objective behind a tax measure, while the "architecture" to the form of the tax law, and the "revealing structure" to the protective application resulting from a tax imposition.[81]

Surprisingly, in *Canada – Periodicals*, the Appellate Body put some weight on the statements of Canadian government officials about the policy objectives of the Excise Tax Act in order to emphasize its protectionist nature.[82] Noting this "change" in the Appellate Body's attitude, the Panel in *Chile – Alcoholic Beverages* assumed that the

79) *Ibid.*, pp. 27-28.

80) WTO Appellate Body Report, *Chile – Alcoholic Beverages*, *supra* note 9, para. 62.

81) See 이재형 (2000), pp. 34-36.

82) WTO Appellate Body Report, *Canada – Periodicals*, *supra* note 41, pp. 30-32.

Appellate Body may still consider statements of a *government* rather than those of *individual legislators*, as the stated objectives of the *government* would be relevant in evaluating the "design" of a measure, whereas statements of *individual legislators* would not.[83] It seems that the subjective intent factor is not entirely excluded from the scope of Article III:2, second sentence. At least, it can play the role of a supplementary – *i.e.* non-decisive – element to support conclusions on other factors of the protective application analysis. Indeed, the Panel in *Chile – Alcoholic Beverages* noted that the government officials' statements are only useful as a factor confirming other evidence.[84]

83) WTO Panel Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/R, WT/DS110/R, adopted 12 January 2000, para. 7.118.

84) *Ibid.*, para. 7.120.

VI. National Treatment under Korea FTAs

As noted in Section I of this paper, the national treatment clause originally appeared in bilateral commercial agreements before being introduced to the GATT. However, with the current rise of regionalism, one can see the opposite trend of reintroducing this principle from the GATT into the regional trade agreements. This section is about how this principle is set forth under Korea FTAs.

As of 1 January 2008, Korea has concluded five FTAs with Chile, Singapore, EFTA, ASEAN (trade in goods and services) and US. Korea-US FTA and Korea-ASEAN FTA (trade in services) have not entered into force yet. These agreements provide that the parties affirm their existing rights and obligations *vis-à-vis* each other under the WTO Agreement.[85] Accordingly, each party has a commitment to accord national treatment to the goods of the other party in accordance with Article III of the GATT. To this end, GATT Article III and its interpretative notes are incorporated into and made part of the given FTAs.[86]

85) Article 1.3.1 of Korea-Chile FTA, Article 1.3.1 of Korea-Singapore FTA, Article 1.5 of Korea-EFTA FTA, Article 1.4.2 of Framework Agreement on Comprehensive Economic Cooperation among the Governments of the Republic of Korea and the Member Countries of the Association of Southeast Asian Nations, Article 1.2.1 of Korea-US FTA.

86) Article 3.3.1 of Korea-Chile FTA, Article 3.3 of Korea-Singapore FTA, Article 2.6 of Korea-EFTA FTA, Article 2 of Agreement on Trade in Goods under the Framework Agreement on Comprehensive Economic Cooperation among the Governments of the Republic of Korea and the Member Countries of the Association of Southeast Asian Nations, Article 2.2.1 of Korea-US FTA.

WTO case law on Article III will also provide some useful guidance when a dispute arises between the FTA parties over the application of the national treatment clause. Korea FTAs provide for the complainant's right to choose between the WTO or FTA dispute settlement mechanisms.[87] If the matter is referred to a WTO panel, the panel will most likely follow the existing jurisprudence due to the *de facto* stare desisis rule. However, FTA arbitral panels are not constrained by rulings of the WTO Dispute Settlement Body (DSB) and may thus apply and construe the GATT provisions differently. Therefore, a complaining party may prefer to resort to the FTA panel procedure if, for example, it wants to avail itself of the "aim-and-effect" test, which was rejected in the WTO but still has the potential to be used in the FTA context.

Some Korea FTAs contain "GATT-plus" elements – provisions which are not found in GATT Article III. For instance, Korea-Chile FTA reads that:

> For the purpose of paragraph 1 [on national treatment under GATT Article III], each Party shall grant to the goods of the other Party a treatment no less favourable *than the most favourable treatment* granted by that Party to its own like or directly competitive or substitutable goods of national origin.[88] (emphasis added)

87) Article 19.3 of Korea-Chile FTA, Article 20.3 of Korea-Singapore FTA, Article 9.1 of Korea-EFTA FTA, Article 2.5 of Agreement on Dispute Settlement Mechanism under Korea-ASEAN FTA, and Article 22.6 of Korea-US FTA.

88) Article 3.3.2 of Korea-Chile FTA.

With respect to internal taxes, this suggests that, *inter alia*, the lowest possible tax rate envisaged for domestic like, directly competitive or substitutable products – as the case may be – is applicable to the other party's product concerned. In Korea-US FTA, the obligation to accord such most favorable treatment is imposed on a regional level of government.[89] This obligation is pertinent to the US only, as the FTA itself clearly stipulates that the term "regional level of government" means, for the US, a state of the US, the District of Columbia, or Puerto Rico; whereas for Korea, the concept in question is not applicable.[90] Interestingly, the Korea-US FTA provision on national treatment refers to "any like, directly competitive, or substitutable goods" putting a comma between "competitive" and "or substitutable."[91] Whether it was made for a merely technical purpose, or intentionally to separate the "directly competitive" standard from the "substitutable" (without "directly") standard is an open question.

Under Korea-Chile FTA, not only "existing" measures but also "proposed" ones may be the subject of a complaint.[92] This clearly goes beyond the scope of challengeable measures under the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). If an arbitral panel established under the FTA finds that a proposed measure by Korea or Chile would violate the national treatment obligation, that party, wherever possible, must "abstain from executing the measure."[93]

89) Article 2.2.2 of Korea-US FTA.
90) Article 1.4 of Korea-US FTA.
91) Article 2.2.2 of Korea-US FTA.
92) Article 19.2(b) of Korea-Chile FTA.
93) Article 19.14.2 of Korea-Chile FTA.

Korea-US FTA envisages some exceptions to both the national treatment principle, and import and export restrictions. Namely, actions authorized by the WTO DSB are not subject to national treatment.[94] This is the case for suspension of the GATT Article III obligation authorized pursuant to DSU Article 22. Another exceptional case involves the party's measures to address market disruption in accordance with procedures that have been incorporated into the WTO Agreement.[95] While the two instances above are applicable to both parties, the US has reserved for itself two more exemptions, namely (1) any control on the export of logs of all species which appears to be pertinent to import and export restrictions, rather than national treatment, and (2) any measure under the so called Jones Act which requires that vessels carrying passengers and goods within the US to be built and documented in the US, owned and run by US citizens.[96] Initially, this Act had been justified in GATT 1947 by a "grandfather" clause which was later reintroduced in GATT 1994 and is now subject to regular reviews by the WTO Ministerial Conference.[97] Notwithstanding the multilateral exception, the US government has persistently secured the Jones Act exception in its FTAs.[98]

94) Annex 2-A, Section A(a) and Section B(c) of Korea-US FTA.
95) Annex 2-A, Section A(b) and Section B(d) of Korea-US FTA.
96) US Merchant Marine Act of 1920, 46 App. U.S.C. 883.
97) See paragraph 3 of GATT 1994.
98) See *e.g.* Annex 3.2 of US-Chile FTA, Annex 2A of US-Singapore FTA, and Annex 2-A of US-Australia FTA.

VII. Conclusion

The GATT national treatment clause on internal taxation is relatively straightforward. However, it involves a multitude of complex issues depending on what sentence of Article III:2 is invoked. Given the broader product coverage in Article III:2, second sentence, the complaining party may prefer to invoke the second sentence instead of resorting to the first sentence which employs a stricter likeness standard. On the other hand, the first sentence does not require a determination of the protectionist purpose or effect, nor does it allow a *de minimis* threshold for the tax differential. Accordingly, the overall burden of challenge of the tax measure, whether under the first sentence or the second sentence, seems to be virtually the same.

In the wake of on-going trade liberalization and ever-increasing transparency in government actions, WTO Members will tend to use sophisticated means of protection of domestic production through origin-neutral, rather than origin-specific, measures. Obviously, complaining Members will bear heavier burden of proof with respect to implicit or *de facto* discrimination to expose disguised protectionism behind the contested measure.

Some discrepancy in the Appellate Body's approach to the subjective intent issue seems to leave some room for referring to government statements in future analyses of protective application. At least, interested parties will tend to submit such evidence to persuade panels or the Appellate Body of the protectionist purpose of a contested measure. However, it appears that the adjudicatory bodies will most likely avoid relying on these sources as primary evidence for their findings.

Korea and its FTA partners have affirmed their adherence to GATT Article III. When the FTA parties enter into a dispute over national treatment, the problem of applicable law may arise. Specifically, can WTO panels apply or interpret the GATT-plus provisions on national treatment contained in the FTA, *i.e.* non-WTO treaty? It seems that panel's jurisdiction may cover the provisions in question if the parties agree, pursuant to DSU Article 7.3, on non-standard terms of reference of the panel where those provisions are explicitly listed.[99] Alternatively, in order to avoid some possible jurisprudential difficulties, the parties may choose to refer the matter to an FTA panel, instead of launching a WTO dispute settlement procedure. In any case – be it a WTO panel acting on the basis of special terms of reference or an FTA panel – the GATT-plus national treatment clause, as a *lex posterior*, should prevail over the corresponding GATT provision.[100] Finally, given the incorporation of GATT Article III into the FTA text, it is suggested that FTA panels, wherever possible, follow the WTO interpretations of Article III provisions to secure consistent and predictable application of the national treatment rule.

99) See Pauwelyn (2003), pp. 444-445.

100) Article 30.3 of the Vienna Convention on the Law of Treaties reads: When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.

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Appendix

WTO Disputes Involving GATT Article III
(1 January 1995 - 1 January 2008)

No.	Dispute Title	Complainant	DS No.	GATT Art. III, Paragraph (?)[101]
1	United States - Standards for Reformulated and Conventional Gasoline	Venezuela	2	Para. 4
2		Brazil	4	Para. 4
3	Korea - Measures Concerning the Testing and Inspection of Agricultural Products	US	3	N/A
4	Korea - Measures Concerning the Shelf-Life of Products	US	5	N/A
5	European Communities - Trade Description of Scallops	Canada	7	N/A
6		Peru	12	N/A
7		Chile	14	N/A
8	Japan - Taxes on Alcoholic Beverages	EC	8	Para. 2
9		Canada	10	Para. 2
10		US	11	Para. 2
11	Japan - Measures Affecting the Purchase of Telecommunications Equipment	EC	15	Para. 4
12	European Communities - Regime for the Importation, Sale and Distribution of Bananas	Guatemala, Honduras, Mexico, US	16	N/A
13		Ecuador, Guatemala, Honduras, Mexico, US	27	N/A

101) This column points to the particular provisions of GATT Article III which were initially referred to in consultation requests or subsequently at the panel/appellate stage. "N/A" refers to cases where Article III was mentioned without further specification as to the provision thereunder.

No.	Dispute Title	Complainant	DS No.	GATT Art. III, Paragraph (?)
14	Korea - Measures concerning Bottled Water	Canada	20	N/A
15	European Communities - Measures Concerning Meat and Meat Products (Hormones)	US	26	N/A
16		Canada	48	N/A
17	Canada - Certain Measures Concerning Periodicals	United States	31	Para. 2
18	United States - The Cuban Liberty and Democratic Solidarity Act	EC	38	N/A
19	Korea - Laws, Regulations and Practices in the Telecommunications Procurement Sector	EC	40	N/A
20	Korea - Measures concerning Inspection of Agricultural Products	US	41	N/A
21	Turkey - Taxation of Foreign Film Revenues	US	43	N/A
22	Japan - Measures Affecting Consumer Photographic Film and Paper	US	44	Para. 4
23	Brazil - Certain Automotive Investment Measures	Japan	51	Para. 4
24	Brazil - Certain Measures Affecting Trade and Investment in the Automotive Sector	US	52	Para. 4
25		US	65	Para. 4
26	Indonesia - Certain Measures Affecting the Automobile Industry	EC	54	Paras. 2 and 4
27		Japan	55	Paras. 2 and 4
28		US	59	Paras. 2, 4, 5 and 7
29	United States - Import Prohibition of Certain Shrimp and Shrimp Products	Philippines	61	Paras. 2, 4, 5 and 7
30	Philippines - Measures Affecting Pork and Poultry	US	74	N/A
31		US	102	N/A
32	Korea - Taxes on Alcoholic Beverages	EC	75	Para. 2
33		US	84	Para. 2
34	Brazil - Measures Affecting Trade and Investment in the Automotive Sector	EC	81	Para. 4

No.	Dispute Title	Complainant	DS No.	GATT Art. III, Paragraph (?)
35	United States – Measures Affecting Textiles and Apparel Products	EC	85	N/A
36	Chile – Taxes on Alcoholic Beverages	EC	87	Para. 2
37		US	109	Para. 2
38		EC	110	Para. 2
39	United States – Measures Affecting Imports of Poultry Products	EC	100	N/A
40	United States – Tax Treatment for "Foreign Sales Corporations"	EC	108	Para. 4
41	United States – Harbour Maintenance Tax	EC	118	N/A
42	Slovak Republic – Measures Concerning the Importation of Dairy Products and the Transit of Cattle	Switzerland	133	N/A
43	European Communities – Restrictions on Certain Import Duties on Rice	India	134	N/A
44	United States – Anti-Dumping Act of 1916	EC	136	Para. 4
45		Japan	162	N/A
46	European Communities – Measures Affecting Imports of Wood of Conifers from Canada	Canada	137	N/A
47	Canada – Certain Measures Affecting the Automotive Industry	Japan	139	Para. 4
48		EC	142	Para. 4
49	United States – Certain Measures Affecting the Import of Cattle, Swine and Grain from Canada	Canada	144	N/A
50	India – Measures Affecting the Automotive Sector	EC	146	Para. 4
51	India – Import Restrictions	EC	149	N/A
52	India – Measures Affecting Customs Duties	EC	150	Para. 2
53	United States – Measures Affecting Textiles and Apparel Products (II)	EC	151	N/A

No.	Dispute Title	Complainant	DS No.	GATT Art. III, Paragraph (?)
54	United States - Sections 301 - 310 of the Trade Act 1974	EC	152	N/A
55	Argentina - Measures Affecting the Export of Bovine Hides and the Import of Finished Leather	EC	155	Para. 2
56	Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef	US	161	Para. 4
57		Australia	169	Para. 4
58	European Communities - Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs	US	174	Para. 4
59		Australia	290	Para. 4
60	India - Measures Affecting Trade and Investment in the Motor Vehicle Sector	US	175	Para. 4
61	United States - Section 337 of the Tariff Act of 1930 and Amendments thereto	EC	186	N/A
62	Philippines - Measures Affecting Trade and Investment in the Motor Vehicle Sector	US	195	Paras. 4 and 5
63	Brazil - Measures Affecting Patent Protection	US	199	N/A
64	Mexico - Measures Affecting Trade in Live Swine	US	203	Para. 4
65	United States - US Patents Code	Brazil	224	N/A
66	Peru - Taxes on Cigarettes	Chile	227	Para. 2
67	European Communities - Trade Description of Sardines	Peru	231	N/A
68	Mexico - Measures Affecting the Import of Matches	Chile	232	Para. 4
69	Argentina - Measures Affecting the Import of Pharmaceutical Products	India	233	N/A
70	Turkey - Certain Import Procedures for Fresh Fruit	Ecuador	237	N/A
71	Romania - Import Prohibition on Wheat and Wheat Flour	Hungary	240	Para. 4

No.	Dispute Title	Complainant	DS No.	GATT Art. III, Paragraph (?)
72	United States – Equalizing Excise Tax Imposed by Florida on Processed Orange and Grapefruit Products	Brazil	250	Paras. 1, 2 and 4
73	Peru – Tax Treatment on Certain Imported Products	Chile	255	N/A
74	Uruguay – Tax Treatment on Certain Products	Chile	261	N/A
75	European Communities – Export Subsidies on Sugar	Australia	265	Para. 4
76		Brazil	266	Para. 4
77		Thailand	283	Para. 4
78	United States – Subsidies on Upland Cotton	Brazil	267	Para. 4
79	Venezuela – Import Licensing Measures on Certain Agricultural Products	US	275	N/A
80	India – Import Restrictions Maintained Under the Export and Import Policy 2002-2007	EC	279	N/A
81	United States – Anti-Dumping Measures on Cement from Mexico	Mexico	281	Para. 4
82	South Africa – Definitive Anti-Dumping Measures on Blanketing from Turkey	Turkey	288	N/A
83	European Communities – Measures Affecting the Approval and Marketing of Biotech Products	US	291	N/A
84		Canada	292	Para. 4
85		Argentina	293	N/A
86	Dominican Republic – Measures Affecting the Importation of Cigarettes	Honduras	300	Paras. 2 and 4
87	European Communities – Measures Affecting Trade in Commercial Vessels	Korea	301	Para. 4
88	Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes	Honduras	302	Paras. 2 and 4
89	Mexico – Tax Measures on Soft Drinks and Other Beverages	US	308	Paras. 2 and 4

No.	Dispute Title	Complainant	DS No.	GATT Art. III, Paragraph (?)
90	China – Value-Added Tax on Integrated Circuits	US	309	N/A
91	United States – Measures Affecting Trade in Large Civil Aircraft	EC	317	Para. 4
92	Brazil – Measures Affecting Imports of Retreaded Tyres	EC	332	Para. 4
93	Turkey – Measures Affecting the Importation of Rice	US	334	Paras. 4, 5 and 7
94	China – Measures Affecting Imports of Automobile Parts	EC	339	Paras. 1, 2, 4, and 5
95		US	340	Paras. 2, 4, and 5
96		Canada	342	Paras. 2, 4 and 5
97	United States – Measures Relating to Shrimp from Thailand	Thailand	343	N/A
98	European Communities – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)	US	347	Para. 4
99	India – Measures Affecting the Importation and Sale of Wines and Spirits from the European Communities	EC	352	Paras. 2 and 4
100	United States – Measures Affecting Trade in Large Civil Aircraft – Second Complaint	EC	353	Para. 4
101	Canada – Tax Exemptions and Reductions for Wine and Beer	EC	354	Paras. 1, 2 and 4
102	China – Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments	US	358	Para. 4
103		Mexico	359	Para. 4
104	India-Additional and Extra-Additional Duties on Imports from the United States	US	360	Paras. 2 and 4
105	Colombia – Indicative Prices and Restrictions on Ports of Entry	Panama	366	Paras. 2 and 4
106	European Communities – Certain Measures Prohibiting the Importation and Marketing of Seal Products	Canada	369	Para. 4

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