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ORGANIZATION**

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**CHILE – TAXES ON ALCOHOLIC BEVERAGES**

**AB-1999-6**

*Report of the Appellate Body*



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WORLD TRADE ORGANIZATION  
APPELLATE BODY

**Chile – Taxes on Alcoholic Beverages**

Chile, *Appellant*  
European Communities, *Appellee*

Mexico, *Third Participant*  
United States, *Third Participant*

AB-1999-6

Present:

Feliciano, Presiding Member  
Ehlermann, Member  
Lacarte-Muró, Member

**I. Introduction**

1. Chile appeals certain issues of law and legal interpretation developed in the Panel Report, *Chile – Taxes on Alcoholic Beverages*.<sup>1</sup> Following a request for consultations<sup>2</sup>, a Panel was established on 25 March 1998 by the Dispute Settlement Body (the "DSB") to consider a complaint by the European Communities against Chile regarding its Special Sales Tax on Spirits, as modified by the Additional Tax on Alcoholic Beverages ("Impuesto Adicional a las Bebidas Alcohólicas" or "ILA").<sup>3</sup>

2. The ILA provides a transitional tax system (the "Transitional System") for distilled spirits ("spirits") which is applicable until 1 December 2000, and a revised tax system (the "New Chilean System") which will be applied from 1 December 2000.<sup>4</sup> The New Chilean System taxes all spirits on the basis of their alcohol content and price. Spirits with an alcohol content of 35° or less are taxed at a rate of 27 per cent *ad valorem*. From a rate of 27 per cent *ad valorem*, the tax rate increases in increments of 4 percentage points per additional degree of alcohol, until a maximum rate of 47 per cent *ad valorem* is reached for all spirits over 39°. <sup>5</sup> The Panel found that roughly 75 per cent

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<sup>1</sup>WT/DS87/R, WT/DS110/R, 15 June 1999.

<sup>2</sup>On 4 June 1997, the European Communities requested consultations with Chile with regard to the Special Sales Tax on Spirits (WT/DS87/1). On 15 December 1997, the European Communities further requested consultations with Chile with regard to the modifications to the Special Sales Tax on Spirits introduced by the enactment of the Additional Tax on Alcoholic Beverages, contained in Law No. 19,534 of 13 November 1997 (WT/DS110/1).

<sup>3</sup>Pursuant to Article 9.1 of the DSU, the DSB, at its meeting of 25 March 1998, agreed that the Panel established on 18 November 1997 to examine the complaint contained in document WT/DS87/5 should also examine the complaint contained in document WT/DS110/4.

<sup>4</sup>Panel Report, para. 2.3.

<sup>5</sup>*Ibid.*, paras. 2.5 and 2.6, and Table 2.

of the total volume of domestically produced spirits will be taxed at 27 per cent *ad valorem*, while over 95 per cent of the total volume of imported spirits will be taxed at 47 per cent *ad valorem*.<sup>6</sup> A detailed description of the factual aspects of the dispute is provided at paragraphs 2.1 to 2.29 of the Panel Report.

3. The Panel considered claims made by the European Communities that the measure at issue is inconsistent with Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994") because it accords preferential tax treatment to pisco, a distilled alcoholic beverage produced in Chile, thereby affording "protection" to domestic production in relation to certain imported alcoholic beverages. The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 15 June 1999. The Panel reached the conclusion that "the domestic distilled alcoholic beverages produced in Chile, including pisco, and the imported products presently identified by HS classification 2208, are directly competitive or substitutable products."<sup>7</sup> The Panel also concluded that both the "Transitional System and [the] New Chilean System provide for dissimilar taxation of the imports in an amount that is greater than *de minimis* levels."<sup>8</sup> Furthermore, the dissimilar taxation in both systems was found to be "applied in a manner so as to afford protection to Chile's domestic production."<sup>9</sup> As a result, the Panel concluded that "there is nullification or impairment of the benefits accruing to the complainant under GATT 1994 within the meaning of Article 3.8 of the Dispute Settlement Understanding"<sup>10</sup>, and recommended that the DSB request Chile to bring its taxes on distilled alcoholic beverages into conformity with its obligations under the GATT 1994.<sup>11</sup>

4. On 13 September 1999, Chile notified the DSB of its intention to appeal certain issues of law and legal interpretation developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). In its Notice of Appeal, Chile appealed certain of the Panel's findings with respect to the New Chilean System.<sup>12</sup> On 23 September 1999, Chile filed its

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<sup>6</sup>Panel Report, para. 7.158.

<sup>7</sup>*Ibid.*, para. 8.1. The imported products identified in HS classification 2208 include the following: whisky, brandy, rum, gin, vodka, liqueurs, aquavit, korn, fruit brandies, ouzo and tequila (*ibid.*, para. 2.7).

<sup>8</sup>*Ibid.*, para. 8.1.

<sup>9</sup>*Ibid.*

<sup>10</sup>*Ibid.*

<sup>11</sup>*Ibid.*, para. 8.2.

<sup>12</sup>Chile does not appeal the Panel's findings on the Transitional System.

appellant's submission.<sup>13</sup> On 8 October 1999, the European Communities filed its appellee's submission<sup>14</sup> and Mexico and the United States filed their respective third participant's submissions.<sup>15</sup> The oral hearing in the appeal was held on 20 October 1999.<sup>16</sup> At the oral hearing, the participants and the third participants presented oral arguments and answered questions from the Division of the Appellate Body hearing the appeal.

## II. Arguments of the Participants and Third Participants

### A. *Claims of Error by Chile – Appellant*

#### 1. "Not Similarly Taxed"

5. Chile argues that the Panel erred in finding that the New Chilean System results in dissimilar taxation of directly competitive or substitutable imported and domestic products under Article III:2, second sentence, of the GATT 1994. Chile asserts that it is important to adopt the "proper perspective"<sup>17</sup> when determining whether dissimilar taxation exists: margins of difference in the taxation of imported and domestic products will vary depending on the perspective chosen.

6. The New Chilean System taxes all distilled alcoholic beverages, irrespective of their origin or type, according to the same criteria: alcohol content and price. These are standard, non-"arbitrary"<sup>18</sup> criteria widely used in the taxation of alcoholic beverages.

7. According to Chile, the Panel chose an incorrect perspective from which to examine the New Chilean System. The Panel looked at the system in two alternative ways: as if it were an *ad valorem* tax and as if it were a specific tax. It was the decision to use this erroneous perspective that led to the Panel's conclusion that dissimilar taxation existed. Chile objects to the fact that the Panel viewed its system with "skepticism" simply because it was a "hybrid", or mixed, system applying two criteria, instead of one.<sup>19</sup>

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<sup>13</sup>Pursuant to Rule 21(1) of the *Working Procedures*.

<sup>14</sup>Pursuant to Rule 22(1) of the *Working Procedures*.

<sup>15</sup>Pursuant to Rule 24 of the *Working Procedures*.

<sup>16</sup>Pursuant to Rule 27 of the *Working Procedures*.

<sup>17</sup>Chile's appellant's submission, page 13, heading 4.

<sup>18</sup>*Ibid.*, para. 39.

<sup>19</sup>*Ibid.*, paras. 40 and 41.

8. Since the Panel looked at the tax from the wrong perspective, it considered the *effect* of the tax rather than the tax *as such*. The consequence is that dissimilarities appear. However, these perceived dissimilarities in taxation result simply from dissimilarities in the alcohol content and price of different types of alcoholic beverage.

9. The Panel should have looked at the tax as a percentage of the price of a distilled alcoholic beverage of a particular alcohol content. If looked at in this way, the system applies an identical *ad valorem* tax rate to *all* products of a particular alcohol content, regardless of origin.

10. Chile believes that the Panel Report, if upheld, would require WTO Members to adopt tax systems based on either an *ad valorem* or a specific tax. In practice, only these two types of tax system would be permitted under WTO rules. This would seriously limit the freedom of WTO Members in establishing tax policies, since the practical effect of the Panel's finding would be that "hybrid" systems are not permitted.

2. "So As To Afford Protection"

11. Chile argues that this case is very different from *Japan – Taxes on Alcoholic Beverages* ("*Japan – Alcoholic Beverages*")<sup>20</sup> and *Korea – Taxes on Alcoholic Beverages* ("*Korea – Alcoholic Beverages*")<sup>21</sup> in that the New Chilean System is not discriminatory. Chile's tax law does not identify products by name or refer to their characteristics. The New Chilean System distinguishes between products on the basis of two widely accepted criteria: alcohol content and price. For this reason, imports are able to compete with domestic products in each and every tax category. The European Communities and other exporters produce numerous alcoholic beverages that will fall into the lowest tax bracket. The fact that more domestic products than imported products fall into the lowest tax bracket cannot be attributed to the New Chilean System. This product distribution is based on market factors, and the market is subject to change and evolution in the future.

12. Chile stresses that many domestic products, such as Chilean whisky, brandy, rum, gin, vodka, gran pisco, and pisco reservado, will fall into the highest tax bracket. Applying the New Chilean System to current trade, in volume terms, the burden of the highest tax bracket would fall mainly on domestic products: 70 per cent of the products in the tax brackets applying to products of an alcoholic strength of more than 35° are Chilean, and 63 per cent of the products in the tax bracket applying to

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<sup>20</sup>Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

<sup>21</sup>Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999.



products of an alcoholic strength of more than 39° are also Chilean. The Panel erred by disregarding the existence of many domestic products subject to the higher tax brackets.

13. Chile contends that there is nothing inherently "domestic" or "imported" about the production of a beverage of a particular alcoholic strength. Both domestic and foreign producers can and do produce spirits of different strengths. Therefore, the Panel's conclusion that the tax is applied "so as to afford protection" was erroneous.

14. Chile asserts that the Panel erred in finding that the stated objectives of the measure were "inconsistent"<sup>22</sup> with the measure. While perhaps not fully successful in achieving the objectives, the measure is not inconsistent with its goals. Such a finding constitutes an indirect evaluation by the Panel of the "efficiency"<sup>23</sup> of the policies of WTO Members. This is inappropriate. A WTO Member has the right to choose between different tax systems and the mere fact that one system may "inconvenience"<sup>24</sup> imports more than another system does not render it inconsistent with WTO law. The Panel was wrong even to consider Chile's legislative objectives, since the Appellate Body has established that the "so as to afford protection" requirement is not a matter of intent.

15. Finally, Chile insists that the Panel's assertion that there is a "logical connection" between the New Chilean System and the previous tax systems is inappropriate and irrelevant. This statement "seems to be mainly motivated by the old cliché 'once a thief always a thief'." <sup>25</sup>

### 3. Article 12.7 of the DSU

16. Chile submits that the Panel failed to provide the "basic rationale" for its findings on the "not similarly taxed" issue, as required by Article 12.7 of the DSU. The Panel based its findings on the Appellate Body's findings in *Japan – Alcoholic Beverages*, but the findings in that case do not resolve the question for the more complicated facts of the dispute at hand.

17. In Chile's view, the Panel's findings do not explain how it interpreted the term "not similarly taxed". Furthermore, the Panel did not explain how the New Chilean System could, in the future, satisfy the "similarity" criteria. Finally, in its reasoning, the Panel, in essence, listed and discarded a number of arguments, but did not elaborate on how it reached its own conclusions. Thus, the Panel did not provide a "basic rationale" for its findings as required by Article 12.7 of the DSU.

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<sup>22</sup>Chile's appellant's submission, para. 97, and Panel Report, para. 7.154.

<sup>23</sup>Chile's appellant's submission, para. 98.

<sup>24</sup>*Ibid.*, para. 99.

<sup>25</sup>*Ibid.*, para. 101.

4. Articles 3.2 and 19.2 of the DSU

18. Chile contends that the Panel compromised the "security and predictability" of the multilateral trading system, and added to the obligations provided in the covered agreements, in contravention of Articles 3.2 and 19.2 of the DSU. The violation of Article 3.2 of the DSU arises in part from the absence of a "basic rationale" for the "not similarly taxed" finding in the Panel Report. As a result, the Report leaves Members without clear guidelines as to how to design their systems of taxation. Furthermore, by preferring certain systems of taxation over others, the Panel has unlawfully added to the obligations of WTO Members, in violation of Articles 3.2 and 19.2 of the DSU.

19. Moreover, Chile argues that the Panel's evaluation of the "efficiency" or "rationality" of the measure in light of its stated objectives also adds to the obligations of WTO Members in contravention of Articles 3.2 and 19.2 of the DSU.

B. *Arguments by the European Communities - Appellee*

1. "Not Similarly Taxed"

20. The European Communities argues that, contrary to Chile's claims, the New Chilean System is like any other *ad valorem* tax system in which different tax rates are applied to different categories of product. All tax systems impose a tax burden based on a percentage of the price (an *ad valorem* tax) or an absolute amount per unit (a specific tax). The New Chilean System is no exception. The fact that *ad valorem* rates vary with alcohol content does not set this system apart from other *ad valorem* systems.

21. According to the European Communities, the "not similarly taxed" issue requires a comparison of the relative tax burdens on imported and domestic products, rather than an examination of the method of taxation, as proposed by Chile. Under the New Chilean System, tax burdens are expressed in *ad valorem* terms, and, therefore, must be compared on that basis. Thus, the Panel's method of analysis, comparing the *ad valorem* rates applied to pisco with the *ad valorem* rates applied to imported spirits, was appropriate.

22. The European Communities argues that panels must compare the tax burden on each individual imported product with the tax burden on each individual directly competitive or substitutable domestic product. This principle requires a comparison between the tax burden on imported spirits and the tax burden on low alcohol content pisco. This comparison leads to a finding of dissimilar taxation of pisco and imported products under the New Chilean System. Chilean law prescribes a minimum alcohol strength for each type of spirit. The principal types of imported spirits

are products required to have a minimum alcohol content of 40°, placing them in the highest tax bracket. By contrast, the minimum alcohol content of pisco is 30°, with 35° alcohol content being the most widely consumed pisco, placing these pisco products in the lowest tax bracket. As a result, the tax distinctions between spirits with a different alcohol content under the New Chilean System necessarily lead to low alcohol content pisco always being taxed "at a lower rate than imported spirits."<sup>26</sup>

23. In addition, the European Communities suggests that if Chile's arguments were adopted it would be extremely easy to circumvent the prohibitions of Article III:2, second sentence, of the GATT 1994. WTO Members would be able to draw many types of distinction between spirits as long as they avoided making formal distinctions based on the name of the product. The result would be that, based on these distinctions, domestic products and imports could in reality be "not similarly taxed". Chile attempts to deal with this problem by distinguishing between the use of tax criteria that are "arbitrary" as against criteria that are "non-arbitrary". However, this distinction has no support in Article III:2, second sentence, of the GATT 1994 and, moreover, Chile offers no guidance as to how "arbitrary" and "non-arbitrary" criteria are to be distinguished from each other.

24. Finally, the New Chilean System is based on an unusual method of taxation that combines two criteria that may conflict. Since higher priced products may, in some cases, have a low alcohol content, the use of *ad valorem* rates will, in those cases, lead to higher tax on high-priced products with low alcohol content than the tax imposed on low-priced products with high alcohol content.

## 2. "So As To Afford Protection"

25. The core of the Chilean argument is that the structure of the New Chilean System does not support a finding that the law is applied "so as to afford protection" because it does not distinguish between products by name. The European Communities insists that this is irrelevant. The issue is whether the New Chilean System, although "facially neutral"<sup>27</sup>, is *de facto* discriminatory under Article III:2, second sentence, of the GATT 1994.

26. The European Communities notes that, contrary to Chile's claim, the Panel did not reject the relevance of the fact that some domestic products were in the highest tax category. The more important fact is that the percentage of domestic products in the highest tax bracket, as compared to the percentage of domestic products in other tax brackets, is "relatively small".<sup>28</sup> The percentage of

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<sup>26</sup>European Communities' appellee's submission, para. 33.

<sup>27</sup>*Ibid.*, para. 58.

<sup>28</sup>*Ibid.*, para. 63.

domestic products in the highest tax bracket is comparable to the equivalent figures in *Japan – Alcoholic Beverages*.

27. Moreover, the fact that there are some imports in the lowest tax bracket does not undermine the Panel's finding that the New Chilean System was applied "so as to afford protection". The amount of imports in this bracket, approximately five percent of total imports, is very small. In both *Japan – Alcoholic Beverages* and *Korea – Alcoholic Beverages*, the existence of a small amount of imports in the lowest tax bracket did not preclude a finding that the measures were applied "so as to afford protection". Furthermore, according to the European Communities, Chile's argument that foreign producers have the opportunity to export low alcohol content products in the future is irrelevant.

28. The European Communities contends that the Panel was right to review the rational connection between the New Chilean System and its stated objectives. The Panel did not evaluate the objectives themselves; it simply examined whether there was a rational connection between the measure and the objectives. This was one piece of evidence supporting the finding of protective application. Furthermore, the Panel did not, as Chile claims, apply a "necessity" test to assess the relationship of the measures with their stated objectives. Certain of the Panel's factual findings establish that the New Chilean System is, in fact, "inconsistent" with its stated policy objectives. Finally, if the Panel's review of the rational connection between Chile's stated objectives and the measure was in error, the other factors cited by the Panel nevertheless constitute sufficient evidence that the measure was applied "so as to afford protection".

3. Article 12.7 of the DSU

29. The European Communities states that Chile's argument that the Panel failed to provide a "basic rationale" for its findings, in contravention of Article 12.7 of the DSU, is, in fact, the same as its argument that the Panel erred in interpreting Article III:2, second sentence, of the GATT 1994. Chile's disagreement with the logic behind the Panel's reasoning is not sufficient to conclude that the Panel failed to provide a "basic rationale" for its findings.

4. Articles 3.2 and 19.2 of the DSU

30. The Panel could only have added to the rights and obligations of WTO Members in contravention of Articles 3.2 and 19.2 of the DSU if it had made a legal error in its interpretation of Article III:2, second sentence, of the GATT 1994. Similarly, Chile's claim that the Panel's findings undermine the "security and predictability" of the multilateral trading system contrary to Article 3.2 of the DSU is premised on an assumption that the Panel erred in its interpretation of Article III:2, second

sentence, of the GATT 1994. The European Communities believes that the Panel's findings on Article III:2, second sentence, of the GATT 1994 should be upheld. Therefore, the Panel could not have acted in contravention of Articles 3.2 and 19.2 of the DSU. Finally, it is doubtful whether the first sentence of Article 19.2 of the DSU creates a legal obligation, violation of which would provide the basis for a claim.

C. *Arguments by the Third Participants*

1. Mexico

(a) "Not Similarly Taxed"

31. Mexico notes that, in previous WTO disputes involving Article III:2, second sentence, of the GATT 1994, a simple and direct analysis has been carried out to determine whether imports and domestic products are "not similarly taxed". In this case, the Panel did not deviate from this method. The fact that the Panel recognized the existence of difficulties in the analysis, or omitted to make suggestions on how the New Chilean System could comply with the "not similarly taxed" requirement, is not a legal error.

(b) "So As To Afford Protection"

32. According to Mexico, the Panel was correct to observe that, even though the New Chilean System is based on alcohol content, that System mainly benefits domestic producers. For example, the tax differential between pisco corriente and tequila is very high. This differential is compounded by the fact that the difference in alcohol content between these products is low.

33. Mexico contests Chile's assertion that the Panel erred by examining the consistency of the New Chilean System with its stated objectives. The Panel examined only whether the stated objectives had a logical connection with the measure itself. In any case, this was just one of several elements that the Panel took into account in examining the design, architecture and structure of the New Chilean System.

(c) Article 12.7 of the DSU

34. According to Mexico, the Panel was not obliged to determine how Chile's taxation of distilled alcoholic beverages might comply with Article III:2, second sentence, of the GATT 1994. The Panel's failure to do this does not violate Article 12.7 of the DSU.

(d) Articles 3.2 and 19.2 of the DSU

35. In Mexico's view, the Panel's finding does not prejudice the "security and predictability" of the multilateral trading system under Article 3.2 of the DSU, nor does it "add to or diminish" the rights and obligations of WTO Members under the *WTO Agreement* in terms of Articles 3.2 and 19.2 of the DSU.

2. United States

(a) "Not Similarly Taxed"

36. The United States notes that the tax brackets set forth in the New Chilean System for products with an alcohol content of over 35° affect the vast majority of imports and are subject to steeply increasing *ad valorem* rates. The increased rates do not apply to spirits at or below 35°, which, in fact, are "almost all" pisco, a product that is "by law" Chilean.<sup>29</sup> The result is a difference in tax treatment between those products above and those at or below the 35° threshold. According to the United States, this difference in tax treatment is more than *de minimis*.

37. The United States emphasizes that the existence of dissimilar taxation does not render a tax measure inconsistent with Article III:2, second sentence, of the GATT 1994 because the third issue of "so as to afford protection" must be examined.

(b) "So As To Afford Protection"

38. According to the United States, it is the particular design of the alcohol content threshold established by New Chilean System that raises questions about protective application. The New Chilean System has been designed to provide the same, or even more, protection to pisco as did previous tax systems. The fact that some imported liqueurs will have access to the lower *ad valorem* rates does not alter the protective treatment applied against the *great majority* of imports.

39. The second critical factor revealing a protective structure is the extent of the difference in treatment for imported and domestic products. In this respect, there are large increases in the tax rate in relation to proportionally small differences in alcohol content. This disproportionate increase implies that Chile rejected a single specific tax or a straight *ad valorem* tax because neither would provide sufficient protection for pisco.

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<sup>29</sup>United States' third participant's submission, para. 14.

40. In the view of the United States, the issue of whether a measure is applied "so as to afford protection" is clearly a question of the "intent of the law in its classic sense."<sup>30</sup> However, the way in which the Panel examined Chile's alleged policy objectives appears to create new kinds of *ad hoc* legal criteria. Nevertheless, since the Panel's finding on this issue has a sufficient basis in the other factors examined, the United States concludes that the New Chilean System is applied "so as to afford protection".

(c) Article 12.7 of the DSU

41. According to the United States, the Panel cited the correct authority for its findings, set out all of Chile's claims, and then rejected them with detailed findings of fact and arguments. The fact that Chile does not agree with the Panel's logic, or that the Panel did not develop a definitive theory for other disputes, does not mean that a "basic rationale" was not provided. The Panel's reasoning is, therefore, consistent with the requirements of Article 12.7 of the DSU.

(d) Articles 3.2 and 19.2 of the DSU

42. The United States believes that the provisions of Article 3.2 do not give rise to an obligation on which a claim can be made. The first sentence of Article 3.2 describes a very important objective, which sheds light on the meaning of all legal obligations in the *WTO Agreement*. This objective, however, is not an obligation in and of itself and should not be raised as the basis for an independent violation.

### III. Issues Raised in this Appeal

43. The following issues are raised in this appeal:

- (a) whether the Panel erred in its interpretation and application of the term "not similarly taxed", which appears in the *Ad Article to Article III:2*, second sentence, of the GATT 1994;
- (b) whether the Panel erred in its interpretation and application of the term "so as to afford protection", which is incorporated into Article III:2, second sentence, of the GATT 1994, by specific reference to the "principles set forth in paragraph 1" of Article III of that Agreement;

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<sup>30</sup>United States' third participant's submission, para. 31.

- (c) whether the Panel failed to set out the basic rationale for its findings and recommendations regarding the interpretation and application of the term "not similarly taxed", as required by Article 12.7 of the DSU; and
- (d) whether the Panel acted inconsistently with Articles 3.2 and 19.2 of the DSU by adding to the rights and obligations of WTO Members in its interpretation and application of the terms "not similarly taxed" and "so as to afford protection", under Article III:2, second sentence, of the GATT 1994.

#### IV. "Not Similarly Taxed"

44. On the issue of "not similarly taxed", the Panel observed:

The difference in taxation between the top (47%) and bottom (27%) levels of *ad valorem* rates of taxation of distilled alcoholic beverages is clearly more than *de minimis* and is so by a very large margin. Indeed, it is obvious that the difference of four percentage points between the various levels of alcohol content also constitutes a greater than *de minimis* level of dissimilar taxation.<sup>31</sup>

45. The Panel found that, from the aggregate group of directly competitive or substitutable products, "some of the imports are being taxed dissimilarly from some of the domestic production and the difference is more than *de minimis*."<sup>32</sup> (emphasis added) The Panel concluded that there was, therefore, "dissimilar taxation of the imports in an amount that is greater than *de minimis*".<sup>33</sup>

46. Chile argues on appeal that, if the New Chilean System is examined from the "proper perspective"<sup>34</sup>, it is clear that all of the beverages at issue, regardless of their origin, are taxed according to the same objective criteria: alcohol content and price. When evaluated from this "perspective", Chile maintains, the New Chilean System does not apply dissimilar taxation because all distilled alcoholic beverages, whether domestic or imported, with the same alcohol content are taxed at an identical *ad valorem* rate. Chile contends that, because there is no dissimilar taxation, there is no need or justification to proceed to the third issue under Article III:2, second sentence, of the GATT 1994 and examine whether the New Chilean System is applied "so as to afford protection to domestic production."

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<sup>31</sup>Panel Report, para. 7.110.

<sup>32</sup>*Ibid.*, para. 7.113.

<sup>33</sup>*Ibid.*, para. 8.1.

<sup>34</sup>Chile's appellant's submission, page 13, heading 4.



47. We begin by recalling that, in *Japan – Alcoholic Beverages*, we stated that three separate issues must be addressed when assessing the consistency of an internal tax measure with Article III:2, second sentence, of the GATT 1994. These three issues are whether:

- (1) the imported products and the domestic products *are "directly competitive or substitutable products" which are in competition with each other;*
- (2) the directly competitive or substitutable imported and domestic products *are "not similarly taxed";* and
- (3) the dissimilar taxation of the directly competitive or substitutable imported and domestic products *is "applied ... so as to afford protection to domestic production".*<sup>35</sup>

48. The Panel's conclusion on the first issue, that "domestic distilled alcoholic beverages produced in Chile, including pisco, and the imported products presently identified by HS classification 2208, are directly competitive or substitutable products", has not been appealed.<sup>36</sup> Therefore, we have to base our reasoning, for the purposes of this appeal, on the finding that all the domestic and imported products at issue are directly competitive or substitutable with each other, within the meaning of *Ad Article III:2* of the GATT 1994.

49. In *Japan – Alcoholic Beverages*, we stated that "to be 'not similarly taxed', the tax burden on imported products must be heavier than on 'directly competitive or substitutable' domestic products, and that burden must be more than *de minimis* in any given case."<sup>37</sup> Like the Panel<sup>38</sup>, we consider that this is the appropriate legal standard to apply under the second issue of "not similarly taxed". We must, therefore, assess the relative tax burden imposed on directly competitive or substitutable domestic and imported products.

50. The New Chilean System applies a minimum tax rate of 27 per cent *ad valorem* to all distilled alcoholic beverages with an alcoholic content of 35° or less and a maximum rate of 47 per cent *ad valorem* to all such beverages with an alcohol content of more than 39°. The Panel found, as a factual matter, that "roughly 75% of domestic production will enjoy the lowest rate and ... over 95% of all current (and potential) imports will be taxed at the highest rate ...".<sup>39</sup>

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<sup>35</sup>*Supra*, footnote 20, p. 24.

<sup>36</sup>Panel Report, para. 8.1. The imported products at issue include whisky, brandy, rum, gin, vodka, liqueurs, aquavit, korn, fruit brandies, ouzo and tequila.

<sup>37</sup>*Supra*, footnote 20, p. 27.

<sup>38</sup>Panel Report, para. 7.89.

<sup>39</sup>*Ibid.*, para. 7.158. Chile has not contested this factual finding.

51. Chile has argued that there is "similar taxation" of domestic and imported production under the New Chilean System because all beverages with a specific alcohol content are subject to identical *ad valorem* tax rates, irrespective of their origin. In making this argument, Chile invites us to focus exclusively on a comparison of the relative tax burden on domestic and imported products *within each fiscal category* and to disregard the differences of tax burden on distilled alcoholic beverages which have different alcohol contents and which are, therefore, in *different fiscal categories*. In other words, Chile asks us to disregard the comparison which the Panel undertook of the relative tax burden on domestic and imported products located in *different fiscal categories*.

52. It is certainly true that, as Chile claims, if we were to focus the inquiry under the second issue solely on a comparison of the taxation of beverages of a specific alcohol content, we would have to conclude that all distilled alcoholic beverages of a specific alcohol content are taxed similarly. However, as we stated at the outset, in our analysis we must assume that the group of directly competitive or substitutable products in this case is broader than simply the products *within each fiscal category*.<sup>40</sup> Chile's argument fails to recognize that the Panel has found, and Chile has not appealed, that imported beverages of a specific alcohol content are directly competitive or substitutable with other domestic distilled alcoholic beverages of a different alcohol content. To accept Chile's argument on appeal would, we believe, disregard the objective of Article III, which is to "provide equality of competitive conditions" for *all* directly competitive or substitutable imported products in relation to domestic products, and not simply for *some* of these imported products.<sup>41</sup> The examination under the second issue must, therefore, take into account the fact that the group of directly competitive or substitutable domestic and imported products at issue in this case is not limited solely to beverages of a specific alcohol content, falling within a *particular* fiscal category, but covers *all* the distilled alcoholic beverages in *each and every* fiscal category under the New Chilean System.

53. A comprehensive examination of this nature, which looks at *all* of the directly competitive or substitutable domestic and imported products, shows that the tax burden on imported products, most of which will be subject to a tax rate of 47 per cent, will be heavier than the tax burden on domestic products, most of which will be subject to a tax rate of 27 per cent. We agree with the Panel that the difference in the level of the tax burden is clearly more than *de minimis* and, in any event, Chile has not appealed the Panel's finding that the difference between these tax rates is more than *de minimis*.

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<sup>40</sup>*Supra*, para. 48.

<sup>41</sup>Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 20, p. 16.

54. In these circumstances, we uphold the Panel's finding, in paragraph 8.1 of the Panel Report, that directly competitive or substitutable imported and domestic products are "not similarly taxed", within the meaning of *Ad Article III:2* of the GATT 1994.

55. We stress, finally, that a tax measure is inconsistent with Article III:2, second sentence, of the GATT 1994 *only* if dissimilar taxation of directly competitive or substitutable imported products is applied "so as to afford protection to domestic production". As we stated in *Japan – Alcoholic Beverages*, the issues of "not similarly taxed" and "so as to afford protection" are entirely separate, and both issues must be resolved before a finding of consistency or inconsistency can be reached under Article III:2, second sentence.<sup>42</sup> A finding of dissimilar taxation *by itself* is not sufficient to sustain a conclusion that the New Chilean System is inconsistent with Article III:2, second sentence. Rather, a finding of dissimilarity of taxation merely calls for an inquiry under the third issue, to which we now turn.

#### V. "So As To Afford Protection"

56. The Panel began its analysis of whether the New Chilean System will be applied "so as to afford protection" by recalling certain of the Appellate Body's statements in *Japan – Alcoholic Beverages*.<sup>43</sup> The Panel stated that the "real issue" is "how the measure in question is *applied*."<sup>44</sup> The Panel noted that this can often be discerned from an examination of the "design, architecture and revealing structure" of the measure, as well as from the magnitude of the dissimilar taxation.<sup>45</sup> The Panel also took the view that "an important question is who receives the benefit of the dissimilar taxation."<sup>46</sup>

57. The Panel expressed its conclusion on this issue in the following terms:

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<sup>42</sup>*Supra*, footnote 20, pp. 24 and 27.

<sup>43</sup>Panel Report, paras. 7.114 and 7.115.

<sup>44</sup>*Ibid.*, para. 7.115, citing the Appellate Body Report in *Japan – Alcoholic Beverages*, *supra*, footnote 20, p. 28.

<sup>45</sup>*Ibid.*, para. 7.115, citing the Appellate Body Report in *Japan – Alcoholic Beverages*, *supra*, footnote 20, p. 29.

<sup>46</sup>*Ibid.*, para. 7.123.

In sum, considering: (1) the structure of the New Chilean System (with its lowest rate at the level of alcohol content of the large majority of domestic production and its highest rate at the level of the overwhelming majority of imports); (2) the large magnitude of the differentials over a short range of physical difference (35° versus 39° of alcohol content); (3) the interaction of the New Chilean System with the Chilean regulation which requires most of the imports to remain at the highest tax level without losing their generic name and changing their physical characteristics; (4) the lack of any connection between the stated objectives and the results of such measures (recognizing that "good" objectives cannot rescue an otherwise inconsistent measure); and, (5) the way this new measure fits in a logical connection with existing and previous systems of *de jure* discrimination against imports, we find that the dissimilar taxation assessed on directly competitive or substitutable imports and domestic products is applied in a way that affords protection to domestic production.<sup>47</sup>

58. Chile argues, first, that since its law is based on two widely accepted, non-arbitrary criteria – alcohol content and price – the structure of the system does not support a finding of protection.<sup>48</sup> In fact, imports are able to compete equally with domestic products in each and every fiscal category. Second, Chile submits that the New Chilean System is not applied "so as to afford protection" because a majority of the products in the highest tax brackets are domestic, not imported. Third, Chile contends that the Panel erred in taking into account the objectives of the New Chilean System. Finally, Chile rejects as non-relevant the Panel's assertion of a "logical relationship" between existing and previous systems of *de jure* discrimination against imports.

59. At the outset, it is useful to recall that in *Japan – Alcoholic Beverages*, we observed:

Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the *WTO Agreement*.<sup>49</sup>

60. Members of the WTO have sovereign authority to determine the basis or bases on which they will tax goods, such as, for example, distilled alcoholic beverages, and to classify such goods accordingly, provided of course that the Members respect their WTO commitments. The reference in *Ad Article III:2*, second sentence, of the GATT 1994 to "not similarly taxed" is not in itself a prohibition against classifying goods for revenue and regulatory purposes that Members set for themselves as legitimate and desirable. Members of the WTO are free to tax distilled alcoholic

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<sup>47</sup>Panel Report, para. 7.159.

<sup>48</sup>Chile's appellant's submission, para. 39.

<sup>49</sup>*Supra*, footnote 20, p. 16.

beverages on the basis of their alcohol content and price, as long as the tax classification is not applied so as to protect domestic production over imports. Alcohol content, like any other basis or criterion of taxation, is subject to the legal standard embodied in Article III:2 of the GATT 1994.

61. We turn now to consider the Panel's interpretation and application of the expression "so as to afford protection to domestic production", an expression which we have already had occasion to consider in other appeals. In our Report in *Japan – Alcoholic Beverages*, we said that examination of whether a tax regime affords protection to domestic production "is an issue of how the measure in question is *applied*"<sup>50</sup>, and that such an examination "requires a comprehensive and objective analysis"<sup>51</sup>:

... it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.<sup>52</sup>

62. We emphasized in that Report that, in examining the issue of "so as to afford protection", "it is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent."<sup>53</sup> The *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. It does not follow, however, that the statutory purposes or objectives – that is, the purpose or objectives of a Member's legislature and government as a whole – to the extent that they are given *objective* expression in the statute itself, are not pertinent. To the contrary, as we also stated in *Japan – Alcoholic Beverages*:

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the *design*, the *architecture*, and the revealing *structure* of a measure.<sup>54</sup> (emphasis added)

63. We turn, therefore, to the design, the architecture and the structure of the New Chilean System itself. That system taxes *all* alcoholic beverages with an alcohol content of 35° or below on a linear basis, at a fixed rate of 27 per cent *ad valorem*. Thereafter, the rate of taxation increases steeply, by 4 percentage points for every additional degree of alcohol content, until a maximum rate

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<sup>50</sup>*Supra*, footnote 20, p. 28.

<sup>51</sup>*Ibid.*, p. 29.

<sup>52</sup>*Ibid.*

<sup>53</sup>*Ibid.*, p. 27.

<sup>54</sup>*Ibid.*, p. 29.

of 47 per cent *ad valorem* is reached. This fixed tax rate of 47 per cent applies, once more on a linear basis, to *all* beverages with an alcohol content in excess of 39°, irrespective of how much in excess of 39° the alcohol content of the beverage is.

64. We note, furthermore, that, according to the Panel, approximately 75 per cent of all domestic production has an alcohol content of 35° or less and is, therefore, taxed at the lowest rate of 27 per cent *ad valorem*.<sup>55</sup> Moreover, according to figures supplied to the Panel by Chile, approximately *half* of all domestic production has an alcohol content of 35° and is, therefore, located on the line of the progression of the tax at the point *immediately before* the steep increase in tax rates from 27 per cent *ad valorem*.<sup>56</sup> The start of the highest tax bracket, with a rate of 47 per cent *ad valorem*, coincides with the point at which most imported beverages are found. Indeed, according to the Panel, that tax bracket contains approximately 95 per cent of all directly competitive or substitutable imports.<sup>57</sup>

65. Although the tax rates increase steeply for beverages with an alcohol content of more than 35° and up to 39°, there are, in fact, very few beverages on the Chilean market, either domestic or imported, with an alcohol content of between 35° and 39°.<sup>58</sup> The graduation of the rates for beverages with an alcohol content of between 35° and 39° does not, therefore, serve to tax distilled alcoholic beverages on a progressive basis. Indeed, the steeply graduated progression of the tax rates between 35° and 39° alcohol content seems anomalous and at odds with the otherwise linear nature of the tax system. With the exception of the progression of rates between 35° and 39° alcohol content, this system simply applies one of two fixed rates of taxation, either 27 per cent *ad valorem* or 47 per cent *ad valorem*, each of which applies to distilled alcoholic beverages with a broad range of alcohol content, that is, 27 per cent for beverages with an alcoholic content of *up to* 35° and 47 per cent for beverages with an alcohol content of *more than* 39°.

66. In practice, therefore, the New Chilean System will operate largely as if there were only two tax brackets: the first applying a rate of 27 per cent *ad valorem* which ends at the point at which most domestic beverages, by volume, are found, and the second applying a rate of 47 per cent *ad valorem* which begins at the point at which most imports, by volume, are found. The magnitude

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<sup>55</sup>Panel Report, para. 7.158. See also Panel Report, para. 7.155.

<sup>56</sup>Chile's response to Question 1 of the Panel, 26 November 1998. At the oral hearing, Chile confirmed the accuracy of the figures contained in this response.

<sup>57</sup>Panel Report, para. 7.158.

<sup>58</sup>Chile's response to Question 1 of the Panel, 26 November 1998. These figures indicate that approximately 5 per cent of *all* distilled alcoholic beverages have an alcohol content in this range. At the oral hearing, Chile confirmed that very few beverages have an alcohol content of between 35° and 39°.

of the difference between these two rates is also considerable. The absolute difference of 20 percentage points between the two rates represents a 74 per cent increase in the lowest rate of 27 per cent *ad valorem*. Accordingly, examination of the design, architecture and structure of the New Chilean System tends to reveal that the application of dissimilar taxation of directly competitive or substitutable products will "afford protection to domestic production."

67. It is true, as Chile points out, that domestic products are not only subject to the highest tax rate but also comprise the major part of the volume of sales in that bracket. This fact does not, however, by itself outweigh the other relevant factors, which tend to reveal the protective application of the New Chilean System. The relative proportion of domestic versus imported products within a particular fiscal category is not, in and of itself, decisive of the appropriate characterization of the total impact of the New Chilean System under Article III:2, second sentence, of the GATT 1994. This provision, as noted earlier, provides for equality of competitive conditions of *all* directly competitive or substitutable imported products, in relation to domestic products, and not simply, as Chile argues, those imported products within a particular fiscal category.<sup>59</sup> The cumulative consequence of the New Chilean System is, as the Panel found, that approximately 75 per cent of all domestic production of the distilled alcoholic beverages at issue will be located in the fiscal category with the lowest tax rate, whereas approximately 95 per cent of the directly competitive or substitutable imported products will be found in the fiscal category subject to the highest tax rate.

68. The comparatively small volume of imports consumed on the Chilean market may, in part, be due to past protection.<sup>60</sup> We consider that it would defeat the objective of Article III:2, second sentence, of the GATT 1994 if a Member of the WTO were able to avoid a finding that a measure is applied "so as to afford protection" for reasons that could, in part, result from its past protection of domestic production.<sup>61</sup>

69. Before the Panel, Chile stated that the New Chilean System pursued four different objectives: "(1) maintaining revenue collection; (2) eliminating type distinctions [such] as [those which] were found in Japan and Korea; (3) discouraging alcohol consumption; and (4) minimizing the potentially regressive aspects of the reform of the tax system."<sup>62</sup> Chile also stated that the New Chilean System

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<sup>59</sup>*Supra*, para. 52.

<sup>60</sup>Chile acknowledged to the Panel that it reformed its taxation of distilled alcoholic beverages, in part, in order to eliminate the "type distinctions" between spirits condemned in *Japan – Alcoholic Beverages* and *Korea – Alcoholic Beverages* (see Panel Report, paras. 4.450 and 4.504). The "type distinctions" were formal distinctions between "pisco", "whisky" and "other spirits" (*ibid.*, para. 2.4).

<sup>61</sup>See Appellate Body Report, *Korea – Alcoholic Beverages*, *supra*, footnote 21, para. 120.

<sup>62</sup>Panel Report, para. 7.147. See also Panel Report, paras. 4.449, 4.450 and 4.452.

reflected compromises between the four objectives which became necessary in the process of legislative enactment. The Panel did not find any clear relationship between the stated objectives and the tax measure itself and considered the absence of a clear relationship as "evidence *confirming* the discriminatory design, structure and architecture of [the Chilean] measure."<sup>63</sup> (emphasis added)

70. On appeal, Chile argues that the Panel was "wrong to even consider the objectives" underlying the New Chilean System.<sup>64</sup> Chile declines to explain the relationship between the design, architecture and structure of the New Chilean System and the objectives it stated that System sought to realize. At the oral hearing, Chile confirmed that, in its view, the stated objectives of the New Chilean System were not "relevant" in assessing whether that measure would be applied "so as to afford protection".<sup>65</sup>

71. We recall once more that, in *Japan – Alcoholic Beverages*, we declined to adopt an approach to the issue of "so as to afford protection" that attempts to examine "the many reasons legislators and regulators often have for what they do".<sup>66</sup> We called for examination of the design, architecture and structure of a tax measure precisely to permit identification of a measure's objectives or purposes as revealed or objectified in the measure itself. Thus, we consider that a measure's purposes, objectively manifested in the design, architecture and structure of the measure, *are* intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production. In the present appeal, Chile's explanations concerning the structure of the New Chilean System – including, in particular, the truncated nature of the line of progression of tax rates, which effectively consists of two levels (27 per cent *ad valorem* and 47 per cent *ad valorem*) separated by only 4 degrees of alcohol content – might have been helpful in understanding what *prima facie* appear to be anomalies in the progression of tax rates. The conclusion of protective application reached by the Panel becomes very difficult to resist, in the absence of countervailing explanations by Chile. The mere statement of the four objectives pursued by Chile does not constitute effective rebuttal on the part of Chile.

72. At the same time, we agree with Chile that it would be inappropriate, under Article III:2, second sentence, of the GATT 1994, to examine whether the tax measure is *necessary* for achieving its stated objectives or purposes. The Panel did use the word "necessary" in this part of its

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<sup>63</sup>Panel Report, para. 7.154.

<sup>64</sup>Chile's appellant's submission, para. 100.

<sup>65</sup>Response by Chile to questioning at the oral hearing.

<sup>66</sup>*Supra*, footnote 20, p. 27.



reasoning.<sup>67</sup> Nevertheless, we do not read the Panel Report as showing that the Panel did, in fact, conduct an examination of whether the measure is necessary to achieve its stated objectives. It appears to us that the Panel did no more than try to relate the observable structural features of the measure with its declared purposes, a task that is unavoidable in appraising the application of the measure as protective or not of domestic production.

73. In reaching its conclusion on the issue of "so as to afford protection", the Panel also relied on the fact that Chilean law imposes minimum alcohol content requirements on a range of distilled alcoholic beverages, including most of the beverages imported into Chile.<sup>68</sup> The Panel invoked the "interaction of the New Chilean System with the Chilean regulation which requires most of the imports to remain at the highest tax level without losing their generic name and changing their physical characteristics".<sup>69</sup> We believe this reliance by the Panel to be unjustified. Chilean law does not prohibit the importation of any distilled alcoholic beverages, whatever their alcohol content. Under Chilean law, a regulation imposes minimum quality standards, in respect of various kinds of distilled alcoholic beverages, relating to, *inter alia*, alcohol content, maximum sugar content and maximum volatile (e.g., aldehydes, furfural) impurities content.<sup>70</sup> This regulation appears to be broadly reflective of similar standards enforced in many markets. The "interaction" the Panel sees between the New Chilean System and the Chilean regulation does not contribute to the cogency of the Panel's conclusion on the "so as to afford protection" issue and, in our view, should not have been taken into account by the Panel.

74. The final factor that the Panel relied upon in reaching the conclusion under the issue of "so as to afford protection" was "the way this new measure fits in a logical connection with existing and previous systems of *de jure* discrimination against imports".<sup>71</sup> In our view, the Panel has relied on the fact that previous Chilean measures, which are no longer applicable, involved some protection of domestic alcoholic beverages to show that the *new* tax system will also be applied "so as to afford protection". The Panel's reliance on this factor is wrong. Members of the WTO should not be assumed, in any way, to have *continued* previous protection or discrimination through the adoption of

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<sup>67</sup>Panel Report, para. 7.149.

<sup>68</sup>Panel Report, para. 7.155.

<sup>69</sup>*Ibid.*, para. 7.159.

<sup>70</sup>Articles 9-13, Title II, Decree No. 78 of 31 July 1986, implementing Law No. 18,455 of 31 October 1985 (Exhibit No. 13 submitted by the European Communities to the Panel).

<sup>71</sup>Panel Report, para. 7.159.

a new measure.<sup>72</sup> This would come close to a presumption of bad faith. Accordingly, we hold that the Panel committed legal error in taking this factor into account in examining the issue of "so as to afford protection".

75. However, in view of the other factors properly relied upon by the Panel, we believe that the Panel's conclusion that the dissimilar taxation is applied "so as to afford protection" is unaffected by the exclusion of these last two factors.

76. In light of the foregoing, we uphold the Panel's finding, in paragraph 8.1 of the Panel Report, that the dissimilar taxation under the New Chilean System is applied "so as to afford protection to domestic production", and, hence, is inconsistent with the requirements of Article III:2, second sentence, of the GATT 1994.

## **VI. Article 12.7 of the DSU**

77. Chile argues that "the Panel failed to fulfill its obligation under Article 12.7 [of the] DSU to provide the basic rationale behind its findings when analyzing the 'dissimilarity' condition of Article III:2, second sentence."<sup>73</sup> Specifically, Chile states that "the Panel did not provide a basic rationale for defining 'dissimilarity' as such nor did it explain how the Chilean tax system could satisfy that condition."<sup>74</sup>

78. A similar claim was made by Korea in *Korea – Alcoholic Beverages*. In that case the Appellate Body concluded that the Panel had provided a "detailed and thorough" rationale for its findings.<sup>75</sup> In our view, in this case, the Panel did "set out" a "basic rationale" for its finding and recommendation on the issue of "not similarly taxed", as required by Article 12.7 of the DSU. The Panel identified the legal standard it applied, examined the relevant facts, and provided reasons for its conclusion that dissimilar taxation existed.<sup>76</sup> Therefore, Chile's claim that the Panel failed to "set out" a "basic rationale" for its findings and recommendations in accordance with Article 12.7 of the DSU is denied.

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<sup>72</sup>As we have said, past protection of domestic production may, however, be a relevant factor in assessing current consumer preferences and the current structure of a market, since these may have been influenced, in part, by that past protection (see *supra*, para. 68, and Appellate Body Report, *Korea – Alcoholic Beverages*, *supra*, footnote 21, para. 120).

<sup>73</sup>Chile's appellant's submission, para. 47.

<sup>74</sup>*Ibid.*, para. 52.

<sup>75</sup>*Supra*, footnote 21, para. 168.

<sup>76</sup>The Panel's reasoning is set out in paragraphs 7.103 to 7.113 of the Panel Report.

## **VII. Articles 3.2 and 19.2 of the DSU**

79. Chile claims that the Panel's findings on the issues of "not similarly taxed" and "so as to afford protection" compromise the "security and predictability" of the multilateral trading system, provided for in Article 3.2 of the DSU, and "add to ... the rights and obligations of Members" under Article III:2, second sentence, of the GATT 1994, in contravention of Articles 3.2 and 19.2 of the DSU. In this dispute, while we have rejected certain of the factors relied upon by the Panel, we have found that the Panel's legal conclusions are not tainted by any reversible error of law. In these circumstances, we do not consider that the Panel has added to the rights or obligations of any Member of the WTO. Moreover, we have difficulty in envisaging circumstances in which a panel could add to the rights and obligations of a Member of the WTO if its conclusions reflected a correct interpretation and application of provisions of the covered agreements. Chile's appeal under Articles 3.2 and 19.2 of the DSU must, therefore, be denied.

## **VIII. Findings and Conclusions**

80. For the reasons set out in this Report, the Appellate Body:

- (a) upholds the Panel's interpretation and application of the term "not similarly taxed", which appears in the *Ad Article* to Article III:2, second sentence, of the GATT 1994;
- (b) upholds the Panel's interpretation and application of the term "so as to afford protection", which is incorporated into Article III:2, second sentence, of the GATT 1994, by specific reference to the "principles set forth in paragraph 1" of Article III of that Agreement, subject, however, to the exclusion of the third and fifth considerations relied upon by the Panel in reaching its conclusion in paragraph 7.159 of its Report;
- (c) concludes that the Panel did not fail to set out the basic rationale for its findings and recommendations regarding the interpretation and application of the term "not similarly taxed", as required by Article 12.7 of the DSU; and
- (d) concludes that the Panel did not act inconsistently with Articles 3.2 and 19.2 of the DSU by adding to the rights and obligations of WTO Members in its interpretation and application of the terms "not similarly taxed" and "so as to afford protection", under Article III:2, second sentence, of the GATT 1994.

81. The Appellate Body *recommends* that the DSB request Chile to bring the New Chilean System, contained in the Additional Tax on Alcoholic Beverages, into conformity with its obligations under Article III:2, second sentence, of the GATT 1994.

Signed in the original at Geneva this 9<sup>th</sup> day of November 1999 by:

Florentino Feliciano  
Presiding Member

Claus-Dieter Ehlermann  
Member

Julio Lacarte-Muró  
Member