

CANADA - CERTAIN MEASURES CONCERNING PERIODICALS

Report of the Panel

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I. INTRODUCTION

1.1 On 11 March 1996, the United States requested Canada to hold consultations pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and Article XXIII of the General Agreement on Tariffs and Trade 1994 (GATT 1994) on certain measures maintained by Canada, namely, measures prohibiting or restricting the importation into Canada of certain periodicals; tax treatment of so-called "split-run" periodicals; and the application of favourable postage rates to certain Canadian periodicals (WT/DS31/1). These consultations were held on 10 April 1996. As they did not result in a satisfactory adjustment of the matter, the United States, in a communication dated 24 May 1996, requested the Dispute Settlement Body (DSB) to establish a panel to examine the matter (WT/DS31/2).

1.2 The DSB, at its meeting on 19 June 1996, established a panel on the matter in accordance with Article 6 of the DSU. In document WT/DS31/3, the Secretariat reported that the Panel would have the following standard terms of reference and composition:

"To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS31/2, the matter referred to the DSB by the United States in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.3 On 25 July 1996, the Panel was constituted with the following composition:

Chairman: Mr. Lars Anell

Panelists: Mr. Victor Luiz do Prado
Mr. Michael Reiterer

1.4 No Members reserved their rights to participate in the Panel proceedings as a third party.

1.5 The Panel met with the parties to the dispute on 11 October 1996 and 14-15 November 1996. The Panel submitted its report to the parties on 21 February 1997.

II. FACTUAL ASPECTS

2.1 This Panel concerns three Canadian measures: Tariff Code 9958 which prohibits the importation into Canada of certain periodicals; Part V.I of the Excise Tax Act, as enacted by Bill C-103 of 15 December 1995, which imposes an excise tax on certain "split-run" periodicals; and the application of certain postal rates to certain Canadian periodicals including through actions of Canada Post Corporation and the Department of Canadian Heritage.

A. Tariff Code 9958 - Import Prohibition

2.2 In 1965, the Canadian Government enacted Tariff Code 9958, in Schedule VII of the Customs Tariff. It is put into effect by Article 114 of the Customs Tariff which provides that "the importation into Canada of any goods enumerated or referred to in Schedule VII is prohibited".¹ Tariff Code 9958 applies if an issue of a periodical imported into Canada is a special edition, including a split-run or regional edition, that contains an advertisement that is primarily directed to a market in Canada and that

¹R.S.C. 1985, c. 41 (3rd Suppl.) as amended to 30 April 1996, s.114, Sch. VII, Item 9958, (1996 Customs Tariff: Departmental Consolidation) Ottawa: Minister of Supply & Services Canada, 1996.

does not appear in identical form in all editions of that issue of the periodical that were distributed in the periodical's country of origin. The Code defines an "issue" to include a special annual issue, and a "periodical" to mean a periodical, the issues of which other than the special annual issue, are published at regular intervals of more than six days and less than fifteen weeks and are distributed as issues of a distinct publication or as a supplement to more than one newspaper, but does not include a catalogue, a newspaper, or a periodical, the principal function of which is the encouragement, promotion or development of the fine arts, letters, scholarship or religion.

2.3 For the purposes of determining whether or not an advertisement is primarily directed at the Canadian market, a number of factors are taken into consideration such as whether there are enticements to the Canadian market, references to the goods and services tax, listing of Canadian addresses as opposed to foreign addresses, and specific invitations to Canadian consumers only.

2.4 The Code also applies where an issue of a periodical imported into Canada is an edition in which more than five per cent of the advertising content consists of advertisements directed to the Canadian market. Advertisements directed to the Canadian market include those that indicate specific sources of product or service availability in Canada or which include specific terms or conditions relating to the sale of goods or services in Canada.² The publisher of a periodical is notified by the Department of National Revenue for Customs and Excise when a periodical is found to be in contravention of Tariff Code 9958.³

2.5 In 1988, the Canadian Parliament enacted an exception to Tariff Code 9958 which allows Canadian publishers to have their periodicals, which must otherwise be Canadian issues of Canadian periodicals, typeset or printed wholly or partially in the United States.

B. Part V.I of the Excise Tax Act

2.6 In 1995, Bill C-103, which added Part V.I - Tax on Split-run Periodicals to the Excise Tax Act, became law.⁴ The amendment calls for the imposition, levy and collection, in respect of each split-run edition of a periodical, a tax equal to 80 per cent of the value of all the advertisements contained in the split-run edition. The tax is levied on a per issue basis. The value of all advertisements in a split-run edition of a periodical is the total of all the gross fees for all the advertisements contained in the edition.⁵ The term "periodical" means printed material that is published in a series of issues that appear not less than twice a year and not more than once a week. Where an issue of a periodical is published in several versions, each version is an edition of the issue. Each edition of the issue must be considered separately when determining whether an edition is a split-run edition. The definition of "periodical" explicitly excludes a catalogue which is substantially made up of advertisements.⁶

2.7 The amendment defines a split-run edition as an edition of an issue of a periodical that:

- (i) is distributed in Canada;
- (ii) in which more than 20 per cent of the editorial material is the same or substantially the

²The Department of National Revenue for Customs and Excise has adopted and published guidelines providing details relating to the application and administration of Code 9958 of the Customs Tariff (Revenue Canada Memorandum D9-1-10, 21 May 1993).

³The Importation of Periodicals Regulations (C.R.C., c. 533 as amended on 30 April 1996) describe the review process as carried out by an officer or the Deputy Minister of the Department of National Revenue for Customs and Excise.

⁴An Act to amend the Excise Tax Act and the Income Tax Act, S.C. 1995, c. 46.

⁵*Ibid.*, s. 38.

⁶*Ibid.*, ss.35(1) and 35(5).

same as editorial material that appears in one or more excluded editions of one or more issues of one or more periodicals; and

- (iii) contains an advertisement that does not appear in identical form in all the excluded editions.

There are two exclusionary provisions. Under the first, the particular edition is not a split-run edition if it is an edition that is primarily circulated outside Canada. In effect, this is an exemption for editions that are distributed in Canada, but are mainly distributed outside Canada. Under the second, a particular edition of an issue of a periodical that would otherwise be a split-run edition is not a split-run edition if all the advertisements in the particular edition appear in identical form in one or more editions of that issue that are primarily distributed outside Canada and that have a combined circulation outside Canada that is greater than the circulation in Canada of the particular edition. The purpose is to prevent a publisher from qualifying for this exemption by having all the advertisements in its Canadian split-run edition also appear in one of its excluded editions that has a very small circulation.⁷

2.8 Further, a grandfathering provision provides limited "grandfathering" treatment to certain existing periodicals that distributed Canadian split-run editions prior to 26 March 1993. A particular periodical is eligible for "grandfathering" treatment and therefore not subject to the tax on split-runs if the number of split-run editions per year does not exceed the number of split-run editions that were distributed during the 12-month period ending on 26 March 1993, provided that the periodicals continue to be similar in editorial content and direction to the split-run editions distributed before that date. If the number of split-run editions per year is increased, the tax applies to the additional split-run editions.⁸

2.9 Depending on the circumstances, the person responsible for paying the tax is the publisher, a person connected with the publisher, the distributor, the printer or the wholesaler of the split-run edition. (The Excise Tax Act stipulates that a person is considered to be connected to another person if one of them is controlled by the other or if both of them are controlled by the same person.⁹ A corporation is controlled by a particular person if 50 per cent or more of its share of capital with voting rights belongs to that person or to persons with whom that person does not deal at arm's length. A partnership is controlled by a particular person if the person or persons with whom that person does not deal at arm's length is or are entitled to 50 per cent or more of the partnership's income.¹⁰) The responsible person is the first of these persons who resides in Canada.¹¹ The responsible person can be domestic- or foreign-owned or controlled. In order to ensure enforcement and collection of the tax, the tax is imposed on a person who resides in Canada. The persons connected with the responsible person are jointly and severally liable for payment of the tax.¹² As well, where the responsible person is a distributor, a printer or a wholesaler (and if there is more than one), they are jointly and severally liable for payment of the tax.¹³ Where a person other than the publisher pays the excise tax in respect of a split-run edition, the person is deemed to have paid the tax on behalf of the publisher of the periodical. The legislation authorizes the person to recover the amount of the tax from the publisher in a court of competent jurisdiction or to deduct or withhold the amount from any amount payable by the person to the publisher or distributor of the periodical.¹⁴

⁷ *Ibid.*, ss.35(5).

⁸ *Ibid.*, s. 39.

⁹ *Ibid.*, ss.35(2).

¹⁰ *Ibid.*, ss.35(3).

¹¹ *Ibid.*, ss.35(1).

¹² *Ibid.*, s. 41.1.

¹³ *Ibid.*, s. 41.2.

¹⁴ *Ibid.*, ss.41.3(2).

C. Funded and Commercial Postal Rates

2.10 In 1981, the Canada Post Corporation (hereafter called Canada Post) was established by the Parliament of Canada as a Crown corporation pursuant to the Canada Post Corporation Act (CPC Act).¹⁵ Crown corporations are created by one of three methods: an Act of Parliament; letters patent under the Canada Business Corporations Act; or Articles of Incorporation under the Canada Business Corporations Act. According to a treatise on Crown law cited by Canada, Crown corporations are created to separate the management of an activity from continuous partisan intervention and to provide independence from the close financial controls within the government departmental structure.¹⁶ The Government of Canada gains control over, and accountability from, Crown corporations primarily through the Financial Administration Act (FA Act) and its Regulations. The FA Act endeavours to strike a balance between the desires for public accountability and for private industry independence. Parliament is required to approve the creation, mandate, and financing of new parent Crown corporations. Government approval is required for annual corporate plans operating and capital budgets, and major corporate acquisitions. The FA Act and the CPC Act define the responsibilities for the direction and daily operation of the corporations.

2.11 The Canada Post publication entitled *Publications Mail Postal Rates*, (effective 4 March 1996), describes the three categories of publications mail postal rates which are the subject of this dispute: the "funded" publications rates and the commercial "Canadian" and commercial "International" publications rates. The first two categories apply to periodicals published and printed in Canada. "Funded" rates are rates that are subsidized by the Canadian Government and commercial rates are for publications ineligible for "funded" rates. "Canadian" rates are commercial rates available to Canadian publications and "International" commercial rates apply to all foreign publications mailed in Canada.

(i) "Funded" rates

2.12 Since its incorporation, the Government of Canada has provided funding to Canada Post to support special rates of postage for eligible publications through the Publications Distribution Assistance Program (hereafter called the Program). The Program, which was developed to promote Canadian culture, provided funding through Canada Post to eligible Canadian publications, including periodicals, mailed in Canada for delivery in Canada. "Funded" postal rates are available to Canadian-owned and -controlled paid circulation publications that are published and printed in Canada and meet certain editorial and advertising requirements. In January 1990, the Government announced plans to gradually phase out the Program and replace it with a system of direct funding to eligible publications. Since the announcement, funding available for the Program has been gradually reduced. On 30 April 1996, the current policy and funding agreement concerning the Program between Canada Post and the Department of Canadian Heritage (hereafter called Canadian Heritage) was set to expire. At that time, available funding would have been directed to eligible publishers through a replacement program.¹⁷

2.13 The Program and its funding structure was extended for three years through a Memorandum of Agreement (MOA), signed in March 1996 and effective 1 May 1996, between the Department of Communications (now the Department of Canadian Heritage) and Canada Post.¹⁸ This new agreement

¹⁵R.S.C. 1985, c. C-10.

¹⁶P. Lordon, *Crown Law* (Toronto: Butterworths 1991) at 49, 57 and 58. The next five sentences are also from this source.

¹⁷*Canada Gazette*, Part II, Vol 130, No. 10, Newspapers and Periodicals Regulations, repeal, SOR/96-209, 23 April 1996, Regulatory Impact Analysis Statement.

¹⁸Memorandum of Agreement (MOA) Concerning the Publications Assistance Program Between the Department of Communications and Canada Post Corporation.

provides for payments of funds in quarterly instalments by Canadian Heritage to Canada Post "in exchange for providing prescribed postage rates for publications deemed eligible to the Publications Assistance Program", and the transfer of the program administration from Canada Post to Canadian Heritage.¹⁹ Canadian Heritage had requested within the new agreement that Canada Post initiate the complete removal of funded publications mail from the regulations associated with the CPC Act, effective April 1996.²⁰ On 23 April 1996, Canada Gazette published a repeal of the Newspapers and Periodicals Regulations pursuant to Subsection 19(1) of the CPC Act. The revocation was intended to facilitate the transfer of eligibility assessment from Canada Post to Canadian Heritage, to reduce the Program's administrative costs while expediting and simplifying modifications to its policies²¹, and to allow Canada Post and Canadian Heritage to respond more appropriately and more rapidly to Program and customer needs.

2.14 The amounts authorized by the MOA are CD\$58 million for the period commencing 1 May 1996 and ending 31 March 1997; CD\$57.9 million for the period 1 April 1997 to 31 March 1998; and CD\$47.3 million for the period 1 April 1998 to 31 March 1999.

2.15 Canadian Heritage administers the eligibility requirements for the Program based on the criteria specified in Schedule A to the MOA. Canadian Heritage is responsible for the administration of the eligibility requirements for the Program, and Canada Post must accept for distribution all publications that are eligible under the Program once the publication is approved by Canadian Heritage. For eligible publications to receive funded rates, the publisher must first enter into a sales agreement with Canada Post prior to posting under the Program. Rates of postage for publications eligible under the Program are set out in Schedule C of the MOA and are as follows:

a) First 10,000 copies of an issue addressed to *Bona Fide* Subscribers and newsdealers in Canada:

per kg or fraction thereof:	Year 1: \$0.390
	Year 2: \$0.395
	Year 3: \$0.405
or, per individually addressed copy whichever is the greater:	
	Year 1: \$0.078
	Year 2: \$0.079
	Year 3: \$0.081

b) Copies exceeding the first 10,000 copies of an issue addressed to *Bona Fide* Subscribers and newsdealers in Canada:

per kg or fraction thereof:	Year 1: \$0.430
	Year 2: \$0.435
	Year 3: \$0.445
or, per individually addressed copy, whichever is the greater:	
	Year 1: \$0.086
	Year 2: \$0.087
	Year 3: \$0.089

(Year 1: 1 May 1996 to 31 March 1997; Year 2: 1 April 1997 to 31 March 1998;
Year 3: 1 April 1998 to 31 March 1999.)

2.16 In order to be eligible for funded rates, Canadian publications must generally meet the following

¹⁹ *Canada Gazette*, Part II, Vol 130, No. 10.

²⁰ *Ibid.*

²¹ *Ibid.*

criteria: (i) produced by a person or company whose primary business is publishing²²; (ii) Canadian ownership and control; (iii) published, printed and mailed in Canada; (iv) edited in Canada²³; (v) eligible editorial categories²⁴; (vi) minimum paid circulation requirement²⁵; (vii) maximum advertising allowance²⁶; (viii) frequency²⁷; and (ix) minimum price.²⁸

(ii) Commercial "Canadian" and commercial "International" rates

2.17 Canada Post has authority to set its commercial rates outside of regulation, pursuant to subsections 16(1) and 21(a) of the CPC Act, for any person who has entered into an agreement with Canada Post for (a) the variation of rates of postage on the mailable matter of that person in consideration of his mailing in bulk, preparing the mailable matter in a manner that facilitates the processing thereof or receiving additional services in relation thereto;...".²⁹ In order to take advantage of this provision and receive commercial postal rates and service, a publisher must enter into an agreement with Canada Post. For a Canadian publication, this agreement is the "Publications Mail Product Service Agreement"³⁰, and for a foreign publication mailed in Canada, this agreement is the "International Publications Mail Product (Canadian Distribution) Sales Agreement".³¹ These arrangements are intended to benefit Canadian and foreign publications and their subscribers by reducing mailing costs and improving delivery standards. Appendix A of each "Agreement" contains the commercial "Canadian" and commercial "International" rates. These rates are identical to those found in the *Publications Mail Postal Rates* (referred to in paragraph 2.11) which divides commercial rates into those that apply for (i) mail service for Canadian publications that are ineligible for "funded" rates (Rate Code 5); and (ii) mail service for international publications (Rate Code 6 or what are called "International" rates in this dispute). Further, special agreements may be entered into for both Canadian and non-Canadian publications whereby terms and conditions (including rates of postage) may be established on a case-by-case basis.

2.18 Publications must meet the six criteria enumerated below in order for their publishers to enter into either a "Publications Mail Products Sales Agreement" or an "International Publications Mail Product Sales Agreement". Additionally for the former, the publication "must be a newspaper, newsletter or periodical, published, printed and mailed in Canada".³² Additionally for the latter, the publications "must be a newspaper, newsletter or periodical printed outside of Canada or registered

²²Funded rates cannot be used to promote a specific business, service, fraternal, trade or professional organizations (MOA).

²³An eligible publication must be edited by persons residing in Canada (editing encompasses the commissioning of editorial material and artwork, supervising writers, illustrators and photographers regarding the final format of the material, as well as laying out, copy editing and proofreading, and otherwise preparing the contents for printing) (MOA).

²⁴Eligible publications must be published for the dissemination to the public consisting of either news, comment and analysis of news and articles on topics of current public interest; or articles on religion, the sciences, agriculture, forestry, the fisheries, social or literary criticism, reviews of literature or the arts, or be an academic or scholarly journal; or articles promoting public health and published by a non-profit organization administered on a national or provincial basis (MOA).

²⁵No less than 50 per cent of an eligible publication's total circulation must be paid circulation (MOA).

²⁶No more than 70 per cent of the space, including advertising inserts, in an eligible publication may be devoted to advertising (MOA).

²⁷It must be published not less than twice a year and not more than 56 times a year (MOA).

²⁸It must have a stated subscription price of \$0.50 or more per copy and \$6.00 or more per year.

²⁹R.S.C. 1985, c.C-10, s. 21(a).

³⁰Canadian Publications Mail Products Sales Agreement, 1 March 1995.

³¹International Publications Mail Product (Canadian Distribution) Sales Agreement, 1 March 1994.

³²Canadian Publications Mail Products Sales Agreement, para. 5.1.

under Rate Code 5 prior to 1 March 1992".³³

Six criteria:

- (i) published for the purposes of disseminating to the public news, articles containing comments on or analysis of the news, and articles with respect to other topics currently of interest to the general public;
- (ii) devoted primarily to one or more of religion, the sciences, agriculture, forestry, the fisheries, social or literary criticism or reviews of literature or the arts, or academic or scholarly writings;
- (iii) published at a frequency of not less than four times a year;
- (iv) addressed to a subscriber, non-subscriber, company or to a newsdealer in Canada;
- (v) containing not more than 70 per cent of the space devoted to advertising in more than 50 per cent of the issues published during any twelve month period; and
- (vi) published by or at the direction of a person whose principal business is publishing.

2.19 The rates for the commercial "Canadian" and commercial "International" publications mail service are summarized as follows:

Commercial "Canadian" rates:

Minimum postage per addressed copy (100g or less)	Price per copy
Local rural rates	\$0.103
Local urban rates	\$0.231
Regional rates	\$0.184
National rates	\$0.378

Commercial "International" rates:

Minimum postage per addressed copy (100g or less)	Price per copy
Rates for foreign magazines, newspapers or newsletters mailed in Canada (inbound)	\$0.436

Two sub-categories include discounts for palletization and by-pass. Non-subsidized Canadian publications can receive discounts of \$0.01 to \$0.02 per copy if palletized, and discounts ranging from \$150.00 to \$200.00 per truck load for a by-pass or downstream entry. These discounts are not available generally to foreign publications mailed in Canada. Further, the commercial "Canadian" and commercial "International" categories have not been subject to regulation since 1994 and 1992, respectively.³⁴

[Parties' arguments in Section III deleted from this version]

³³International Publications Mail Product (Canadian Distribution) Sales Agreement, para. 4.1.

³⁴SOR/94-210, 24 February 1994 and SOR/91-641, 7 November 1991.

IV. INTERIM REVIEW

4.1 On 23 January 1997, the United States requested the Panel to review, in accordance with Article 15.2 of the DSU, precise aspects of the interim report that had been issued to the parties on 16 January 1997. Canada did not request a review, but wished to reserve its right to respond to the US comments. The Panel ruled that, given the circumstances in this particular case, Canada could submit its response by 31 January 1997. Canada submitted its response to the US comments on 31 January 1997, urging the Panel to disregard a large part of the US comments. Neither the United States nor Canada requested the Panel to hold a meeting. The Panel reviewed the entire range of arguments presented by the parties in their written submissions, and finalized its findings as in Section V below, taking into account the specific aspects it considered to be relevant.

4.2 Regarding Tariff Code 9958, the interim report had focused on the "split-run" rule, which the Panel found to be the principal issue, and had not mentioned the second part of the Code, namely the five-per-cent rule. The United States requested the inclusion of this part in the findings. Canada did not object to this request. The Panel agreed to the inclusion and introduced some drafting modifications in the final report at paragraphs 5.1 and 5.4.

4.3 The interim report had, in a part corresponding to paragraph 5.24 of the final report, stated that the definition of a "split-run" edition relied *solely* on factors external to the Canadian market. The United States suggested that the Panel change this word to *decisively*. Canada objected to this change. However, the Panel considered the US suggestion to be a useful one to improve the accuracy of the findings, and accordingly modified the expression in the way it now appears in paragraph 5.24.

4.4 Regarding paragraph 5.25 of the final report, the United States suggested that the Panel add that "(1) any number of additional hypothetical examples could be devised that would further show that split-run and non-split-run periodicals need not be any different, and that (2) this is to be expected because the definition of split-run periodicals provides that two virtually identical products can be taxed differently depending on whether or not a similar product is sold outside Canada". While the Panel did not disagree with this observation, it was not persuaded that such an addition would enhance the clarity of the logic in the final report. The Panel therefore decided not to introduce the suggested change.

4.5 Regarding the directness of the taxation (paragraphs 5.28 and 5.29 of the final report), the United States argued that this was a case of direct taxation because the excise tax was focused on a particular type of good. The Panel rejected this argument. However, in this connection, the United States pointed out that a certain citation of past cases in the interim report could be somewhat misleading. The Panel accepted this point, and modified the paragraphs accordingly.

4.6 Regarding the differences between "commercial Canadian" and "international" rates applied by Canada Post to periodicals, the United States commented that the interim report failed to mention certain additional discount options which were available only to Canadian periodicals. The Panel accepted this comment and introduced some drafting modifications in the final report at paragraphs 5.1, 5.39 and 6.1. The United States further requested that the final report refer to the long-term discount contracts between Canada Post and large-circulation magazine publishers (see paragraph 3.171). Canada objected to this request on the grounds that these agreements or contracts had "never been one of the objects of this dispute". The Panel considered that this particular issue was not presented by the United States in a coherent manner during the proceedings, and that it was too late for the United States to raise this issue as an additional claim at the interim review stage. Accordingly, the Panel did not accept the US request on this point.

4.7 The United States suggested that the Panel restructure paragraph 5.36 of the final report as an

alternative argument because, according to the United States, the fact that Canada Post is an entity of the Canadian Government was a sufficient reason to find a violation of Article III:4 of GATT 1994 in this instance. However, the Panel considered such a change unnecessary. In the Panel's view, it was clear that the *Semi-Conductor* case was cited here as supporting evidence, not as decisive reason for finding the violation.

4.8 The United States questioned the appropriateness of paragraphs 5.37 and 5.38 of the final report, suggesting that the examination of Article III:1 of GATT 1994 was unnecessary in this case. Canada did not object to this comment. However, in the Panel's view, the Appellate Body Report on *Japan - Taxes on Alcoholic Beverages* clearly mandates it to engage in such an examination. The Panel therefore decided to retain these paragraphs unchanged from the way in which they appeared in the interim report.

4.9 Regarding paragraphs 5.42 to 5.44 of the final report, the United States considered that the Panel erroneously concluded that the "funded" rate scheme constituted a payment of subsidies permitted by Article III:8 of GATT 1994. The Panel disagreed for reasons elaborated in its final report. The Panel accordingly did not introduce modifications to the final report in this respect.

4.10 The United States also made other drafting suggestions concerning the descriptive part, some of which the Panel accepted and introduced in its final report.

V. FINDINGS

A. Introduction

5.1 This dispute essentially arises from the following facts: (a) Canada prohibits imports of "split-run" periodicals (periodicals with the same or similar editorial content as those published in foreign countries, which contain an advertisement directed to the Canadian market) through Tariff Code 9958. Tariff Code 9958 further prohibits imports of periodicals in which more than five per cent of the advertising content consists of advertisements directed to the Canadian market, whether or not an edition with similar editorial content is sold outside Canada; (b) Canada, through Part V.1 of the Excise Tax Act, imposes an excise tax of 80 per cent on the value of advertisements in "split-run" periodicals distributed in Canada on a per issue basis; and (c) Canada Post Corporation ("Canada Post") applies reduced ("funded") postal rates, funded by the Department of Canadian Heritage ("Canadian Heritage"), to certain periodicals published in Canada. Postal rates applied to Canadian periodicals not eligible for the "funded" rates ("commercial Canadian" rates) are lower than those applied to imported periodicals ("international" rates). Certain additional discount options (such as for "palletization" and "pre-sort") are available to Canadian periodicals but are not generally available to imported periodicals.

5.2 The United States claims that (a) Tariff Code 9958 is inconsistent with Article XI of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"); (b) Part V.1 of the Excise Tax Act is inconsistent with Article III:2 of GATT 1994, or in the alternative, is inconsistent with Article III:4 of GATT 1994; and (c) the application by Canada Post of lower postal rates to domestically-produced periodicals than to imported periodicals is inconsistent with Article III:4 of GATT 1994, and the "funded" rate scheme is not a domestic subsidy within the meaning of Article III:8 of GATT 1994. The United States requests that the Panel recommend that Canada bring its measures into conformity with its obligations under GATT 1994.

5.3 Canada requests the Panel to dismiss the US claims on the grounds that (a) Tariff Code 9958 is justifiable under Article XX(d) of GATT 1994; (b) Article III of GATT 1994 does not apply to Part V.1 of the Excise Tax Act; even if the Panel decides that Article III of GATT 1994 applies to these provisions, they do not violate Article III of the GATT 1994; and (c) Article III:4 of GATT 1994 does

not apply to the "commercial" rates charged by Canada Post because they are the result of a commercial and marketing policy and not influenced by government policy and the "funded" rate scheme is a payment of subsidies allowable under Article III:8(b) of GATT 1994.

B. Tariff Code 9958

5.4 Tariff Code 9958 prohibits the importation into Canada of the following:

"1. Issues of a periodical, one of the four immediately preceding issues of which has, under regulations that the Governor in Council may make, been found to be an issue of special edition, including a split-run or a regional edition, that contained an advertisement that was primarily directed to a market in Canada, and that did not appear in identical form in all editions of that issue of that periodical that were distributed in the country of origin.

"2. Issues of a periodical, one of the four immediately preceding issues of which has, under regulations that the Governor in Council may make, been found to be an issue of more than five per cent of the advertising space in which consisted of space used for advertisements that indicated specific sources of availability in Canada, or specific terms or conditions relating to the sale of provision in Canada, of any goods or services except where the indication of such sources of availability or such terms or conditions was primarily directed at persons outside Canada".¹²¹

5.5 Since the importation of certain foreign products into Canada is completely denied under Tariff Code 9958, it appears that this provision by its terms is inconsistent with Article XI:1 of GATT 1994. Article XI:1 reads in relevant part as follows:

"No prohibitions or restrictions other than duties, taxes or other charges ... shall be instituted or maintained by any [Member] on the importation of any product of the territory of any other [Member] ...".

5.6 The question presented here is whether the import prohibition under Tariff Code 9958 may be justified under other provisions of the WTO Agreement. Canada claims that the measure is justified under Article XX(d) of GATT 1994. The relevant part of Article XX of GATT 1994 reads as follows:

"Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any [Member] of measures: ... (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices; ...".

5.7 The panel on *United States - Standards for Reformulated and Conventional Gasoline* approached this provision in the following fashion. Having stated that the party invoking an exception under Article XX bore the burden of proving that the inconsistent measures came within its scope, the panel observed that the complainant had to demonstrate the following elements:

"(1) that the measures for which the exception were being invoked - that is, the particular trade measures inconsistent with the General Agreement - *secure compliance* with laws

¹²¹ Paragraphs 2.2-2.3 *supra*.

or regulations themselves not inconsistent with the General Agreement;

- "(2) that the inconsistent measures for which the exception was being invoked were *necessary* to secure compliance with those laws or regulations; and
- "(3) that the measures were applied in conformity with the requirements of the *introductory clause* of Article XX".¹²²

In order to justify the application of Article XX(d), according to the panel, all the above elements had to be satisfied. We will follow the same approach in the present case.¹²³

5.8 First, as to whether the import prohibition under Tariff Code 9958 secures compliance with a law or regulation not inconsistent with GATT 1994, Canada argues that Tariff Code 9958 is a measure intended to secure the attainment of the objectives of Section 19 of the Income Tax Act, which allows for the deduction of expenses for advertising directed to the Canadian market on condition that the advertisements appear in Canadian editions of Canadian periodicals. Since the United States is not challenging the GATT consistency of Section 19 of the Income Tax Act in this proceeding, the issue of GATT consistency is not before the Panel. However, the United States claims that Tariff Code 9958 is not a measure to "secure compliance" with the Income Tax Act.

5.9 The interpretative issue here is what is meant by "to secure compliance with laws and regulations" in Article XX(d) of GATT 1994. In this connection, the panel on *European Economic Community - Regulations on Imports of Parts and Components* found this phrase to mean "to enforce obligations under laws and obligations", not "to ensure the attainment of the objectives of the laws and regulations".¹²⁴ Canada suggests that this precedent should not be rigidly followed in the case of fiscal or economic incentives in general, and particularly in the present case, because Tariff Code 9958 and the income tax provision have always been considered part of a single, indivisible package. We are not persuaded by this argument. Canada's view will inherently lead to a situation where "[w]henver the objective of a law consistent with the General Agreement cannot be attained by enforcing the obligations under that law, the imposition of further obligations inconsistent with the General Agreement could then be justified under Article XX(d) on the grounds that this secures compliance with the objectives of that law", as was pointed out by the aforementioned panel.¹²⁵ We fail to see any differences that would obviate this problem in the case of fiscal or economic incentives. It should be noted, however, that we are neither examining nor passing judgment on the policy objectives of the Canadian measure regarding periodicals; we are nevertheless called upon to examine the *instruments* chosen by the Canadian Government for the attainment of such policy objectives.

5.10 Tariff Code 9958 cannot be regarded as an enforcement measure for Section 19 of the Income Tax Act. It is true that if a government bans imports of foreign periodicals with advertisements directed at the domestic market, as does Canada in the present case, the possibility of non-compliance with a tax provision granting tax deductions for expenses incurred for advertisements in domestic periodicals will be greatly reduced. It would seem almost impossible for an enterprise to place an advertisement in a foreign periodical because there would be virtually no foreign periodical available in which to place it.

¹²²Panel Report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/R, para. 6.31 (emphasis in original). The relevant part of the panel report was not modified by the Appellate Body.

¹²³We note that the Appellate Body in a recent report stated as follows: "[Adopted panel reports] create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute". Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R, p. 14.

¹²⁴Panel Report on *European Economic Community - Regulations on Imports of Parts and Components*, adopted on 16 May 1990, BISD 37S/132, paras. 5.14-5.18.

¹²⁵*Ibid.*, para. 5.17.

Thus, there would be no way for the enterprise legally to claim a tax deduction therefor. However, that is an incidental effect of a separate measure distinct (even though it may share the same policy objective) from the tax provision which is designed to give an incentive for placing advertisements in Canadian, as opposed to foreign, periodicals.¹²⁶ We thus find that Tariff Code 9958 does not "secure compliance" with Section 19 of the Income Tax Act.

5.11 In view of the above finding that Tariff Code 9958 does not secure compliance with Section 19 of the Income Tax Act, we need not consider whether the import prohibition under the Code is "necessary" to secure compliance with the tax provision or whether the measure meets the conditions in the introductory clause (or "chapeau") to Article XX. Canada has failed to satisfy at least one of the conditions identified in paragraph 5.7 above. Thus we conclude that Tariff Code 9958 is inconsistent with Article XI:1 of GATT 1994 and cannot be justified under Article XX(d).

C. The Excise Tax Act

5.12 We now turn to the examination of whether the 80 per cent excise tax on advertisements in split-run periodicals under Part V.1 of the Excise Tax Act is compatible with Canada's obligations under Article III of GATT 1994. The United States claims that Part V.1 of the Excise Tax Act is inconsistent with Article III:2 of GATT 1994, or in the alternative, is inconsistent with Article III:4.

(i) Applicability of GATT 1994

5.13 Since Canada challenges the applicability of GATT 1994 to this part of the Excise Tax Act, we address this issue first. Canada claims that Article III of GATT 1994 does not apply to Part V.1 of the Excise Tax Act because the latter is a measure pertaining to advertising services, which is within the purview of the General Agreement on Trade in Services ("GATS"). Canada further claims that the examination of Part V.1 of the Excise Tax Act in light of GATS is not covered by the terms of reference of this Panel.

5.14 Canada's argument is essentially that since Canada has made no specific commitments for advertising services under GATS, the United States should not be allowed to "obtain benefits under a covered agreement that have been expressly precluded under another covered agreement".¹²⁷ Put another way, Canada seems to argue that if a Member has not undertaken market-access commitments in a specific service sector, that non-commitment should preclude all the obligations or commitments undertaken in the goods sector to the extent that there is an overlap between the non-commitment in services and the obligations or commitments in the goods sector. Canada claims that because of the existence of the two instruments - GATT 1994 and GATS - both of which may apply to a given measure, "it is necessary to interpret the scope of application of each such as to avoid any overlap".¹²⁸

5.15 We are not fully convinced by Canada's characterization of the Excise Tax as a measure intended to regulate trade in advertising services, in view of the fact that there is no comparable regulation on advertisements through other media and the fact that the tax is imposed on a "per issue" basis. However, assuming that Canada intended to carve out Part V.1 of the Excise Tax Act from the coverage of its GATS commitments by not inscribing advertising services in its Schedule¹²⁹, does that

¹²⁶ An import ban under these circumstances is rather likely to be an enforcement measure in respect of a ban on possession or sale of a product. An import ban on alcoholic beverages might share the same objective as a criminal statute against drunk driving, but if alcoholic drinks are not banned or their sale prohibited domestically, the import ban could not be considered as an enforcement measure of the criminal statute.

¹²⁷ Paragraph 3.35 *supra*.

¹²⁸ Paragraph 3.38 *supra*.

¹²⁹ We note in this connection that Part V.1 of the Excise Tax Act was enacted in 1995, after Canada's acceptance of the

exonerate Canada from the Panel's scrutiny regarding the alleged violation of its obligations and commitments under GATT 1994?

5.16 In order to answer this question, we need to examine the structure of the WTO Agreement including its annexes. Article II:2 of the WTO Agreement is the relevant provision, which reads as follows:

"The agreements and associated legal instruments included in Annexes 1, 2 and 3 ... are integral parts of this Agreement, binding on all Members".¹³⁰

5.17 According to Article 31(1) of the 1969 Vienna Convention on the Law of Treaties ("Vienna Convention"), a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. Furthermore, as the Appellate Body has repeatedly pointed out, "one of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".¹³¹ The ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicates that obligations under GATT 1994 and GATS can co-exist and that one does not override the other. If the consequences suggested by Canada were intended, there would have been provisions similar to Article XVI:3 of the WTO Agreement or the General Interpretative Note to Annex 1A in order to establish hierarchical order between GATT 1994 and GATS. The absence of such provisions between the two instruments implies that GATT 1994 and GATS are standing on the same plain in the WTO Agreement, without any hierarchical order between the two.

5.18 In this connection, Canada also argues that overlaps between GATT 1994 and GATS should be avoided.¹³² We disagree. Overlaps between the subject matter of disciplines in GATT 1994 and in GATS are inevitable, and will further increase with the progress of technology and the globalization of economic activities. We do not consider that such overlaps will undermine the coherence of the WTO system. In fact, certain types of services such as transportation and distribution are recognized as a subject-matter of disciplines under Article III:4 of GATT 1994. It is also noteworthy in this respect that advertising services have long been associated with the disciplines under GATT Article III. As early as 1970, the Working Party on Border Tax Adjustment made the following observation:

"The Working Party noted that there was a divergence of views with regard to the eligibility for adjustment of certain categories of tax and that these could be sub-divided into

(a) "Taxes occultes" which the OECD defined as consumption taxes on capital equipment, auxiliary materials and *services* used in the transportation and production of other taxable goods. Taxes on *advertising*, energy, machinery and transport were among the more important taxes which might be involved. ... ;

(b) Certain other taxes, ...".¹³³

(..continued)

WTO Agreement.

¹³⁰GATT 1994 is included in Annex 1A. GATS is included in Annex 1B.

¹³¹Appellate Body Report on *United States - Standards for Reformulated and Conventional Gasoline*, adopted on 20 May 1996, WT/DS2/AB/R, p. 23. Also cited in the Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, *op. cit.*, p.12.

¹³²Paragraphs 3.38 and 5.14 *supra*.

¹³³"Border Tax Adjustments", Report of the Working Party adopted on 2 December 1970 (L/3464), BISD 18S/97, para. 15 (emphasis added).

We also note that there are several adopted panel reports that examined the issue of services in the context of GATT Article III. For instance, the panel on *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies* addressed the issues of access to points of sale and restrictions on private delivery of beer.¹³⁴ The panel on *United States - Measures Affecting Alcoholic and Malt Beverages* also dealt with the issues of distribution of wine and beer.¹³⁵ More to the point, the panel on *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes* specifically addressed the question of advertising.¹³⁶

5.19 In any event, since Canada admits that in the present case there is no conflict between its obligations under GATS and under GATT 1994¹³⁷, there is no reason why both GATT and GATS obligations should not apply to the Excise Tax Act. Thus, we conclude that Article III of GATT 1994 is applicable to Part V.1 of the Excise Tax Act.

(ii) **GATT Article III:2**

5.20 The next issue to be examined is whether there is a violation of Article III. The principal claim of the United States is that Part V.1 of the Excise Tax is inconsistent with Article III:2 of GATT 1994. The relevant parts of Article III read as follows:

"1. The [Members] 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.

"2. The products of the territory of any [Member] imported into the territory of any other [Member] 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 [Member] 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".

Furthermore, the Interpretative Note *ad* Article III reads in part as follows:

"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".

5.21 In the present case, the following two questions need to be answered to determine whether there is a violation of Article III:2 of GATT 1994: (a) Are imported "split-run" periodicals and domestic non "split-run" periodicals like products?; and (b) Are imported "split-run" periodicals subject to an internal tax in excess of that applied to domestic non "split-run" periodicals? If the answers to both questions are

¹³⁴Panel Report on *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, BISD 39S/27.

¹³⁵Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages*, adopted on 19 June 1992, BISD 39S/206.

¹³⁶Panel Report on *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes*, adopted on 7 November 1990, BISD 37S/200, para. 78.

¹³⁷Paragraph 3.38 *supra*.

affirmative, there is a violation of Article III:2, first sentence.¹³⁸ If the answer to the first question is negative, we need to examine further whether there is a violation of Article III:2, second sentence.

(iii) *Like product issue*

5.22 As the Appellate Body confirmed in its report on *Japan - Taxes on Alcoholic Beverages*, the definition of "like products" in Article III:2, first sentence, should be construed narrowly, on a case-by-case basis, in light of such factors as the product's end uses in a given market, consumer's tastes and habits, and the product's properties, nature and quality.¹³⁹ In applying these criteria to the present case, it should be noted that our mandate under the terms of reference of this Panel is not to discuss the likeness of periodicals in general. The question before us, as presented by the United States in its request for the establishment of a panel (WT/DS31/2) and subsequently elaborated¹⁴⁰, is a comparison between imported "split-run" periodicals and domestic non "split-run" periodicals.

5.23 This comparison, at first glance, might seem impossible in view of the fact that there are no imported "split-run" periodicals marketed in Canada due to the import prohibition under Tariff Code 9958. However, as the panel on "United States - Taxes on Petroleum and Certain Imported Substances" observed, the rationale for the national treatment obligation of Article III is to protect expectations of the Members as to the competitive relationship between their products and those of other Members.¹⁴¹ In so far as imported "split-run" periodicals are subject to the relevant provisions of the Excise Tax Act (as Canada admits to be the case)¹⁴², the comparison can be made on the basis of a hypothetical import.

5.24 We note in this regard that the Excise Tax Act defines a "split-run" edition of a periodical in terms of its editorial content (whether more than 20 per cent of the editorial material is the same or substantially the same as editorial material that appears in editions that are primarily distributed outside Canada) and advertising content (whether it contains an advertisement that does not appear in identical form in other editions distributed outside Canada). Despite the Canadian claim that the purpose of the legislation is to promote publications of original Canadian content, this definition essentially relies on factors external to the Canadian market - whether the same editorial content is included in a foreign edition and whether the periodical carries different advertisements in foreign editions.

5.25 Putting these external factors aside, imported "split-run" periodicals and domestic non "split-run" periodicals can be extremely similar. In the course of the Panel process, Canada made the following statement:

"*Harrowsmith Country Life* is a Canadian-owned magazine. Before the adoption of Part V.1 of the Excise Tax Act, *Harrowsmith Country Life* had two editions - A Canadian edition and a US edition. The Canadian and the US editions had different advertisements and a certain amount of

¹³⁸In this context, we need not examine the applicability of Article III:1 separately, because, as the Appellate Body noted in its recent report, the first sentence of Article III:2 is, in effect, an application of the general principle embodied in Article III:1. Therefore, if the imported and domestic products are "like products", and if the taxes applied to the imported products are "in excess of" those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence. Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, *op. cit.*, pp. 18-9.

¹³⁹*Ibid.*, p.20. According to the Appellate Body, the narrow construction of the term was necessary in Article III:2, first sentence, "so as not to condemn measures that its strict terms are not meant to condemn".

¹⁴⁰See paragraphs 3.104-3.108 *supra*.

¹⁴¹Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances*, adopted on 17 June 1987, BISD 34S/136, para. 5.2.2. See also the Panel Reports on *Italian Discrimination against Imported Agricultural Machinery*, adopted on 23 October 1958, BISD 7S/60, para. 18, and on *United States - Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, BISD 36S/345, para. 5.13.

¹⁴²Paragraphs 3.58 and 3.98 *supra*.

common editorial content. Because more than 20 per cent of the editorial content in the Canadian edition was the same as that in the US edition, the tax would have applied to the Canadian edition (even if the editorial content was entirely produced in Canada). As a result of the excise tax, *Harrowsmith Country Life* stopped publishing its US edition".¹⁴³

In the case of this particular periodical, if all the volumes of *Harrowsmith Country Life* had been printed in the United States (including its Canadian edition) and the Canadian edition had been exported to Canada because they were somehow exempted from the coverage of Tariff Code 9958, and if the publisher decided to publish the final issue of the US edition after the introduction of the excise tax, the publisher would have been subject to the tax for the imported Canadian edition. If this publisher thereafter discontinued the publication of the US edition, it would no longer be subject to the excise tax. Now, let us compare the two issues of this hypothetical *Harrowsmith Country Life* (Canadian edition) before and after the discontinuation of the US edition. These two editions would have common end uses, very similar physical properties, nature and qualities. It is most likely that the two volumes would have been designed for the same readership with the same tastes and habits. In all respects, these two volumes are "like", and yet one is subject to the Excise Tax, while the other is not.

5.26 Thus, we conclude that imported "split-run" periodicals and domestic non "split-run" periodicals can be like products within the meaning of Article III:2 of GATT 1994. In our view, this provides sufficient grounds to answer in the affirmative the question as to whether the two products at issue are like because, as stated earlier, the purpose of Article III is to protect expectations of the Members as to the competitive relationship between their products and those of other Members, not to protect actual trade volumes. If Tariff Code 9958 were lifted, a wide variety of "split-run" periodicals ranging from general news magazines to specialty journals dedicated to specific areas of business or profession could be imported into Canada. This situation can hardly be called an "isolated instance of differential taxation" as Canada describes.¹⁴⁴

5.27 Having found that imported "split-run" periodicals and domestic non "split-run" periodicals are like products, we need not consider the second sentence of Article III:2. The only remaining question is whether imported "split-run" periodicals are subject to an internal tax in excess of that applied to domestic non "split-run" periodicals.

(iv) ***Taxation in excess: "directly or indirectly"***

5.28 In light of the fact that the excise tax is applied only with respect to "split-run" periodicals, it would seem evident that imported "split-run" periodicals are subject to an internal tax in excess of one that is applied to domestic non "split-run" periodicals. However, Canada argues that the excise tax does not apply "indirectly" to a good within the meaning of Article III:2. According to Canada, the drafting history of this paragraph suggests that the expression "indirectly" was intended to capture taxes that apply to inputs that contribute to the production of a good, and not to end products in their own right. Canada also claims that the panel on *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* interpreted the term in a manner consistent with Canada's position.¹⁴⁵

5.29 We note that the excise tax is not "directly" applied to periodicals in that it is levied on the value of advertisements, not on the value of periodicals *per se*. However, it is clear that the tax is applied in respect of each split-run edition of a periodical on a "per issue" basis. Therefore, the tax is applied "indirectly" to periodicals within the ordinary meaning of the terms of Article III:2. Canada's narrow

¹⁴³See paragraph 3.99 *supra*.

¹⁴⁴Paragraph 3.101 *supra*.

¹⁴⁵Paragraph 3.49 *supra*.

reading of the term "indirectly" is supported only by Canada's own interpretation of the drafting history, which is contested by the United States.¹⁴⁶ Since, according to Article 32 of the Vienna Convention, the preparatory work of a treaty is merely a supplementary means of interpretation to be relied upon in cases where the terms of the treaty, taken in their context and in light of its object and purpose, are ambiguous or obscure, or lead to a manifestly absurd or unreasonable result, we need not take the drafting history into account on this particular point. Furthermore, the panel report cited by Canada in support of its argument referred to taxation on raw materials by way of example. It did not conclude that the scope of the term "indirectly" is limited to taxation on inputs.¹⁴⁷ We thus conclude that imported "split-run" periodicals are subject to an internal tax in excess of that applied to domestic non "split-run" periodicals.

5.30 Having found that Part V.1 of the Excise Tax Act to be in violation of Article III:2, first sentence, we need not examine whether it is inconsistent with Article III:2, second sentence or with Article III:4.

D. Postal Rates

5.31 Now we proceed to examine whether the postal rates scheme applied by Canada Post discriminates against foreign periodicals in contravention of Article III of GATT 1994, as argued by the United States. There are two separate issues involved here: (a) whether the fact that Canada Post applies the "commercial Canadian" rates or the "funded" rates to Canadian periodicals, which are lower than the "international" rates applied to imported periodicals, constitute a violation of Article III:4¹⁴⁸; and (b) whether the "funded" rate scheme for certain periodicals is allowed as a subsidy within the meaning of Article III:8(b).

(i) "International" versus "commercial Canadian" and "funded" rates

5.32 The United States claims that Canada Post's practice of charging domestic periodicals lower postal rates than imported periodicals is in violation of Article III:4 of GATT 1994. The relevant part of the Article reads as follows:

"4. The products of the territory of any [Member] imported into the territory of any other [Member] shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product".

In examining the relevance of this provision in the present dispute, we also need take into account the first paragraph of Article III, which reads:

"1. The [Members] 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

¹⁴⁶Paragraph 3.56 *supra*.

¹⁴⁷Paragraph 3.49 *supra*.

¹⁴⁸We are aware that "international" rates applied to foreign periodicals belong to a subcategory of the "commercial" rate scheme in a broader sense. See paragraphs 2.17-2.19 *supra*. However, in so far as different rates are applied between "international" periodicals and "commercial Canadian" periodicals, it is necessary to draw the distinction. We are also aware, as described in paragraph 5.1, that there are additional discounts for Canadian periodicals which are not generally available to imported periodicals. In our view, these additional discounts constitute part of the "commercial Canadian" rate scheme.

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".

5.33 There is no disagreement between the parties to the dispute that, in respect of this issue, domestic and imported periodicals are like products. We, too, so find. Nor does Canada contest the fact that Canada Post applies higher postal rates to imported periodicals than to domestic periodicals, which clearly affects the sale, transportation and distribution of imported periodicals. Canada's argument is essentially that since Canada Post is a privatized agency (a Crown corporation) with a legal personality distinct from the Canadian Government, the "commercial Canadian" or "international" rates it charges for the delivery of periodicals are out of the Government's control and do not qualify as "regulations" or "requirements" within the meaning of Article III:4.

5.34 The United States argues that Canada Post is a government entity fully subject to Canadian Government direction because it is a wholly-government-owned, government-created chartered body, managed by a board of directors appointed by the Canadian Government. Canada argues that the different rates charged by Canada Post are a reflection of competitive situations and that the degree of control the Government exercises over Canada Post's commercial operations (including delivery of periodicals) is one dictated by the Government shareholder's interests. In other words, Canada argues here that Canada Post's pricing policy is not a governmental measure subject to Article III:4. The essential question then is whether Canada Post is implementing Canadian Government policy in such a manner that its postal rates on periodicals may be viewed as governmental regulations or requirements for the purposes of Article III:4.

5.35 First, it is clear that Canada Post generally operates under governmental instructions. Canada Post has a mandate to operate on a "commercial" basis in this particular sector of periodical delivery: a mandate that was set by the Canadian Government.¹⁴⁹ Second, Canada admits that if the Canadian Government considers Canada Post's pricing policy to be inappropriate, it can instruct Canada Post to change the rates under its directive power based on Section 22 of the Canada Post Corporation Act.¹⁵⁰ Thus, the Canadian Government can effectively regulate the rates charged on the delivery of periodicals.

5.36 This analysis is unaffected by the fact that Canada Post has a legal personality distinct from the Canadian Government. The panel on *Japan - Trade in Semi-Conductors* faced a similar question with respect to the interpretation of the status of "administrative guidance" given to private-sector entities in interpreting the term "measures" in Article XI:1. The panel stated as follows:

"In order to determine [whether the measures taken in this case would be such as to constitute a contravention of Article XI], the Panel considered that it needed to be satisfied on two essential criteria. First, there were reasonable grounds to believe that sufficient incentives or disincentives existed for non-mandatory measures to take effect. Second, the operation of the measures ... was essentially dependent on Government action or intervention. The Panel considered each of these two criteria in turn. The Panel considered that if these two criteria were met, the measures would be operating in a manner equivalent to mandatory requirements such that the difference between the measures and mandatory requirements was only one of form and not of substance, and that there could be therefore no doubt that they fell within the range of measures covered by Article XI:1".¹⁵¹

¹⁴⁹From the entirety of Canada's submissions, we take it that the Canadian Government considers Canada Post's pricing policy on periodicals to be driven by "commercial" considerations, although we fail to understand why any document delivery operation aiming at profit maximization would want to make artificial distinctions based on the origin of documents.

¹⁵⁰Paragraph 3.156 *supra*.

¹⁵¹Panel Report on *Japan - Trade in Semi-Conductors*, adopted on 4 May 1988, BISD 35S/116, para. 109.

Applying this two-pronged test, *mutatis mutandis*, to the present case, we conclude that the pricing policy of Canada Post is a governmental measure. First, in view of the control exercised by the Canadian Government on "non-commercial" activities of Canada Post, we can reasonably assume that sufficient incentives exist for Canada Post to maintain the existing pricing policy on periodicals. Second, as analyzed in the previous paragraph, Canada Post's operation is generally dependent on Government action. This leads us to the conclusion that Canada Post's pricing policy on periodicals can be regarded as governmental regulations or requirements within the meaning of Article III:4 of GATT 1994.

5.37 Given that imported and domestic periodicals are like products and that Canada Post charges lower rates on domestic periodicals than imported ones, this conclusion might seem sufficient to determine that a less favourable treatment is accorded to imported products in violation of Article III:4. However, before reaching that determination, as the Appellate Body has stated, we need to turn to Article III:1 as a general principle that informs the rest of Article III.¹⁵² Article III:1 constitutes part of the context of Article III:4, which is to be taken into account in our interpretation of the latter, under Article 31(1) of the Vienna Convention.

5.38 Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production.¹⁵³ The protective application of a measure can most often be discerned from the design, the architecture, and the revealing structure of the measure.¹⁵⁴ We find that the design, architecture and structure of Canada Post's different pricing policy on domestic and imported periodicals all point to the effect that the measure is applied so as to afford protection to the domestic production of periodicals. In the case of "funded" rates, the scheme is clearly designed to promote domestic production of periodicals with Canadian content under the supervision of Canadian Heritage. In the case of "commercial Canadian" rates, the very fact that they are lower than "international" rates which are applied to imported products strongly suggests that the scheme is operated so as to afford protection to domestic production.

5.39 In light of the above, we find that Canada Post's application of the "commercial Canadian" and "funded" rates to Canadian periodicals, which are lower than the "international" rates applied to imported periodicals (including the availability of additional discounts only to Canadian periodicals), is inconsistent with Article III:4 of GATT 1994.

(ii) *Applicability of Article III:8(b) to the "funded" rate scheme*

5.40 Having found that the "funded" rate scheme violates Article III:4 of GATT 1994, we next examine whether this scheme is justified under Article III:8(b) of GATT 1994, as argued by Canada. The relevant part of Article III:8 reads as follows:

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

5.41 The United States claims that this provision is not applicable in the present case because the payment of subsidies by Canadian Heritage is not made directly to Canadian publishers, but rather to

¹⁵² Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, *op. cit.*, p. 18. The Report states: "The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of words actually used in the texts of those other paragraphs".

¹⁵³ *Ibid.*, p. 18.

¹⁵⁴ *Ibid.*, p. 29.

Canada Post. The United States argues that past panels have interpreted the term "exclusively" narrowly, to mean only direct payments to domestic producers.¹⁵⁵ To support its argument, the United States quotes the following paragraph from the panel report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* (the "Oilseeds" case):

"The Panel noted that Article III:8(b) applies only to payments made *exclusively* to domestic producers and considered that it can reasonably be assumed that a payment not made directly to producers is not made "exclusively" to them. It noted moreover that, if the economic benefits generated by the payments granted by the Community can at least partly be retained by the processors of Community oilseeds, the payments generate a benefit conditional upon the purchase of oilseeds of domestic origin inconsistently with Article III:4. Under these circumstances Article III:8(b) would not be applicable because in that case the payments would not be made exclusively to domestic producers but to processors as well".¹⁵⁶

5.42 We do not disagree with this panel report. However, the United States has failed to show that the factual situation in the present case is similar to that in the *Oilseeds* case. Particularly, the United States has not submitted any evidence to indicate that the economic benefits are partly retained by Canada Post. Furthermore, this argument by the United States is inconsistent with its position regarding Article III:4, where it maintains that Canada Post is a government agency. If Canada Post is a government agency, the payment of funds from Canadian Heritage to Canada Post is merely an internal transfer of resources, and the payment of the subsidy is made directly to Canadian publishers.

5.43 Canada, on the other hand, explains that the payment of the funds from Canadian Heritage to Canada Post is made based on negotiations between the two agencies, taking into account the fact that Canada Post gets an exclusive contract for the delivery of periodicals at subsidized rates.¹⁵⁷ Following the logic of the *Oilseeds* panel cited above, one could argue that there is a reasonable assumption that the "funded" rate scheme is not an exclusive payment of subsidies because the payment is not made directly to the beneficiary. However, in our view, Canada has presented an effective rebuttal to this assumption.

5.44 Thus, we do not find that Canada Post retains any economic benefits from the "funded" rate scheme it applies to certain Canadian periodicals. The payment of the subsidy is made "exclusively" to Canadian publishers that qualify for the scheme. Since Article III:8(b) explicitly recognizes that subsidies exclusively paid to domestic producers are not subject to the national treatment rules of Article III, including those under Article III:4, we find that Canada's "funded" rate scheme on periodicals can be justified under this provision.

E. Concluding Remarks

5.45 Before concluding, in order to avoid any misunderstandings as to the scope and implications of the findings above, we would like to stress that the ability of any Member to take measures to protect its cultural identity was not at issue in the present case. The only task entrusted to this Panel was to examine whether the treatment accorded to imported periodicals under specific measures identified in the complainant's claim is compatible with the rules of GATT 1994.

VI. CONCLUSIONS

¹⁵⁵ Paragraphs 3.191-3.197 *supra*.

¹⁵⁶ Panel Report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted on 25 January 1990, BISD 37S/86, para. 137 (emphasis in original).

¹⁵⁷ Paragraph 3.173 *supra*.

6.1 On the basis of the findings set out in paragraphs 5.1 to 5.44 above, the Panel concludes that (a) Tariff Code 9958 is inconsistent with Article XI:1 of GATT 1994 and cannot be justified under Article XX(d) of GATT 1994; (b) Part V.1 of the Excise Tax Act is inconsistent with Article III:2, first sentence, of GATT 1994; (c) the application by Canada Post of lower "commercial Canadian" postal rates to domestically-produced periodicals than to imported periodicals, including additional discount options available only to domestic periodicals, is inconsistent with Article III:4 of GATT 1994; but (d) the maintenance of the "funded" rate scheme is justified under Article III:8(b) of GATT 1994.

6.2 The Panel recommends that the Dispute Settlement Body request Canada to bring the measures that are found to be inconsistent with GATT 1994 into conformity with its obligations thereunder.