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DOMINICAN REPUBLIC – MEASURES AFFECTING THE IMPORTATION AND INTERNAL SALE OF CIGARETTES

Report of the Panel

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US – Tobacco	Panel Report, *United States Measures Affecting the Importation, Internal Sale and Use of Tobacco*, adopted 4 October 1994, BISD 41S/I/131

I. INTRODUCTION

1.1 On 8 October 2003, Honduras requested consultations with the Dominican Republic pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and Article XXII:1 of the General Agreement on Tariffs and Trade 1994 (the GATT 1994) concerning certain measures by the Dominican Republic affecting the importation and internal sale of cigarettes. The request was circulated to Members on 13 October 2003.[1]

1.2 Consultations were held on 4 November 2003, but did not lead to a mutually satisfactory resolution of this matter.

1.3 On 8 December 2003, Honduras requested the Dispute Settlement Body ("DSB") to establish a Panel pursuant to Articles 4.7 and 6 of the DSU and Article XXIII:2 of the GATT 1994.[2] On 9 January 2004, the DSB established the Panel with the following terms of reference:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Honduras in document WT/DS302/5, the matter referred by Honduras to the DSB 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."[3]

1.4 On 17 February 2004, the parties agreed to the following composition of the Panel:

Chairman: Mr. Elbio ROSSELLI

Members: Mr. Tae-Yul CHO
Mr. Cristian ESPINOSA CAÑIZARES[4]

1.5 Chile, China, El Salvador, the European Communities, Guatemala, Nicaragua and the United States reserved their respective right to participate in the Panel proceedings as third parties.[5]

1.6 The Panel met with the two parties on 11 May and continued on 12 May 2004 after the third parties' meeting. The Panel met again with the parties on 29 and 30 June 2004.

1.7 Chile, China, El Salvador, the European Communities, Guatemala, and Nicaragua presented third-party submissions before the first substantive meeting of the Panel. These countries, as well as the United States, made oral statements during the first substantive meeting of the Panel. El Salvador and Nicaragua made joint submissions and a joint oral statement at the first substantive meeting.

1.8 Pursuant to the terms of Paragraph 8 of the 1996 Agreement between the International Monetary Fund (IMF) and the World Trade Organization, the Panel, on 17 May 2004, requested the IMF to provide information on how the *"Comisión Cambiaria a las Importaciones"* (previously called *"Comisión de Cambio"* and originally introduced by the Monetary Board of the Dominican Republic's Central Bank on 24 January 1991) is being implemented by the Dominican Republic. The Panel also requested the IMF to provide its views on whether the *"Comisión Cambiaria a las Importaciones"*, as applied by the Dominican Republic, is considered to be an "exchange control" or "exchange

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[1] Request for Consultations by Honduras, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes* (*Dominican Republic – Import and Sale of Cigarettes)*, 13 October 2003, WT/DS302/1.

[2] Request for the Establishment of a Panel by Honduras, *Dominican Republic – Importation and Internal Sale of Cigarettes*, 8 December 2003,WT/DS302/5.

[3] Constitution of the Panel Established at the Request of Honduras, *Dominican Republic – Importation and Internal Sale of Cigarettes*, 18 February 2004, WT/DS302/6, para. 2.

[4] Ibid., para. 3.

[5] Ibid., para. 4.

restriction" under the Articles of Agreement of the International Monetary Fund. On 25 June 2004 the IMF sent its response to the Panel.[6] The letter from the IMF was circulated to Parties and the Panel invited Parties to make comments. Honduras made some comments and the Dominican Republic did not submit any comments.

1.9 The Panel gave the parties a draft version of the descriptive part of the Report for their comments on 9 August 2004. The Panel issued its interim report to the parties on 21 September 2004. The Panel issued its final report to the parties on 20 October 2004.

II. FACTUAL ASPECTS

2.1 The specific measures at issue in the present case are the following:

2.2 The imposition by the Dominican Republic of a transitional surcharge on all imports, described as a "transitional surcharge for economic stabilisation" (*recargo transitorio de estabilización económica*), in accordance with Decrees 646-03 and 693-03.[7] The surcharge currently amounts to 2 per cent of the c.i.f. value of the imported goods.

2.3 The imposition by the Dominican Republic of a foreign exchange fee on all imports (*comisión de cambio*), in accordance with the Seventeenth Resolution of the Dominican Republic Central Bank's Monetary Board dated 24 January 1991 as amended, *inter alia*, by the First Resolution of 27 September 2001, the First Resolution of 20 August 2002, and the First Resolution of 22 October 2003. The current level of the fee is 10 per cent calculated on the value of the imports at the selling exchange rate for foreign currency. The surcharge applies to both bound and unbound tariff items.

2.4 The requirement by the Dominican Republic that tax stamps be affixed to cigarette packets in the territory of the Dominican Republic, pursuant to Article 37 of Decree 79-03 – Regulation on the Implementation of Section IV of the Tax Code (*Reglamento para la Aplicación del Título IV del Código Tributario de la República Dominicana*)[8] and Articles 1 and 2 of Decree 130-02.[9]

2.5 The rules and the administrative practice used by the Dominican Republic in order to determine the tax base for the purpose of applying the Selective Consumption Tax (*Impuesto Selectivo al Consumo*) to cigarettes, in accordance with Article 367 of its Tax Code (*Código Tributario de la República Dominicana*)[10], Article 3 of Decree 79-03 and Article I of General Rule 02-96.[11] More specifically, Honduras identifies three types of situations in this regard: (i) the regulations used to establish the value of imported cigarettes, in order to determine the tax base for the Selective Consumption Tax (SCT); (ii) the determination of the tax base for imported cigarettes in specific cases; and, (iii) the lack of publication of the surveys conducted by the Dominican Republic Central Bank that are used to determine the value of cigarettes for the purpose of applying the SCT.

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[6] Letter dated 25 June 2004 addressed to Chairman of the Panel, from the General Counsel of the International Monetary Fund, in response to Panel request for information (See Annex D).

[7] The text of Decree 646-03, dated 30 June 2003, and Decree 693-03, dated 16 July 2003, of the Dominican Republic was submitted by Honduras, as Exhibit HOND-2.

[8] The text of Decree 79-03 of the Dominican Republic, dated 4 February 2003, approving the Regulations on the implementation of Section IV of the Tax Code (*Reglamento para la Aplicación del Título IV del Código Tributario de la República Dominicana*, the Regulation), was submitted by Honduras, as Exhibit HOND-4.

[9] The text of Decree 130-02 of the Dominican Republic, dated 11 February 2002, was submitted by Honduras, as Exhibit HOND-5.

[10] Portions of the text of the Dominican Republic Tax Code, Law 11-92 (*Código Tributario de la República Dominicana*, as modified by Law 147-00) were submitted by Honduras, as Exhibit HOND-6.

[11] The text of General Rule 02-96 of the Dominican Republic, dated 1 June 1996, was submitted by Honduras, as Exhibit HOND-7.

2.6 The requirement by the Dominican Republic that importers of cigarettes post a bond to ensure payment of taxes, pursuant to Article 376 of the Tax Code and Article 14 of Decree 79-03.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

3.1 Honduras requested the Panel to find that:

- the surcharge on imported goods is inconsistent with Article II:1(b), second sentence, and consequently, likewise with Article II:1(a) of the GATT;

- the foreign exchange fee is inconsistent with Article II:1(b), second sentence and consequently, likewise with Article II:1(a) of the GATT;

- the requirement to affix a stamp on imported cigarettes in the territory of the Dominican Republic and under the supervision of the local tax authorities, in a manner that accords to imported cigarettes treatment less favourable than that accorded to domestic cigarettes, is inconsistent with Article III:4 of the GATT;

- the application of the Selective Consumption Tax to certain imported cigarettes is inconsistent with Article III:2 of the GATT;

- the manner in which the Dominican Republic determines the value of imported cigarettes for the purpose of applying the Selective Consumption Tax is inconsistent with Article X:3(a) of the GATT;

- the failure to publish the surveys conducted by the Central Bank, on which the Selective Consumption Tax on cigarettes is supposed to be based, is inconsistent with Article X:1 of the GATT; and,

- the requirement that importers of cigarettes post a bond is inconsistent with Article X1:1 or, in the alternative, with Article III:4 of the GATT.

3.2 Honduras requests the Panel to recommend, in accordance with Article 19.1 of the DSU, that the DSB request the Dominican Republic to bring the measures at issue into conformity with the GATT.

3.3 The Dominican Republic rejected all the foregoing claims made by Honduras and requested the following from the Panel based on reasons given by the Dominican Republic during the whole Panel proceedings:

- to dismiss the claim that the determination of the tax base of the Selective Consumption Tax levied on imported cigarettes is inconsistent with Article III:2 of the GATT.

- to dismiss the claim that the manner in which the Dominican Republic administers its provisions governing the Selective Consumption Tax (SCT) is inconsistent with Article X:3(a) of the GATT.

- to dismiss the claim that the surveys that identify the retail selling price to be used as the tax base for the SCT is inconsistent with Article X:1 of the GATT.

- to dismiss the claim that the requirement to affix a tax stamp in the territory of the Dominican Republic is inconsistent with Article III:4 of the GATT. Nevertheless, should the Panel find that this requirement is inconsistent with Article III:4, the Dominican Republic requests that

the Panel find that the requirement is justified by the general exception in Article XX(d) of the GATT.

- to dismiss the claim that the requirement that importers of cigarettes post a bond is inconsistent with Article XI of the GATT or, in the alternative, with Article III:4 of the GATT. Nevertheless, should the Panel find that this requirement is inconsistent with either Article XI or Article III:4, the Dominican Republic requests that the Panel find that the requirement is justified by the general exception in Article XX(d) of the GATT.

- to dismiss the claim that the transitional surcharge on imports is inconsistent with Article II:1 of the GATT.

- to dismiss the claim that the transitional foreign exchange fee is inconsistent with Article II:1 of the GATT or find that it is an exchange measure justified by Article XV:9(a) of the GATT.

IV. ARGUMENTS OF THE PARTIES

A. FIRST WRITTEN SUBMISSION OF HONDURAS

1. The measures at issue

(a) The surcharge imposed on imports

4.1 The Dominican Republic imposes a surcharge on all goods that is described as the "transitional surcharge for economic stablisation" ("surcharge"). The surcharge amounts to 2 per cent of the c.i.f. value of all goods imported into the Dominican Republic. It is imposed on imports, upon their importation, concurrently with and in addition to, the ordinary customs duties. The surcharge applies to both bound and unbound items.

(b) The foreign exchange fee imposed on imports

4.2 The Dominican Republic imposes a foreign exchange fee on all imports at the same time as the surcharge and the ordinary customs duties are imposed, namely, upon importation. Given its name, the fee is ostensibly intended to address "foreign exchange" matters related to the payment of imports in a foreign currency. However, the single criterion which determines the amount of the "foreign exchange fee" is the "value of imports at the selling rate of foreign exchange". The foreign exchange fee, originally introduced in 1991, has been amended several times. The most recent modification which increased the foreign exchange fee to 10 per cent was made effective by the First Resolution of the Monetary Board of the Dominican Republic dated 22 October 2003. The foreign exchange fee applies to both bound and unbound items.

(c) The requirement to affix a stamp on cigarettes in the territory of the Dominican Republic

4.3 The Dominican Republic requires that a stamp be affixed on all cigarette packets in the territory of the Dominican Republic. This requirement applies both to domestic and imported cigarette packets. For domestic cigarettes, the stamp may be affixed during the production process before the cellophane wrap is applied. In other words, domestic producers may affix the stamp on the cigarette packets at their own premises. However, the effect of this requirement for imported cigarettes is that the stamp can only be placed on the cellophane of each cigarette packet after it is imported into the Dominican Republic, but prior to its sale. Foreign producers are not allowed to affix the stamp on their own premises abroad. Instead, the Dominican Republic requires that imported cigarette packets be placed in a bonded warehouse or a warehouse under the control of the Directorate General of Internal Taxes (*Dirección General de Impuestos Internos*, DGII) in the territory of the Dominican Republic. The stamp then has to be affixed on the imported cigarette

packets in these warehouses in the presence of tax inspectors. This requirement and their administrative procedures are established by Article 37 of Decree 79-03 and Articles 1 and 2 of Decree 130-02.

(d) The application of the Selective Consumption Tax for certain imported cigarettes

4.4 The Dominican Republic establishes a Selective Consumption Tax on certain products, such as tobacco products. In order to apply the tax rate to certain imported cigarettes, the Dominican Republic determines the value of these products based on the retail selling price of the so-called "nearest similar product". According to Article 367 (b) of the Tax Code, the determination of the value of domestic cigarettes for the purpose of the tax must be based on the retail selling price of each brand, as provided in the survey. By contrast, the tax base for imported cigarettes is the value of the "nearest similar product on the domestic market". There are no regulations in the Tax Code which establish the criteria and procedures that should be used to determine the "nearest similar product on the domestic market".

4.5 Furthermore, Article 3 of Regulation 79-03 reaffirms that the tax base for both domestic and imported cigarettes is the retail selling price as determined by the average market price in accordance with the survey. However, not all imported cigarettes are included in the survey and therefore, for these products, the Dominican Republic uses the price of the "nearest similar product". The Dominican Republic has not published the criteria that it uses to determine the "nearest similar product".

4.6 On the other hand, the General Rule 02-96 specifies that the tax base for the Selective Consumption Tax for domestic goods shall be determined on the basis of the price to the retailer of the product. Pursuant to this provision, the tax base for tobacco products, including domestic cigarettes, is determined by increasing by 20 per cent the listed price of the cigarettes. The survey is not used to establish the tax base for these domestic products.

4.7 Honduras exports to the Dominican Republic cigarettes of the brands *Viceroy* and *Belmont*. For the purpose of applying the Selective Consumption Tax to *Viceroy* cigarettes, the Dominican Republic bases the value of the imported product on what it considers to be the nearest similar product in the domestic market. In this regard, the Dominican Republic disregards the retail selling price of *Viceroy* as the relevant factor in determining the tax base for applying the Selective Consumption Tax. The Dominican Republic does not consider *Líder* cigarettes as the nearest similar product to *Viceroy* cigarettes, even though they both sell for the same retail selling price. The result is that *Viceroy* cigarettes are deemed to be selling at a retail price higher than the actual selling price and therefore, are required to pay taxes based on this higher amount.

(e) The administration of the law for determining the tax base for cigarettes

4.8 Article 367(b) of the Tax Code, Article 3 of the Regulation 79-03 and Article I of the General Norm 02 96 are the relevant laws governing the application of the Selective Consumption Tax on cigarettes, particularly with respect to the determination of the "nearest similar product". The determination of what is the nearest similar product is required for the imposition of the Selective Consumption Tax on imported cigarettes. As noted above, the tax base for imported cigarettes is determined by the value of the nearest similar product. However, the relevant laws do not contain any criteria to determine what is the "nearest similar product" in the Dominican Republic's market. Therefore, the Dominican Republic has wide scope to determine what is the "nearest similar product" to certain brands of imported cigarettes, such as *Viceroy*.

(f) The lack of publication of the survey on which the Selective Consumption Tax is to be based

4.9 As noted above, Article 367(b) of the Tax Code and Article 3 of the Regulation 79-03 both require that the Central Bank of the Dominican Republic conducts a survey in order to determine the retail selling price to be used as the tax base for the application of the Selective Consumption Tax.

4.10 The survey, which is supposed to reflect average prices, should be the primary source for the determination of the retail selling price for cigarettes. Therefore, the information contained in the survey is of critical importance to traders for the following reasons:

4.11 The retail selling price as determined by the survey should be used as the tax base for domestic cigarettes. This amount should subsequently be used to determine the tax base of imported cigarettes which have not yet been included in the survey.

4.12 In addition, as imported goods may also be included in the survey, the prices listed in the survey would be the primary source for determining the tax base for the Selective Consumption Tax to be applied for these products.

4.13 However, the Dominican Republic has failed to publish, or otherwise make available to importers, any of these surveys. As a result, traders are not apprised of the basis upon which their products will be taxed.

(g) The bond requirement for importers of cigarettes

4.14 Article 376 of the Tax Code requires that domestic producers of alcohol and tobacco products post a bond. Even though Article 376 of the Tax Code requires that only domestic producers post a bond, Article 14 of Regulation 79-03 subsequently introduced a bond requirement for importers of cigarettes.

4.15 There is a bond requirement for both domestic producers and importers. The purpose of this bond requirement is ostensibly to ensure that the Selective Consumption Tax is paid. However, the timing of when the Selective Consumption Tax must be settled with the government differs between importers and domestic producers. An importer must liquidate and pay the Selective Consumption Tax together with the corresponding customs duties at the moment that the products enter into the Dominican Republic. However, domestic producers must settle the Selective Consumption Tax on the 20th day following the month in which the actual sale (or transfer) occurred.

4.16 It would appear that the bond is a security in the event that the tax obligation is not properly discharged by the domestic producer on the 20th day in the month following the month in which the actual sale (or transfer) occurred. However, as noted above, importers are required to pay the full amount of the Selective Consumption Tax upon the importation of the product. Therefore, with respect to the importers, there is no potential Selective Consumption Tax liability that the bond requirement would secure as the tax obligation has already been discharged.

4.17 In addition, the bond requirement is a fixed amount of RD$ 5 million that must be posted by each importer and each domestic producer. In contrast, the Selective Consumption Tax is dependent upon variable factors such as monthly volumes of sales and changes in the retail selling price according to market factors. Therefore, there is no direct relationship between the amount required to be guaranteed (i.e. the fixed amount of the bond) and the actual amount giving rise to the tax. These two amounts are not commensurate.

2. Legal arguments:

(a) The surcharge is inconsistent with Article II:1(b) of the GATT

(i) The surcharge is a duty or charge other than an ordinary customs duty

4.18 The surcharge applies to both bound and unbound items. In the Dominican Republic's Schedule of Concessions, cigarettes which fall under the 4-digit tariff heading 2402 have a bound rate of 40 per cent. As the surcharge applies to the bound item of cigarettes, the surcharge falls within the scope of Article II:1(b), second sentence, of the GATT.

4.19 Article 2 of Decree 646-03 refers to two different and distinct types of amounts that are payable: (i) the surcharge, and (ii) the customs duty payable. The term "customs duty payable" on its face comprises the obligation to pay all duties, including "ordinary customs duties". The obligation to pay the surcharge – while this term is not specifically defined – arises concurrently with the customs duty payable. It follows that the obligation to pay the surcharge is an obligation separate from that of the obligation to pay the "customs duty", including ordinary customs duties. In other words, it is an "other" duty or charge within the meaning of Article II:1(b), second sentence. The term "other" means "existing besides or distinct from that or those already specified or implied; further, additional". The placement of the term "transitional surcharge" beside the term "customs duty payable" indicates that it is a distinct type of charge or duty. The surcharge is a "duty or charge" other than an "ordinary customs duty" within the meaning of Article II:1(b), second sentence, of the GATT.

(ii) The surcharge is imposed on, or in connection with, importation

4.20 The surcharge is "…levied *on the c.i.f value of [all] goods* included in the Harmonized Commodity Description and Coding System and *which fall under the regime of customs clearance for consumption*" (emphasis added in the submission). It is only products that are imported that would fall under "the regime of customs clearance for consumption". Therefore, the surcharge is imposed on, or in connection with, the importation of all goods.

(iii) The Dominican Republic did not record the surcharge in its Schedule of Concessions and the surcharge is therefore inconsistent with Article II:1(b), second sentence, in the light of the Understanding on Article II:1(b)

4.21 According to the Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994, as of 15 April 1994, all WTO Members had to record all charges and duties in their respective Schedules of Concessions. The Dominican Republic did not record this surcharge. Indeed, as the surcharge did not exist as of 15 April 1994, it was not possible for it to be recorded in the Dominican Republic's Schedule of Concessions.

(iv) The surcharge is in excess of the duties or charges imposed as of 15 April 1994

4.22 Article II:1(b), second sentence, read together with the Understanding, prohibits Members after 15 April 1994 from imposing "other duties or charges" in excess of the binding in the "other duties and charges" column of the Schedule. As the Dominican Republic did not record the surcharge as an "other duty or charge" in its Schedule of Concessions, any surcharge that it now introduces must be "in excess of" those set out and provided in its Schedule. It follows from the above that the 2 per cent surcharge is in excess of, and therefore is inconsistent with, the Dominican Republic's obligations under Article II:1(b), second sentence, of the GATT. Honduras submits that as the surcharge is inconsistent with the specific obligation set out in Article II:1(b), second sentence, it is consequently inconsistent with the general prohibition set out in Article II:1(a) of the GATT.

(b) The foreign exchange fee is inconsistent with Article II:1(b) of the GATT

(i) The foreign exchange fee is a duty or charge other than an ordinary customs duty

4.23 As noted above, the Dominican Republic imposes a foreign exchange fee on all imports at the same time as it imposes the ordinary customs duties, namely, upon importation. The "ordinary customs duties" are levied upon the entry of goods into a customs territory. The foreign exchange fee applies to both bound and unbound items. In the Dominican Republic's Schedule of Concessions, cigarettes which fall under the 4-digit tariff heading 2402 have a bound rate of 40 per cent. As the foreign exchange fee applies to the bound item of cigarettes, the foreign exchange fee falls within the scope of Article II:1(b), second sentence, of the GATT. As a result, the foreign exchange fee is a duty or charge "other" than an ordinary customs duty. Article II:1(b) applies to "other duties or charges" of any kind, whether they take the form of an "exchange action" or a "trade action". For the purpose of making a finding under Article II:1(b), therefore, the Panel need not decide whether the fee is an "exchange action" or a "trade action" within the meaning of Article XV:4 of the GATT.

(ii) The foreign exchange fee is imposed on, or in connection with, importation

4.24 The First Resolution of 22 October 2003 states clearly that the foreign exchange fee referred to in (amended) Paragraph 12 of the Seventeenth Resolution adopted by the Board on 24 January 1991 is a "foreign exchange fee *on imports*" (emphasis added). Furthermore, the foreign exchange fee is collected by Customs at the time of importation, and is "computed on the value of the imports". As it is applied on the value of imports and at the time of importation, the foreign exchange fee clearly is a duty or charge other than "ordinary customs duties" imposed on, or in connection with, importation, within the meaning of Article II:1(b), second sentence.

(iii) The Dominican Republic did not record the foreign exchange fee in its Schedule of Concessions and the fee is therefore inconsistent with Article II:1(b), second sentence, in the light of the Understanding on the Interpretation of Article II:1(b) of the GATT

4.25 The Understanding requires that all duties or charges, other than ordinary customs duties, must be recorded in a Member's Schedule of Concessions. Article II:1(b), second sentence, read together with the Understanding, prohibits Members after 15 April 1994 from imposing "duties or charges" other than those that were recorded in the "other duties or charges" column of that Member's Schedule. Honduras notes that the foreign exchange fee was never recorded as an "other duty or charge" in the Dominican Republic's Schedule of Concessions. Therefore, Honduras submits that the foreign exchange fee is inconsistent with Article II:1(b), second sentence, in the light of the Understanding on Article II:1(b).

(iv) The current foreign exchange fee is in excess of the duties or charges imposed as of 15 April 1994

4.26 If the Panel were to find that the imposition of the foreign exchange fee is WTO-consistent notwithstanding the Dominican Republic's failure to record it as an "other duty or charge" in its Schedule of Concessions, Honduras submits that it is nevertheless "in excess of" the rate applied as of 15 April 1994. The legislation establishing the foreign exchange fee was enacted in 1991; it provided that the fee would be levied at a rate of 2.5 per cent. Therefore, Honduras notes that the rate of 2.5 per cent that was applied before 15 April 1994 is lower than the rate of 10 per cent that is currently applied. The foreign exchange fee is inconsistent with Article II:1(b), second sentence, of the GATT because it is imposed in excess of the Dominican Republic's recorded bindings in the "other duties or charges" column in its Schedule of Concessions. Honduras submits that the foreign exchange fee is inconsistent with Article II:1(a) and, based on the principle underlying the relationship between Article II:1(a) and Article II:1(b), second sentence, it is consequently inconsistent with Article II:1(a).

(c) The requirement to affix a stamp in the territory of the Dominican Republic is inconsistent with Article III:4 of the GATT

4.27 The Appellate Body has stated that, in order to establish a violation of Article III:4, three elements must be satisfied: "…that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the imported products are accorded 'less favourable' treatment than that accorded to like domestic products".[12] These three elements are met.

(i) Imported and domestic cigarettes are "like products" within the meaning of Article III:4

4.28 Based on the four criteria stated in the GATT Working Party Report on *Border Tax Adjustments*[13], as followed by the Appellate Body in *EC –Asbestos*[14], Honduras submits that imported cigarettes and domestic cigarettes of all brands are like products. In general, both imported and domestic cigarettes have the same physical properties (i.e. tobacco) and similar presentation; they have the same end-use (i.e. they are smoked); they are interchangeable for consumers (e.g. many consumers do switch from one brand to another); and; they are classified under the same tariff heading.

(ii) The requirement of affixing a stamp on cigarette packets in the territory of the Dominican Republic is a requirement that affects the internal sale of imported cigarettes

4.29 The requirement to affix a stamp on both imported and domestic cigarettes is found in Article 37 of the Regulation and Articles 1 and 2 of Decree 130-02. The fulfilment of this requirement is a prerequisite for withdrawing the cigarettes from the warehouse in order that they may be distributed and sold in the Dominican Republic and, therefore, affects the internal sale of imported cigarettes.

(iii) The requirement of affixing a stamp in the territory of the Dominican Republic accords treatment less favourable to imported cigarettes than that accorded to domestic cigarettes

4.30 The requirement of affixing a stamp in the territory of the Dominican Republic applies to both domestic and imported cigarettes and is, as such, a formally identical requirement. Nevertheless, it has been recognised in GATT jurisprudence that "…there may be cases where application of formally identical legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favourable…"[15] In the case at hand, the identical requirement of affixing the stamp in the Dominican Republic imposes the following additional steps and costs for importers of cigarettes. As the stamp must be affixed in the territory of the Dominican Republic, imported cigarettes must undergo additional steps in order to comply with this requirement. For domestic cigarettes, no additional steps are required to so comply; the stamp may be affixed during the production process prior to the final packaging of the product. In contrast, as shown below, in the case of imported cigarettes the affixing of the stamp requires a separate process after cigarettes have been produced and packed in the exporting country. This additional process requires the re-opening of boxes and cartons, the affixation of the stamps on the cigarette packets (over the cellophane), and the repackaging of cartons and boxes.

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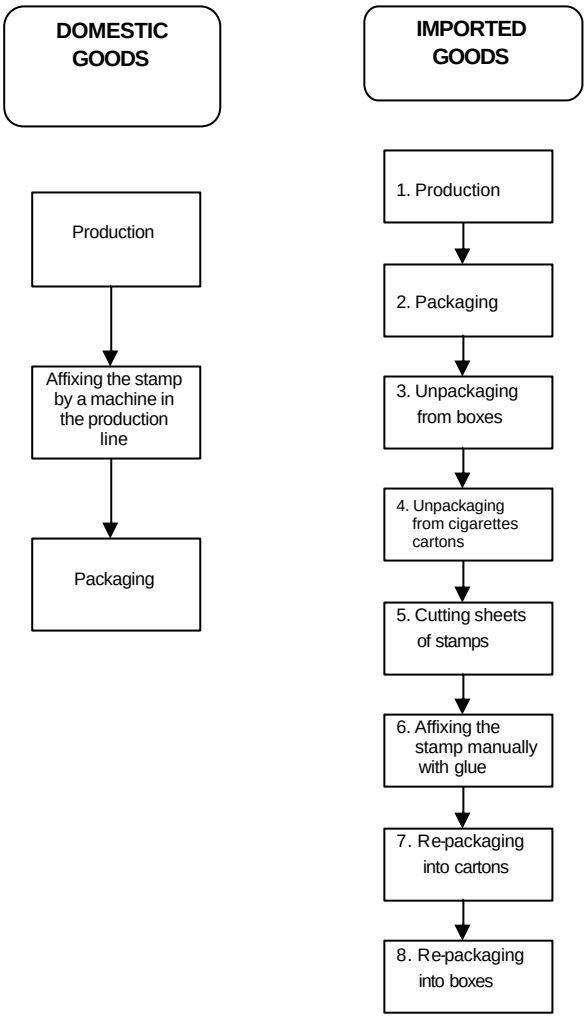
[12] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

[13] Report of the GATT Working Party on *Border Tax Adjustments*, adopted on 2 December 1970, BISD 18S/97, L/3464, para. 18.

[14] Appellate Body Report, *EC –Asbestos*, paras. 101-103.

[15] GATT Panel Report, *US – Section 337*, para. 5.11. See also, GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, paras. 5.30–5.31.



4.31 First, the importer must reopen the boxes and then reopen the cigarette cartons in order to remove the cigarette packets so that the stamp may be affixed on the cigarette packets. The sheets of stamps have to be individually cut and then individually glued onto the packets. Subsequently, the cigarette packets have to be replaced in the cartons and then replaced in the boxes. All these additional steps require the importer to hire additional labour to carry out these tasks in the Dominican Republic. Honduras submitted photographs which provide graphic evidence of the burdensome steps that the importer has to undertake to comply with this requirement. Domestic producers, on the other hand, do not have to carry out all these additional steps.

4.32 In addition, the fact that the stamp on imported cigarettes is placed over the cellophane aesthetically detracts from the overall presentation of the final product. Cigarettes manufactured in the Dominican Republic are allowed to have the stamp added to the packets before the cellophane wrap is applied and during the production process. As a result, imported cigarettes cannot be as attractively packaged as domestic cigarettes.

4.33 The costs to the importer of affixing the stamp in the territory of the Dominican Republic amount to US$0.9 per thousand cigarettes; that is 9.70 per cent of the c.i.f. average price. Honduras does not have access to the costs incurred by a domestic producer in the Dominican Republic to affix the stamp in the course of the production process. However, a report from Price Waterhouse Coopers demonstrates that the cost for a cigarette producer in Honduras for affixing the stamp during the

overall production process is US$0.01 per thousand cigarettes; that is 0.1 per cent of the c.i.f. average cost. It is reasonable to assume that these costs in terms of percentage would be the same for a domestic producer in the Dominican Republic.

4.34 In the light of the foregoing analysis, Honduras submits that the requirement to affix the stamp in the Dominican Republic modifies the conditions of competition for imported cigarettes in the Dominican Republic to their detriment, and thus treats imported cigarettes less favourably. Therefore, Honduras submits that the measure at issue is inconsistent with Article III:4 of the GATT.

(d) The application of the Selective Consumption Tax for certain imported cigarettes is inconsistent with Article III:2 of the GATT

4.35 Based on the methodology set out by the Appellate Body regarding the analysis of a claim under Article III:2, first sentence, Honduras submits that the measure at issue is inconsistent with Article III:2 of the GATT for the reasons set out below.

(i) Domestic and imported cigarettes are "like products" within the meaning of Article III:2, first sentence

4.36 The Appellate Body has stated that it agrees "with the practice under the GATT 1947 of determining whether imported and domestic products are 'like' on a case-by-case basis".[16] Honduras has established above that imported and domestic cigarettes are "like products". If the Panel were to find that domestic and imported cigarettes were not like products, Honduras submits that domestic and imported cigarettes are nevertheless directly competitive or substitutable and are not similarly taxed in accordance with Article III:2 and Note *Ad Article III:2* of the GATT.

(ii) Certain imported cigarettes are subject to internal taxes in excess of those applied to like domestic products

4.37 The Dominican Republic treats like products which sell for the same retail selling price differently. In other words, the Dominican Republic establishes the tax base for certain imported cigarettes such as *Viceroy* on the basis of what it determines to be the retail selling price of the "nearest similar product", whereas it determines the tax base for its domestic cigarettes such as *Líder* and *Marlboro* on their actual retail selling prices. This difference in approach in determining the tax base has led to various complaints being filed with the courts in the Dominican Republic.

4.38 The difference in approach has resulted in lower-priced imported cigarettes being taxed at a rate higher than their actual selling price. In practical terms, this means that cigarettes like *Viceroy* which sell for RD$18 are taxed at a higher rate than the like domestic products, which sell for the same retail selling price.

4.39 Honduras provides the following table to illustrate the retail selling price of the relevant products:

[16] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 20.

Brand	Retail Selling Price	Selective Consumption Tax paid	per cent Actual Tax burden
Kent	RD$ 22.00	RD$ 6.54	29.73 per cent
Marlboro	RD$ 26.00	RD$ 7.73	29.73 per cent
Belmont	RD$ 20.00	RD$ 6.13	30.65 per cent
Nacional	RD$ 24.00	RD$ 7.36	30.65 per cent
Viceroy	**RD$ 18.00**	**RD$ 6.54**	**36.33 per cent**
Líder	**RD$ 18.00**	**RD$ 5.34**	**29.66 per cent**

(Information applicable during the period of 17 March – 1 August 2003.)

4.40 From this table, it can be noted that the retail selling prices for *Viceroy* and *Líder* are the same, but they are not taxed on the same basis.

4.41 Due to this difference in taxation, the Selective Consumption Tax applied to Honduras's *Viceroy* cigarettes is in excess of the Selective Consumption Tax applied to its like domestic product, *Líder*. *Viceroy* cigarettes have a higher tax burden of 36.33 per cent as compared to the tax burden of 29.66 per cent for *Líder*. The measure at issue is therefore inconsistent with Article III:2, first sentence, of the GATT.

(e) The failure to establish and/or apply transparent and generally applicable criteria for determining the value of imported cigarettes is inconsistent with Article X:3(a) of the GATT

4.42 The applicable provision is Article X:3(a) of the GATT. This provision applies to the measures falling under the scope of Article X:1 of the GATT.

(i) The law governing the Selective Consumption Tax falls under Article X:1 of the GATT

4.43 Article 367 (b) of the Tax Code, Article 3 of the Regulation and Article I of the General Rule 02-96 are "laws, regulations… of general application… pertaining to… taxes or other charges". Therefore, these measures fall under the scope of Article X:1 of the GATT.

(ii) The administration of the Selective Consumption Tax is not conducted in a reasonable manner

4.44 The Dominican Republic administers the provisions governing the Selective Consumption Tax in a manner that is not reasonable; in particular, with respect to determination of the "nearest similar product on the domestic market". Honduras submits that there is no adequate reason for the Dominican Republic to disregard the actual retail selling price of *Líder* when determining the tax base for *Viceroy*. As stated above, both *Viceroy* and *Líder* have the same retail selling price. The Dominican Republic, however, relies on the price of *Kent* or *Marlboro* to determine the "nearest similar" product to *Viceroy* in the Dominican Republic's market.

4.45 This unreasonable administration of the criteria to determine the "nearest similar product" to *Viceroy* is inconsistent with Article X:3(a) of the GATT.

4.46 The determination of "nearest similar product" as one with a higher retail selling price leads to the imposition of the Selective Consumption Tax on certain imported cigarettes in excess of like domestic cigarettes. Therefore, this unreasonable administration of the laws and regulations governing the Selective Consumption Tax, particularly the manner in which the "nearest similar product" is determined, has an impact on the competitiveness of imported cigarettes.

(f) The failure to publish the surveys that are used to determine the Selective Consumption Tax is inconsistent with Article X:1 of the GATT

(i) The surveys to be used to determine the rates for the Selective Consumption Tax fall under Article X:1

4.47 Article 3 of Regulation 79-03 confirms that the tax base for both domestic and imported cigarettes is the retail selling price as determined by the average market price in accordance with the survey. The surveys conducted by the Dominican Republic's Central Bank are part of the regulations or administrative rulings of general application pertaining to the determination of the Selective Consumption Tax. Therefore, the survey is a component of the legislation on the Selective Consumption Tax, covered by Article X:1 of the GATT.

(ii) The surveys to be used to determine the Selective Consumption Tax have not been published

4.48 However, the survey has not been made publicly available. According to Article X:1, the survey should have been published promptly in such a manner as to enable governments and traders to become acquainted with them. A WTO Panel has stated that: "[i]ndeed, Article X:1 requires the prompt publication of trade-related regulation 'so as to enable governments and *traders* to become acquainted with them.'"[17]

4.49 However, the Dominican Republic has not published the survey in order to enable governments and traders to become acquainted with their content. Therefore, the Dominican Republic has acted inconsistently with Article X:1.

(g) The requirement to post a bond is inconsistent with Article XI:1 of the GATT, or, in the alternative, if the bond requirement is determined to be an internal measure, is inconsistent with Article III:4 of the GATT

4.50 The applicable provision is Article XI:1 of the GATT. However, alternatively, if the bond requirement were considered to be an internal measure, then the provisions of Article III:4, which is cited above, would apply.

(i) The requirement to post a bond as stated in the applicable law is a restriction inconsistent with Article XI:1

4.51 In the light of Article 14 of the Regulation, importation would not be allowed unless the bond requirement is complied with. Therefore, the bond requirement constitutes a restriction imposed on the importation of cigarettes into the Dominican Republic. In GATT/WTO jurisprudence, Panels have interpreted Article XI:1 as a comprehensive ban of all types of limitations on the importation of products other than duties, taxes and charges. The requirement has the effect of restricting imports when the bond is not provided, in a manner inconsistent with Article XI:1.

(ii) If, in the alternative, the requirement to post the bond is an internal measure, it accords less favourable treatment to imported cigarettes than that accorded to like domestic cigarettes, and is therefore inconsistent with Article III:4

4.52 If the Panel were to consider that the requirement to post a bond is an internal measure, it should find that it is inconsistent with Article III:4 of the GATT because it accords less favourable treatment to imported cigarettes than that accorded to like domestic cigarettes. As stated above, domestic producers have the obligation to pay the amount of the tax on the 20th day of the month following the month in which the original sale (or transfer) was made. In this situation, it appears that

[17] Panel Report, *Argentina – Hides and Leather*, para. 11.68 (italics in text).

the bond is a security in the event that the tax obligation is not properly discharged. However, importers have to pay the full amount of the Selective Consumption Tax upon the importation of the product. Therefore, with respect to the importers, there is no Selective Consumption Tax liability that the bond requirement would secure. In addition, the bond requirement is a fixed amount of RD$ 5 million that must be posted by each importer and domestic producer. In contrast, the Selective Consumption Tax is dependent upon variable factors such as monthly volumes of sales and variations in the retail selling price according to market factors. Therefore, there is no direct relationship between the amount required to be guaranteed (i.e. the fixed amount of the bond) and the actual amount giving rise to the tax. These two amounts are not commensurate. This discrepancy is illustrated by the fact that, as of December 2003, an importer that accounted for, say, 4 per cent of the market would have had to pay RD$4.1 million a month for the Selective Consumption Tax, whereas it would have had to post the bond for RD$5 million. By the same token, a domestic producer which accounted for, say, 88 per cent of the market would have had to pay RD$91.5 million a month for the Selective Consumption Tax, whereas it would have had to post the bond for RD$5 million.

4.53 In the alternative, Honduras submits that the measure at issue for these reasons is inconsistent with Article III:4 of the GATT.

B. FIRST WRITTEN SUBMISSION OF THE DOMINICAN REPUBLIC

1. Introduction

4.54 The claims raised by Honduras target six measures, which can be classified in one of the following categories: (1) dead measures[18], (2) measures applied to enforce internal tax laws, and (3) transitional measures on imports.

4.55 The first category, i.e. dead measures, includes (a) the determination of the tax base of the *ad valorem* Selective Consumption Tax (SCT) for cigarettes, and (b) the publication of the surveys of average retail prices of cigarettes. Both measures were eliminated even before the Panel proceedings commenced (on the day the Panel was established). Honduras's claims are moot.

4.56 The second category of measures, i.e. measures applied to enforce internal tax laws, includes (a) the requirement to affix tax stamps on cigarettes in the territory of the Dominican Republic, and (b) the requirement to post a bond to guarantee compliance with the tax laws of the Dominican Republic. These measures apply equally to importers and to domestic producers. They do not discriminate against imported products, and are not applied so as to afford protection to domestic production.

4.57 The third category of measures, i.e. transitional measures on imports, includes (a) a transitional surcharge on imports, and (b) a transitional foreign exchange fee. Honduras's claims that the surcharge and the exchange fee are inconsistent with the obligations of the Dominican Republic are disproved by the recorded level of other duties or charges in the Schedule of Concessions XXIII – Dominican Republic.

2. Legal arguments

(a) Dead measures

4.58 Honduras's three claims concerning the Selective Consumption Tax for imported cigarettes target measures that the Dominican Republic eliminated on the same day this Panel was established. The claims are therefore moot and should be dismissed.

[18] "Dead measures" was the terminology used throughout these proceedings by the parties to refer to measures no longer in existence, either because they had expired or had been withdrawn.

(i) Selective Consumption Tax

4.59 Honduras's claims under Articles III:2 and X:3(a) of the GATT concerning the SCT are based on the former – and now outdated – provisions of Article 367 of the Dominican Republic Tax Code. Law 3-04 of 9 January 2004 (published on 14 January 2004) amended Articles 367 and 375 of the Tax Code.[19] Articles 367 and 375 of the Tax Code, as amended, establish a specific and identical tax base and tax rate for the SCT for imported and domestic cigarettes – i.e. RD$0.48 per cigarette.[20] The Panel should dismiss Honduras's claims, as they are based on measures that no longer exist.

(ii) Survey of average retail prices

4.60 Honduras claims that the Dominican Republic acts inconsistently with Article X:1 of the GATT because it has not published the Central Bank surveys that identify the retail price to be used as the tax base for the SCT.[21] However, the surveys were removed from Article 367 of the Tax Code by Law 3-04 of 9 January 2004. Honduras's claim concerning the surveys is therefore moot. Consequently, the Panel should dismiss this claim.

(b) Measures applied to guarantee compliance with internal tax laws

(i) The stamp requirement for imported and domestic cigarettes

4.61 There is nothing discriminatory about the stamp requirement specified in Article 37 of Decree 79-03 of 4 February 2003 and Article 2 of Decree 130-02 of 11 February 2002. The requirement to affix stamps to cigarette packets, whether imported or produced domestically, in the territory of the Dominican Republic and in the presence of officials from the DGII is a legitimate exercise of the Dominican Republic's sovereign right to enforce its internal tax laws. Honduras has not presented evidence to establish a *prima facie* case that the stamp requirement is inconsistent with Article III:4 of the GATT.

The stamp requirement is consistent with Article III:4 of the GATT

4.62 Contrary to Honduras's arguments, the requirement to affix stamps does not accord less favourable treatment to imported cigarettes nor is it applied so as to afford protection to the domestic producer.

4.63 The requirement in Article 37 of Decree 79-03 and Articles 1 and 2 of Decree 130-02 to affix tax stamps in the territory of the Dominican Republic is provided for and applied equally to importers and domestic producers. According to Article 37 of Decree 79-03, both the domestic producer and the importer of cigarettes are required to affix tax stamps in the presence and under the supervision of the DGII inspector, whose job is to ensure that each packet of cigarettes that enters the stream of commerce has paid its corresponding tax. The inspectors are neither more lenient nor more stringent on either the domestic producer or the importer. There is no evidence in this case of either *de jure* or *de facto* discriminatory treatment on the part of the Dominican Republic.

4.64 The conditions of competition that Honduras complains about have not been "modified" by the Dominican Republic. Rather, they are the result of inherent differences in the normal conditions under which imported products compete with domestic products. The inherent differences that exist between imported and domestic products mean that there can never be a perfect equality in the

[19] The text of Law 3-04, dated 9 January 2004, published in the Official Journal of the Dominican Republic on 14 January 2004, was submitted by the Dominican Republic as part of Exhibit DR-1.

[20] The tax base of the SCT for cigarettes is provided for by Article 367(c) of the Tax Code, as amended by Law 3-04. The tax rate of the SCT for cigarettes is provided for by Article 375, Para. V, of the Tax Code, as amended by Law 3-04.

[21] First written submission of Honduras, 16 March 2004, paras. 108, 110.

conditions of competition in the market place between importers and domestic producers. Article III:4 requires Members to refrain from modifying or upsetting those conditions of competition to the detriment of importers in a manner that affords protection to the domestic producers. It does not require that Members modify the conditions of competition so as to compensate for inherent differences between imported and domestic products and ensure perfect equality in the conditions of competition. The essence of Honduras's argument is that any cost associated with the performance of legitimate regulations must be borne by the State.

4.65 The examination of whether a measure involves "less favourable treatment" of imported products within the meaning of Article III:4 of the GATT 1994 "must be grounded in close scrutiny of the 'fundamental thrust and effect of the measure itself'".[22] The thrust of the measure is to enforce the tax laws of the Dominican Republic and avoid the endemic problem of trade in smuggled cigarettes, which has been estimated to lead to US$25-30 billion in total lost tax revenue by governments around the world annually.[23]

4.66 The additional costs that Honduras points to in its first written submission are costs associated with compliance with non-discriminatory internal measures. Also, many of the "additional steps" that Honduras refers to are either avoidable or are steps that domestic producers also have to perform. In any event, the effect that the measure has on importers is negligible. Imports by the Honduran cigarette producer *British American Tobacco* (BAT) into the Dominican Republic increased by more than 80 per cent in value in 2003, compared with the previous year, from US$454,497 to US$818,307.[24]

4.67 The Appellate Body and Panels have held consistently that the general principle in Article III:1 informs the other paragraphs of Article III, including paragraph 4, and guides its interpretation.[25] The Panel must determine, therefore, on the basis of the evidence submitted by the complainant, whether the measure has "protective application", i.e. is it applied so as to afford protection to domestic producers.[26]

4.68 In this case, an examination of the design, architecture, and revealing structure of the requirement to affix a stamp in the territory of the Dominican Republic reveals that the measure is not applied so as to afford protection.[27] That conclusion is borne out by the following relevant facts and circumstances, which must be given full consideration:

(a) The tax stamp is a legitimate, internationally-recognized method to prevent and stymie trade in smuggled cigarettes and the resulting loss of tax revenue.

(b) The exact same requirement to affix the tax stamps in the territory of the Dominican Republic is imposed on both domestic producers and importers.[28]

(c) The effective enforcement of the tax stamp legislation requires the presence of inspectors from the DGII at the production facilities of domestic producers and the facilities of importers of cigarettes at the time the stamps are affixed.[29]

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[22] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 215.

[23] Framework Convention Alliance, "The FCTC and Tobacco Smuggling: NGO Briefing for the International Conference on Illicit Trade in Tobacco", New York, 30 July – 1 August 2002, submitted by the Dominican Republic as Exhibit DR-4.

[24] Statistics regarding imports made by the firm *British American Tobacco (BAT) – República Dominicana*, January – December 2003, submitted by the Dominican Republic as Exhibit DR-5.

[25] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 205; Appellate Body Report, *EC – Asbestos*, paras. 93, 98; Panel Report, *Canada – Periodicals*, para. 5.37.

[26] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 18.

[27] Cf., Ibid., p. 29.

[28] Decree 130-02, *supra* note 9, Articles 1 and 2.

[29] See Decree 79-03, *supra* note 8, Article 37.

(d) The Dominican Republic has neither the right nor the resources to relocate DGII officials to foreign countries to enforce the laws of the Dominican Republic abroad and outside of its jurisdiction.

(e) The costs of complying with legitimate and non-discriminatory laws and regulations in the territory of the State enforcing such laws are inherent in the conduct of international trade. The cost to the importer of Honduran cigarettes *BAT* of complying with the Dominican Republic tax regulation is estimated at US$65,641.[30]

(f) There is concrete evidence in the Dominican Republic that allowing tax stamps to be shipped and affixed abroad results in forgery of such tax stamps and smuggling of the products in question.[31]

(g) The alleged associated cost of complying with the stamp requirement is a minimal expense that does not have a protective or discriminatory effect on the competitive conditions of importers of cigarettes in the Dominican Republic.

(h) The tax stamp has no protective effect in practice, as demonstrated by the significant increase in imports of cigarettes by *BAT* from Honduras and elsewhere into the Dominican Republic (more than 80 per cent in value in 2003, compared with the previous year, from US$454,497 to US$818,307).

(i) The Dominican Republic has the inherent and fundamental sovereign right to enforce its laws within its own territory.

(j) The Dominican Republic has the inherent and fundamental sovereign right to set the level of enforcement that it deems appropriate.[32]

4.69 Accepting Honduras's claim against the stamp requirement would leave the Dominican Republic with one of the following options: (a) send DGII inspectors to foreign countries to control the affixation of stamps in foreign producers' plants; or (b) lower its enforcement standard and allow foreign producers to affix stamps abroad without the supervision of the DGII.

4.70 The Dominican Republic cannot presume to have jurisdiction to prescribe nor enforce Decrees 79-03 and 130-02 outside of its territory. A state cannot take measures or exercise its power in any form on the territory of another state by way of enforcement of national laws, except by virtue of a permissive rule to the contrary.[33]

4.71 On the other hand, the Dominican Republic does not have the resources necessary to send DGII inspectors to Honduras (the annual cost to the Dominican Republic of flying one DGII inspector to Tegucigalpa every day to supervise that activity would be approximately US$151,680, or US$168,980 in the case of San Pedro Sula)[34], or to any city of a WTO Member where production for export to the Dominican Republic takes place -in accordance with Article I of the GATT- to ensure that the stamps are affixed to the cigarette packets in accordance with Decrees 79-03 and 130-02.

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[30] Calculation by the Dominican Republic, based on official statistics of imports of *BAT* from Honduras for 2003 and on Honduras's own estimate of costs in para. 82 of its first written submission.

[31] See information submitted by the Dominican Republic as Exhibit DR-8.

[32] Appellate Body Report, *Korea – Various Measures on Beef*, para. 176.

[33] See *S.S. Lotus (France v. Turkey)*, P.C.I.J Ser. A No. 10; Ian Brownlie, *Principles of Public International Law*, Fifth Edition, Oxford University Press, 1998, p. 310.

[34] See Exhibit DR-7.

4.72 The remaining regulatory "option" that would be theoretically available to the Dominican Republic would be to allow foreign producers to affix stamps abroad without the supervision of the DGII. As experience has shown, that would mean that the Dominican Republic would have to lower its desired level of enforcement. The Appellate Body has recognized, however, that "[i]t is not open to doubt that Members of the WTO have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations".[35]

(ii) The bond requirement for domestic and imported cigarettes

4.73 The bond requirement is a non-discriminatory internal measure. It is neither a restriction on importation subject to Article XI:1 nor discriminatory under Article III:4 of the GATT.

4.74 The Panel in *US – Certain EC Products* recognized the right of Members to require bonds as an "enforcement mechanism" that guarantees the performance of internal regulations.[36]

The bond requirement is outside the scope of Article XI:1 of the GATT

4.75 Contrary to Honduras's claim, the requirement to post a bond is not a restriction imposed on the importation of cigarettes into the territory of the Dominican Republic, and it is therefore outside the scope of Article XI:1. Rather, the bond requirement is an internal measure applied in accordance with Article III:4.

4.76 Article XI:1 applies to measures that impose a prohibition or restriction "on the importation" of a product. Article III covers measures that are applied to both imported and domestic products equally. Honduras acknowledges that the bond is applied identically to importers and to domestic producers of cigarettes. Article 14 of Decree 79-03 explicitly notes that under the Dominican Republic's regulations both domestic producers and importers of cigarettes must post a bond of RD$5 million.[37] The fact that the bond is not enforced at the time or point of importation in the case of imported cigarettes is further evidence that the bond requirement is not a measure "on the importation" of a product. It is, therefore, an internal measure within the scope of Article III:4, not Article XI:1.

The bond requirement is consistent with Article III:4 of the GATT

4.77 There is no explanation of how, in the view of Honduras, the bond modifies the conditions of competition in the Dominican Republic to the detriment of imported cigarettes. There is also no indication of how the bond is applied to imported or to domestic cigarettes so as to afford protection to domestic production.

4.78 Contrary to Honduras's assertion, the bond does secure compliance by importers of their tax obligations, including the SCT. The fact that the importer is required to pay the SCT upon importation does not mean that no tax liability can arise after cigarettes have cleared customs.

4.79 It is often the case that the SCT originally assessed at the time of importation is insufficient to cover the tax liability of the importer. The Tax Authority of the Dominican Republic retains the right to conduct that reassessment and adjustment within a maximum of three years after the initial payment of the relevant tax.[38] This right to reassess tax liquidation applies to importers and domestic producers equally.

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[35] Appellate Body Report, *Korea – Various Measures on Beef*, para. 176.
[36] Panel Report, *US – Certain EC Products*, para. 6.43.
[37] First written submission of Honduras, 16 March 2004, para. 4.
[38] Law 11-92, *supra* note 10, Article 21; Law 3489, Article 118, submitted by the Dominican Republic as Exhibit DR-11.

4.80 Moreover, although Article 376 of the Tax Code appears to refer only to the SCT, in practice the Tax Authority of the Dominican Republic treats the bond as a guarantee of compliance with other internal tax obligations incumbent on the domestic producer and the importer of cigarettes.[39]

4.81 The assertion by Honduras that there is no tax liability for importers that the bond can secure is in any case legally irrelevant for purposes of an examination under Article III:4. Furthermore, even if the timing of the payment of the SCT was legally relevant, which it is not, the issue is outside the terms of reference of the Panel.

4.82 Honduras has also not explained how a specific amount that applies equally to importers and to domestic producers accords treatment less favourable to importers than to domestic producers. The absence of a so-called "direct relationship" between the amount of the bond and the underlying obligation it guarantees applies equally to domestic producers and to importers. Honduras appears to suggest that any bond for a specific amount that guarantees payment of a variable amount is inconsistent with Article III:4 of the GATT.

4.83 Finally, the bond requirement is not applied by the Dominican Republic "so as to afford protection" to domestic producers of cigarettes. The design, architecture, and revealing structure of the bond requirement in Article 14 of Decree 79-03 confirms that the measure is not protectionist in scope, application, or effect.

(iii) The requirement to affix stamps in the territory of the Dominican Republic and the requirement to post a bond are justified by Article XX(d) of the GATT

4.84 Should the Panel find the Dominican Republic's stamp and/or bond requirements are inconsistent with other provisions of the GATT, it should nevertheless find these measures are justified because they are necessary to secure compliance with laws or regulations that are not GATT inconsistent in accordance with Article XX(d) and they are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, in accordance with the *chapeau* of Article XX.[40]

The requirement to affix stamps in the territory of the Dominican Republic is justified by Article XX(d) of the GATT

4.85 The Dominican Republic's stamp requirement satisfies the requirements of Article XX(d) of the GATT.

4.86 First, the stamp requirement secures compliance with other Dominican Republic tax laws and regulations; particularly, the Dominican Republic Tax Code, including but not limited to the SCT for cigarettes. The stamp requirement is specifically under the supervision of the DGII, who is charged with securing compliance with the Dominican Republic Tax Code. The stamp requirement also helps prevent cigarette smuggling, which is a widespread problem intimately linked to tax compliance.

4.87 Second, the Dominican Republic Tax Code is consistent with the GATT; and Honduras has not challenged the GATT-consistency of the Tax Code. Moreover, the SCT on cigarettes, as amended by Law 3-04 of 9 January 2004, is consistent with the GATT[41], and this measure is not at issue in this case.

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[39] Letter from the Director General of Internal Taxes, dated 12 April 2004, submitted by the Dominican Republic as Exhibit DR-12.

[40] Appellate Body Report, *US – Gasoline*, p. 22.

[41] Law 3-04, *supra* note 19.

4.88 Third, the stamp requirement is "necessary" to secure compliance with the Dominican Republic Tax Code and prevent cigarette smuggling. A measure need not be "indispensable" or "of absolute necessity" to be "necessary" within the meaning of Article XX(d).[42] The contribution made by the measure to law enforcement, the importance of the common values at issue, and the impact on imports or exports must all be considered.[43] The greater the contribution to these factors, the more likely a measure is to be "necessary".[44]

4.89 The stamp requirement contributes greatly to law enforcement because it allows Dominican Republic tax authorities to monitor the placement of stamps on cigarette cartons to ensure compliance with the Dominican Republic Tax Code and prevent cigarette smuggling. A WTO panel recognized that tax evasion could be addressed through prevention techniques, not solely through repressive enforcement strategies.[45]

4.90 There is also international agreement that tax stamps are necessary to prevent cigarette smuggling. The International Conference on Illicit Tobacco Trade (ICITT) has identified tax stamps as a method of labelling that is necessary to constrain distribution of contraband.[46] The World Health Organization has also stressed the importance of marking cigarette packets.[47]

4.91 Without strict enforcement of its tax laws, the Dominican Republic would face more serious problems of smuggling and tax evasion. Evidence shows that where tax stamps for alcohol are permitted to be affixed abroad, there is a greater risk of smuggling and tax evasion, including through forgery of tax stamps.[48]

4.92 In addition, the slight impact that the measure has on imported cigarettes further supports the conclusion that the stamp requirement is "necessary" to secure compliance with the tax laws of the Dominican Republic. This slight impact is evidenced by the US$65,641 per year estimated cost to the importer of Honduran cigarettes *BAT* of affixing tax stamps to cigarettes imported from Honduras, and the 80 per cent increase of imports by *BAT* into the Dominican Republic in 2003, compared with the previous year.[49] Moreover, any additional impact on imports arises from the inherent differences between imports and domestically manufactured goods.

4.93 The Dominican Republic has no reasonable alternatives to prevent tax evasion and cigarette smuggling that would meet the level of enforcement set by the Dominican Republic. The Dominican Republic has the right to determine the level of enforcement of its WTO consistent laws and regulations[50], and it has done so in a manner that is identical for imported and domestically produced cigarettes. Moreover, it is impractical for the Dominican Republic to send its tax authorities abroad to monitor the affixation of stamps.

4.94 Thus, the stamp requirement is "necessary" within the meaning of Article XX(d) of the GATT.

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[42] Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.

[43] Ibid., para. 164.

[44] Ibid., para. 163.

[45] Panel Report, *Argentina – Hides and Leather*, para. 11.305.

[46] International Conference on Illicit Tobacco Trade, Chairperson's Executive Summary, 30 July-1 August 2002, submitted by the Dominican Republic as Exhibit DR-9.

[47] WHO Framework Convention on Tobacco Control (21 May 2003), Article 15:2, submitted by the Dominican Republic as Exhibit DR-17.

[48] See information submitted by the Dominican Republic as Exhibit DR-8.

[49] Statistics regarding imports by the firm *British American Tobacco – República Dominicana*, *supra* note 24.

[50] Appellate Body Report, *Korea – Various Measures on Beef*, para. 176.

The stamp requirement also satisfies the *chapeau* of Article XX

4.95 First, the stamp requirement is not applied in a manner that discriminates between countries where the same conditions prevail. Discrimination within the meaning of the *chapeau* does not refer to the same standard of discrimination under other provisions of the GATT, including Article III[51], so the Panel must examine discrimination under the *chapeau* independently from its examination under Article III:4. There is no evidence that the stamp requirement is applied in a manner that discriminates between different countries supplying cigarettes to the Dominican Republic, or between importers and domestic producers of cigarettes, as all cigarette producers are required to affix stamps in the territory of the Dominican Republic.

4.96 Second, any alleged discrimination is neither arbitrary nor unjustifiable. For discrimination to be arbitrary, the measure must be applied inconsistently at the will or discretion of a legal authority[52], or its application must result in a denial of basic fairness and due process.[53] The stamp requirement does not meet this definition of arbitrary. The manner in which the measure is to be applied is clearly stipulated in the text, so it is transparent and does not deny basic fairness and due process.

4.97 For discrimination to be unjustifiable, it must be not reasonable, not defensible, not unavoidable, or coercive.[54] The stamp requirement does not meet this definition of unjustifiable because any discrimination in its application between importers and domestic producers of cigarettes arises from the inherent differences between imports and domestically produced goods.

4.98 Third, the stamp requirement is not applied in a manner that constitutes a disguised restriction on international trade. A disguised restriction on international trade includes both concealed and unconcealed measures, as well as disguised discrimination. The analysis in determining whether the application of a measure constitutes arbitrary or unjustifiable discrimination also factors into whether such application is a disguised restriction on international trade.[55] The intention of a measure to pursue trade-restrictive objectives is also relevant.[56] The stamp requirement does not satisfy this definition. It is neither concealed nor unannounced. Moreover, it is not arbitrary or unjustifiable as it has not affected trade flows. Finally, the design, architecture, and revealing structure of the stamp requirement show no intent to pursue trade-restrictive objectives.

4.99 As the stamp requirement satisfies both Article XX(d) of the GATT and the *chapeau* of Article XX, it is justified by Article XX(d).

The requirement to post a bond is justified by Article XX(d) of the GATT

4.100 Should the Panel find that the Dominican Republic's requirement to post a bond is inconsistent with Article XI:1 or Article III:4 of the GATT, it should also find that the requirement is justified by the general exception provided for in Article XX(d) of the GATT, since that requirement (a) falls within the scope of paragraph (d) of Article XX of the GATT, and (b) satisfies the *chapeau* of Article XX.

4.101 The Dominican Republic's bond requirement is "necessary" within the meaning of that term as interpreted by WTO jurisprudence. First, it is undeniable that bonds are effective instruments to prevent tax evasion. Second, tax compliance and the prevention of tax evasion are extremely

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[51] Appellate Body Report, *US – Shrimp*, para. 150.

[52] *The New Shorter Oxford English Dictionary*, Fourth Edition, Oxford University Press, 1993, Vol. I, p. 107.

[53] Appellate Body Report, *US – Shrimp*, paras. 177-184.

[54] *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. I, p. 1,466, and Vol. II, p. 3,493. Panel Report, *Argentina – Hides and Leather*, paras. 11.324-11.325, 11.330.

[55] Panel Report, *EC – Asbestos*, paras. 8.234-8.235, 8.237.

[56] Ibid., para. 8.236.

important global interests and sovereign rights for any state. Third, the bond requirement impacts importers and domestic producers equally, as it is fixed at RD$5 million for all importers and domestic producers of cigarettes. Therefore, this requirement remains "necessary" within the meaning of Article XX(d) of the GATT. Also, as is the case with the tax stamp requirement, the bond requirement has not had any discernable impact on the imports of cigarettes by *BAT* in the Dominican Republic, which have increased significantly in the last year.

4.102 The purpose of the bond requirement is to secure the payment of tax obligations arising from the Tax Code – i.e. it is a state measure intended to prevent tax evasion. The bond guarantees the full payment of the tax liability in cases where there has been an under-payment at the time of importation. Moreover, the Directorate General of Internal Taxes (DGII) relies on the bond under Article 376 to secure compliance with other internal taxes that are not paid before the products clear customs.[57]

4.103 Tax authorities cannot solely rely on repressive tax enforcement strategies, but must direct efforts toward preventing tax evasion in the first place.[58] The Dominican Republic's bond requirement is precisely the type of measure that is indispensable for avoiding tax evasion. Furthermore, there is international consensus that bonds are necessary to prevent the smuggling of cigarettes.

4.104 The fiscal laws and regulations of the Dominican Republic, including those relating to the SCT, are consistent with the provisions of the GATT.

The requirement to post a bond also satisfies the *chapeau* of Article XX

4.105 The requirement to post a bond is not applied in a discriminatory manner within the meaning of the *chapeau* of Article XX. However, should the Panel find that the bond is applied in a discriminatory manner, it should also find that such discrimination is neither arbitrary nor unjustifiable. Also, the requirement is not applied in a manner that constitutes a disguised restriction on international trade.

4.106 First, there is no evidence that the bond requirement discriminates between different countries supplying cigarettes to the Dominican Republic, or between importers and domestic producers of cigarettes. Moreover, the application of this requirement has not resulted in discrimination against importers of cigarettes, as the volume of cigarette imports from Honduras has actually increased significantly.

4.107 Second, the Dominican Republic Tax Code has been published, and therefore the Dominican Republic's bond requirement is transparent. There is no denial of basic fairness or due process in the administration of this bond requirement. Moreover, there is no authority in the Tax Code for any government administrator to waive this bond requirement at his or her will or discretion, nor has this bond requirement been waived for any importer or domestic producer of cigarettes. Thus, there has been no arbitrary discrimination in the application of its bond requirement to imported cigarettes.

4.108 Third, there is no imposition of an additional tax burden on importers in this case. The amount of the bond, the commercial cost of posting the bond, and the main obligation that the bond guarantees, are all identical for both importers and domestic producers. In any event, to the extent there is any "discrimination" resulting from the fact that importers must post this bond at the border, such discrimination is foreseen and permitted by the GATT, as it is the result of the additional steps inherent in enforcing internal measures at the border.[59] There is, therefore, no unjustifiable

[57] Letter from the Director General of Internal Taxes, *supra* note 39.
[58] Ibid.
[59] See Note *Ad* Article III of the GATT.

discrimination in the application of the Dominican Republic's bond requirement to imported cigarettes.

4.109 Finally, the application of the Dominican Republic's requirement that importers and domestic manufacturers of tobacco products post a bond is not a "disguised restriction on international trade". The bond requirement is not concealed or unannounced. It is published and available for all to see in Article 376 of the Tax Code and Article 14 of Regulation 79-03. It is not discriminatory, and therefore it is not a disguised restriction. Also, the design, architecture, and revealing structure of the Dominican Republic's bond requirement show no protective application or intent to pursue trade-restrictive objectives.

4.110 In conclusion, the Dominican Republic's requirement to post a bond is a measure that is necessary to secure compliance with the Dominican Republic Tax Code, which itself is consistent with the GATT. This requirement is not applied in a manner that constitutes either arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. Consequently, even if the Panel finds that this requirement is inconsistent with Article XI:1 or Article III:4 of the GATT, it must nevertheless find that this requirement is justified by Article XX(d) of the GATT.

(c) Temporary measures imposed on imports

(i) The transitional surcharge is consistent with Article II:1 of the GATT

4.111 Decree 646-03 of 30 June 2003, is no longer in force. It has been replaced by Law 2-04 of 4 January 2004 – enacted before the Panel was established – which establishes a transitional surcharge of 2 per cent on imports.[60] (The Dominican Republic will rebut Honduras's claim against the transitional surcharge as if it had addressed Law 2-04 of 4 January 2004 instead of Decree 646-03 of 30 June 2003. Nevertheless, the Dominican Republic does not waive its right to argue that Law 2-04 of 4 January 2004 is not within the terms of reference of the Panel.)

Honduras erroneously interprets Article II:1(a) of the GATT

4.112 Honduras misinterprets Article II:1(a) of the GATT. Article II:1(a) only prohibits less favourable treatment than provided for by each Member's Schedule, and as each Schedule records both ordinary customs duties and ODCs, the transitional surcharge cannot be inconsistent with Article II:1(a) solely by virtue of being a levy in addition to ordinary customs duties.

4.113 As Honduras's argument for inconsistency with Article II:1(a) derives from and is dependent on its claim that the transitional surcharge is inconsistent with Article II:1(b), second sentence, the Dominican Republic need not separately rebut Honduras's claim that this measure is inconsistent with Article II:1(a).

The Dominican Republic properly recorded ODCs in its Schedule of Concessions

4.114 Contrary to Honduras's contentions, the Dominican Republic did properly record ODCs applied to cigarettes as of 15 April 1994 in its Schedule. The Dominican Republic's Schedule XXIII lists an ODC level of 30 per cent for tariff heading 2402.[61] Since the total level of ODCs currently

[60] The text of Law 2-04, dated 6 January 2004, published in the Official Journal of the Dominican Republic on 14 January 2004, was submitted by the Dominican Republic as part of Exhibit DR-1.

[61] Preparatory Committee for the World Trade Organization, "Additions to Schedules Annexed to the Marrakesh Protocol to the GATT 1994, Schedule XXIII – Dominican Republic", G/SP/3, 12 October 1994, submitted by the Dominican Republic as Exhibit DR-19.

imposed by the Dominican Republic on cigarettes, including the transitional surcharge, is less than 30 per cent, the transitional surcharge is consistent with Article II:1(b), second sentence.

(ii) The Dominican Republic has the right to maintain the Foreign Exchange Fee

The transitional Foreign Exchange Fee is justified by Article XV:9(a) of the GATT

4.115 The Dominican Republic has the right under Article XV:9(a) of the GATT to impose the foreign exchange fee established by the decision of the Monetary Board of 22 October 2003. Where a Member implements exchange restrictions or exchange controls that are consistent with the International Monetary Fund Articles, those exchange measures cannot be the basis for a finding of violation of the GATT.

4.116 The transitional foreign exchange fee is an exchange restriction within the jurisdiction of the IMF, not a charge on imports within the jurisdiction of the GATT. It is provided for in a regulation of the Dominican Republic monetary authorities, not a regulation of the trade or customs authorities, and it applies to exchange transactions, not to import transactions as such. An exchange charge can legitimately be levied only on imports, as a means of implementing a multiple exchange rate system; if so, that does not alter the fact that the nature of the charge is an exchange charge, and not an import charge.

4.117 The practice of the GATT 1947, following the agreed standards of the IMF, was to determine whether a measure was an exchange measure not on the basis of the purpose or effect of the measure in question, but by applying the formal criterion of whether the measure involved a direct governmental limitation on the availability or use of exchange as such. The foreign exchange fee is an exchange measure because it is a direct governmental limitation on the availability or use of exchange as such. It would also qualify as an "exchange control" in the sense of Article XV:9(a), since it effectively and legitimately requires all payments to be channelled through the banking system.

4.118 The foreign exchange fee is being used by the Dominican Republic "in accordance with" the Articles of Agreement of the IMF, as provided in Article XV:9(a). The IMF was aware of the Dominican Republic's non-unified exchange rate and approved its retention until the end of December 2003. On 11 February 2004, the IMF Executive Board completed its first review of the Dominican Republic's performance under the 29 August 2003 stand-by arrangement, and approved the Dominican Republic's request to waive the non-observance of structural performance criteria regarding, *inter alia*, the unification of the foreign exchange market, the continuous performance criteria concerning accumulation of external arrears, exchange rate restrictions, and multiple currency practices.[62]

The transitional Foreign Exchange Fee is consistent with Article II:1 of the GATT

4.119 Even if the Panel finds that the transitional foreign exchange fee is not an exchange measure justified by Article XV:9(a), the claim that it is inconsistent with Article II:1 must still fail because it is within the level of ODCs recorded in the Dominican Republic's Schedule.[63] Through its rectification of 14 September 1994, the Dominican Republic recorded in its Schedule XXIII the list of ODCs "applied by the Dominican Republic as of April 1994". According to that Schedule, a 30 per cent level of ODCs applied to cigarettes as of April 1994.[64] No Member, including Honduras,

[62] International Monetary Fund Press Release No. 04/23, 11 February 2004, text at http://www.imf.org/external/np/sec/pr/2004/pr0423.htm (visited on 12 April 2004), submitted by the Dominican Republic as Exhibit DR-27.

[63] Additions to Schedules, Schedule XXIII – Dominican Republic, G/SP/3, *supra* note 61.

[64] Ibid.

notified any objection to the list of ODCs recorded by the Dominican Republic. Since the total level of ODCs currently imposed by the Dominican Republic on cigarettes, including the foreign exchange fee, is less than 30 per cent, the transitional foreign exchange fee must be found in conformity with Article II:1(b), second sentence.

4.120 The Dominican Republic has rebutted Honduras's claim that the transitional foreign exchange fee is inconsistent with Article II:1(b), second sentence. Therefore, Honduras's claim that the foreign exchange fee is "consequently" inconsistent with Article II:1(a) must also be dismissed.

3. Conclusion

4.121 For the reasons stated above, the Dominican Republic requests the Panel to dismiss the claims made by Honduras in its first written submission of 16 March 2004. In particular, the Dominican Republic requests that the Panel:

(a) Dismiss the claim that the determination of the tax base of the Selective Consumption Tax levied on imported cigarettes is inconsistent with Articles III:2 of the GATT.

(b) Dismiss the claim that the manner in which the Dominican Republic administers its provisions governing the SCT is inconsistent with Article X:3(a) of the GATT.

(c) Dismiss the claim that the surveys that identify the retail selling price to be used as the tax base for the SCT are inconsistent with Article X:1 of the GATT.

(d) Dismiss the claim that the requirement to affix a tax stamp in the territory of the Dominican Republic is inconsistent with Article III:4 of the GATT. Nevertheless, should the Panel find that this requirement is inconsistent with Article III:4, the Dominican Republic requests that the Panel find that the requirement is justified by the general exception in Article XX(d) of the GATT.

(e) Dismiss the claim that the requirement that importers of cigarettes post a bond is inconsistent with Article XI of the GATT or, in the alternative, with Article III:4 of the GATT. Nevertheless, should the Panel find that this requirement is inconsistent with either Article XI or Article III:4, the Dominican Republic requests that the Panel find that the requirement is justified by the general exception in Article XX(d) of the GATT.

(f) Dismiss the claim that the transitional surcharge on imports is inconsistent with Article II:1 of the GATT.

(g) Dismiss the claim that the transitional foreign exchange fee is inconsistent with Article II:1 of the GATT or find that it is an exchange measure justified by Article XV:9(a) of the GATT.

C. ORAL STATEMENT OF HONDURAS AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

4.122 This dispute is not just about cigarettes. Its outcome could have broader implications on all products, not just cigarettes.

4.123 Honduras submitted that the transitional surcharge is inconsistent with Article II:1(b), and consequently with Article II:1(a) of the GATT. In response, the Dominican Republic alleges that its Schedule of Concessions "…lists an ODC level of 30 per cent for tariff heading 2402...", concluding that "...as the properly recorded level of ODCs imposed on cigarettes as of 15 April 1994 is 30 per cent, and the total level of ODCs currently imposed by the Dominican Republic on cigarettes,

including the transitional surcharge, is less than 30 per cent, the transitional surcharge is consistent with Article II:1(b), second sentence". In support of this allegation, the Dominican Republic presents WTO Doc. No. G/SP/3. This document and Law 11-92 of the Dominican Republic (in force as of 15 April 1994) confirm that what the Dominican Republic had inscribed in Doc. No. G/SP/3, under "other duties or charges" was the Selective Consumption Tax, an internal tax levied on selected products, both domestic and imported.

4.124 However, even if the recording of the Selective Consumption Tax engendered legal effects, then the Dominican Republic has always acted and continues to act inconsistently with Article II:1(b) of the GATT because (i) the Selective Consumption Tax is imposed on selected products, and the transitional surcharge is imposed on all products; (ii) the rates ostensibly "bound" in the Dominican Republic's Schedule of Concessions indicate that the rates specified therein are to be applied on an *ad valorem* basis, meaning on 100 per cent of the value of the product. On the other hand, the Dominican Republic had applied the Selective Consumption Tax on 100 per cent of the tax base, inflated by 20 per cent, rendering the effective *ad valorem* rate imposed higher than the rates ostensibly "bound". Furthermore, in the case of cigarettes, the rate applied was 50 per cent, which is higher than the 30 per cent ostensibly bound in the Dominican Republic's Schedule of Concessions; (iii) the current specific tax applied on cigarettes -RD$0.48 per cigarette- is much higher than the ostensibly bound rate of 30 per cent *ad valorem*.

4.125 According to the Understanding on the Interpretation of Article II:1(b) of the GATT, the "nature and level of any 'other duties or charges' … shall be recorded in the Schedules of concessions annexed to GATT 1994 against the tariff items to which they apply". The nature of the "*Impuesto Selectivo*" is not the same as that of the transitional surcharge. Therefore, the Dominican Republic had not recorded the transitional surcharge as "other duties or charges" in its Schedule of Concessions. The Dominican Republic could not have recorded the transitional surcharge in its Schedule of Concessions, as what could have been recorded was "other duties or charges… imposed on [15 April 1994]" in the context of Article II:1(b), second sentence, of the GATT. The transitional surcharge was first imposed on 30 June 2003. Even if the recording of the "*Impuesto Selectivo*" as "other duties or charges" in the Dominican Republic's Schedule of Concessions were to be deemed as a proper recording of the transitional surcharge, the transitional surcharge would nevertheless still be inconsistent with Article II:1(b) of the GATT to the extent that it is imposed on products not included in the "*Lista de productos …que pagan el Impuesto Selectivo en Aduanas*".

4.126 Should the Panel find that the transitional surcharge is inconsistent with the second sentence of Article II:1(b) of the GATT, it should also find that the transitional surcharge is likewise inconsistent with Article II:1(a) of the GATT.

4.127 The foreign exchange fee is inconsistent with the second sentence of Article II:1(b), and consequently also inconsistent with Article II:1(a) of the GATT. In response, the Dominican Republic contends that the claim of inconsistency with "…Article II:1 must still fail because [the foreign exchange fee] is within the level of [other duties or charges] recorded in the Dominican Republic's Schedule". As already stated, the Dominican Republic had recorded only the "*Impuesto Selectivo*" under its "other duties or charges" in its Schedule of Concessions. It did not record the foreign exchange fee. Even assuming that the recording of the "*Impuesto Selectivo*" as "other duties or charges" in the Dominican Republic's Schedule of Concessions were to be deemed as a proper recording of the foreign exchange fee, the foreign exchange fee would nevertheless still be inconsistent with the second sentence of Article II:1(b) of the GATT (i) to the extent that the foreign exchange fee is imposed on products not included in the "*Lista de productos importados que pagan el Impuesto Selectivo en Aduanas*" and (ii) to the extent that the rate currently being applied, 10 per cent, is higher than the rate applied as of 15 April 1994 – 1.5 per cent.

4.128 The Dominican Republic contends that the foreign exchange fee is justified under Article XV:9(a) of the GATT. However, the foreign exchange fee is an import charge because (i) the

operative act giving rise to the foreign exchange fee is importation, (ii) the amount of the fee is calculated based on the transaction value of the merchandise imported. It is not an "exchange restriction" even in the context of the IMF's definition, because it is not a "direct… limitation on the availability or use of exchange as such". The fee merely increases the costs of imports, but foreign exchange is still unrestrictedly available to pay for imports. The Dominican Republic has likewise failed to substantiate its assertion that the foreign exchange fee is a "multiple currency practice" in accordance with the Articles of Agreement of the IMF. Even if the foreign exchange fee were an exchange restriction or a multiple currency practice, the Dominican Republic has failed to establish that the IMF has approved the same, in accordance with Sections 2 and 3 of Article VIII of the Agreement.

4.129 Honduras claimed that the requirement under Article 2 of Decree 130-02 and Article 37 of Decree 79-03 that the tax stamp on cigarette packets be affixed in the territory of the Dominican Republic in the presence of tax authorities, in combination with the practice of allowing domestic producers to purchase tax stamps in advance, is inconsistent with Article III:4 of the GATT as it accords to imported cigarettes treatment less favourable than that accorded to domestic cigarettes. Domestic producers of cigarettes have the privilege of being able to purchase tax stamps in advance and affix those stamps to cigarette packets in the course of the production process. After one continuous production process, domestic cigarettes are ready for sale in the domestic market.

4.130 On the other hand, because the Dominican Republic does not allow the purchase of tax stamps in advance for affixation on imported cigarettes, upon importation and even after customs clearance, and notwithstanding the payment of all customs duties and other charges in connection with importation and the Selective Consumption Tax and other internal taxes imposed at the border, imported cigarettes still could not be sold in the domestic market. Upon importation and even after customs clearance, imported cigarettes have to be processed further before they could be sold in the domestic market.

4.131 Imported cigarettes first have to be transferred to a warehouse or other facility. This requires a prior investment in that warehouse or other facility. Then the imported cigarettes have to be further processed, which requires additional investments in manpower and costs of materials used in repackaging the cigarettes, as well as additional inventory days, which entails additional financing costs. Production includes each and every process required to render a product capable of being introduced into the market. Introduction of a product into any market means not only rendering the product as such available, but packaging that product in a manner suitable to consumer preferences, taking into consideration conditions of competition. Thus, an entity wanting to engage in the business of selling cigarettes in the Dominican Republic has two options: (i) to buy from a domestic producer or (ii) to import. If that entity were to purchase from a domestic producer, it could sell the domestic cigarettes immediately after purchase. On the other hand, if that entity were to import cigarettes, it cannot sell the imported cigarettes immediately even after customs clearance. At its own cost and expense, (i) it must make a prior investment in warehouses or similar facilities (ii) hire manpower and (iii) go through the process of unpacking, affixing stamps and repacking, all of which is essentially an additional production process. Therefore, there is a built-in disincentive against importing cigarettes, as compared to buying from domestic producers. Consequently, the requirement that tax stamps be affixed in the territory of the Dominican Republic in the presence of the tax authorities distorts conditions of competition between imported cigarettes in relation to domestic cigarettes, to the disadvantage of imported cigarettes.

4.132 Conditions of competition are likewise distorted to the disadvantage of imported cigarettes at the point of sale to the ultimate consumer. The tax stamps of domestic cigarettes are uniformly affixed by machine as part of the production process of domestic cigarettes underneath the cellophane wrapping of the individual cigarette packets. On the other hand, because of the requirement that the tax stamps be affixed in the territory of the Dominican Republic in the presence of tax authorities, tax stamps are affixed manually on the cellophane wrapping of individual cigarette packets to minimize

costs. Necessarily, the affixation is not uniform, and the risk of technical and other imperfections is enhanced. For purposes of the final presentation to the ultimate consumer therefore, imported cigarettes are rendered less appealing than domestic cigarettes.

4.133 That the requirement that the tax stamps be affixed in the territory of the Dominican Republic in the presence of tax authorities is applied equally to both imported and domestic cigarettes is irrelevant in this instance as formal equality is the factor that precisely results in less favourable treatment to imported cigarettes as compared to domestic cigarettes. As Guatemala and the European Communities have referred to, less favourable treatment can arise both from formally different and formally identical treatment of imports and like domestic products. The Dominican Republic likewise contends that the additional costs incurred by importers are "negligible", implying the need for a trade effects test. However, it must be recalled that the GATT protects expectations of equal competitive opportunities, not trade volumes. Since the additional process and the additional costs affect competitive opportunities, the degree of onerousness is not material.

4.134 That Honduras has not submitted evidence to demonstrate that the requirement of affixing the stamp in the Dominican Republic is a measure implemented "so as to afford protection to the domestic industry" is not material for establishing a violation of Article III:4 as confirmed by Appellate Body jurisprudence.[65] Therefore, as Honduras has established that there is "less favourable treatment", Honduras has likewise established that the measure at issue is implemented "so as to afford protection to the domestic industry".

4.135 The Dominican Republic contends that the requirement that tax stamps be affixed in the territory of the Dominican Republic in the presence of tax authorities is justified under Article XX(d) of the GATT. However, the Dominican Republic has not discharged the burden of establishing that the requirement at issue is justified under that provision. The Dominican Republic states that the requirement that stamps be affixed in its territory is a measure necessary to secure compliance with "other Dominican Republic tax laws and regulations; particularly, the Dominican Republic's Tax Code, including but not limited to the [Selective Consumption Tax] for cigarettes". Even assuming that this is correct, the fact is that, prior to customs clearance, imported cigarettes are within the custody and control of the Dominican Republic authorities and customs clearance cannot be obtained without the payment of all (i) customs duties and charges and (ii) the Selective Consumption Tax and all other internal taxes imposed at the border. Thus, the affixation of the tax stamp in the presence of the tax authorities after all of these duties, charges and internal taxes imposed at the border have been paid is not necessary to ensure that they will be paid. In short, the requirement at issue is not necessary to enforce the tax laws of the Dominican Republic.

4.136 The Dominican Republic contradicts itself when it states that the "stamp requirement exists as a state measure to prevent tax evasion". As the stamps are affixed on domestic cigarettes prior to the payment of the Selective Consumption Tax (which may be paid up to the 20th day of the month following that in which the sale is made) then the stamp cannot be a mark that the applicable taxes have been collected. In any event, even assuming that the requirement at issue is closer to the pole of "indispensable", as distinguished from the pole of "making a contribution to", there are other less-trade restrictive alternatives available, such as allowing affixing tax stamps outside the territory of the Dominican Republic or resort to pre-shipment inspection and certification at the expense of the importer.

4.137 If the defence of the Dominican Republic were to be upheld, then any Member could require that tax stamps be affixed on any product in its territory in the presence of tax authorities. Domestic industry would be able to affix those stamps in the course of the production process. That same opportunity will not be available to imported products. Importers would have to make additional investments and incur additional expenses. Thus, any Member could always accord less favourable

[65] Appellate Body Report, *EC – Asbestos*, para. 100.

treatment to imported products, as compared to domestic products, by requiring the affixation of stamps in its territory and in the presence of its tax authorities.

4.138 The requirement to post a bond as a condition for the importation of cigarettes into the Dominican Republic is inconsistent with Article XI:1 of the GATT. Based on the distinction cited by the Dominican Republic between measures that fall under the scope of Article XI:1 and measures that fall under the scope of Article III, the requirement to post a bond is a condition for importation related to "the opportunities for importation itself". It applies prior to the entry of both domestic and imported cigarettes into the domestic market. Therefore, the requirement to post a bond does not affect "the competitive opportunities on the domestic market", and therefore, Article XI:1 applies, not Article III. The bond requirement operates as a "restriction" in the context of Article XI:1.

4.139 Even assuming that the Panel were to consider the bond requirement as an internal measure falling under Article III of the GATT, the bond requirement is inconsistent with Article III:4 of the GATT. For both imported and domestic cigarettes, the bond requirement is an accessory obligation related to the payment of the Selective Consumption Tax. In respect of imported cigarettes, the Selective Consumption Tax is collected in its entirety upon importation. On the other hand, for domestic cigarettes, the Selective Consumption Tax may be paid up to the 20th day of the month following that in which the sale is made. Therefore, for domestic producers, there is a tax liability the non-payment of which the bond properly secures. However, for imported cigarettes, since the Selective Consumption Tax accrues and is immediately paid upon importation, there is no similar tax liability. Furthermore, domestic producers can collect the Selective Consumption Tax in advance as part of the purchase price paid by buyers. This accords domestic producers the opportunity to earn interest income on the Selective Consumption Tax for a period of 20-50 days. On the other hand, importers have to pay the Selective Consumption Tax in advance. This entails either financing costs or opportunity costs.

4.140 An entity wanting to engage in the business of selling cigarettes in the Dominican Republic has two options: (i) to buy from a domestic producer or (ii) to import. If that entity were to purchase from a domestic producer, it need not post a bond. On the other hand, if that entity were to import cigarettes, it has to post a bond and incur additional costs. Therefore, there is a built-in disincentive against importing cigarettes, as compared to buying from domestic producers.

4.141 The Dominican Republic argues that the bond requirement is justified under Article XX(d) of the GATT. The Dominican Republic has not discharged the burden of establishing that the requirement at issue is justified under that provision. The bond requirement is not necessary to secure the payment of the Selective Consumption Tax for imported cigarettes as that tax is paid in full prior to customs clearance.

4.142 The Dominican Republic states that the bond requirement is a measure necessary to secure compliance with "other Dominican Republic tax laws and regulations; particularly, the Dominican Republic Tax Code, including but not limited to the [Selective Consumption Tax] on cigarettes". The Dominican Republic attempts to link the bond requirement with the circumstances provided for in Article 81 of the Tax Code, on the basis of which, the Tax Administration may impose "precautionary measures" on goods where there is a risk of non-payment of tax obligations as a result of the possible disappearance of those goods. In the case of imported products, prior to customs clearance, the products are in the custody and complete control of the customs authorities. Customs clearance is given only after payment of (i) customs duties and other charges in connection with importation and (ii) the Selective Consumption Tax and other internal taxes imposed at the border. Thus, if imported products "disappear" before customs clearance, the disappearance would be before importation, and the tax liabilities would not accrue. Furthermore, the customs authorities could be held accountable for the disappearance.

4.143 Honduras presented specific arguments in support of its claims relating to the Selective Consumption Tax. The Dominican Republic did not present any substantive arguments in specific rebuttal of any of the arguments presented by Honduras in support of these claims. Instead, the sole defence presented by the Dominican Republic is that the claims of Honduras "are based on an outdated version of Article 367 of the Tax Code…", and that "all three claims target measures that the Dominican Republic eliminated on the same day this Panel was established". The Dominican Republic then concludes that the Panel should dismiss the claims of Honduras as "they are based on measures that no longer exist". Law 3-04 was signed by the President of the Dominican Republic on 9 January 2004, and was published in the Official Gazette on 14 January 2004. Through its assertion that "all three claims…" of Honduras in relation to the Selective Consumption Tax "… target measures that the Dominican Republic eliminated on the same day this Panel was established", the Dominican Republic seeks to convey that Law 3-04, published on 14 January 2004, came into force as of 9 January 2004.

4.144 In any event, under the Constitution and the Civil Code of the Dominican Republic, laws take effect only after publication, and not earlier than the lapse of the periods specified in the Civil Code to be considered known in each part of the territory of the Dominican Republic.

4.145 Thus, Law 3-04 was not in force as of 9 January 2004, prior to its publication on 14 January 2004, and prior to the lapse of the periods provided by law for it to be considered known in each part of the territory of the Dominican Republic. As of 8 December 2003, when the request for the establishment of a Panel was made, the operative provisions of Article 367 of the Tax Code and related provisions that constitute the basis for the claims of Honduras were in force and were in existence. The Panel is therefore competent to examine measures existing as of that date. There are cogent policy reasons for upholding the competence of Panels to examine the WTO consistency of measures that are withdrawn after the request for the establishment of a Panel is made. If withdrawal of a measure after the request for the establishment of a Panel is made were deemed to be a ground for dismissal of a claim based on the pre-existing measure, then all that the defendant has to do each time is to withdraw the measure after the Panel request is made, and once the case is dismissed, the defendant can again re-introduce the pre-existing measure. And this could go on indefinitely. Under these circumstances, the dispute settlement system would cease to provide security and predictability to the multilateral trading system. In any event, as of the date of the establishment of the Panel on 9 January 2004, the measure in existence consisted of, among others, Articles 367 and 375 of the Tax Code, as amended, but excluding the amendments introduced by Law 3-04 of 14 January 2004.

4.146 Finally, it would appear that the Dominican Republic treats payments on tax stamps for domestic cigarettes as an advance payment of the Selective Consumption Tax. On the other hand, when an importer pays for tax stamps the receipt issued indicates: *"[Impuesto] adicional sobre cigarillos*". Thus, for domestic cigarettes, the effective cost of tax stamps is zero, as it is credited as part of the payment for the Selective Consumption Tax. For imported cigarettes, the cost of the stamps is in addition to the Selective Consumption Tax. Therefore, the Selective Consumption Tax as applied to imported cigarettes is higher than that applied to domestic cigarettes, and is therefore inconsistent with Article III:2 of the GATT.

D. ORAL STATEMENT OF THE DOMINICAN REPUBLIC AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL

4.147 Honduras's objection to the way in which the tax base of the Selective Consumption Tax on imported cigarettes is determined and to certain aspects of the survey of average prices conducted by the Central Bank of the Dominican Republic relies mainly on Article 367(b) of the Tax Code of the Dominican Republic, and additionally on Article 37 of Decree 79-03 and General Rule 02-96. However, Article 367(b) of the Tax Code was amended by Law 3-04 of 9 January 2004.[66] The new

[66] Law 3-04, *supra* note 19.

tax base and the amount of the Selective Consumption Tax bear no relationship, likeness or similarity to the measures that Honduras is challenging. The new Article 367 of the Tax Code does not fall within the terms of reference of this Panel. The Dominican Republic would therefore ask the Panel, as a preliminary matter, to reject Honduras's complaint with respect to these two measures.

4.148 Honduras objects to the bond requirement on the basis of Article XI and, alternatively, on the basis of Article III:4 of the GATT.

4.149 The bond is an internal measure that does not even fall within the scope of that provision. According to WTO jurisprudence, measures that apply both to imported products and to like domestic products are considered to be internal measures subject to the requirements of Article III.[67] If a measure leads to the same result for both products, it is an internal measure, regardless of whether it is applied at the border or once the product has cleared customs.[68] In the case of cigarettes, the obligation to post a bond applies to both the domestic product and the imported product, without any distinction or discrimination whatsoever. Consequently, it is an internal measure. It is not an import measure. The bond does not regulate the importation of cigarettes, but guarantees the tax interests of the State, regardless of the origin of the product.[69]

4.150 The fact that the bond is not even required at the border is additional proof that it is an internal measure and not a restriction on the importation of cigarettes. The bond is required by the Directorate General of Internal Taxes (DGII), and not the customs authorities. It does not have to be posted for every importation.

4.151 Honduras acknowledges that the amount of the bond -RD$5 million (approximately US$100,000)- is the same for importers as for domestic producers.[70] The only difference that Honduras mentions between the situation of the importer and that of the domestic producer is the moment at which the importer must pay the Selective Consumption Tax. This circumstance has nothing to do with the bond.

4.152 Contrary to Honduras's assertion, the bond does fulfil the purpose of ensuring compliance with the tax obligations associated with the sale of imported cigarettes.

4.153 It often happens that the payment made by the importer upon importation of the goods does not cover the totality of taxes due, including the Selective Consumption Tax. Many are the cases in which, upon reassessing the taxes, the competent authority finds that the payment made upon importation falls short of the tax obligation. In such cases, the Value Control Department of the Directorate General of Customs must ensure that the tax payer pays the missing amount and complies fully with its tax obligation. The bond helps to ensure that the taxpayer does not evade this tax obligation.

4.154 There is yet another reason why Honduras's erroneous argument that the bond serves no purpose fails to convince. As can be seen from the copy of the certification issued by the Director General of DGII, which the Dominican Republic has submitted to the Panel, the bond for imported cigarettes fulfils the double purpose of preventing the incursion of unregulated importers into the market and "guaranteeing the collection of other internal taxes ... such as income tax, the tax on the transfer of industrialized goods and services (ITBIS) and official and employee salary deductions".[71]

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[67] First written submission of the Dominican Republic, 13 April 2004, paras. 73 and 74.
[68] Panel Report, *EC – Asbestos*, paras. 8.91-8.99.
[69] First written submission of the Dominican Republic, 13 April 2004, para 76.
[70] First written submission of Honduras, 16 March 2004, para. 4.
[71] Letter from the Director General of Internal Taxes, *supra* note 39.

4.155 The only other argument adduced by Honduras against the bond is that its amount is fixed while the amount of the tax is variable. In other words, Honduras considers that a bond whose amount is not a percentage of the tax obligation to which it corresponds is a measure which results in less favourable treatment for imported products. The fact that the amount of the bond is fixed does not imply less favourable treatment for imported cigarettes. Honduras fails to demonstrate that there is discrimination against imported cigarettes in the case of the bond.

4.156 The Appellate Body has stated that Article III:4 is a specific expression of the overarching "general principle" set forth in Article III:1.[72] In addition to altering the conditions of competition to the detriment of the imported product, the measure in question must be *applied* so as to afford protection to domestic production.[73]

4.157 The bond is not applied so as to afford protection to domestic production. The Directorate General of Internal Taxes, which is the authority responsible for enforcing the bond, has no discretion regarding its application. The amount of the bond is the same, and it is enforced in exactly the same way. The cost for the importer and for the domestic producer is also identical. Both obtain the bond from insurance companies or banking institutions accredited in the country, which fix their charges according to the laws of the market.

4.158 Honduras's arguments in support of its objection to the stamp requirement must be rejected. Honduras's line of reasoning leaves the importing country no choice but to forego its desired level of enforcement of tax laws or take the measures necessary to apply its laws extraterritorially, regardless of the cost to the government, and regardless of what public international law has to say on the subject.

4.159 The stamp is an internationally recognized instrument for controlling tobacco imports, and its purpose is to prevent the smuggling of cigarettes and the resulting tax evasion.

4.160 GATT and WTO jurisprudence recognize that there can be *de facto* discrimination when the law accords identical treatment to domestic and imported products.[74] However, differences in the conditions of competition in cases in which treatment is identical do not necessarily mean that there is *de facto* discrimination. In order to establish whether there is such discrimination, it is necessary to determine whether the identical treatment fulfils a legitimate objective, or whether its sole purpose is to protect domestic production. In this case, the identical treatment accorded by the law -i.e. the requirement that the stamp be affixed in the presence of internal tax inspectors- is necessary to ensure the desired level of enforcement of the Dominican Republic's tax laws, whose WTO-consistency Honduras has not challenged.

4.161 It is important to bear in mind here the Appellate Body's recognition that "[i]t is not open to doubt that Members of the WTO have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations".[75] The Dominican Republic decided that the best way to secure compliance with its tax laws in the case of cigarettes was through direct supervision by the Directorate General of Internal Taxes of the affixation of the stamps. This is what the Dominican Republic determined to be the necessary control measure to ensure the desired level of enforcement of its tax laws. In cases where there has been no direct supervision by the Directorate General of Internal Taxes (DGII) of the affixation of stamps, there have been problems of smuggling and stamp

[72] Appellate Body Report, *EC – Asbestos*, para. 93.
[73] See Panel Report, *Canada – Periodicals*, para. 5.38.
[74] GATT Panel Report, *US – Section 337*, para. 5.11.
[75] Appellate Body Report, *Korea – Various Measures on Beef*, para. 176.

forgery. As the Dominican Republic demonstrated with documentary evidence, this has occurred in the case of alcoholic beverages.[76]

4.162 The only way to maintain the desired level of enforcement -that is, to prevent tax evasion by requiring that the stamp be affixed under the supervision of inspectors- while at the same time permitting, as Honduras would require, that the stamp be affixed during the production of the imported cigarettes, would be to have inspectors in the producing country. However, this option is costly, possibly contrary to public international law, and potentially impossible to implement.

4.163 It is costly because it would require the Dominican Republic to have more inspectors to carry out the supervision at the place of production, wherever that may be.[77] It is possibly contrary to public international law because it would mean that the Dominican Republic would be enforcing its laws in the territory of other sovereign States in which it has neither jurisdiction nor the possibility of State enforcement.[78] It is potentially impossible to apply, because the most-favoured-nation obligation would require the Dominican Republic to have an inspector in each one of the centres producing cigarettes for export to the Dominican Republic, throughout the world.[79]

4.164 Besides, to require that the stamps be affixed under the supervision of inspectors from the Directorate General of Internal Taxes in the territory of the Dominican Republic does not alter the conditions of the competition to the detriment of imported cigarettes. Whatever differences may exist in the conditions of competition are not the result of the laws of the Dominican Republic. The additional cost the importer may have to bear as a result of the requirement to affix the stamp in the presence of official inspectors is no different in nature from the additional cost resulting from transport, or from affixing labels in the official language of the importing country, or the cost of sanitary or phytosanitary inspections in the territory of the importing country.[80]

4.165 Even if there were some difference in the treatment that the stamp requirement accords to imported cigarettes, the fact is that the measure is not applied for protectionist reasons or purposes. As the Dominican Republic stated earlier, the jurisprudence reveals that the purpose of Article III is to ensure that internal measures are not applied so as to afford protection to domestic production.[81] It is not enough to determine that the measure alters the conditions of competition; its actual application must additionally have a protectionist effect. Consequently, it is unacceptable that Article III should be invoked as a basis for challenging measures whose effect is not to protect the domestic industry.

4.166 In the case of the importation of cigarettes from Honduras, the measure has not been applied so as to protect the domestic industry. In fact, imports increased by much more than half between 2002 and 2003.[82] During the first quarter of this year, imports of cigarettes from Honduras increased almost fifty-fold compared to the same period last year.[83] Thus, the stamp requirement clearly has not limited or adversely affected the volume or value of cigarette imports.

4.167 The stamp requirement and the bond are justified by Article XX(d) of the GATT since both measures are necessary in order to secure compliance with laws or regulations which are not inconsistent with the GATT.[84] These measures do not constitute a means of arbitrary or unjustifiable

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[76] See information submitted by the Dominican Republic as Exhibit DR-8.
[77] First written submission of the Dominican Republic, 13 April 2004, para. 58.
[78] Ibid., paras. 56 and 57.
[79] Ibid., paras. 35-59.
[80] Ibid., paras. 39-40, 42.
[81] Ibid., paras. 46-52.
[82] Statistics regarding imports by the firm *British American Tobacco – República Dominicana*, *supra* note 24.
[83] Statistics of imports of cigarettes into the Dominican Republic in the period January – March 2004, submitted by the Dominican Republic as Exhibit DR-30.
[84] First written submission of the Dominican Republic, 13 April 2004, paras. 97-167.

discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. The stamp requirement meets the three criteria of Article XX(d). First, it is a measure which *secures* compliance with domestic laws; second, these laws are *consistent* with the GATT; and third, the stamp is *necessary* to secure compliance with these domestic laws.[85] The Dominican Republic shall refer briefly to each one of these elements.

4.168 The requirement to affix stamps under the supervision and control of the Directorate General of Internal Taxes secures compliance with the tax obligations of the domestic producers and importers of cigarettes. The stamp avoids or prevents smuggling and tax evasion. When the stamps are *not* affixed under the supervision of inspectors from the Directorate General of Internal Taxes, tax evasion and even forgery of the stamps occurs.[86] Indeed, this is what happened in the case of alcoholic beverages.

4.169 The stamp is a measure that is *necessary* to secure compliance with tax obligations under the Tax Code of the Dominican Republic. According to the Appellate Body, the factors to be taken into account in determining whether a measure is "necessary" prominently include the contribution made by the measure to enforcement of the law at issue, the importance of the purpose of the law, and the impact of the law on imports.[87]

4.170 The stamp's contribution to the prevention of smuggling and tax evasion is internationally recognized.[88] According to the Appellate Body "[t]he greater the contribution, the more easily a measure might be considered to be 'necessary'".[89] The requirement to affix the stamp in the presence of inspectors makes a greater contribution to the prevention of tax evasion than if the stamp were affixed abroad, without this direct control of the Directorate General of Internal Taxes. This is demonstrated, *inter alia*, by the frequency with which smuggling and forgery of stamps has taken place in the Dominican Republic when the stamp is affixed on products abroad without the supervision of the inspectors.[90]

4.171 Compliance with tax laws is of critical importance in the case of the Dominican Republic. Tax evasion is particularly serious worldwide in the case of cigarettes and would block revenue from this source.[91]

4.172 The Appellate Body stated that "[a] measure with a relatively slight impact upon imported products might more easily be considered as 'necessary' than a measure with intense or broader restrictive effects".[92] Between January and March of this year, imports into the Dominican Republic of cigarettes from Honduras increased by more than *4,800 per cent* in comparison to the same period last year. This shows that the stamp requirement has no real impact on imports.

4.173 The Dominican Republic currently has no reasonable GATT-consistent alternative for dealing with the problem of smuggling and tax evasion in the case of cigarettes.[93] None of the alternatives can secure the desired level of enforcement to which the Dominican Republic is entitled.[94]

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[85] Panel Report, *Argentina – Hides and Leather*, para. 11.290.
[86] See information submitted by the Dominican Republic as Exhibits DR-8 and DR-29.
[87] Appellate Body Report, *Korea – Various Measures on Beef*, para. 164.
[88] First written submission of the Dominican Republic, 13 April 2004, paras. 110-113.
[89] Appellate Body Report, *Korea – Various Measures on Beef*, para. 163.
[90] First written submission of the Dominican Republic, 13 April 2004, para. 113; information submitted by the Dominican Republic as Exhibit DR-8.
[91] See "The FCTC and Tobacco Smuggling", *supra* note 23.
[92] Appellate Body Report, *Korea – Various Measures on Beef*, para. 163.
[93] Panel Report, *Korea – Various Measures on Beef*, para. 652.
[94] Appellate Body Report, *Korea – Various Measures on Beef*, para. 176.

4.174 The stamp requirement is also consistent with the *chapeau* of Article XX. The measure is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail. As in the case of domestically produced cigarettes, a tax stamp must be affixed in the presence of inspectors from the Directorate General of Internal Taxes to every packet of imported cigarettes, regardless of its origin. Consequently, there is no discrimination of any kind within the meaning of Article XX.

4.175 Lastly, the measure is not a disguised restriction on international trade. The stamp requirement fulfils a legitimate objective: to prevent smuggling and secure the payment of taxes. There can be no trade restriction when imports of cigarettes from Honduras increased by more than 80 per cent between 2003 and 2004, and by more than 4,800 per cent during the first quarter of this year as compared to the same quarter in 2003.[95]

4.176 The arguments the Dominican Republic has adduced thus far to justify the stamp requirement under Article XX(d) of the GATT apply *mutatis mutandis* to the obligation to post a bond. In conclusion, both the stamp requirement and the bond requirement are measures which, even if they were inconsistent with Article III:4 of the GATT – which they are *not* – would in any case be justified under the general exception in Article XX(d).

4.177 The foreign exchange fee is an exchange control or exchange restriction within the meaning of Article XV:9(a) of the GATT. Consequently, in accordance with that Article nothing in the GATT, including Article II, can preclude a WTO Member, including the Dominican Republic, from maintaining such a measure.

4.178 The foreign exchange fee is a transitional measure which is justified under Article XV:9(a) of the GATT, since it is an exchange control or an exchange restriction in accordance with the Articles of Agreement of the International Monetary Fund (IMF). As such, it is under the exclusive jurisdiction of that institution.

4.179 The foreign exchange fee is an exchange control or exchange restriction, and hence covered by Article XV of the GATT. The foreign exchange fee was imposed by the monetary authorities as an element of the new foreign exchange system, and was placed under the responsibility of the Central Bank. Once the fee had been introduced, the Central Bank delegated the responsibility for collecting it to the Directorate General of Customs, not because it was a trade measure, but to facilitate its administration. The resolution of the Monetary Board establishing the fee shows that it targets foreign currency transactions and not imports of goods. It is not a charge levied on imports, but a charge levied on foreign currency outflows from the territory of the Dominican Republic. This charge increases the cost of foreign currency transactions, enabling the Government to limit the outflow of foreign currency. Consequently, it is an exchange control or exchange restriction.

4.180 The IMF agreed that the Dominican Republic could maintain its current exchange system while taking the necessary measures to unify its exchange markets. On 11 February 2004, the IMF announced that it had approved a request by the Dominican Republic, seeking inter alia a temporary waiver for certain commitments, including those relating to exchange rate restrictions and multiple currency practices.[96] In other words, the foreign exchange fee was permitted by the IMF.

4.181 In any event, as applied to cigarettes the foreign exchange fee, like the transitional surcharge, is consistent with Article II of the GATT.

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[95] See Statistics of imports of cigarettes, *supra* note 83.
[96] International Monetary Fund Press Release, *supra* note 62.

4.182 Contrary to what Honduras asserts, the Dominican Republic did record in its Schedule of tariff concessions the other duties or charges applied to imports of cigarettes, at a level that far exceeds the level of the transitional surcharge and the foreign exchange fee.

4.183 Under paragraph 1(b) of Article II, if a Member applies an ordinary customs duty to imports of a product in *excess* of the tariff bound in its Schedule for that product, the importing Member is violating its obligation under Article II. Similarly, if a Member imposes *other duties* or *charges* on imports of a product in *excess* of the level of other duties or charges bound in its Schedule for that product, the importing Member is likewise in violation of its obligation under Article II. On the other hand, a Member is not in violation of that obligation merely because it has levied duties or charges other than ordinary customs duties. What determines whether a Member has met its obligation under Article II is the applied level as compared to the level bound in its Schedule. According to this criterion, the Dominican Republic has faithfully fulfilled its obligations under Article II.

4.184 The Dominican Republic has recorded, in its Schedule XXIII of tariff concessions, a level for other duties or charges of 30 per cent *ad valorem* levied on cigarettes classified under tariff heading 2402.[97] The transitional surcharge and the foreign exchange fee taken individually or together do not exceed 12 per cent of the value of imported cigarettes. Consequently, the Dominican Republic clearly accords Honduras and other WTO Members "treatment *no* less favourable" than that provided for in its Schedule of concessions for cigarettes, in accordance with Article II of the GATT.

4.185 The 30 per cent level corresponding to other duties or charges for cigarettes was recorded in the Dominican Republic's Schedule as an addition on 14 September 1994. Honduras expressed no objection or reservation.

4.186 As its title indicates, this dispute between Honduras and the Dominican Republic concerns measures affecting the importation and internal sale *of cigarettes*. Products other than *cigarettes* are not included in the scope of the dispute.

E. SECOND WRITTEN SUBMISSION OF HONDURAS

1. Introduction

4.187 Throughout these proceedings, the main arguments of the Dominican Republic have been that: the measures no longer exist, the measures are outside the terms of reference of the Panel and, even if they were inconsistent with the basic provisions of the GATT, they were justified by exceptions to those provisions because they were being undertaken to pursue legitimate policy goals, such as macroeconomic stabilization, monetary policies, the prevention of smuggling and the reduction of tax evasion. However, all the measures still exist or were in existence at the time of the establishment of the Panel and are therefore covered by the Panel's terms of reference. Moreover, the measures all violate basic GATT provisions and do not meet the requirements set out in the exceptions invoked by the Dominican Republic. The arguments of the Dominican Republic are based on novel interpretations of the provisions of the GATT that -if upheld by the Panel- would jeopardise the effectiveness of the GATT as a legal framework for the incorporation of market access concessions. The issues raised in this dispute have for these reasons legal implications that go far beyond the importation and internal sale of cigarettes.

[97] Additions to Schedules, Schedule XXIII – Dominican Republic, G/SP/3, *supra* note 61.

2. Legal arguments

(a) The requirement to affix a stamp in the territory of the Dominican Republic is inconsistent with Article III:4 of the GATT

4.188 The requirement that a stamp be affixed on cigarette packets in the territory of the Dominican Republic is inconsistent with Article III:4 of the GATT because it accords to imported cigarettes treatment less favourable than that accorded to domestic cigarettes. The Dominican Republic argues that because the requirement applies equally to both imported and domestic cigarettes, there is no inconsistency with Article III:4. However, in this instance, formal equality is the very factor that results in less favourable treatment being accorded to imported cigarettes as compared to domestic cigarettes: by imposing costs and administrative burdens on importers that domestic producers do not have to bear and by making imported cigarettes less attractive than domestic cigarettes for the consumer. Thus, an entity wishing to engage in the business of selling cigarettes in the Dominican Republic has two options: (i) to buy from a domestic producer or (ii) to import. If that entity were to purchase from a domestic producer, it could sell the domestic cigarettes immediately after purchase. On the other hand, if that entity were to import cigarettes, it could not sell the imported cigarettes immediately even after customs clearance. At its own cost and expense: (i) it must make a prior investment in warehouses or similar facilities (ii) hire manpower and (iii) go through the process of unpacking, affixing stamps and repacking, all of which are essentially additional production processes. Therefore, there is a built-in disincentive against importing cigarettes, as compared to buying from domestic producers. As a consequence, the requirement distorts conditions of competition between imported cigarettes and domestic cigarettes, to the disadvantage of imported cigarettes. The Dominican Republic has argued that the "additional costs are inevitably linked to the condition of an imported product" and are basically the result of the "inherent differences in the normal conditions under which imported products compete with domestic products". Honduras reiterates that the additional costs result from the imposition of the stamp affixation requirement and that they are not the inherent costs of doing business. Inherent costs of doing business would include freight charges and insurance premiums. Any additional cost that is incurred as a result of governmental action cannot be an "inherent cost". Honduras considers that whether the governmental action is origin-neutral or not is completely irrelevant in order to determine that the measure at issue has caused additional costs to importers. The Dominican Republic argues that "many of the 'additional steps' that Honduras refers to… are either avoidable or are steps that domestic producers also have to perform... The step of unpacking cigarettes from cartons before affixing stamps could be avoided if importers simply packaged individual cigarette packets into boxes". In Exhibits HOND 14, 15, 23, 24 and 25, Honduras had substantiated the number of steps and additional costs that importers have to undergo. In contrast, the Dominican Republic has made an assertion that these steps are avoidable, but has not specified which steps would be avoidable nor has it provided any proof to support this assertion. In Exhibit DR-3, the Dominican Republic has described the steps that a domestic producer in the Dominican Republic has to undertake in order to comply with the stamp requirement. There is no indication that the domestic producers have to comply with steps 3, 4, 6, 7 and 8 of the steps required for imported goods as stated in the comparative diagram presented in the first submission of Honduras. The Dominican Republic has suggested that the step of unpacking cigarettes from cartons before affixing stamps could be avoided if importers simply packaged individual cigarette packets. As demonstrated in Exhibit HOND-39, it is not feasible to export individual cigarettes or to export unwrapped cigarette packets as they would lose their firmness, freshness, humidity and visual attractiveness, and would be more susceptible to damage in the course of transportation.

4.189 Honduras submits that whether or not the effect of the measure on imported products is negligible is irrelevant for the purpose of establishing a violation of Article III:4. Honduras reiterates the fundamental principle that the GATT protects equality of competitive conditions for imported products in relation to domestic products, not trade volumes. The concept of "negligibility" implies a trade effects test. In this regard, Article III does not contain a *de minimis* exception. Even though

trade volumes are not a relevant factor to be taken into consideration in this dispute, Honduras nevertheless observes that in the context of its market share of cigarettes in the Dominican Republic, $65,641 per year represents 8.41 per cent of the total amount of sales by Honduran exporters to the Dominican Republic. This amount is not negligible for a country like Honduras. Indeed, as Honduran exporters are attempting to increase their share in the cigarette market of the Dominican Republic, this amount is only expected to increase.

4.190 In addition, Honduras considers that the Dominican Republic implements the requirement to affix stamps in a manner that makes imported cigarettes less attractive than domestic cigarettes for the consumer. Therefore, conditions of competition are also adversely affected for imported cigarettes from this perspective. The tax stamps of domestic cigarettes are uniformly affixed by machine as part of the production process of domestic cigarettes underneath the cellophane wrapping of the individual cigarette packets. On the other hand, because of the requirement that the tax stamps be affixed in the territory of the Dominican Republic in the presence of tax authorities, tax stamps are affixed manually on the cellophane wrapping of individual cigarette packets to minimize costs. The manual affixation of the stamp results in a product that is not as visually pleasing as the professionally packaged product. The final "look" of a product influences consumer preferences and therefore adversely affects conditions of competition. Exhibits HOND–25 (a) to (n), and Exhibits HOND–27 (a) to (n) show that, as a result of the lack of opportunity to affix tax stamps as part of the production process for imported cigarettes (a privilege accorded to domestic producers), less favourable treatment is accorded to imported cigarettes in that domestic cigarettes are more aesthetically packaged as compared to imported cigarettes. Of course, imported cigarettes could also be as aesthetically packaged as domestic cigarettes, but in order to achieve the same result, the importer would have to incur even further costs with respect to the purchase or lease of the appropriate specialised equipment.

4.191 Honduras also considers that in order to establish a violation of Article III:4 of the GATT, Honduras need not demonstrate that the requirement to affix stamps is applied "so as to afford protection to domestic production". The Dominican Republic asserts that Honduras has not demonstrated that the requirement of affixing the stamp in the Dominican Republic is a measure implemented "so as to afford protection to the domestic industry" in the context of Article III:1 of the GATT. In the first place, affording protection to domestic industry is not a material element in establishing a violation of Article III:4. As Honduras has established that there is "less favourable treatment", Honduras has also established that the measure at issue is applied "so as to afford protection to the domestic industry".

4.192 The Dominican Republic has further noted that "if there are differences in the conditions of competition, but such differences do not afford protection to the domestic production, there can be no violation of Article III:4. In conclusion, whether the application of a measure affords protection to domestic production is not a separate inquiry, but rather an inquiry that is part of the determination of whether a measure 'accords less favourable treatment'". However, in *EC – Bananas III*, the Appellate Body sharply rejected an initiative of the Panel to inquire into the purpose of the measure at issue before finding it inconsistent with Article III:4. It ruled that "Article III:4 does not specifically refer to Article III:1. Therefore, a determination of whether there has been a violation of Article III:4 does *not* require a separate consideration of whether a measure 'afford[s] protection to domestic production'".[98] Honduras considers that the Dominican Republic's conclusion does not flow from the wording of the Appellate Body statement. Honduras agrees with the Appellate Body that distinctions do not necessarily lead to less favourable treatment as there could be positive as well as negative distinctions. The conclusion drawn by the Dominican Republic that one needs to ascertain whether the measure affords protection to domestic production is not warranted, and implies a test that does not exist in WTO jurisprudence.

[98] Appellate Body Report, *EC – Bananas III*, paras. 215-216 (italics in original).

(b) The requirement to affix a stamp in the territory of the Dominican Republic is not justified under Article XX(d) of the GATT

4.193 The Dominican Republic has argued that if the Panel finds that the stamp requirement is inconsistent with Article III:4, then it further submits that the stamp requirement is justified under Article XX(d) of the GATT. Article XX(d) is an affirmative defence and the Dominican Republic has the burden of establishing that the requirement at issue is justified under that provision. Honduras considers that the Dominican Republic has not discharged that burden. The Dominican Republic states that the requirement that stamps be affixed in its territory is a measure necessary to secure compliance with "other Dominican Republic tax laws and regulations; particularly, the Dominican Republic's Tax Code, including but not limited to the [Selective Consumption Tax] for cigarettes". However, the Dominican Republic has failed to demonstrate that Selective Consumption Tax and the other fiscal laws and regulations that the Dominican Republic claims to enforce through the requirement to affix stamps on cigarettes in the territory of the Dominican Republic are consistent with the GATT; it has merely asserted the GATT-consistency of these measures, without any substantiation. In addition, it has not specified which "tax laws and regulations" the stamp requirement is intended to secure compliance with. It has not provided any details on the relevant "tax laws or regulations" nor did it provide any copies of the relevant rules thereof. Therefore, Honduras asks that the Panel draw an adverse inference and find that the Dominican Republic's tax laws insofar as they relate to the Selective Consumption Tax are inconsistent with the GATT. Even if the Panel were to find that the Dominican Republic has, at the very least, identified the three taxes listed in its reply to the Panel's question, Honduras then submits that, as the party bearing the burden of proof, the Dominican Republic has failed to demonstrate that the Selective Consumption Tax, the tax on the transfer of goods and services (ITBIS) and the income tax are consistent with the GATT.

4.194 Even if the Panel were to find that the tax laws and regulations of the Dominican Republic are not inconsistent with the GATT, then Honduras submits that the stamp requirement is not a measure to secure compliance with the Selective Consumption Tax, the ITBIS and the income tax. The measure at issue is contained in the provisions of the specific Regulations of the Application of Title IV of the Tax Code (Selective Consumption Tax) and not in the general tax laws and regulations of the Dominican Republic. An examination of the design, structure and architecture of the measure at issue reveals that it is not related to any tax laws or regulations, other than the specific Regulations for the Application of Title IV if the Tax Code (Selective Consumption Tax). As the party bearing the burden of proof, the Dominican Republic has failed to demonstrate that the stamp requirement is designed to secure compliance with the laws imposing the Selective Consumption Tax or other tax laws.

4.195 Furthermore, the Dominican Republic has stated that: "[t]he stamp requirement exists as a state measure to prevent tax evasion – *i.e.*, it exists as a mark to alert Dominican Republic tax authorities that the applicable taxes have been collected". Nonetheless, in its response to Question No. 67 from the Panel, the Dominican Republic noted that: "[t]ax stamps may be affixed to domestic cigarette packets *before the Selective Consumption Tax is paid* (Article 368 of the Dominican Republic Tax Code, Exhibit HOND–6)" (Emphasis added). In the case of domestic cigarettes, the stamps are affixed prior to the payment of the Selective Consumption Tax, which may be paid up to the 20th day of the month following that in which the sale is made. Therefore, it is clear that as the stamp may be affixed on domestic cigarettes *before* the Selective Consumption Tax is paid, it cannot be "a mark to alert Dominican Republic tax authorities that [the Selective Consumption Tax has] been collected". In addition, given the fact that the stamp on domestic cigarettes may be affixed before the payment of the Selective Consumption Tax is made, it may not be characterised as "indispensable" to ensure the collection of the Selective Consumption Tax. In the light of the fact that not all the products that are subject to the Selective Consumption Tax are also subject to the stamp requirement, the question arises as to why the stamp requirement is necessary to secure compliance with the Selective Consumption Tax. Second, if all imported products have to pay the Selective Consumption Tax upon importation at the border, then the question arises as to why the stamp requirement on

imported cigarettes is necessary to secure compliance with a Selective Consumption Tax that has already been paid.

4.196 The Dominican Republic has referred to an "… international agreement that properly affixed and monitored tax stamps are necessary to prevent the smuggling of cigarettes". In support of this assertion, the Dominican Republic has referred to documents related to the International Conference on Illicit Tobacco Trade (ICITT) in 2002 (Exhibit DR–4) and to the World Health Organization Framework Convention on Tobacco Control of 2003 (WHO Framework Convention) (Exhibit DR–17). As noted by Honduras, Exhibit DR–4 is a briefing paper presented by the Framework Convention Alliance in the course of the ICITT in 2002. The Framework Convention Alliance is a non-governmental organization described as "a heterogeneous alliance of non-governmental organizations from around the world". Exhibit DR-4 therefore has no legal status and is not legally binding on both parties to this dispute. The WHO Framework Convention (Exhibit DR-17) has not entered into force. The number of parties required for its entry into force is 40 contracting parties. Of the 116 signatories to the Convention, thus far, only 16 have deposited their instruments of ratification. The Dominican Republic and Honduras are not signatories. Therefore, that Convention is not legally binding on the parties to this dispute. There is no obligation for the parties, pursuant to this Convention, to enact a stamp requirement to prevent smuggling. Honduras further notes that even if the WHO Framework Convention were binding on the parties, Article 15 which is the relevant provision of this Convention would not provide cover for the stamp requirement the Dominican Republic has. The Dominican Republic's stamp requirement is not used for determining the origin of cigarettes, so as to ascertain "any possible point of diversion from the exporters' factory to the importing country". As the Dominican Republic has itself stated, "[t]he stamp requirement exists as…a mark to alert Dominican Republic tax authorities that the applicable taxes have been collected".[99] The stamp requirement, therefore, serves only fiscal purposes. On the other hand, there are other less-trade restrictive alternatives available that would fulfil the concerns raised in Article 15 of the Convention, such as allowing stamps to be affixed in the exporting country and/or permitting pre-shipment inspections, which would facilitate the objective of determining the origin of cigarettes to monitor the movement of such goods between the exporting and the importing country, in order to determine any possible intervening diversion.

4.197 In any event, even if the stamp requirement were closer to the pole of "indispensable", as distinguished from the pole of "making a contribution to", Honduras submits that there are other less-trade restrictive alternatives available to which the Dominican Republic could easily resort to enforce its tax laws and regulations. For example, the Dominican Republic could make the stamps available for affixation on cigarette packets as part of the production process of the producer abroad, prior to importation into the Dominican Republic. The authenticity of the stamps could be verified upon importation. Furthermore, as domestic producers are held accountable and are required to keep track of their inventory of tax stamps, importers could be held accountable in the same manner. As a matter of fact, in respect of alcoholic beverages and matches in boxes, the Dominican Republic allows affixation of tax stamps outside its territory. There is no reason why it could not apply the same system to cigarettes. Another less trade-restrictive option is pre-shipment inspection and certification at the expense of the importer. For example, the SGS, a private certification and verification company has confirmed that pre-shipment inspection services are available to ensure that tax stamps of the Dominican Republic are affixed on tobacco products in Honduras. Both these options would be less trade-restrictive than the current stamp requirement and would at least fulfil the objective of countering smuggling in keeping with the concerns raised in Article 15 of the WHO Framework Convention.

4.198 The Dominican Republic has also not demonstrated that the stamp requirement is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail. Even though Honduras does not bear the burden of

[99] First written submission of the Dominican Republic, 13 April 2004, para. 102.

proof on this matter, it nevertheless takes this opportunity to demonstrate that the stamp requirement is applied in a manner constituting arbitrary and unjustifiable discrimination.

4.199 As demonstrated in Exhibit DR-3 (RP-01), the Dominican Republic treats payments on tax stamps for domestic cigarettes as an advance payment of the Selective Consumption Tax. For domestic cigarettes, the effective cost of tax stamps is zero as it is credited as part of the payment for the Selective Consumption Tax. For imported cigarettes, the cost of the stamps is in addition to the Selective Consumption Tax. The Dominican Republic has defined "arbitrary" as "dependent on will or pleasure; dependent on the decision of a legally recognized authority; discretionary" or "based on mere opinion or preference as opposed to the real nature of things; capricious, unpredictable, inconsistent". Honduras notes that there is no provision either in the Tax Code or in the Regulations for the Application of the Selective Consumption Tax which would authorise domestic producers to deduct the cost of the stamp from the Selective Consumption Tax. Thus, Honduras submits that such discriminatory treatment in the application of the stamp requirement depends on the will of the Dominican Republic's tax authorities, and therefore, it is "arbitrary" according to the Dominican Republic's own definition. This discriminatory application of the tax stamp is also "unjustifiable" as there is no reason for such less favourable treatment accorded to imported cigarettes.

4.200 The Dominican Republic has suggested that in WTO jurisprudence, "unjustifiable discrimination means discrimination that is not unavoidable or discrimination that is coercive". It added that "in *Argentina – Hides and Leather*, in particular, the Panel equated the *question of whether discrimination is justifiable with the question of whether it is unavoidable*. The Panel in that case found the application of the measures in question was not justifiable because the *extra tax burden imposed on importers as a result of those measures was not unavoidable*" (Emphasis added). In this case, applying the Dominican Republic's own definition of "unjustifiable discrimination", Honduras notes that by allowing domestic producers to deduct the cost of the stamps from their payment of the Selective Consumption Tax, and not similarly providing this option to importers, the Dominican Republic is imposing an extra tax burden on importers. This extra tax burden would be avoidable if either domestic producers were not allowed to deduct the cost of the stamp or if importers were given the option to so deduct. Therefore, the manner in which the stamp requirement is applied by the Dominican Republic constitutes a means of arbitrary or unjustifiable discrimination.

(c) The requirement to post a bond is inconsistent with Article XI:1 of the GATT

4.201 In its first submission, Honduras claimed that the requirement to post a bond is a restriction on the importation of cigarettes into the Dominican Republic that is inconsistent with Article XI:1 of the GATT. In response to this claim, the Dominican Republic cites the distinction between Article XI and Article III. Based on Note *Ad* Article III, as well on the Panel's findings in *EC – Asbestos*[100] that when the applied measure leads to the same result for both the imported product and the like domestic product, it falls within the terms of the Note *Ad* Article III the Dominican Republic concludes that because the bond "does not affect the opportunities for importation itself, but rather opportunities on the domestic market", the bond requirement is subject to Article III:4. However, a careful examination of Note *Ad* Article III indicates that it contains two separate requirements that are relevant for Honduras's purpose; namely, (i) that the measure applies to an imported product and to the like domestic product; and, (ii) that it is "an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1". In its response to Question 86 from the Panel, the Dominican Republic states that: "the bond requirement does not "affect" the internal sale, offering for sale, or distribution of imported cigarettes in the sense of Article III:4 [and therefore Article III:1] of the GATT". Indeed, the Dominican Republic goes even further to state: "[t]he bond requirement is not even related and does not affect the 'specific transactions' covered by Article III:4 of the GATT, and is thus outside the scope of that provision". Given the fact that the Dominican Republic has acknowledged that the "bond requirement does not "affect" the internal sale, offering for

[100] Panel Report, *EC – Asbestos*, paras. 8.91-8.99.

sale, or distribution of cigarettes", Honduras submits the bond requirement is not subject to Article III:4 and III:1, and by implication, Note *Ad* Article III, of the GATT. Applying the test in *India – Autos* set out by the Dominican Republic, the bond requirement must therefore be a measure subject to Article XI:1 of the GATT. Based on this definition, the requirement to post a bond is related to "the opportunities for importation itself, i.e., entering the market". The bond is required for both domestic and imported cigarettes prior to their entry on the domestic market. As the bond requirement is a condition for the importation of cigarettes, it operates as a "restriction" within the meaning of Article XI:1 of the GATT.

(d) In the alternative, the bond requirement is inconsistent with Article III:4 of the GATT

4.202 If the Panel were to consider that the bond requirement is a measure falling under Article III of the GATT, then Honduras submits that the bond requirement is inconsistent with Article III:4. The less favourable treatment results from the modification of the conditions of competition between imported and domestic cigarettes. The bond requirement adversely modifies the incentives for a local buyer who wishes to purchase imported cigarettes for sale. A company that sells cigarettes in the Dominican Republic has two options: (i) to buy from a domestic producer; or, (ii) to import. If that company were to purchase from a domestic producer, it would not have to post a bond. On the other hand, if that company were to import cigarettes, it would have to post a bond and incur additional costs of the amount of the bond. Therefore, there is a built-in disincentive against importing cigarettes, as compared to buying from domestic producers.

4.203 In addition, the bond requirement accords less favourable treatment to importers in the context of the liability and payment for the Selective Consumption Tax. For domestic producers, the bond requirement is imposed under Article 376 in Title IV of the Tax Code. Title IV of the Tax Code deals only with the Selective Consumption Tax. For both imported and domestic cigarettes, the bond requirement is a supplementary obligation related to the principal obligation which is the payment of the Selective Consumption Tax. However, with respect to imported cigarettes, the Selective Consumption Tax is collected in its entirety upon importation. On the other hand, for domestic cigarettes, the Selective Consumption Tax may be paid up to the 20th day of the month following that in which the sale is made. Therefore, for domestic producers, the bond serves as a security in the event that the tax obligation is not properly discharged. However, for imported cigarettes, as the importers pay the full amount of Selective Consumption Tax upon importation, there is no liability that the bond requirement would serve to secure. On a related point, the Dominican Republic has argued that "the timing of the payment of the SCT, however, is not tied to or contingent on the bond…It is an entirely distinct measure not specified in either Honduras's Request for Consultations or in its Request for Establishment of a Panel". Honduras notes that the measure at issue is the bond requirement which is clearly set out as a challenged measure in both Requests. As the Dominican Republic has noted in its response to Question 88, "[a]rticle 376 of the Dominican Republic Tax Code explicitly provides that the bond shall secure the Selective Consumption Tax". It is obvious that the Selective Consumption Tax has to be paid at a certain time for importers and domestic producers, respectively, as set out in Articles 368 and 369, in relation to Article 353 of the Tax Code of the Dominican Republic. Furthermore, domestic producers can collect the Selective Consumption Tax as of the time of the purchase of the packet of cigarettes by the buyers. This accords domestic producers the opportunity to earn interest income on the money they receive as payment of the Selective Consumption Tax for the period between the time of the purchase and the time they have to remit that amount to the tax authorities.

4.204 The Dominican Republic has also argued that "it is often the case that the SCT originally assessed at the time of importation is insufficient to cover the tax liability of the importer. As a result, the tax liability for a particular importer and transaction may have to be adjusted". From the evidence of the 20 letters from the Directorate General of Customs submitted in Exhibit DR-28, it appears that the reassessments have been made with respect to unpaid customs duties and other charges, and not the Selective Consumption Tax. Therefore, the Dominican Republic has not demonstrated that the

reassessments are necessary to cover shortfalls in the collection of the Selective Consumption Tax. It follows from that conclusion that the Dominican Republic has not demonstrated that the bond requirement secures the payment of the Selective Consumption Tax after reassessments.

4.205 In any event, the Dominican Republic has acknowledged that, out of the 494 companies on the list of reassessment for the period of March 2003 to April 2004, only cigarette and tobacco companies were required to post bonds. It further noted that the list "...include[s] at least one cigarette importer…" However, Honduras wishes to advise the Panel that, in that particular instance, the duties or taxes that were reassessed were related to the importation of merchandising material and not of tobacco products. In any event, as the Dominican Republic has acknowledged, out of the 494 companies on the list of reassessment for the period of March 2003 to April 2004, the majority of the companies listed have not posted bonds.

(e) The bond requirement is not justified under Article XX(d) of the GATT

4.206 The Dominican Republic has argued that if the Panel finds that the bond requirement is inconsistent with either Article XI:1 or Article III:4, it should also find that the bond requirement is justified under Article XX(d) of the GATT. In order to support this defence, the Dominican Republic has merely asserted the GATT-consistency of its measures, without any substantiation. The Dominican Republic has not provided the Panel with a definitive listing of all the legal obligations that are supposed to be guaranteed by the bond. The Dominican Republic has indicated that the bond requirement is also used to guarantee obligations, other than those it had specified, namely the withholding of salaries of officials and employees. There may be other legal obligations that the bond is intended to secure that the Dominican Republic has failed to reveal. As the Dominican Republic has not provided complete information on all the legal obligations the bond requirement would secure compliance with, the Panel cannot find that all the measures that the bond is intended to secure compliance with, are GATT-consistent. Even if the Panel were to limit its examination to the three taxes specified in the Dominican Republic's reply to the Panel's question, Honduras would nevertheless submit that, as the party bearing the burden of proof, the Dominican Republic has failed to demonstrate that these three taxes; namely the Selective Consumption Tax, the ITBIS and the income tax are consistent with the GATT.

4.207 Even if the Panel were to assume that the Tax Code or any other tax obligation of the Dominican Republic is not inconsistent with the GATT, then Honduras submits that the bond requirement is not a measure to secure compliance with the Tax Code, including the Selective Consumption Tax, the ITBIS and the Income Tax. An examination of the design, structure and architecture of the measure at issue reveals that it is not related to any tax laws or regulations, other than the specific Regulations for the Application of Title IV of the Tax Code (Selective Consumption Tax). As the party bearing the burden of proof, the Dominican Republic has not demonstrated the manner in which that the bond requirement is a measure to secure compliance with the tax obligations other than the Selective Consumption Tax.

4.208 As not all the products that are subject to the Selective Consumption Tax are also subject to the bond requirement, the question arises as to why the bond requirement is necessary to secure compliance with the Selective Consumption Tax. The Selective Consumption Tax is imposed on many products. However, the bond is only required for tobacco and cigarettes. If the bond were necessary to secure compliance with the Selective Consumption Tax, then presumably, it should be applied to all products subject to the Selective Consumption Tax. Second, if all imported products have to pay the Selective Consumption Tax upon importation at the border, then the question arises as to why the stamp requirement on imported cigarettes is necessary to secure compliance with a Selective Consumption Tax that has already been paid.

4.209 The Dominican Republic has argued that the bond requirement is also intended to secure the payment of reassessments. However, as noted above based on Exhibit DR–28, the Dominican

Republic has acknowledged that out of the 494 companies on the list of reassessment for the period of March 2003 to April 2004, only cigarette and tobacco companies on that list had to post a bond. Furthermore, based on Exhibit DR-28, it appears that the reassessments have been made with respect to unpaid customs duties and other charges, and not the Selective Consumption Tax. Therefore, the Dominican Republic has not demonstrated that the reassessments are necessary to cover shortfalls in the collection of the Selective Consumption Tax. Following from that conclusion, the Dominican Republic has not demonstrated that the bond requirement is a measure necessary to secure reassessments of the Selective Consumption Tax.

4.210 The Dominican Republic has argued that "bonding and guarantee requirements" have been identified by the 2002 International Conference on Illicit Tobacco Trade "as an aid to monitoring and documenting the movement of tobacco products to ensure control over the movement of such goods". As Honduras has previously stated, the document that the Dominican Republic refers to is not legally binding. In any event, Honduras considers that the bond identified by the 2002 ICITT is a bond of a different nature than that currently required by the Dominican Republic. The bond that the ICITT identified "as an aid to monitoring and documenting the movement of tobacco products to ensure control over the movement of such goods" is a bond intended to be provided by the exporters with the view to tracking and tracing the movement of tobacco products from the exporters' factory to the declared importer or buyer in the importing country; it does not refer to bonds imposed on importers to secure the payment of general tax obligations. Furthermore, the fact that the bond may be "an aid" does not mean that it is necessary. Recalling the Appellate Body finding in *Korea – Various Measures on Beef*, a measure that is "necessary" must be closer to "indispensable" than to "making a contribution". The Dominican Republic has contended that WTO Members have the right to determine the level of enforcement of their laws and regulations. However, the Dominican Republic only partially quoted the Appellate Body's finding. The full quote, contained in paragraph 176 of the Appellate Body Report in *Korea – Various Measures on Beef* should be considered. Honduras fully agrees that WTO Members have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations, provided that the condition set forth by the Appellate Body, i.e. that such law and such level of enforcement must be the same for imported and domestically-produced products. In this case, that condition is not observed by the Dominican Republic.

4.211 Furthermore, in Exhibit DR-12, the Dominican Republic attempts to link the bond requirement with the circumstances provided for in Article 81 of the Tax Code. However, this provision of the Tax Code is not applicable.

4.212 As it is clear that the bond requirement cannot be provisionally justified under Article XX(d), then there is no need for the Panel to proceed with the examination of compliance with the *chapeau* of Article XX(d).

(f) The Selective Consumption Tax and its application are inconsistent with Articles III:2, Article III.4, X:1, X:3(a) of the GATT

4.213 With respect to the Selective Consumption Tax imposed under Article 367 of the Dominican Republic's Tax Code, Honduras has submitted the following:

- that the Selective Consumption Tax, as applied to imported cigarettes, is inconsistent with Article III:2 of the GATT;

- that the Dominican Republic's failure to establish or apply transparent and generally applicable criteria for determining the value of imported cigarettes is inconsistent with Article X:3(a) of the GATT; and,

- that the Dominican Republic's failure to publish the surveys that are used to determine the Selective Consumption Tax is inconsistent with Article X:1 of the GATT.

4.214 The Dominican Republic has not presented any substantive arguments in specific rebuttal of any of the claims made by Honduras. Instead, the sole defence presented by the Dominican Republic is that the claims of Honduras "are based on an outdated version of Article 367 of the Tax Code…", and that "all three claims target measures that the Dominican Republic eliminated on the same day this Panel was established". The Dominican Republic states that "Law No. 3-04 of 9 January 2004 amended Articles 367 and 375 of the Tax Code", and that "Articles 367 and 375 of the Tax Code, as amended, establish a specific and identical tax base for the [Selective Consumption Tax] for imported and domestic cigarettes". Furthermore, according to the Dominican Republic, Law 3-04 was "enacted and published on [1]4 January 2004". The Dominican Republic then concluded that the Panel should dismiss the claims of Honduras as "they are based on measures that no longer exist".

4.215 The Dominican Republic has now acknowledged that Law 3-04 entered into force on 15 January 2004, 6 days following the establishment of the Panel. Therefore, when the Panel was established, the Selective Consumption Tax that was in force was the measure challenged by Honduras in its request for the establishment of the Panel dated 8 December 2003; the operative provisions of Article 367 of the Tax Code and related provisions that constitute the basis for the claims of Honduras were in force. The Panel is therefore competent to examine measures existing as of that date. The Panel should make findings on the claims related to the determination of the tax base for the Selective Consumption Tax. The "matter" before a Panel is determined by its terms of reference. The "matter" referred by Honduras to the DSB is clearly indicated in document WT/DS302/5 and includes "the Selective Consumption Tax in accordance with Article 367 of its Tax Code, Article 3 of Decree 79-03 and Article I of General Rule 02-96", in the context of those provisions as they existed and were applied as of 8 December 2003, the date of the Request of the Establishment of a Panel by Honduras.

4.216 In addition to the legal obligation of the Panel to make an objective assessment of the "matter before it", there are cogent policy reasons for upholding the competence of Panels to examine the WTO consistency of measures that are withdrawn after the request for the establishment of a Panel is made. If withdrawal of a measure after the request for the establishment of a Panel is made were deemed to be a ground for dismissal of a claim then a WTO Member could escape the enforcement of its obligations by revoking the measures challenged by another Member after the request for the establishment of a Panel is submitted and re-introducing them as soon as the Panel is established. In order to avoid such circumvention, GATT and WTO Panels have agreed to examine measures that have been withdrawn or that were no longer in existence.

4.217 In *India – Autos*, the Panel confirmed that the measure at issue as it existed at the time of the complainants' request for the establishment of a Panel are expressly contained in the Panel's terms of reference and are consequently within its jurisdiction in accordance with Articles 6.2 and 7 of the DSU.

4.218 As the Dominican Republic has only presented a procedural defence to address the claims of Honduras with respect to the Selective Consumption Tax, and as Honduras has shown that this defence is baseless, Honduras requests the Panel to find that the measure is properly before it and to proceed with its examination of the consistency of the measure based on the arguments and evidence that Honduras has submitted throughout these proceedings. The Dominican Republic has not presented any substantive defences to these claims and arguments. Therefore, Honduras has made a *prima facie* case which the Dominican Republic has not rebutted.

4.219 In addition, as stated above, it appears that the Dominican Republic treats payments on tax stamps for domestic cigarettes as an advance payment of the Selective Consumption Tax.

4.220 The Dominican Republic has stated that "[t]he authorities of the Dominican Republic relied on several factors, including the declared customs value of the imported cigarettes, whenever there was evidence that the pricing policies of the importer alone could not be relied on to determine the nearest similar product in the domestic market". However, there is no provision in either the Tax Code or the Regulation 79-03 which would allow the tax authorities to exercise discretion as to the selection of the factors that they could consider to determine the nearest similar product in the domestic market. There is no provision that would allow the authorities to rely on the declared customs value. As a matter of fact, Article 15 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 establishes that "'customs value of imported goods' means the value of goods for the purposes of levying *ad valorem* duties on customs of imported goods". Pursuant to Article 367 and Article 3 of Decree 79-03, the relevant factor to determine the tax base for the Selective Consumption Tax is the "retailing selling price". There are no other factors listed. Recourse to ""customs value" is certainly not listed. Therefore, the manner in which the authorities have recourse to factors other than those listed in the laws is not reasonable and is, therefore, inconsistent with Article X:3(a).

4.221 The Dominican Republic has alleged that it determined that the "nearest similar product" to *Viceroy* was *Marlboro* "given the disparity and inconsistency in the information by the importer". First, Honduras notes that the Dominican Republic has not provided any evidence supporting the alleged disparities and inconsistencies in the information from the importer. On the other hand, the importer has presented detailed evidence of the prices that *Viceroy*, *Líder*, *Kent* and *Marlboro* (among others) were selling at. There is no legal basis for the authorities to disregard the relevant criterion of the retail selling price established in the law. As a result of this unreasonable and arbitrary administration of the regulations governing the Selective Consumption Tax, the Dominican Republic has acted inconsistently with Article X:3(a) of the GATT. In addition, the arbitrary determination of the tax base for imported cigarettes has resulted in the imposition of the Selective Consumption Tax at higher amount than that applied to the like domestic product, e.g. less favourable treatment provided to *Viceroy* as compared to *Líder.*

4.222 The Dominican Republic acknowledges that for determining the nearest similar product to imported cigarettes it uses criteria other than the retail selling prices. However, these are not stated in any of the regulations governing the Selective Consumption Tax.

(g) The transitional surcharge for economic stabilization is inconsistent with Article II:1(a) and Article II:1 (b) of the GATT

4.223 Honduras notes that both Decree 646-93 and Law 2-04 are within the terms of reference of the Panel. Therefore, the Panel's finding in respect of the transitional surcharge should refer to both instruments establishing it. The Dominican Republic has argued that this dispute between Honduras and the Dominican Republic relates to cigarettes, and, the transitional surcharge as it relates to products other than cigarettes is outside the terms of reference of the Panel.

4.224 As a matter of principle, Article 6.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") which sets out the requirements of a request for the establishment of a Panel does not require the identification of products. El Salvador and Nicaragua have noted that the Appellate Body has confirmed that "…Article 6.2 of the DSU does *not* explicitly require that the products to which the 'specific measures at issue' apply be identified".[101] Honduras acknowledges that the Appellate Body has also stated that: "[h]owever, with respect to certain WTO obligations, in order to identify "the specific measures at issue", it may also be necessary to identify the products subject to the measures in dispute". Honduras is of the view that it would be illogical for a challenge of the transitional surcharge which, by definition, applies to all products, to require the complainant to "identify the products subject to the measure in dispute". In the view of this fact, both the request for

[101] Appellate Body Report, *EC – Computer Equipment*, para. 67 (italics in original).

consultations and the request for the establishment of the Panel challenged the transitional surcharge as applied to all "imported goods". In *US – FSC*, the United States argued that a claim brought by the EC concerning the U.S. Foreign Sales Corporation scheme and its inconsistency with Articles 3 and 8, in conjunction with Articles 9.1(d), 10.1 and 10.3 of the Agreement on Agriculture, was inconsistent with Article 6.2 of the DSU as the EC had failed to identify specific products. Following the same reasoning, the text of the Panel request by Honduras shows that the claim regarding the WTO-inconsistency of the transitional surcharge has an "all-encompassing nature". It is a claim that gives rise to violations of Articles II:1(a) and II:1(b) of the GATT with respect to any imported good. Furthermore, from the text of the Panel request both the Dominican Republic and third parties were put on notice that Honduras was asserting the existence of violations of Articles II:1(a) and II:1(b) of the GATT with respect to all imported goods.

4.225 The transitional surcharge is an "other duty or charge" that was not imposed as of 15 April 1994. A Member may not impose "other duties or charges of any kind" … "in excess of those imposed on the date of [the] Agreement" i.e. on 15 April 1994, in excess of the levels applying on that date.

4.226 The transitional surcharge was first imposed by Decree 646-03 of 30 June 2003, as subsequently modified by Decree 693-03 of 16 July 2003, and more recently by Law 2-04. The Dominican Republic acknowledges that "the transitional surcharge for economic stabilisation was introduced for the first time in June 2003" and that "it did not replace any previous similar or equivalent measure". It is therefore undisputed that the transitional surcharge was not imposed on 15 April 1994. The provisions set out in the second sentence of Article II:1(b), however, cannot justify the imposition of charges that did not exist on that date.

4.227 In any event, the transitional surcharge was not recorded in the Dominican Republic's Schedule of concessions and, therefore, it is inconsistent with Article II:1(b) of the GATT.

4.228 The nature and level of "other duties or charges" levied on bound tariff items should have been recorded in the Schedules of concessions annexed to the GATT 1994 against the tariff item to which they apply.

4.229 Therefore, even if a Member had imposed an "other duty or charge" as of 15 April 1994, that fact alone would not authorize that Member to impose that "other duty or charge" thereafter. The Understanding requires the recording of the "nature and level" of that "other duty or charge" in the Schedules of concessions annexed to the GATT 1994 against the tariff item to which they apply. Thus, both the nature and the level of any "other duty or charge" that is recorded are bound.

4.230 The Understanding provides that the recording "does not change the legal character of 'other duties or charges'". In relation to Article II:1(b) of the GATT, what could have been recorded therefore were only "other duties or charges", "imposed on or in connection with… importation" as of 15 April 1994. Thus, if a Member had recorded an internal tax in its Schedule of concessions, the recording does not change the nature of that tax into an "other duty or charge" the imposition of which is, subject to certain conditions, permitted under Article II:1(b) of the GATT.

4.231 In its Schedule of concessions, the Dominican Republic did not record the transitional surcharge; it recorded only the Selective Consumption Tax.

4.232 An examination of Law 11-92 of the Dominican Republic in force as of 15 April 1994 confirms that what the Dominican Republic had recorded in its Schedule of concessions as "other duties or charges" was the Selective Consumption Tax, an internal tax levied on selected products, both domestic and imported. Title IV, Chapter VI of that law contains a list of selected products entitled "*Lista de productos importados que pagarán el Impuesto Selectivo en Aduanas*". Thus, both the Schedule of concessions of the Dominican Republic and Law 11-92 refer to "*Impuesto Selectivo*",

or the Selective Consumption Tax. Furthermore the products listed in Exhibit DR-19 and in Law 11-92 and the respective *ad valorem* tax rates imposed on them are identical.

4.233 Considering that "other duties or charges" may be levied only if they were imposed on 15 April 1994 and only to the extent of the levels applied on that date, it is incumbent on the Dominican Republic to establish that as of 15 April 1994, there was another law in existence (other than the legislation establishing the Selective Consumption Tax) under which "other duties or charges" "imposed on or in connection with… importation" were levied on the specific products and at the *ad valorem* rates recorded in the Dominican Republic's Schedule. The Dominican Republic has not provided this demonstration. The simple explanation is that there is no such other law. As a matter of fact, the Dominican Republic acknowledges that "[T]he *only* duty or charge in force on 15 April 1994 was the exchange fee, at a rate of 1.5 per cent …" (emphasis supplied). Therefore, the recording by the Dominican Republic must refer to the Selective Consumption Tax which had been applied on 15 April 1994.

4.234 As the Dominican Republic recorded only the Selective Consumption Tax (an internal tax) the Dominican Republic effectively did not record any "duty or charge" of the kind that could be recorded in its Schedule of Concessions according to the Understanding. Thus, even assuming that the transitional surcharge was imposed on 15 April 1994, it is inconsistent with Article II:1(b) of the GATT, because it has not been recorded in the Dominican Republic's Schedule of Concessions.

4.235 Members retain their right to challenge at any time the WTO consistency of "other duties or charges" imposed by other Members.

4.236 The Dominican Republic contends that since no objection was made to the addition of the Selective Consumption Tax as "other duties or charges" in its Schedule of concessions within the period specified in the note of the Secretariat, "the addition was approved". If the Dominican Republic implies that approval of the addition means that Members have waived the right to challenge the WTO consistency of what was recorded under "other duties or charges", the Dominican Republic is in error.

4.237 The Secretariat's statement in the note -that "[i]f no objection is notified to the Secretariat within thirty days from the date of this document, the rectifications to Schedule XXIII – Dominican Republic will be deemed to be approved and will be annexed to the Protocol Supplementary to the Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994"- simply means that if there are no objections, the Dominican Republic's additions will be annexed, i.e. they will be deemed to have been recorded in the Dominican Republic's Schedule. That is all that it means. The above statement certainly cannot be interpreted to mean that the Secretariat intended -as it has no authority to do so- to divest Members of their right to challenge the WTO-consistency of what is recorded under "other duties or charges". That right is governed solely by WTO law.

4.238 Thus, the recording of "other duties or charges" is without prejudice to their consistency with rights and obligations under GATT 1994, and Members retain the right to challenge that consistency "at any time". The sole exception to this general rule is paragraph 4 of the Understanding. However, as the party raising the exception, it is incumbent on the Dominican Republic to establish that the exception applies.

4.239 In any event, paragraph 4 does not apply because what the Dominican Republic had recorded under "other duties or charges" was an internal tax, not "other duties or charges" in the context of Article II:1(b) of the GATT.

4.240 Thus, paragraph 4 applies only to "other duties or charges" imposed on "a tariff item [that] has previously been the subject of a concession". Even assuming that the Dominican Republic had previous concessions on all tariff items currently bound and that other duties or charges had been

imposed on those tariff items, the three-year prescriptive period applies only to the "existence of an 'other duty or charge' … at the time of the original binding, as well as the consistency of any 'other duty or charge' with the previously bound level". In short, if a Member that had a previously bound concession on a tariff item imposed a 10 per cent *ad valorem* "other duty or charge" at the time of the first incorporation of its concession in the appropriate Schedule and imposed a 20 per cent *ad valorem* "other duty or charge" on that tariff item on 15 April 1994, other Members had three years after the date prescribed to challenge the 20 per cent *ad valorem* "other duty or charge". After that three year period, other Members can no longer challenge the imposition of the 20 per cent *ad valorem* duty or charge on the ground that it is higher than the 10 per cent *ad valorem* "other duty or charge" imposed at the time of the first incorporation of the (previous) concession in the appropriate Schedule of Concessions. After the lapse of the three-year period, the WTO consistency of the 20 per cent *ad valorem* "other duty or charge" may still be challenged at any time, pursuant to paragraph 5 of the Understanding.

4.241 In any event, according to the Dominican Republic, the only "other duty or charge" imposed on 15 April 1994 was the foreign exchange fee, which was then imposed at the rate of 1.5 per cent.

4.242 The recording of the Selective Consumption Tax at the level of 30 per cent does not give the Dominican Republic the authority to levy other types of duties or charges up to that level now. The Dominican Republic proceeds on a fundamental misunderstanding of paragraph 7 of the Understanding and Article II:1(b) of the GATT. The Dominican Republic implies that an "other duty or charge" need not have been imposed on 15 April 1994 for it to be recorded in a Member's Schedule of Concessions. It further implies that every Member reserved the right to impose any "other duties or charges" at any level (notwithstanding the non-existence of that ODC on 15 April 1994 or notwithstanding that the level imposed on 15 April 1994 was lower), subject only to the condition that it recorded those "other duties or charges" within the period provided for under paragraph 7 of the Understanding.

4.243 Paragraph 7 of the Understanding refers to two categories of "other duties or charges": (i) those omitted from a Schedule at the time of the deposit of the instrument of incorporation into the Schedule in question and (ii) those recorded at a level lower than that prevailing on the applicable date. Paragraph 7 allows corresponding "additions or changes" within the six-month period specified. But those "other duties or charges" allowed to be added or changed cannot be just any "other duties or charges".

4.244 Each Member therefore had the obligation to record the "nature and level of any 'other duties or charges' levied on bound tariff items, referred to in that provision…" That provision is "paragraph 1(b) of Article II [of the GATT]". The second sentence of Article II:1(b) of the GATT in turn refers to "all other duties or charges of any kind imposed on or in connection with… importation in excess of those imposed on [15 April 1994] …" Thus, no Member had a right to record any "other duty or charge" and to impose that solely on the basis that the ODC had been recorded. Rather, it is necessary that that "other duty or charge" must have been (i) imposed on 15 April 1994, (ii) on or in connection with importation and, (iii) recorded in the appropriate Schedule of Concessions. A Member may incorporate in its Schedules of Concessions an act yielding its rights, but not diminishing its obligations.

(h) The Foreign Exchange Fee

4.245 The Dominican Republic makes the same argument with respect to the foreign exchange fee that it made with respect to the transitional surcharge, namely that this dispute relates to cigarettes and that products other than cigarettes are outside the terms of reference of the Panel. Honduras briefly recalls the arguments it submitted with respect to the competence of the Panel to examine the transitional surcharge as it applies to products other than cigarettes. Honduras therefore considers that the foreign exchange fee, as it applies to products other than cigarettes, is within the terms of

reference of the Panel, and therefore, requests the Panel to examine the WTO-consistency of the foreign exchange fee as it applies to products other than cigarettes.

4.246 The imposition of the foreign exchange fee is inconsistent with Article II:1(b) of the GATT, in relation to the Understanding, because it was not recorded as an "other duty or charge" in the Dominican Republic's Schedule. The foreign exchange fee currently applied is imposed pursuant to the First Resolution of the Monetary Board of 22 October 2003. The operative act giving rise to the accrual of "other duties and charges" under Article II:1(b) is "importation". The operative act giving rise to the accrual of the foreign exchange fee is likewise "importation", and not the purchase of foreign currency to pay for the imported products. Thus, regardless as to when payment is actually made, importation gives rise to the liability for the foreign exchange fee. Furthermore, the foreign exchange fee is computed on the "value of imports at the selling rate of foreign exchange". This is no different from the "transaction value" for purposes of the imposition of customs duties. The phrase "at the selling rate of foreign exchange" does not effectively establish a distinction between customs duties and the foreign exchange fee, as the "transaction value" of most, if not all, imports is denominated in the currency of the exporter, and customs duties are paid in the currency of the importer. Invariably, in the imposition of customs duties, there is also a conversion from one currency to another. Thus, the foreign exchange fee constitutes another "duty or charge" imposed on or in connection with importation within the meaning of Article II:1(b) of the GATT.

4.247 Furthermore, Honduras makes the following points:

- The nature and level of "other duties or charge" levied on bound tariff items should have been recorded in the Schedules of concessions annexed to the GATT 1994 against the tariff item to which they apply.

- The recording of a tax or charge under the Schedules of concessions does not change the legal character of "other duties or charges".

- In its Schedule, the Dominican Republic had recorded only the Selective Consumption Tax, an internal tax.

- Therefore, for all intents and purposes, the Dominican Republic had not recorded any "other duties or charges" in its Schedule, including the foreign exchange fee.

- Members retain their right to challenge at any time the WTO consistency of "other duties or charges" imposed by other Members.

4.248 Even assuming that the Dominican Republic had recorded the foreign exchange fee as an "other duty or charge" in its Schedule, the foreign exchange fee would be inconsistent with Article II:1(b) of the GATT because it is imposed at a rate in excess of the rate applicable on 15 April 1994.

4.249 The foreign exchange fee currently applied pursuant to the First Resolution of the Monetary Board of 22 October 2003 is 10 per cent of the value of imports. According to the Dominican Republic, the "only duty or charge in force on 15 April 1994 was the exchange fee, at a rate of 1.5 per cent…" Thus, the rate currently applied is higher than that imposed on 15 April 1994. This is inconsistent with Article II:1(b) of the GATT, which provides that "all other duties or charges of any kind imposed on or in connection with... importation [shall not be] in excess of those imposed on [15 April 1994]".

4.250 The foreign exchange fee is not justified under Article XV:9 of the GATT. The International Monetary Fund ("IMF") has its own "guiding principle" in determining what constitutes a "[foreign] exchange restriction". As cited by the Dominican Republic, "[t]he guiding principle in ascertaining

whether a measure is a restriction on payments and transfers for current transactions under Article VIII, Section 2, is whether it involves a direct governmental limitation on the availability or use of exchange as such".

4.251 Since there does not exist in the WTO "a formal decision on how to distinguish between trade and exchange controls … the [WTO Members] have thus in practice used the same definition as the IMF even though they have not formally taken a decision to that effect". Thus, applying the IMF's guiding principle, Honduras submits that the foreign exchange fee is not a "[foreign] exchange restriction" because it is not a "direct… limitation on the availability or use of exchange as such". "As such" in relation to "limitation on the availability or use" means that the limitation must be on access to or the use of (foreign) exchange, as such, or per se. While the foreign exchange fee increases the costs of imports (which renders it a "trade restriction"), the availability of foreign exchange to pay for those imports remains unrestricted.

4.252 The Dominican Republic itself confirms that the foreign exchange fee is a measure applied to imports of goods, not on exchange transactions as such.

4.253 Even if the foreign exchange fee is determined to be an exchange restriction in the context of Article XV:9(a), its use is not in accordance with the Articles of Agreement of the IMF. Under Sections 2 and 3 of Article VIII of the Agreement, exchange restrictions or multiple currency practices, respectively, cannot be imposed without the approval of the IMF. The Dominican Republic has not presented evidence that the IMF has approved the imposition of the foreign exchange fee either as an exchange restriction or a multiple currency practice.

4.254 The Dominican Republic contends that the approval of the stand-by arrangement by the IMF on the basis of Letters of Intent constitutes such an approval. Without establishing what "continuous performance criteria" concerning exchange rate restrictions and multiple currency practices have been waived, the Dominican Republic regards this statement by the Executive Board of the IMF as providing a carte blanche for the imposition of exchange restrictions or multiple currency practices. Regardless of what those "continuous performance criteria" might be, a waiver thereof is not equivalent to the approval of the imposition of exchange restrictions or multiple currency practices in the context of Sections 2 and 3 of the Article VIII of the Articles of Agreement of the IMF.

4.255 Paragraph 3 of the Agreement between the International Monetary Fund and the World Trade Organization provides that the IMF "shall inform the WTO of any decisions approving restrictions on the making of payments or transfers for current international transactions, decisions approving discriminatory currency arrangements or multiple currency practices, and decisions requesting a IMF member to exercise controls to prevent a large or sustained outflow of capital. A search of the WTO website as of 6 May 2004 reveals that thus far, there have been 31 notifications relating to exchange restrictions, exchange measures, or exchange systems of 18 countries. The latest decision reported to the WTO was taken on 24 March 2004, relating to the exchange restrictions of Botswana. The IMF has not reported any decision on any approval of the imposition of an exchange restriction or a multiple currency practice by the Dominican Republic. That no such approval by the IMF has been notified to the WTO is further confirmed by the WTO Secretariat. Honduras is submitting a copy of the letter of the Trade and Finance Division dated 5 May 2004 confirming that "…no such notification from the IMF has been received by the WTO". The simple explanation is that the IMF has not granted any such approval.

4.256 Therefore, even assuming that the foreign exchange fee is an exchange restriction or a multiple currency practice, the Dominican Republic has not discharged its burden of establishing that the foreign exchange fee is imposed "in accordance with the Articles of Agreement of the [IMF]" in the context of Article XV:9(a) of the GATT.

F. SECOND WRITTEN SUBMISSION OF THE DOMINICAN REPUBLIC

1. Introduction

4.257 The Dominican Republic responds to Honduras's latest arguments in this second written submission, which is organized into three sections, showing the measures challenged by Honduras are not GATT-inconsistent or are justified by the GATT. The First Section deals with the "Dead Measures": (a) the manner in which the Selective Consumption Tax (SCT) tax base was determined, (b) the manner in which the Dominican Republic administered the provisions used to determine the "nearest similar product in the domestic market", and (c) the Central Bank surveys that identified the retail price to be used as the SCT tax base. The Second Section deals with the "Measures Applied to Guarantee Compliance with Internal Tax Laws": (a) the obligation of domestic producers and importers to post a bond, and (b) the requirement to affix tax stamps to domestic and imported cigarette packets in the presence of tax inspectors in the territory of the Dominican Republic. The Third Section deals with the "Temporary Measures Imposed on Imports": (a) the transitional surcharge, and (b) the foreign exchange fee.

2. Rebuttal of Honduras's claims

(a) Dead measures

4.258 The Panel should issue no recommendations and make no findings regarding withdrawn laws and practices of the Dominican Republic because: (i) recommendations in this case would be legal error and devoid of purpose, inutile, and redundant; (ii) there is no evidence that the measures are still in place or have lingering effects; (iii) there is no evidence that the Dominican Republic will reintroduce the measures; and (iv) the measures were revoked before the Panel began its adjudication process.

(i) The measures challenged by Honduras have been withdrawn

4.259 Honduras continues to argue against (a) the manner in which the SCT tax base was determined, (b) the manner in which the Dominican Republic administered the provisions used to determine the "nearest similar product in the domestic market", and (c) the Central Bank surveys that identified the retail price to be used as the SCT tax base (the "Dead Measures"). However, those measures were based on a version of Article 367(b) of the Dominican Republic Tax Code that has been radically modified by Law 3-04 of 9 January 2004. The current determination of the SCT tax base is completely different, and the Central Bank surveys no longer exist, as confirmed by the Directorate General of Internal Taxes (DGII). Even Honduras agrees that the Dominican Republic has completely eliminated the challenged measures.[102] Therefore, the Panel should dismiss Honduras's claims regarding these Dead Measures.

(ii) A recommendation with respect to the dead measures would constitute legal error

4.260 WTO jurisprudence makes clear that Panels should not rule on expired or withdrawn measures.[103] In fact, it is legal error for Panels to issue recommendations regarding measures no longer in existence, or make findings regarding such measures unless necessary to "secure a positive solution" to the dispute.[104]

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[102] See Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 39, p. 31.

[103] Panel Report, *Japan – Film*, para. 10.58.

[104] Appellate Body Report, *US – Certain EC Products*, para. 81; Panel Report, *Chile – Price Band System*, para. 7.112.

4.261 In addition, making recommendations in this case would violate the principle of judicial economy, which states that Panels should address only those claims on which a finding is necessary for recommendations and rulings that would resolve the matter at issue and "secure a positive solution to the dispute".[105] In *India – Autos*, the Panel considered modifications made by India during the proceedings because it felt those changes may affect its ability to make meaningful recommendations to the DSB.[106] This shows that if a finding or recommendation cannot help secure a positive solution, the Panel should not make that finding or recommendation.

(iii) There is no evidence that the dead measures are still in place or have lingering effects

4.262 In cases where Panels have made findings regarding withdrawn measures, those measures have been carried forward in some way. For instance, the Panel in *EC – Poultry* found it not moot to examine a measure that was within its terms of reference, but which had been withdrawn, because of such "lingering effects".[107] Similarly, in *India – Autos*, a case cited by Honduras, the Panel considered withdrawn measures, noting that although the challenged framework measure had ceased to operate, related Memorandums of Understanding (MOUs) remained.[108] The circumstances in the present case are fundamentally different. Honduras does not contest that the Dead Measures have been withdrawn, nor does it claim any lingering effects from those measures. Honduras's only concern is that the measures may be *reintroduced*.[109]

(iv) There is no evidence that the Dominican Republic will reintroduce the dead measures

4.263 Honduras's argument that the Panel should make findings on the Dead Measures lest the Dominican Republic revert to them[110] is incorrectly premised on the assumption that WTO Members will act in bad faith and violate the principle of *pacta sunt servanda*. The Appellate Body has made clear that the correct assumption is that Members act in good faith.[111] Panels have applied this assumption and refused to assume respondents would reintroduce withdrawn measures.[112] In the present case, there is no evidence the Dominican Republic will reintroduce the Dead Measures. Accordingly, the Panel must assume the Dominican Republic is acting in good faith and must not make findings based on a bad faith presumption.

(v) The dead measures were revoked before the panel began its examination

4.264 Honduras erroneously believes that if the measures complained of are within the terms of reference and jurisdiction of the Panel, the Panel will be compelled to make recommendations and findings regarding these measures. As such, Honduras has devoted most of its energy to demonstrating that Law 3-04 entered into force six days after the Panel was established on 9 January 2004.

4.265 What is dispositive, however, is not whether these measures were in force on the date the Panel was established, but whether they were revoked before the Panel began its adjudication process, which is a question of fact based on individual circumstances. In the present case, the Panel began its adjudication process long after the elimination of these measures, as it did not hold an organizational

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[105] Appellate Body Report, *Australia – Salmon*, para. 223.
[106] Panel Report, *India – Autos*, para. 7.30.
[107] Panel Report, *EC – Poultry*, paras. 153, 252.
[108] Panel Report, *India – Autos*, para. 7.28.
[109] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 40, p. 34.
[110] Ibid., reply to question No. 39, p. 31.
[111] See Appellate Body Report, *Chile – Alcoholic Beverages*, para. 74. See also Panel Report, *US – Certain EC Products*, para. 6.110.
[112] Panel Report, *Argentina – Footwear (EC)*, para. 6.14.

meeting until almost two months after establishment. Therefore, the Panel should not review these Dead Measures.

4.266 In its Replies to Questions Addressed by the Panel, Honduras has relied almost entirely on cases where a measure was modified, amended, or withdrawn long *after* these Panels began their adjudication process. In *US – Wool Shirts and Blouses*, the measure in question was withdrawn several weeks *after* the issuance of the interim report to the parties.[113] In *Indonesia – Autos*, the respondent's communication that the measure in question had been terminated came *after* the Panel's deadline for submitting information and arguments, and moreover, the complainants challenged the effective termination of the measure.[114]

(vi) The dead measures do not cause nullification or impairment of the benefits of Honduras

4.267 Should the Panel decide to find the Dead Measures were GATT-inconsistent, the Dominican Republic requests it find no resulting nullification or impairment to Honduras. The withdrawal of these measures is sufficient evidence to rebut the presumption in DSU Article 3.8 that a rules breach adversely impacts other Members. No prospective adverse impact can result from measures that no longer exist.

4.268 For the reasons stated above, the Dominican Republic requests the Panel to dismiss Honduras's claims against the Dead Measures and make no recommendations or findings with regard to these claims. Furthermore, the Dominican Republic requests the Panel to find that such Dead Measures, at present, do not constitute a case of nullification or impairment.

(b) Measures applied to guarantee compliance with internal tax laws

(i) The bond requirement for domestic and imported cigarettes is consistent with Article XI:1 and Article III:4 of the GATT

4.269 The bond requirement is neither a restriction or prohibition on the importation of cigarettes contrary to Article XI:1, nor an internal measure that discriminates against imported cigarettes contrary to Article III:4. Honduras and the Dominican Republic agree that Article XI and Article III cannot apply concurrently to the same measure.[115] In any event, Honduras did not request a cumulative analysis of the bond requirement under the two provisions.[116] Instead, Honduras claimed a violation of Article XI:1 and, *in the alternative*, a violation of Article III:4.[117] Both claims are unfounded and should be dismissed.

The bond requirement is outside the scope of Article XI:1 of the GATT

4.270 Honduras argument that the bond requirement is contrary to Article XI:1 is incorrect for two reasons. First, the bond requirement is outside the scope of Article XI:1. Second, even if it were within the scope of Article XI:1, it is not a "prohibition" or "restriction" "on the importation" of cigarettes.

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[113] Panel Report, *US – Wool Shirts and Blouses*, para. 6.2.

[114] Panel Report, *Indonesia –Autos*, para. 14.9.

[115] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 18, p. 19. Replies of the Dominican Republic to the questions addressed by the Panel, reply to question No. 18, para. 28.

[116] See Panel Report, *EC – Asbestos*, para. 8.100 (finding that a claim by Canada for cumulative application of Article III:4 and Article XI:1 would not be within the terms of reference of the Panel).

[117] Request for the Establishment of a Panel by Honduras, *supra* note 2, para. 4. First written submission of Honduras, 16 March 2004, section IV.G. and para. 112.

4.271 The bond requirement is outside the scope of Article XI:1 because, contrary to Honduras's argument[118], it is not a "condition" for the importation of cigarettes that applies "*prior*" to importation, as there is no law or regulation in the Dominican Republic that stipulates such. Article 14 of Decree 79-03 provides that importers and domestic producers of cigarettes alike must provide the bond, which is enforced by the DGII. Article 40 of Decree 79-03 requires importers of cigarettes to obtain an import license from the DGII, but posting the bond is *not* among the conditions for obtaining a license.[119] Moreover, after a bond is posted, a local producer or importer must simply renew it prior to expiration – i.e. importers need not post a new bond every time they import. Customs authorities do not even check if an importer has posted the bond, as evidenced by the fact that the importer *BAT República Dominicana* has been importing cigarettes from Honduras for years despite never posting the bond.[120]

4.272 The bond requirement is also outside the scope of Article XI:1 because it is an internal measure that applies equally to imported and domestic cigarettes, not a measure "on the importation" of cigarettes. When an applied measure leads to the same result for both imported and like domestic products, it is subject to Article III:4, not Article XI:1.[121] Honduras admits that the bond's application leads to the same result[122], and it does not deny that the bond requirement applies identically to importers and domestic cigarette producers.[123] Rather, it argues that identical treatment between imported and domestic products can result in less *favour*able treatment[124], which is a separate issue under the purview of Article III.

4.273 Even if the bond requirement is a measure "on the importation" of cigarettes, Honduras has not established that it prohibits or restricts the importation of cigarettes, as its only argument along these lines is based on the same incorrect assertion highlighted above that the bond requirement is a "condition" for the importation of cigarettes.[125] The facts show that Dominican Republic authorities do not regard nor require, either *de jure* or *de facto*, the posting of the bond as a pre-requisite for the importation of cigarettes, as evidenced by the fact that *BAT República Dominicana* has been importing cigarettes for several years without ever having posted the bond.[126] Honduras also specifically chose not to answer the Panel's question asking whether its cigarette exports to the Dominican Republic had suffered restrictive effects, given the fact that such exports seem to have increased.[127]

4.274 In conclusion, the Dominican Republic requests the Panel find that the bond requirement is not a measure "on the importation" of cigarettes, and therefore outside the scope of Article XI:1. Should the Panel find otherwise, the Dominican Republic requests the Panel find that it is not a "prohibition" or "restriction" on the importation of cigarettes, and therefore not contrary to Article XI:1.

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[118] Oral statement of Honduras to the Panel, 11 May 2004, para. 79 (English version). Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 35, p. 30.

[119] Decree 79-03, *supra* note 8, Article 40.

[120] Certification by the Director General of Customs, dated 26 May 2004, submitted by the Dominican Republic as Exhibit DR-43. Certification by the Directorate General of Internal Taxes, dated 24 May 2004, submitted by the Dominican Republic as Exhibit DR-35.

[121] Panel Report, *EC – Asbestos*, paras. 8.91-8.99.

[122] Oral statement of Honduras to the Panel, 11 May 2004, para. 79 (English version). See also Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 35, p. 30.

[123] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 31, p. 27.

[124] Ibid.

[125] Oral statement of Honduras to the Panel, 11 May 2004, para. 80 (English version). First written submission of Honduras, 16 March 2004, para. 113.

[126] See Certification by the Directorate General of Internal Taxes, *supra* note 120.

[127] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 32, p. 29.

The bond requirement is also outside the scope of Article III:4 of the GATT

4.275 The bond requirement is outside the scope of Article III:4, and consequently cannot be contrary to that Article, because it does not *affect* the "internal sale, offering for sale, purchase, transportation, distribution or use" of imported cigarettes.[128] The Appellate Body has agreed that it is a requirement that, in addition to being an internal measure, a measure must fall within the scope of Article III:4.[129] In fact, Honduras has stated, in unequivocal terms, that "the requirement to post a bond *does not affect*" these specific transactions.[130] The bond does not preclude cigarette importers from clearing cigarettes through customs, selling or offering them for sale, transporting them, or distributing them within the territory of the Dominican Republic. Moreover, it does not preclude consumers from buying or using imported cigarettes. As already mentioned, *BAT República Dominicana* has been importing and selling cigarettes in the Dominican Republic for years, despite not having posted the bond.[131]

Alternatively, the bond requirement is consistent with Article III:4 of the GATT

4.276 Assuming the bond requirement is within the scope of Article III:4, it is nevertheless not contrary to that Article since it does not accord "less favourable treatment" to imported cigarettes, which according to the Appellate Body depends on whether a measure "modifies the *conditions of competition* in the relevant market to the detriment of imported products".[132] Honduras acknowledges that the bond "does not affect *per se* 'the competitive opportunities on the domestic market,'"[133] and it has not disagreed that the bond applies identically to importers and domestic producers.[134] Honduras argues instead, based on *US – Section 337 (GATT)*, that identical treatment can result in less favourable treatment.[135] The situation in that case, however, is different from the situation in the present case because that Panel did not deal with a situation involving formally identical legal treatment for domestically produced and imported products.[136]

4.277 Honduras has not demonstrated how the equal treatment accorded by the bond to domestic and imported cigarette producers modifies conditions of competition, for it does not. All foreign cigarettes can be imported, offered for sale, sold, transported, distributed, purchased, and used within the Dominican Republic, just like any domestic cigarette. Moreover, the bond does not impose an additional charge on the importation of cigarettes, which Honduras recognizes as it desisted from pursuing such a claim.[137]

4.278 Honduras seems to challenge the timing of the payment of the SCT, rather than the bond requirement itself, as it continues to highlight the difference in timing between importers and domestic producers.[138] That difference, however, does not explain how the bond affects importers' conditions of competition. Moreover, requiring importers to post the bond at the time of importation

[128] GATT, Article III:4.

[129] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 208.

[130] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 35, p. 30 (emphasis added).

[131] See Certification by the Directorate General of Internal Taxes, *supra* note 120.

[132] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137 (emphasis in original).

[133] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 35, p. 30 (emphasis in original). See also oral statement of Honduras to the Panel, 11 May 2004, para. 79 (English version).

[134] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 31, p. 27.

[135] Ibid.

[136] See GATT Panel Report, *US – Section 337*, para. 3.11.

[137] Request for the Establishment of a Panel by Honduras, *supra* note 2, para. 4.

[138] First written submission of Honduras, 16 March 2004, paras. 115-116. Oral statement of Honduras to the Panel, 11 May 2004, para. 86 (English version).

is consistent with Note *Ad* Article III. In any event, the timing issue is not within the Panel's terms of reference.

4.279 Honduras has also not demonstrated how the identical treatment accorded to domestic and imported cigarettes by the bond requirement modifies conditions of competition "to the detriment of imported products".[139] To ascertain detriment and find an Article III:4 violation, the Panel must determine whether differences in conditions of competition afford protection to domestic producers[140], which Honduras has not shown. To the contrary, the fact that cigarette imports into the Dominican Republic have increased in recent years shows that importers have not been disadvantaged by the bond requirement.[141]

(ii) The stamp requirement for imported and domestic cigarettes is consistent with Article III:4 of the GATT

4.280 Honduras has not established that the stamp requirement accords "less favourable treatment" to imported cigarettes, thereby violating Article III:4, as it has not shown that the stamp affords protection to domestic producers, which is a necessary inquiry under Article III:4.[142] Honduras argues that affording protection to domestic industry "is not a material element" of Article III:4[143], citing the Appellate Body's statement in *EC – Asbestos* that where there is less favourable treatment, there is conversely protection of the like domestic product.[144] That statement, however, does not support Honduras's conclusion.

4.281 The inquiry of whether a measure "afford[s] protection to domestic production" is an integral part of the determination of whether a measure "accords less favourable treatment" –i.e. it is not a separate inquiry. Only those modifications of the conditions of competition that are *detrimental* to imported products are considered "less favourable treatment" under Article III:4.[145] "Detriment" means "loss sustained by or damage done to a person or thing" or "a cause of loss or damage".[146] Determining detriment requires inquiry into the thrust and effects of the measure to ascertain if imported products have sustained damage relative to like domestic products.[147]

4.282 Thus, it is of course true that a finding of "less favourable treatment" necessarily includes: "so as to afford protection to domestic production"[148], which is consistent with the Appellate Body's conclusion in *EC – Asbestos* mentioned above.[149] This, however, does not contradict the necessity of examining the effects that differences in conditions of competition have on imported products.

4.283 The Dominican Republic has shown that the stamp requirement is not applied "so as to afford protection".[150] The fact that Honduras's cigarette imports have increased significantly in 2003 and the first trimester of 2004 shows that the stamp requirement has had no, or at most negligible, detrimental

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[139] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

[140] See Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, reply to question No. 75, para. 89.

[141] Oral statement of the Dominican Republic to the Panel, 11 May 2004, para. 41. See also Statistics of imports of cigarettes, *supra* note 83.

[142] First written submission of the Dominican Republic, 13 April 2004, paras. 34, 44, 46-54.

[143] Oral statement of Honduras to the Panel, 11 May 2004, para. 64 (English version). See also Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 29, p. 25.

[144] Appellate Body Report, *EC – Asbestos*, para. 100.

[145] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

[146] *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. I, p. 652.

[147] See Appellate Body Report (Article 21.5), *US – FSC*, para. 215.

[148] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 29, p. 26.

[149] See Appellate Body Report, *EC – Asbestos*, para. 100.

[150] First written submission of the Dominican Republic, 13 April 2004, para. 53.

effect on imports.[151] Honduras has not reconciled this fact with its assertions that the stamp requirement adds costs to the production process and affects the presentation of cigarettes to consumers.

4.284 The Dominican Republic reiterates that any difference in the conditions of competition between imported and domestic products caused by the stamp requirement is inherent in the nature of imported products, not the result of formally equal treatment as Honduras claims.[152] While Article III:4 prohibits Members from modifying the conditions of competition to the detriment of imported products, it does not require Members to compensate for the inherent differences between imported and domestic products.

(iii) The requirement to affix stamps in the territory of the Dominican Republic and the requirement to post a bond are justified by Article XX(d) of the GATT

4.285 The Dominican Republic has argued, in the alternative, that the stamp and bond are both justified by GATT Article XX(d), as they are necessary to secure compliance with the Dominican Republic's GATT-consistent tax laws, and are consistent with the Article XX *chapeau*.[153] The Dominican Republic rebuts Honduras's few counter-arguments below, bearing in mind the purpose of Article XX.

4.286 As noted by the Appellate Body, Article XX establishes a "line of equilibrium" between the trade-specific rights of exporting members and the equally-important non-trade specific rights of importing members.[154] In this case, Honduras has the right to import cigarettes, which it claims is affected by the Dominican Republic's stamp and bond requirements. However, these measures are not trade-restrictive at all, as they are not structured to have protective application, apply equally to imported and domestic products, and have not resulted in fewer imports. On the other hand, the Dominican Republic has the right to enforce its GATT-consistent tax laws, and it has demonstrated these measures are necessary to ensure the collection of taxes, which is especially crucial given the country's serious macroeconomic crisis.

The requirement to affix stamps in the territory of the Dominican Republic is justified by Article XX(d) of the GATT

4.287 The Dominican Republic has already demonstrated that its stamp requirement is justified by Article XX(d) of the GATT, as it is necessary to secure compliance with its GATT-consistent Tax Code, and is not arbitrary or unjustifiable discrimination or a disguised restriction on international trade contrary to the Article XX *chapeau*.[155] Honduras only questions the necessity of the stamp requirement to secure compliance with the Dominican Republic Tax Code. The Dominican Republic answers below.

4.288 First, the Dominican Republic has already shown, and there is no dispute over, the fact that the stamp secures compliance with its Tax Code, specifically the SCT, which is all GATT consistent.[156]

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[151] Oral statement of the Dominican Republic to the Panel, 11 May 2004, para. 41. First written submission of the Dominican Republic, 13 April 2004, para. 114. See also Statistics regarding imports by the firm *British American Tobacco – República Dominicana*, *supra* note 24 and Statistics of imports of cigarettes, *supra* note 83.

[152] Oral statement of Honduras to the Panel, 11 May 2004, para. 59 (English version).

[153] First written submission of the Dominican Republic, 13 April 2004, paras. 97-167; Oral statement of the Dominican Republic to the Panel, 11 May 2004, paras. 33-47.

[154] Appellate Body Report, *US – Shrimp*, para. 159.

[155] First written submission of the Dominican Republic, 13 April 2004, paras. 100-140.

[156] Ibid., paras. 102-105.

4.289 Honduras primarily argues the stamp is not a *necessary* measure, claiming it does not alert tax authorities that applicable taxes have been collected[157], especially since the dispute is over cigarettes that enter through regular customs channels.[158] Honduras's argument misses the point of the stamp requirement and is wrong for two reasons. First, even if customs agents collect the taxes, the stamp still serves to alert authorities that required taxes have been paid. Second, alerting authorities is only one objective of the stamp requirement. Another is to foreclose non-legitimate channels of commerce and ensure cigarettes enter through regular channels, thereby allowing authorities to log the number of cigarette imports and account for the taxes on those cigarettes. Without stamps, cigarette smuggling would increase, leading to a diminution of tax collection. Thus, the stamp requirement is indeed necessary to secure tax compliance.

4.290 Honduras also argues the stamp requirement is not necessary because there are reasonable alternatives. However, these alternatives would not achieve zero tolerance of tax evasion and cigarette smuggling, which the Dominican Republic has the sovereign right to pursue.[159] These alternatives also do not recognize the Dominican Republic's limited resources and the history of smuggling in similar products. First, Honduras suggests tax stamps be made available to importers abroad.[160] This would require customs agents to spend extra time verifying the affixation and authenticity of the stamps, while this is currently ensured by affixation in the presence of DGII agents. Moreover, sending stamps abroad has led to smuggling and tax evasion with alcohol[161], while there have been no such problems with cigarettes. Consequently, the stamp requirement may be extended to alcohol.[162] Second, Honduras suggests pre-shipment inspection and certification at the importer's expense.[163] However, private companies cannot substitute for the state in enforcing domestic laws. Finally, Honduras highlights that in the United States, agents stamp both domestic and imported cigarettes at warehouses.[164] This would require extra resources to ensure all cigarettes are properly transported to and stamped at this facility. It cannot be assumed the Dominican Republic has the means to implement the system of a developed Member.

4.291 Honduras also failed to answer the Panel's question as to whether less trade-restrictive methods used by other countries have achieved zero-tolerance enforcement. Instead, Honduras tried to shift the burden of this question to the Dominican Republic[165], which it cannot do simply because the Dominican Republic has the original burden with respect to the issue underlying the question. The Dominican Republic has met its burden of proof under Article XX(d) by demonstrating the stamp is necessary to achieve zero-tolerance enforcement, as it has led to no known instances of cigarette smuggling, while there have been such problems with alcoholic beverages where there is no similar stamp requirement.

4.292 Finally, the stamp is consistent with the *chapeau* of Article XX, which only admonishes discrimination "between countries where the same conditions prevail"; a discrimination standard different from elsewhere in the GATT.[166] As the stamp is applied consistently across all countries

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[157] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 25, p. 22.

[158] Oral statement of Honduras to the Panel, 11 May 2004, para. 69 (English version).

[159] First written submission of the Dominican Republic, 13 April 2004, para. 117.

[160] Oral statement of Honduras to the Panel, 11 May 2004, para. 71 (English version). See also Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 25, p. 22.

[161] See information submitted by the Dominican Republic as Exhibit DR-8.

[162] Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, reply to question No. 65, para. 70.

[163] Oral statement of Honduras to the Panel, 11 May 2004, para. 72 (English version). Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 25, p. 22.

[164] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 12, p. 16.

[165] Ibid., reply to question No. 26, p. 23.

[166] First written submission of the Dominican Republic, 13 April 2004, para. 122.

where the same conditions prevail, there is no discrimination of any kind, let alone arbitrary or unjustifiable discrimination, or disguised restrictions on trade.

The Requirement to post a bond is justified by Article XX(d) of the GATT

4.293 The Dominican Republic has already shown that its bond requirement is justified by Article XX(d) of the GATT, as it is necessary to secure compliance with its GATT-consistent Tax Code, and is not arbitrary or unjustifiable discrimination or a disguised restriction on international trade contrary to the Article XX *chapeau*.[167] Honduras only questions whether the bond secures compliance with the Tax Code, and whether it is necessary to do so. The Dominican Republic answers below.

4.294 Honduras first claims that the bond cannot secure compliance with the Dominican Republic Tax Code because tax liabilities cannot accrue to imported products that disappear before clearing customs.[168] The Dominican Republic has already demonstrated how the bond requirement indeed secures such compliance, especially as tax liabilities can arise *after* a product has cleared customs and after a tax has been paid.[169]

4.295 Honduras then argues that the bond is not *necessary* to secure such compliance. First, it notes that taxes are paid before customs clearance.[170] However, the bond is indeed necessary to secure payment of tax liabilities that may arise *after* customs clearance and tax payment. Second, it points out there is no bond requirement for other products also subject to the SCT.[171] However, a bond may be necessary to collect taxes only for some products, especially those susceptible to smuggling, such as alcohol and cigarettes.[172]

4.296 Moreover, the Dominican Republic has no reasonable alternatives available to it to achieve the same zero-tolerance level of enforcement it has chosen, which is its sovereign right.[173] Honduras specifically failed to answer the Panel's question regarding reasonable alternatives to the bond, choosing instead to reiterate, erroneously, that there is no fiscal obligation for the bond to secure.[174] The lack of cigarette smuggling to date in the Dominican Republic shows the bond is necessary.

4.297 Finally, the bond is consistent with the *chapeau* of Article XX, which only admonishes discrimination "between countries where the same conditions prevail"; a discrimination standard different from other GATT provisions.[175] As the bond is applied consistently across all countries where the same conditions prevail, there is no discrimination of any kind, whether arbitrary, unjustifiable, or disguised.

(c) Temporary measures imposed on imports

(i) The Dominican Republic has the right to maintain the Foreign Exchange Fee

4.298 The Dominican Republic has argued that the foreign exchange fee is an exchange measure justified by GATT Article XV:9(a), and, *in the alternative*, is consistent with Article II:1 since it is

[167] Ibid., paras. 141-167.
[168] Oral statement of Honduras to the Panel, 11 May 2004, paras. 92-93 (English version).
[169] First written submission of the Dominican Republic, 13 April 2004, paras. 82-91, 143-145.
[170] Oral statement of Honduras to the Panel, 11 May 2004, para. 91 (English version).
[171] Ibid.
[172] Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, reply to question No. 79, para. 97.
[173] First written submission of the Dominican Republic, 13 April 2004, para. 150.
[174] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 33, p. 29.
[175] First written submission of the Dominican Republic, 13 April 2004, para. 153.

within the level of other duties or charges (ODCs) recorded by the Dominican Republic in its Schedule. As the Dominican Republic has explained, GATT Article XV establishes that where a Member implements exchange restrictions or exchange controls consistent with the Articles of Agreement of the International Monetary Fund (IMF), those exchange measures cannot be the basis for a GATT violation.

4.299 Honduras wrongly tries to resurrect its Article XV:4 claim, which it raised in its Request for the Establishment of a Panel[176], but not in its first written submission. Parties must "present the facts of the case and their arguments" in their first written submission.[177] Honduras's assertion that Article XV:4 is an exception to Article XV:9 is specious. Article XV:9 is unqualified. Honduras could have raised its Article XV:4 claim, at least in the alternative, in its first written submission. Having not done so, it must be deemed to have abandoned this claim now.

4.300 Honduras also claims the Dominican Republic acknowledges the exchange fee is a "trade restriction"[178], but Honduras fails to distinguish arguments in the alternative from admissions of fact. The Dominican Republic argued that even if the Panel finds the exchange fee is not justified by Article XV:9(a), Honduras's Article II:1 claim still fails as the fee is consistent with the ODCs recorded in the Dominican Republic's Schedule.[179] This was an argument in the alternative, not an admission of fact.

(ii) The transitional surcharge and foreign exchange fee are consistent with Article II:1 of the GATT

4.301 Honduras still argues the Dominican Republic's transitional surcharge and foreign exchange fee are inconsistent with Articles II:1(a) and II:1(b) of the GATT.[180] The Dominican Republic disputes these claims below, and objects to Honduras's undue expansion of the product coverage of these claims.

The transitional surcharge and foreign exchange fee are consistent with Article II:1(b) of the GATT

4.302 Honduras argues the transitional surcharge and foreign exchange fee are inconsistent with GATT Article II:1(b) because the Dominican Republic did not record them as ODCs in its Schedule[181], and because they are "in excess of" the ODCs imposed -i.e. did not exist- as of 15 April 1994.[182] The Dominican Republic has already shown it properly recorded these ODCs in accord with paragraph 7 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994 (the "Understanding").[183] Honduras acknowledges no Member objected to this recording[184] which means the recorded ODCs properly reflect those imposed as of 15 April 1994. The Dominican Republic has also already shown that the surcharge and exchange fee are within this recorded level of ODCs.[185]

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[176] Request for the Establishment of a Panel by Honduras, *supra* note 2, para. 6.

[177] Panel Report, *US – Steel Plate*, paras. 7.27-7.29.

[178] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 10, p. 12, citing first written submission of the Dominican Republic, 13 April 2004, para. 204.

[179] First written submission of the Dominican Republic, 13 April 2004, paras. 189 and 202.

[180] Oral statement of Honduras to the Panel, 11 May 2004, paras. 4-21 (English version). Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 24, pp. 20-21.

[181] First written submission of Honduras, 16 March 2004, paras. 53-56, 64-66. Replies of Honduras to the questions addressed by the Panel, 27 May 2004, question No. 23, p. 20.

[182] First written submission of Honduras, 16 March 2004, paras. 57-58, 67.

[183] First written submission of the Dominican Republic, 13 April 2004, paras. 179-183, 203-205. Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, para. 4.

[184] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 3, p. 3.

[185] First written submission of the Dominican Republic, 13 April 2004, paras. 183, 204.

Nevertheless, the Dominican Republic shows below that Honduras is time-barred from challenging the recording or existence of these ODCs based on the Understanding, and that such challenge is not within the Panel's terms of reference.

4.303 Honduras's claim, based on paragraph 5 of the Understanding, that it can challenge the recording or existence of the Dominican Republic's ODCs at any time[186], is wrong. Paragraph 5 of the Understanding does not apply to rights affected by paragraph 4, which states the right to challenge "the existence of an 'other duty or charge'" or "the consistency of the recorded level of any 'other duty or charge'" lapses three years after the recording of the ODCs (14 September 1997 in this case). The negotiating history of the Understanding demonstrates that this time limit for such challenges was established to ensure certainty over the legal status of ODCs.[187] Therefore, Honduras's current claims as to the recording and existence of the surcharge and exchange fee as ODCs are time-barred. Even if Honduras challenges these ODCs under Articles XXII and XXIII of the GATT, the GATT Secretariat has indicated that Panels should find "an ODC, having been recorded in the schedule for more than three years, could no longer be challenged".[188]

4.304 In addition, as the right to challenge the recording or existence of ODCs is established by paragraph 4 of the Understanding, Honduras needed to raise these claims under the Understanding, not under Article II:1(b) of the GATT. Honduras has not done so, and may not do so now. Honduras's claims that the surcharge and exchange fee are inconsistent with Article II:1(b) because they were not recorded as ODCs or did not exist as ODCs as of 15 April 1994 are therefore outside the terms of reference of this Panel and should be dismissed.

The transitional surcharge and foreign exchange fee are consistent with Article II:1(a) of the GATT

4.305 Honduras's arguments that the surcharge and exchange fee are inconsistent with Article II:1(a) must be rejected for two reasons. First, contrary to Honduras's claim that Article II:1(a) forbids all ODCs[189], only ordinary customs duties or ODCs "in excess of" those recorded in a Schedule can be inconsistent with Article II:1(a).[190] The European Communities agrees.[191] Second, Honduras has only argued inconsistency with Article II:1(a) *as a consequence of* inconsistency with Article II:1(b).[192] Honduras's contention that the Dominican Republic has not rebutted its Article II:1(a) arguments[193] is therefore unfounded, as the Dominican Republic has done so by rebutting its Article II:1(b) arguments.[194] There is nothing separate for the Dominican Republic to rebut.

Honduras attempts to unduly expand the product coverage of its claims in respect of the Transitional Surcharge and the Foreign Exchange Fee

4.306 Honduras's expansion of the product coverage of its challenge to the surcharge and exchange fee is barred by due process, equity, and good faith, which must be accorded to all WTO respondents

[186] Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 3, p. 3.

[187] See "Article II:1(b): Legal Questions, Note by the Secretariat", Group of Negotiations on Goods (GATT), Negotiating Group on GATT Articles, MTN.GNG/NG7/W/61, 16 November 1989, paras. 7-10, submitted by the Dominican Republic as Exhibit DR-49.

[188] Ibid.

[189] First written submission of Honduras, 16 March 2004, para. 2.

[190] First written submission of the Dominican Republic, 13 April 2004, paras. 174-178, 206.

[191] Third party submission by the European Communities, 27 April 2004, para. 4.

[192] Oral statement of Honduras to the Panel, 11 May 2004, paras. 4, 15-17 (English version).

[193] Ibid., para. 15.

[194] First written submission of the Dominican Republic, 13 April 2004, paras. 184-186, 207.

to give them full and fair opportunity to defend.[195] As the Appellate Body recognizes, an important element of due process is setting terms of reference early.[196] Although a complainant's Panel request initially defines the terms of reference, they can be narrowed by the proceedings. A complainant that does not raise, in its first written submission, claims listed in its request for the establishment of a Panel should be deemed to have waived such claims.[197] Otherwise, respondents may not have adequate opportunity to respond, as in the case where a complainant raises a claim for the first time during its closing statements at the second Panel meeting with the parties.

4.307 The product coverage of a dispute is an integral element of the terms of reference that must also be defined at an early stage so as not to thwart due process and equity.[198] The present case has been confined specifically to cigarettes based on consultations between the parties, Honduras's reference to the surcharge and exchange fee "as [they apply] to the bound item of cigarettes"[199], and the very title of this dispute. Therefore, Honduras may not expand the product coverage of its challenge to the surcharge and exchange fee at this late stage, as it attempts to do[200], for that would undermine due process, equity, and good faith.

3. Conclusion

4.308 For these reasons, the Dominican Republic again asks the Panel to dismiss Honduras's claims.[201]

G. ORAL STATEMENT OF THE DOMINICAN REPUBLIC AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

1. Introduction

4.309 The Dominican Republic declared that it intended to use the opportunity to respond directly to the assertions made by Honduras in its latest written submission to the Panel which, in its opinion, remains silent as regards many of the arguments and much of the documentary evidence submitted by the Dominican Republic.

4.310 The Dominican Republic began with a general remark. Honduras claims that in this case, what is at issue is the effectiveness of the GATT as a legal framework securing the results of market access negotiations.[202] The main theme of this dispute is not the threat of market access concessions, as Honduras contends. What this dispute is essentially about is an importing country that is enforcing its laws in its own territory, laws which are applied in an identical manner to domestic products and imported products, laws which pursue a legitimate objective and not a protectionist one, namely preventing smuggling and ensuring that taxpayers meet their tax obligations.

4.311 The Dominican Republic stated that it would refer briefly to each one of the measures or categories of measures attacked by Honduras, starting with the stamp requirement.

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[195] See Panel Report, *Thailand – H-Beams*, para. 7.24. See also Appellate Body Report, *US – FSC*, para. 166.

[196] See Appellate Body Report, *Brazil – Desiccated Coconut*, p. 22.

[197] See Panel Report, *US – Steel Plate*, paras. 7.27-7.29. See also Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 50 (noting a Member must raise objections in a timely manner or risk waiving them).

[198] See GATT Panel Report, *EEC – Import Restrictions*, para. 30.

[199] First written submission of Honduras, 16 March 2004, paras. 50, 61.

[200] Oral statement of Honduras to the Panel, 11 May 2004, paras. 14, 21 (English version).

[201] First written submission of the Dominican Republic, 13 April 2004, para. 208.

[202] Second written submission of Honduras, 10 June 2004, para. 7.

2. Stamp requirement for domestic and imported cigarettes

4.312 Before turning to Honduras's arguments regarding the stamp requirement, it is important to remember that in its purpose, design, structure and application, the stamp requirement is intended to secure compliance by taxpayers with their fiscal obligations and to combat smuggling. In that respect, it has been an effective measure.

4.313 Honduras argues that if the Panel recognizes that the stamp requirement for cigarettes is a legitimate measure, this could lead to the imposition of the requirement for any product.[203] The Dominican Republic has explained that it is the particular circumstances surrounding smuggling and tax evasion in the case of cigarettes that justify the stamp requirement. Until Honduras has acknowledged that there is a global problem of smuggling of tobacco products, and until it has recognized that the stamp requirement contributes to eliminating or preventing such smuggling, it will not be able to understand that the affixing of stamps in the presence of inspectors from the Directorate General of Internal Taxes is a legitimate, non-discriminatory and necessary measure.

4.314 Unfortunately, Honduras continues to ignore these two fundamental facts. The Dominican Republic has submitted documentary evidence showing that the problem of the smuggling of tobacco products is recognized worldwide.[204] More specifically, the Dominican Republic presented an international convention negotiated in the World Health Organization and an instrument issued by an alliance of NGOs. Honduras's response was surprising: it said that these documents were not legally binding on either Honduras or the Dominican Republic.[205] The Dominican Republic submitted these documents for their value as evidence in respect of the fact alleged, and not because they represented a source of international rights or obligations for the parties to the case. The Dominican Republic does not need to negotiate, sign and ratify an international treaty stating that the sun rises in the east and sets in the west for this to be an incontrovertible fact. Similarly, the fact that the two instruments submitted by the Dominican Republic as evidence are not binding on Honduras and the Dominican Republic does not alter the truthfulness of their content. In fact, Honduras did not even try to refute their content.

4.315 At the same time, Honduras states that the stamp requirement does not control the movement of tobacco products within the meaning of Article 15 of the WHO Framework Convention – the same convention which, according to Honduras, the Panel should not consider at all.[206] In fact, the stamp requirement does control the movement of tobacco products, since the absence of a stamp on a cigarette packet indicates to the authorities, traders and consumers that that packet entered the market through illegal channels, without paying taxes. And yet Honduras argues that the stamp cannot be a mark to alert Dominican Republic tax authorities that the Selective Consumption Tax has been collected, since the stamp is affixed before that tax is paid.[207] What is important is for the stamp to be affixed *before* the cigarette packets enter the market. No packet, whether domestic or imported, may enter the market without a stamp having been affixed. The internal tax authorities control the stamps that have been sold to each trader and importer. They also know how many of these stamps have been affixed to the packets, and hence how many packets have entered the market. Consequently, traders cannot evade tax control by declaring a number of packets lower than the number that entered the market, and hence they cannot evade their taxes by attempting to be assessed on a lower number of packets.

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[203] Ibid., para. 4.

[204] See "The FCTC and Tobacco Smuggling", *supra* note 23. *See also*, WHO Framework Convention on Tobacco Control, *supra* note 47.

[205] Second written submission of Honduras, 10 June 2004, paras. 53 and 116.

[206] Ibid., para. 55.

[207] Ibid., para. 49.

4.316 Honduras's complaint with respect to the stamp requirement is that it accords identical treatment to imported and domestic cigarettes.[208] According to Honduras, given the conditions in which the two products are competing, identical treatment under the law implies discrimination; specifically, insisting that the imported product having to comply with the requirement in the territory of the Dominican Republic increases the cost of the imported products.[209] According to this reasoning, the "additional cost" of complying with the importing country's non-discriminatory law is a source of discrimination. If this were the case, all WTO Members would be under the obligation to apply differential measures for imported products to eliminate any cost or inconvenience to the importer resulting from compliance with the laws applied to domestic products. The cost of complying with laws which do not discriminate, in letter, between imported and domestic products, is something that any importer takes into account and assumes as a condition and cost inherent to international trade.

4.317 Honduras argues that the Dominican Republic failed to specify which additional steps to comply with the stamp requirement in the case of imported products could be avoided.[210] However, two paragraphs further on Honduras explains why one of the steps that the Dominican Republic suggested as unnecessary is unavoidable.[211] This is one of Honduras's many contradictions according to the Dominican Republic. The Dominican Republic said it would be identifying others in the course of this oral submission.

4.318 Before discussing the Dominican Republic's defence under Article XX of the GATT, the Dominican Republic would briefly mention some other arguments that Honduras has made with respect to the stamp requirement. Honduras did not include, in its request for the establishment of a Panel, the difference in the moment at which the domestic producer and the importer pay the Selective Consumption Tax.[212] The additional steps that the importer must go through before being able to sell the imported product on the local market are inevitable (except, perhaps, in cases where there is a perfect customs union). For example, the importer will always have to complete import forms and fulfil certain requirements which obviously do not apply to the domestic product. Consequently, Honduras's argument that cigarette importers are disadvantaged by the requirement that stamps be affixed in the presence of inspectors is without merit.[213] As regards additional costs, Honduras has ignored the fact that affixing stamps during the production process also has its cost for the domestic producer.

4.319 In its effort to rebut the Dominican Republic's defence under Article XX(d) of the GATT, Honduras errs in its appreciation of the facts and contradicts itself. Honduras claims that the Dominican Republic failed to identify the tax laws in respect of which compliance is secured by the stamp requirement. It also argues that these laws are inconsistent with the GATT.

4.320 Regarding the first of these claims, Honduras contradicts itself once again: in paragraph 42 of its second written submission, it states that the Dominican Republic has not specified which laws the stamp requirement secures compliance with. Two paragraphs later, Honduras cites the reply given by the Dominican Republic to questions of the Panel, namely that the stamp requirement guarantees the payment of the Selective Consumption Tax, the tax on the transfer of goods and services (ITBIS) and the income tax.[214] In its replies, the Dominican Republic states that the ITBIS is established and collected in accordance with Articles 335 to 360 of the Dominican Republic Tax Code, and the

[208] Ibid., para. 12.
[209] Ibid., para. 13.
[210] Ibid., para. 21.
[211] Ibid., para. 23.
[212] Ibid., para. 14.
[213] Ibid., para. 17.
[214] Ibid., para. 44.

income tax in accordance with Articles 267 to 334 of the Dominican Republic Tax Code.[215] In its first written submission, the Dominican Republic pointed out that the Selective Consumption Tax is collected in accordance with Article 367 of the Tax Code as amended by Law 3-04 of 9 January 2004.[216] This was confirmed by a letter from the Director General of the DGII, submitted as Exhibit DR-2.[217]

4.321 Honduras's second argument is that the Dominican Republic's tax laws are contrary to the GATT.[218] Honduras refers in particular to the Selective Consumption Tax, and then goes on to repeat the same argument with respect to the bond requirement.[219] And yet, the Dominican Republic did demonstrate that the Selective Consumption Tax is GATT-consistent. The Selective Consumption Tax on imported and domestic cigarettes is a specific duty of RD$0.48 per cigarette, both in the case of the imported product and in the case of the domestic product. The tax base is provided for by Article 367(c) of the Tax Code, as amended by Law 3-04 of 9 January 2004. The specific amount is provided for by Article 375, paragraph V, of the Tax Code, as amended by Law 3-04. This was all mentioned by the Dominican Republic in its first written submission.[220] No further explanation is needed to demonstrate that the Selective Consumption Tax on cigarettes is not contrary to the national treatment obligation or any other obligation under the GATT. The Dominican Republic has established a *prima facie* case of consistency of its tax laws with the GATT.

4.322 Honduras nevertheless insists on trying to demonstrate that the Selective Consumption Tax, *before* its amendment by Law 3-04, is contrary to the GATT.[221] The Dominican Republic stresses that the versions of Articles 367 and 375 of the Tax Code on which Honduras is basing its argument have ceased to exist, and that it is unnecessary, and indeed a legal error, to refer to a version of a law that is no longer in effect.

4.323 Also in connection with the Dominican Republic's defence of its measures under Article XX(d) of the GATT, Honduras argues that the measures are not "necessary" within the meaning of paragraph (d) as interpreted by the Appellate Body. According to Honduras, for a measure to be necessary, it must be indispensable, and the Dominican Republic's measures are not indispensable to the enforcement of its tax laws.[222] Honduras cites paragraph 161 of the Appellate Body Report in *Korea – Various Measures on Beef*, in which the Appellate Body speaks of "indispensable". However, what Honduras fails to mention is what the Appellate Body states three paragraphs further on:

> "In sum, determination of whether a measure, which is not 'indispensable', may nevertheless be 'necessary' within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports".[223]

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[215] Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, replies to questions 70 and 78, paras. 78 and 96.

[216] First written submission of the Dominican Republic, 13 April 2004, para. 19 and footnotes 11 and 12.

[217] Certification by the Director General of Internal Taxes, dated 5 April 2004, submitted as Exhibit DR-2.

[218] Second written submission of Honduras, 10 June 2004, para. 42.

[219] Ibid., para. 100.

[220] First written submission of the Dominican Republic, 13 April 2004, footnote 11.

[221] Second written submission of Honduras, 10 June 2004, para. 45.

[222] Ibid., paras. 50, 51 and 117.

[223] Appellate Body Report, *Korea – Various Measures on Beef*, para. 164.

4.324 The Dominican Republic has demonstrated how the stamp requirement contributes to securing the desired level of enforcement of its tax laws. Since the introduction of the stamp requirement, there has been practically no cigarette smuggling. On the other hand, in the case of alcoholic beverages and matches, for which the stamp requirement is different, smuggling continues to pose a problem. Nor is there any question of the importance of tax laws and the payment of taxes, especially in a country with little resources like the Dominican Republic. Finally, the Dominican Republic has demonstrated that the impact of the stamp requirement on imports of cigarettes is almost nil. This can clearly be seen from the growth rate in cigarette imports from Honduras, which reached more than 4,800 per cent during the first quarter of this year as compared to the same period last year.[224] Thus, following the Appellate Body's interpretation of the word "necessary" in Article XX(d), the Dominican Republic can only conclude that the stamp requirement is a measure that is necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of the Agreement.

4.325 Honduras asks how the stamp requirement can secure compliance with tax obligations when there are other products that are subject to the Selective Consumption Tax to which the stamp requirement does not apply.[225] The need for the stamp requirement in respect of cigarettes must be assessed in relation to that product alone. It is determined by the particular nature of the product. The stamp requirement is applied to the sale of cigarettes, both imported and domestically produced, because cigarette smuggling is so common and poses such a serious problem. The Dominican Republic knows of no cases of Jacuzzi or jet ski smuggling, or if such smuggling has taken place, it certainly does not represent 25 to 30 thousand million dollars (i.e. 25 to 30 billion dollars) in losses for governments across the world. The evidence shows that cigarette smuggling is a serious problem, whose repercussions at the global level are so serious that they have led to the negotiation of declarations and international treaties under the auspices of such international governmental organizations as the World Health Organization, and non-governmental organizations.[226]

4.326 Honduras contends that there are alternatives to the requirement to affix a stamp in the presence of the Dominican Republic's internal tax inspectors. It insists, for example, that one alternative would be to allow foreign cigarette producers to affix the stamps abroad.[227] However, the Dominican Republic has provided clear evidence, which has not been refuted by Honduras, that when the stamp is allowed to be affixed abroad, without the supervision of inspectors from the Directorate General of Internal Taxes, smuggling and forgery of stamps occur.[228] This is precisely why the Dominican Republic is considering imposing the same stamp requirement on alcoholic beverages. Another alternative measure suggested by Honduras is allowing the stamp to be affixed abroad and then checking at the border that the packets are stamped and that the stamps are authentic.[229] This would require increased resources in the Directorate General of Internal Taxes, since in addition to inspecting each shipment of packets, it would have to open each one of the cigarette boxes and cartons in order to ensure that the stamps had not been forged, a process that would delay the arrival on the market of the imported product and would possibly entail higher costs for importers.

4.327 With respect to the *chapeau* of Article XX, Honduras argues that the stamp requirement is an arbitrary and unjustifiable discrimination.[230] Firstly, Honduras does not deny that it is not just any type of discrimination that the *chapeau* of Article XX prohibits, but only discrimination that is

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[224] Oral statement by the Dominican Republic before the Panel, 11 May 2004, para. 41. See also Statistics of imports of cigarettes, *supra* note 83.

[225] Second written submission of Honduras, 10 June 2004, para. 52.

[226] *See* "The FCTC and Tobacco Smuggling", *supra* note 23. *See also* WHO Framework Convention on Tobacco Control, *supra* note 47.

[227] Second written submission of Honduras, 10 June 2004, para. 58.

[228] See information submitted by the Dominican Republic as Exhibits DR-8 and DR-29.

[229] Second written submission of Honduras, 10 June 2004, para. 58.

[230] Ibid., paras. 68-72.

arbitrary and unjustifiable, between countries where the same conditions prevail.[231] Secondly, Honduras's entire argument concerning the *chapeau* is based on the incorrect assumption that the purchase of the stamp by the domestic producer is credited towards payment of the Selective Consumption Tax.[232] Honduras bases this assumption on an internal document of one of the domestic cigarette producers in the Dominican Republic which was presented as Exhibit DR-3 merely to illustrate the procedure followed by domestic producers in requesting and obtaining the stamps. The contents of that document do not implicate the Government of the Dominican Republic. In any case, paragraph III of Article 37 of Decree 79-03 expressly stipulates that stamp payments shall not be credited to the payment of the Selective Consumption Tax. This is confirmed by the certification from the Directorate General of Internal Taxes that the Dominican Republic circulated as Exhibit DR-50. Thus, since the payment of stamps is not an advance on the payment of the Selective Consumption Tax, the only arguments put forward by Honduras with respect to the consistency of the Dominican Republic's measures with the *chapeau* of Article XX are discredited.

4.328 In conclusion, the Dominican Republic has shown that the stamp requirement is not contrary to Article III:4 of the GATT, and even if it were, it would be justified under Article XX(d) of the GATT.

3. Bond requirement for domestic and imported cigarettes

4.329 Honduras argues that should the Panel uphold the Dominican Republic's right to require bonds to be posted for the sale of imported cigarettes, it will be opening the door for any member to impose bond requirements that would make imports prohibitive.[233] In addition to being an exaggeration, this argument is contradicted by Honduras's other arguments concerning the bond. Honduras never claimed that the bond was a prohibition under Article XI of the GATT. It merely claimed, without any explanation or substantiation, that the bond was a restriction. However, the Dominican Republic demonstrated that the bond was neither a restriction, nor a disincentive, and still less a prohibitive measure. This is best illustrated by the fact that *BAT República Dominicana* imported for more than two years without posting the bond. It was only some four days after the Dominican Republic delegation informed the Panel that *BAT República Dominicana* had not paid the bond, that the company hastily turned to the authorities to rectify its illegal situation. This shows that the imports are not subjected to any such restriction or prior condition. Furthermore, the significant increase in cigarette imports from Honduras over the past year and a half shows that there is no restriction or prohibition.

4.330 It is also important to remember that in this case, Honduras recognized that the bond applies in exactly the same way to domestic cigarettes and imported cigarettes. Indeed, this is precisely Honduras's complaint: that they are given identical treatment. If the law does not discriminate, in letter, as to the origin of the product, the discrimination that Honduras claims exists in this case must be a *de facto* discrimination. If it is a *de facto* discrimination, Honduras must demonstrate how, in this particular case, and not in hypothetical, alleged or invented cases, there is discrimination. However, in spite of its references to the differences in the moment at which the importer and domestic producer pay their respective taxes, Honduras has not been able to explain how a bond which must be posted both for the domestic product and for the imported product, and which does not in any way affect the sale, supply, distribution, transport, use or purchase of the imported product, can be restrictive. If it is not restrictive, then there is no threat that it will become a prohibitive requirement.

4.331 In its second written submission, Honduras focuses its efforts with respect to the bond on explaining why the bond does not reflect one of the situations described in Note *Ad* Article III of the

[231] First written submission of the Dominican Republic, 13 April 2004, para. 125.
[232] Second written submission of Honduras, 10 June 2004, paras. 68-72.
[233] Ibid., para. 5.

GATT. It asserts that the said Note does not apply because the bond requirement does not "affect" the internal sale, offering for sale, purchase, transport, distribution or use of products.[234] This is a matter on which the Dominican Republic and Honduras agree. The bond requirement does not affect the sale, offer for sale, purchase, transport, distribution or use of products on the domestic market. Consequently, Article III does not apply to the bond. However, contrary to what was said earlier, Honduras then claims that the bond is contrary to Article III:4.

4.332 Honduras would appear to think that it is enough to argue that the bond requirement does not match any of the suppositions of Note *Ad* Article III in order to demonstrate that the bond falls within the scope of Article XI. This is an incorrect interpretation of Article XI, and moreover, it does not comply with the general rule of burden of proof so often mentioned by Honduras in its second written submission. It is Honduras that bears the burden of proof with respect to the claim that the bond is contrary to Article XI. And yet, in its legal argument, which is barely two paragraphs long, Honduras fails to demonstrate how a measure that is not even required as a prior condition or upon importation can constitute an import prohibition or restriction. Its legal argument boils down to two paragraphs in its first written submission.[235] In its latest submission, the legal argument consists of one sentence. One sentence which merely claims, without substantiation, that the bond operates as a restriction within the meaning of Article XI.[236]

4.333 This is one of the many occasions on which Honduras fails to respond to the arguments and documentary evidence submitted by the Dominican Republic. Exhibit DR-43 submitted by the Dominican Republic shows that imported cigarettes enter its territory without the Directorate General of Customs even noting whether the importer has posted the bond. Exhibit DR-35 shows that during the period of over two years in which *BAT* has been importing cigarettes into the Dominican Republic, it has never posted the bond. On the basis of these facts, Honduras cannot seriously argue that the bond is a restriction on importation and therefore contrary to Article XI of the GATT.

4.334 At the same time, Honduras claims that the bond does not secure compliance with any tax, since the Selective Consumption Tax is paid upon importation.[237] And yet, the Dominican Republic demonstrated through Exhibit DR-28 that the payment made upon importation frequently has to be adjusted, and as a result, there is a shortfall. In such cases, the bond secures the payment of the tax. Honduras responded to this evidence by stating, without substantiation, that the reassessment of taxes does not include the Selective Consumption Tax. It repeated this same argument in its second written submission, as regards both the stamp requirement and the bond requirement.[238] In its reply to Honduras's written question, the Dominican Republic explained that the reassessments did include the shortfall in the Selective Consumption Tax. The letters sent by the Director General of Customs to importers, provided as Exhibit DR-28, do not exclude the Selective Consumption Tax. Honduras has not proved the contrary, although it is up to Honduras to do so, since it is Honduras that claims that the reassessment in no case includes the Selective Consumption Tax.

4.335 Another issue in respect of which Honduras has not offered a response or explanation is the fact demonstrated by the Dominican Republic through a declaration by the Director General of the DGII that, in practice, the bond secures the payment of other taxes and not only the Selective Consumption Tax.[239] Honduras simply repeats that the provision establishing the bond requirement for domestic producers is contained in the chapter of the Tax Code of the Dominican Republic in

[234] Ibid., para. 79. See also Replies of Honduras to the questions addressed by the Panel, 27 May 2004, reply to question No. 35, para. 30.
[235] First written submission of Honduras, 16 March 2004, paras. 115-116.
[236] Second written submission of Honduras, 10 June 2004, para. 82.
[237] Ibid., para. 86.
[238] Ibid., paras. 89, 115.
[239] Letter from the Director General of Internal Taxes, *supra* note 39.

which the Selective Consumption Tax is established.[240] This is not a response to what is the actual practice of the authorities of the Dominican Republic. That practice qualifies the measure in the same way that the letter of the law qualifies the measure. The ruling of the Panel in the *US - Section 301 Trade Act* confirms this.[241]

4.336 In that case, the practice and statements of the authorities of the United States Government were sufficient to reverse the conclusion that the letter of sections 301-310 of the United States Trade Act was contrary to the provisions of the Dispute Settlement Understanding. Likewise, in this case, the practice of the Dominican Government authorities should be taken into account. Exhibit DR-12 establishes that the practice of the authorities of the Dominican Republic is to use the bond established under Article 376 of the Tax Code and Article 14 of Decree 79-03 as a guarantee of compliance with other taxes.

4.337 Another of Honduras's arguments with respect to the Dominican Republic's defence under Article XX(d) of the GATT is that the Dominican Republic failed to specify all of the obligations in respect of which compliance is secured by the bond.[242] This is yet another of Honduras's contradictions. On the one hand, Honduras argues that the bond does not secure compliance with any obligation, and on the other hand, it argues that it secures compliance with more than one obligation.[243] Moreover, Honduras speculates, without any grounds, that these other unspecified obligations may be contrary to the GATT.

4.338 When it comes to demonstrating that the obligations in respect of which compliance is secured by the bond are contrary to the GATT, Honduras once again relies on a version of Article 367(b) of the Tax Code that no longer exists.[244] The Dominican Republic has shown that the Selective Consumption Tax under the current law cannot under any circumstance be considered contrary to the GATT. It is now up to Honduras to provide evidence to the contrary, and it has not done so. Rather, Honduras persists in asking the Panel to examine a law and a measure that no longer exist.

4.339 With respect to the bond, Honduras repeats what it said with respect to the stamp requirement. It asks how the bond can secure compliance with tax obligations if there are other products that are subject to the Selective Consumption Tax but not to the same bond requirement.[245] The Dominican Republic reverts to the reply it gave to the same argument by Honduras with respect to the stamp requirement. No other product subject to the Selective Consumption Tax is as likely to be smuggled as cigarettes and alcoholic beverages.

4.340 Honduras recognizes the Dominican Republic's right to establish its desired level of enforcement. However, it maintains that according to the Appellate Body, the level of enforcement must be the same for domestic products as for imported products. It argues that in the case of the bond for cigarettes in the Dominican Republic, the level is not the same. The Dominican Republic agrees. The level of enforcement is more strict for domestically produced cigarettes. In its reply to questions 80 and 81 of the Panel, the Dominican Republic explains how in the case of domestically produced cigarettes, the bond must be posted as a pre-requisite to the marketing of the product.[246] In the case of imported cigarettes, on the other hand, the bond is not a prerequisite to importation. If this were not so, it would mean that *BAT República Dominicana* has been operating illegally and in

[240] Second written submission of Honduras, 10 June 2004, para. 111.
[241] Panel Report, *US – Section 301 Trade Act*.
[242] Second written submission of Honduras, 10 June 2004, para. 105.
[243] Ibid., paras. 86 and 105.
[244] Ibid., para. 124.
[245] Ibid., para. 112.
[246] Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, reply to questions 80 and 81, paras. 98 and 99.

violation of the law of the Dominican Republic over the past few years, since although it has been selling cigarettes imported from Honduras and other countries, it has not yet paid the bond.[247]

4.341 Honduras does not provide any argument with respect to the consistency of the bond requirement with the *chapeau* of Article XX.[248] Consequently, the *prima facie* case for consistency made by the Dominican Republic in its written submission has not been refuted.

4. Interpretation of Article III:4 of the GATT

4.342 Before responding to Honduras's arguments regarding the other measures, the Dominican Republic would like to refer to Honduras's interpretation of Article III:4 of the GATT in relation to the stamp and bond requirements.

4.343 The Dominican Republic has explained how it thinks these measures should be examined from a legal point of view under Article III. Honduras points out that Article III:4 does not require a separate inquiry of whether the measures are applied so as to afford protection to the domestic industry.[249] The Dominican Republic does not challenge this conclusion. On the contrary, it recognises what the Appellate Body has stated with respect to a separate inquiry of this element under paragraph 4. The Dominican Republic is not asking the Panel to conduct this inquiry separately. What the Dominican Republic is asking of the Panel is to conduct a complete inquiry under paragraph 4, which requires it to determine whether as a result of the stamp and bond requirements imported cigarettes are being accorded less favourable treatment than that accorded to like domestic products. According to the Appellate Body, a measure accords less favourable treatment to imported products when it modifies the conditions of competition to the detriment of imported products.[250] The definition of the word "detriment" includes the notion of damage or loss. Consequently, it must be determined whether the measure modifies the conditions of competition, and in addition, it must be determined whether this modification causes damage or loss to imports.

4.344 The effect that the measure has on trade in the product in question is also relevant. It can stand as evidence that the differences in the conditions of competition are not detrimental to the imported product, and hence do not result in less favourable treatment. The Appellate Body also pointed out that the determination of whether there was less favourable treatment under Article III:4 must be grounded in close scrutiny of the "fundamental thrust and effect of the measure itself".[251] It is pertinent in this case that the effect of the stamp and bond requirements on imports of cigarettes from Honduras was practically nil.

4.345 Honduras's arguments in its second written submission do not respond to the arguments put forward by the Dominican Republic on the basis of a correct interpretation of Article III:4.

5. Dead measures

4.346 The Dominican Republic turned to what it called the "dead measures". Honduras insists that the Panel has the jurisdiction to examine measures that have already been abolished. Throughout these proceedings it has persisted in trying to demonstrate that the law abolishing the measures which Honduras is challenging entered into force six days after the Panel was established. The Dominican Republic has explained that the law was signed on the day that the Panel was established, and that even if it entered into force six days later, this was not sufficient reason for the Panel to rule and make recommendations concerning measures that had already been abolished.

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[247] Certification by the Directorate General of Internal Taxes, *supra* note 120.
[248] Second written submission of Honduras, 10 June 2004, para. 122.
[249] Ibid., para. 30.
[250] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.
[251] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 215.

4.347 The Dominican Republic has submitted arguments, cited precedent, and pointed to various provisions explaining why the Panel should not issue rulings with respect to measures that have been abolished. The Appellate Body itself pointed out, in similar circumstances, that to issue recommendations with respect to measures that had already been abolished was a legal error.[252]

4.348 The main reason given by Honduras to justify the Panel's examining measures that have already been abolished and issuing a recommendation is that failure to do so would mean that WTO Members could evade their obligations by abolishing measures when they were challenged and reinstating them once the Panel established to examine them had issued its ruling. In essence, what Honduras is saying is that the Dominican Republic appears to be acting in bad faith and intends to reinstate the measures. Apart from being untrue, Honduras's presumption of bad faith is contrary to the principles of international law and to Appellate Body precedent. As the Dominican Republic stated in its second written submission, according to the Appellate Body in *Chile – Alcoholic Beverages*, "Members of the WTO should not be assumed, in any way, to have *continued* previous protection or discrimination through the adoption of a new measure".[253]

4.349 At the same time, according to the Panel in *Argentina – Textiles and Apparel*, "in the absence of clear evidence to the contrary, we cannot assume that Argentina will withdraw the safeguard measure and reintroduce the specific duties measure in an attempt to evade panel consideration of its measures. We must assume that WTO Members will perform their treaty obligations in good faith, as they are required to do by the WTO Agreement and by international law".[254] Honduras has not presented any evidence that the Dominican Republic intends to reintroduce the measure. All that Honduras has done is to submit press Articles expressing the discontent of certain producers of alcoholic beverages with the new measure. Honduras cannot expect this Panel to presume that the Government of the Dominican Republic has the intention of reintroducing the measure it has just withdrawn simply because certain productive sectors are not content with the new measure.

4.350 Consequently, on the basis of the arguments set forth in its second written submission, the Dominican Republic requests the Panel to reject Honduras's complaint against the dead measures.

6. Transitional surcharge and foreign exchange fee

4.351 In the opinion of the Dominican Republic, Honduras attempts to unduly expand the terms of reference of this Panel to include all products subject to the Selective Consumption Tax in its complaint against the transitional surcharge. In its first written submission, Honduras clearly states that it considers the transitional surcharge to be contrary to paragraph 1(b) of Article II of the GATT *as the surcharge applies to cigarettes*. It does not mention any other product. It was not until the first meeting of the Panel that Honduras suddenly included all of the products in the complaint, taking the idea from the written submission of certain third parties. By that time, the Dominican Republic had already used two of its opportunities to present its defence before the Panel. By including other products and thus expanding the coverage of its complaint, Honduras interfered with the Dominican Republic's right of defence and due process.

4.352 As regards substance, the Dominican Republic has already explained its position. By submitting an addition to its Schedule of Concessions on 14 September 1994, it bound other duties or charges at 30 per cent *ad valorem* in the case of cigarettes. This addition to its Schedule was submitted within the six months allowed under paragraph 7 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994. Neither Honduras nor any other WTO Member objected to this binding. Honduras is nevertheless now claiming that in April 1994, the Dominican Republic did not

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[252] Appellate Body Report, *US – Certain EC Products*, para. 81. Second written submission of the Dominican Republic, 10 June 2004, para. 6.

[253] Appellate Body Report, *Chile – Alcoholic Beverages*, para. 74 (italics in original).

[254] Panel Report, *Argentina – Textiles and Apparel*, para. 6.14 (footnote removed).

impose the transitional surcharge.[255] However, as the Dominican Republic has explained, it was up to Honduras to submit that objection within three years following the day on which the Dominican Republic recorded that level of other duties and charges, pursuant to paragraph 4 of the Understanding. In other words, Honduras had until the end of 1997 to argue what it is belatedly claiming now.

4.353 The negotiating history of the Understanding leaves no room for doubt: it belies Honduras's argument. According to that history, set forth in paragraph 84 of the Dominican Republic's second written submission, the level, or indeed the existence, of another duty or charge is considered established as recorded by the Member, unless other Members challenge that binding within a given period of time. After that time, the binding is definitive and can no longer be challenged. According to the negotiating history, this was done in order to guarantee legal security.

4.354 Rather than acknowledging the meaning of the lapse of right under paragraph 4 of the Understanding, Honduras misrepresents the Dominican Republic's argument as suggesting that the lapse of the right to challenge the binding of other duties or charges derives from the approval of the schedules of concessions submitted by each Member to the Secretariat.[256] This is not a faithful reflection of the Dominican Republic's argument. The lapse of the right to challenge the binding of other duties or charges derives from paragraph 4 of the Understanding, and not only from the failure to object to the lists annexed to the accession protocol within a period of 30 days following their submission.

4.355 Honduras also argues that the lapse within a period of three years does not apply because paragraph 4 of the Understanding only provides for situations in which a Member records a level of other duties or charges different from that which existed in April 1994.[257] However, the second sentence of paragraph 4 establishes the lapse in cases in which the Member records a duty or charge that did not exist at the time of binding. That sentence reads as follows:

> "It will be open to any Member to challenge the existence of an 'other duty or charge', on the ground that no such 'other duty or charge' existed at the time of the original binding of the item in question, (...) for a period of three years after the date of entry into force of the WTO Agreement..."

4.356 This is precisely the situation that Honduras claims exists in this case. Consequently, Honduras's claim that the lapse in a period of three years applies only to differences in the levels of other duties or charges and not to the actual existence of that other duty or charge is untrue.

4.357 Since Honduras provides the same arguments against the transitional surcharge and the foreign exchange fee, the Dominican Republic will not repeat the arguments by which it responded to and rejected Honduras's claims. It simply refers to what it had already said with respect to these measures.

4.358 Honduras has also failed to provide any new arguments or documentary evidence regarding the Dominican Republic's defence of the foreign exchange fee under Article XV:9 of the GATT. It merely cites the documentary evidence already presented and repeats its previous arguments. Consequently, the Dominican Republic reiterates its defence and arguments under Article XV in refutation of what Honduras has stated.

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[255] Second written submission of Honduras, 10 June 2004, para. 163.
[256] Ibid., para. 174.
[257] Ibid., para. 30.

H. ORAL STATEMENT OF HONDURAS AT THE SECOND SUBSTANTIVE MEETING OF THE PANEL

4.359 Honduras took this opportunity to focus on the following factors: its claims, its arguments and its evidence, in order to demonstrate that the Dominican Republic is breaching its WTO obligations. It also addressed the points that the Dominican Republic had made in its second submission.

4.360 First, Honduras claims that less favourable treatment for imported products is accorded as a result of the requirement that stamps be affixed in the territory of the Dominican Republic, in light of the privilege granted to domestic producers to affix the stamps in the course of their production process, a privilege that is not similarly accorded to foreign producers. It is important to emphasize that Honduras is not challenging the stamp requirement in and of itself as a fiscal measure. Honduras is challenging the unequal and discriminatory treatment that results from the requirement for importers and for domestic producers to affix the tax stamps at different points in the commercial process. In order to provide equal treatment to both importers and domestic producers, there are two options. The first is to allow the stamp to be affixed in the course of the production process for both. The second is to permit the affixation after the production process for both. It is, of course, up to an individual Member to determine which of these two alternatives would eliminate the discriminatory elements of the measure. Honduras has been consistently of the view that the first option would result in fewer costs than the second option and would also be less trade-restrictive.

4.361 The less favourable treatment accorded to imported cigarettes is inconsistent with the Dominican Republic's obligations under Article III:4 of the GATT. It is undisputed that imported and domestic cigarettes are like products. Therefore, the only issue is whether the Dominican Republic accords less favourable treatment to imported cigarettes. In its second submission, the Dominican Republic reiterates that "[l]ess favourable treatment, according to the Appellate Body, consists of the importing member modifying the conditions of competition in its market 'to the detriment of imported products' ".[258]

4.362 Using the Dominican Republic's own definition of "detriment", that is, "loss sustained by or damage done to a person or thing" or "a cause of loss or damage"[259], Honduras has demonstrated that there is detriment to imported products. Honduras has sustained losses because of the additional costs and additional production steps associated with the affixation of stamps on imported cigarettes. These additional costs and additional production steps are not incurred and are not undertaken in respect of domestic cigarettes. To demonstrate these differences in costs and production steps, Honduras has submitted Exhibits HOND-14, 15, 16, 23, 24, 25, 26(a), 26(b) and 26(c). Until now, the Dominican Republic has not disputed these differences. Honduras also notes that damage in a different context is done to imported cigarettes. As a result of the stamp being fixed manually over the cellophane wrapping, the cigarette packets are less visually appealing to consumers than domestic cigarettes. To demonstrate such damage, Honduras has submitted to the Panel Exhibits 25(a) to (n) and 27(a) to (n).

4.363 The Dominican Republic has implicitly acknowledged that there are differences in the conditions of competition between imported and domestic products in respect of compliance with the tax stamp requirement.[260] The point of contention between the Dominican Republic and Honduras is whether the modification of the conditions of competition is the result of the "inherent differences between imported and domestic products". The Dominican Republic does not explain clearly what it considers to be "inherent differences". As an example, the Dominican Republic refers to transportation costs and states: "There are additional costs that are inevitably linked to the condition of an imported product. The most obvious example of one such additional cost is the cost of

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[258] Second written submission of the Dominican Republic, 10 June 2004, para. 46, citing the Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

[259] Ibid., para. 47, quoting *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. I, p. 652.

[260] First written submission of the Dominican Republic, 13 April 2004, para. 39. Second written submission of the Dominican Republic, 10 June 2004, para. 50.

transportation, which raises a product's delivered price and consequently, the final price of the imported product".[261] Honduras wished to note that transportation costs are not "inherent" in the nature of imported products. It must be noted that transportation costs will also be incurred for the shipment within a country and sometimes the domestic transportation costs may be higher than the transportation costs for imported products. For example, an imported product shipped to Geneva from Ferney-Voltaire in neighbouring France would have lower transportation costs than a product shipped to Geneva from Zurich. Therefore, it is not correct to say that transportation costs are inherent costs in the nature of imported products.

4.364 In addition, the costs arising from compliance with the stamp requirement can hardly be considered as costs arising from the "inherent" differences between imported and domestic cigarettes. Instead, they are costs which arise from the different points in time at which the stamp must be affixed on imported cigarettes as compared to domestic cigarettes. They do not arise as a result of the "inherent differences" between imported and domestic goods. The costs are directly caused by a measure imposed by the Government of the Dominican Republic.

4.365 Moreover, under Article III:4, once a product has cleared customs, it should be subject to the same laws and requirements as a domestic product and should be treated no less favourably than the like domestic product. The issue of whether there are "inherent differences between imported and domestic products" is, therefore, irrelevant under Article III:4.

4.366 In its second submission, the Dominican Republic reiterates that Honduras has not established that the measure in question "has a protective application – i.e. that it affords protection to domestic producers".[262] Honduras rebutted this argument in detail in its oral statement at the first hearing and in its second submission.[263] Honduras emphasizes that the Appellate Body has sharply rejected the approach suggested by the Dominican Republic. It ruled that "Article III:4 does not specifically refer to Article III:1. Therefore, a determination of whether there has been a violation of Article III:4 does not require a separate consideration of whether a measure 'afford[s] protection to domestic production'".[264]

4.367 In its second submission, the Dominican Republic reiterates that because the volume of cigarette imports has increased, then "the stamp requirement has had no, or at most negligible, effect on imports and therefore has not been detrimental to the imported product".[265] Again, Honduras has rebutted this argument in detail. The Appellate Body has also specifically addressed this issue. It stated: "…it is irrelevant that 'the trade effects' of the tax differential between imported and domestic products, as reflected in the volume of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products".[266] This reasoning applies in this case.

4.368 In any event, even though the actual trade volumes are not relevant for the Panel to make a finding of inconsistency, Honduras notes that the Dominican Republic has presented information in its Exhibits that is inconsistent or contradictory. Honduras has presented in its Answers to the Panel's Questions 1 and 2 evidence that total cigarette imports to the Dominican Republic represent less than 4 per cent of the total domestic cigarette market. Exhibit-DR-32 presents an even lower estimate of the market share of imported products: 0.4 per cent in 2002; 0.8 per cent in 2003 and 1.1 per cent in 2004. Yet, in Exhibit DR-31, the Dominican Republic presents information that the percentage of

[261] First written submission of the Dominican Republic, 13 April 2004, para. 39.
[262] Second written submission of the Dominican Republic, 10 June 2004, para. 45.
[263] Oral statement of Honduras at the First Meeting of the Panel, para. 64-65. Second written submission of Honduras, 10 June 2004, paras. 30-34.
[264] Appellate Body Report, *EC – Bananas III*, para. 216.
[265] Second written submission of the Dominican Republic, 10 June 2004, para. 49.
[266] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 16.

total imports is 1.5 per cent in 2001, 23.7 per cent in 2002 and 11.9 per cent in 2003. The information presented in these two exhibits of the Dominican Republic is inconsistent and contradictory.

4.369 The Dominican Republic has also contradicted itself on the issue of the effectiveness of the tax stamp requirement in the prevention of smuggling. In paragraph 60 of its second submission, the Dominican Republic states that this effectiveness is "evidenced by the lack of any known instances of cigarette smuggling in the Dominican Republic to date". However, in paragraph 105 of its first submission, the Dominican Republic stated, "[t]here are still documented cases of smuggling of cigarettes for retail in the Dominican Republic". It is not clear which statement of the Dominican Republic is correct.

4.370 Honduras notes that the Dominican Republic devoted a great deal of its first submission to the important role the stamp requirement plays in the prevention of smuggling in the context of the WHO Framework Convention. Honduras considers this Convention to be laudable and as a matter of fact, it has signed it on 18 June 2004. Honduras observes that despite the extensive references to the objectives of the Framework Convention in attempting to justify its discriminatory requirements, the Dominican Republic has not even signed the Convention as of 28 June 2004. The deadline for signature has now passed. In any event, Honduras notes that the entry into force of this Convention is not a relevant factor in the Panel's assessment of the WTO-consistency of the measures at issue.

4.371 Honduras recalls its detailed arguments rebutting this justification as set out in its second submission in paragraphs 35 to 72. Honduras has submitted evidence to the Panel which demonstrates that there are other less trade-restrictive measures available to the Dominican Republic which would achieve the same objective. (See Exhibit HOND-29.)

4.372 Contrary to the Dominican Republic's position, the requirement to affix the tax stamp at different points in time for domestic and imported cigarettes does not secure compliance with the Dominican Republic's tax code. The Dominican Republic, by defending a procedure designed to give less favourable treatment to imports, has forgotten the objective of the stamp requirement. It is Honduras's view that, by allowing the affixation of the stamp at the factory in Honduras below the cellophane and as part of the manufacturing process, having the Dominican Republic oversee the required administrative controls on the number of stamps given to the importer, and having the Dominican Republic tax inspectors inspect the shipment upon arrival at the Dominican Republic's Customs, the original objective of the stamp tax would be better achieved and with fewer costs to all parties concerned -including the government of the Dominican Republic- than it is now.

4.373 Turning to the bond requirement, Honduras disagrees with the Dominican Republic's recent assertion in its second submission that "[t]he bond requirement for domestic and imported cigarettes is neither a restriction or prohibition on the importation of cigarettes contrary to Article XI:1 of the GATT nor an internal measure that discriminates imported cigarettes contrary to Article III:4 of the GATT".[267] Honduras noted that the Dominican Republic initially subscribed to the fact that the GATT disciplines would be applicable to the bond requirement. In this regard, Honduras recalled the statement in the Dominican Republic's first submission that:

> "The fact that the bond is not enforced at the time or point of importation in the case of imported cigarettes is further evidence that the bond requirement is not a measure 'on the importation' of a product. It is, therefore, an internal measure within the scope of Article III:4, not Article XI:1."[268]

4.374 Honduras's view is that a measure that affects imports of a particular product must be covered under either Article XI or Article III. The bond requirement affects the imports of alcohol and tobacco

[267] Second written submission of the Dominican Republic, 10 June 2004, para. 20.
[268] First written submission of the Dominican Republic, 13 April 2004, para. 76.

products. Therefore, it must be subject to the disciplines of either Article XI or Article III. Honduras therefore maintains the argument that it has presented throughout these proceedings on this issue.

4.375 Honduras's principal claim is that the bond requirement is inconsistent with Article XI:1. In support of this claim, Honduras indicated in its Reply to Question 35 from the Panel, that "the bond requirement applies prior to the entry of both domestic and imported cigarettes in the domestic market". Therefore, for imported products, it is a condition that must be met before importation can take place. Thus, Article XI:1 applies, and not Article III. The Dominican Republic has argued that:

> "... Article 14 of Decree No. 79-03, which requires that the bond requirement under Article 376 of the Dominican Republic Tax Code be posted by importers of alcoholic beverages and tobacco products, does not state that the bond requirement is a condition for importation of such products. It provides simply that importers and domestic producers of cigarettes alike must provide the bond.
>
> Article 40 of Decree No. 79-03 requires that importers of cigarettes obtain an import license from the DGII. For that purpose, importers must meet a few objective and non-discretionary conditions. The posting of the bond required of importers by Article 14 of Decree No. 79-03 is not among those conditions." (footnote omitted.)

4.376 Article 14 of Decree 79-03 did introduce a bond requirement for importers of cigarettes. It specifically states "[t]his bond shall be posted with the Directorate General of Internal Taxes by both importers and domestic producers". Even though Article 14 does not expressly state that the bond requirement is a condition for importation, it does not mean that the bond is not a condition for importation. Article 14 refers to Article 376 of the Dominican Republic's Tax Code which provides:

> "No alcohol or tobacco product may be produced in the Dominican Republic unless the person wanting to manufacture the said products has previously registered and posted with the Tax Administration a bond intended to ensure that any tax obligation established under this Chapter is met."

4.377 Article 376 makes clear that the posting of the bond is a pre-condition for domestic producers of alcohol and tobacco products. It must be recalled that, under the current regulations, the bond is required identically for domestic producers and importers. The Dominican Republic does not disagree with this. The fact remains that importers of cigarettes are obliged to post a bond and, therefore, by implication the bond must also be a pre-condition for importers. If the bond is not a pre-condition, then what would be the consequence of an importer not posting the bond? The only plausible answer is that if an importer is requested to post the bond for certain products, and does not so comply, those products would not be allowed to enter the territory of the Dominican Republic. The fact the Dominican Republic has failed to enforce the bond requirement until 13 May 2004 does not contradict the fact that it is a requirement under the law, and therefore does not undermine Honduras's claim that the measure as such is WTO-inconsistent.

4.378 In its second submission, the Dominican Republic asserts that "Honduras has not presented any evidence that the bond requirement has any restrictive effect on the importation of cigarettes".[269] In response, Honduras refers to the consistent GATT and WTO jurisprudence on the irrelevance of trade effects in the determination that a measure violates Article XI:1. Thus, the GATT Panel in the case of *EEC – Oilseeds I* stated that:

> "… the CONTRACTING PARTIES have consistently interpreted the basic provisions of the General Agreement on restrictive trade measures as provisions establishing conditions of competition. Thus they decided that an import quota

[269] Second written submission of the Dominican Republic, 10 June 2004, para. 30.

> constitutes an import restriction within the meaning of Article XI:1 whether or not it actually impeded imports ..."[270]

4.379 In the context of its claim that the bond requirement falls under Article XI, Honduras stated in its reply to Question 35 addressed by the Panel that "… the requirement to post a bond does not affect 'the internal sale, offering for sale, purchase, transportation, distribution or use of products, an internal quantitative regulations requiring the mixture, processing or use of products in specified amount or proportions". Honduras noted that the Dominican Republic's argument that Article III:4 is not applicable to the bond requirement, attempts to make reference to this reply of Honduras as support. However, Honduras took the opportunity to note that this reply was provided to respond to the Panel's question on whether the measure fell under Article III or Article XI. It has been the consistent position of Honduras that the bond requirement falls under Article XI:1. Honduras has also made an "in the alternative" claim, that should the Panel find that the measure does not fall within Article XI:1, then it should assess the bond requirement under Article III:4. The Dominican Republic has therefore misunderstood the context in which Honduras's reply was given.

4.380 In conclusion, Honduras has established that the bond requirement is *prima facie* inconsistent with the Dominican Republic's obligations under Article XI:1, or, in the alternative, with Article III:4. The Dominican Republic has failed to rebut Honduras's claim. In addition, the Dominican Republic has attempted to justify its violation of its GATT obligations by seeking recourse to Article XX(d), but has failed to demonstrate that its measure is justified by that provision.

4.381 With respect to the Selective Consumption Tax, Honduras claims that the application of this tax as it applied on the date of request of the establishment of the Panel, and on the date of the establishment of this Panel, is inconsistent with Articles III:2, III:4, X:1, and X:3(a) of the GATT. The Dominican Republic has not rebutted the merits of these claims. Instead, the Dominican Republic contends that the Panel should dismiss Honduras's claims regarding the Selective Consumption Tax on procedural grounds. Honduras would address certain new arguments made by the Dominican Republic regarding this procedural argument and then briefly recall the arguments it made earlier on this point.

4.382 In its first submission, the Dominican Republic did not cite any legal authority supporting its contention that the claims should be dismissed.[271] Indeed, at the First Meeting of the Panel, the Dominican Republic conceded that the Selective Consumption Tax as challenged by Honduras is within the terms of reference of the Panel. In their oral statement, the Dominican Republic also asserted that the new Article 367 of the Tax Code, as amended by Law 03-04, is not within the terms of reference of this Panel.[272] Honduras agrees that Law 03-04 is not within the terms of reference of this Panel. Therefore, the measure at issue before the Panel is the Selective Consumption Tax as challenged by Honduras. The Panel is, therefore, obliged to make an objective assessment of the matter before it, including making findings and recommendations.

4.383 In its second submission, the Dominican Republic sought to base its contention on three broad grounds:

- Any recommendations to be made by the Panel regarding the Selective Consumption claims would "constitute legal error"[273]

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[270] GATT Panel Report, *EEC – Oilseeds I*, para. 150, referring to the GATT Panel report on *Japan – Leather II (US)*.

[271] First written submission of the Dominican Republic, 13 April 2004, paras. 15-25.

[272] Oral statement of the Dominican Republic at the First Meeting of the Panel, para. 6.

[273] Second written submission of the Dominican Republic, 10 June 2004, section II.A.2.

- An examination by the Panel of the Selective Consumption Tax claims would be "contrary to the principle of judicial economy"[274]

- An examination by the Panel of the Selective Consumption Tax claims is unwarranted because of two factual circumstances:

  - These measures do not have lingering effects[275], nor is there a danger of their reinstatement[276]

  - And the Selective Consumption Tax claims involve measures which were altered before the date of functioning of the Panel.[277]

4.384 Honduras is of the view that these arguments are without merit and will respond to each of these grounds in turn.

4.385 First, the Dominican Republic contends that recommendations by the Panel regarding the Selective Consumption Tax (as it stood on the date of establishment of the Panel) would constitute "legal error" on the basis of certain observations of the Appellate Body in the *US-Certain EC Products* case. The Appellate Body report in *US-Certain EC Products* does not stand for the proposition that a Panel cannot make findings in respect of measures that are no longer in existence. The Appellate Body merely stated that "[t]he Panel erred in recommending that the DSB request the United States to bring into conformity with its WTO obligations a measure which the Panel has found no longer exists".[278] In that case, there was a disagreement between the parties concerning the measures that were at issue in the terms of reference of the Panel.

4.386 In this case, there is agreement between the parties as to the measure at issue covered by the terms of reference. As noted above, the Dominican Republic conceded that the Selective Consumption Tax as challenged by Honduras is within the terms of reference of the Panel. Therefore, the Panel need not, and cannot, examine any replacement measure.

4.387 Indeed, Honduras submits that the Panel cannot examine the characteristics of any amendment that may have been implemented after the date of the establishment of the Panel as it would be outside of its terms of reference. The Panel cannot examine the provisions of Law 03-04 as it does not fall within the Panel's terms of reference.

4.388 Therefore, the Panel must restrict its examination to the Selective Consumption Tax as challenged by Honduras in the request for the establishment of the Panel and, as the Panel cannot take into account developments after its terms of reference were established, the Panel is duty-bound to make a recommendation on the Selective Consumption Tax as it existed at the time of the establishment of the Panel. As the Panel does not have the factual basis to find that the original Selective Consumption Tax is no longer in existence (because it cannot examine Law 03-04) it must make a finding on the measure before it. If it finds the measure to be WTO-inconsistent, it is obliged to make a recommendation to the Dominican Republic to bring its measures into conformity.

4.389 Second, the Dominican Republic contends that the Panel's findings on the Selective Consumption Tax claims would be contrary to the "principle of judicial economy". In *US – Lead and Bismuth II*, the Appellate Body categorically rejected an attempt by the United States to put forward a general principle that "…panels may not address any issues that need not be addressed in order to

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[274] Ibid., para. 7.
[275] Ibid., section II.A.3.
[276] Ibid., Section II.A.4.
[277] Ibid., Section II.A.5.
[278] Appellate Body Report, *US – Certain EC Products*, para. 81.

resolve the dispute between the parties".[279] The principle of judicial economy involves discretion to decline to rule on particular issues, but only if the resolution of those issues is not necessary to resolve the dispute. In this case, the dispute concerns the Selective Consumption Tax as it stood as of the time of the request for the establishment of the Panel, or as of the time of the Panel's establishment, at the latest. The Panel has a duty to resolve this dispute.

4.390 The cases cited by the Dominican Republic do not support its position on this point. In *Australia – Salmon*, the Appellate Body did not invalidate the Panel's findings because they were contrary to the "principle of judicial economy". Indeed, it did precisely the opposite; it found fault with the Panel for not making findings on matters within the terms of reference.[280] The Dominican Republic cites the Panel in *Chile – Price Band System* to the effect that "a panel is required to make the recommendation to bring a measure which it has found inconsistent into conformity *if* that measure is still in force. Conversely, when a Panel concludes that a measure *was* inconsistent with a covered agreement, the said recommendation cannot and should not be made".[281] Honduras notes that this finding of the Panel was not reviewed by or endorsed by the Appellate Body on appeal.

4.391 Third, the Dominican Republic contends that an examination by the Panel of the Selective Consumption Tax is unwarranted because of factual circumstances. The presence of "lingering effects" or a "danger of reintroduction" is not a prerequisite for the examination of measures which are terminated after the date of establishment of the Panel. These tests were not even considered by the Panels in *United States – Wool Shirts and Blouses*[282] and *Indonesia – Autos*[283], where findings were made in respect of measures terminated or modified in the course of the proceedings. In any case the Dominican Republic cannot assert that Honduras has not provided evidence regarding the possibility of reintroduction of the Selective Consumption Tax system as it stood on the date of establishment of this Panel. Honduras has presented 10 exhibits demonstrating this possibility.[284] The Dominican Republic has not responded to this evidence.

4.392 In a similar vein, the Dominican Republic relies on the fact that the Selective Consumption Tax claims involve measures that were revoked before the organizational meeting of the Panel. It fails to explain why the status of the measures at the time at which the Panel "started its adjudicative process"[285] should be the relevant standard. This assertion is directly contrary to consistent GATT/WTO jurisprudence to the effect that the relevant time to assess whether a measure is within the terms of reference is the time at which the Panel is established.[286] The Dominican Republic's assertion lacks any basis.

4.393 Moreover, the Dominican Republic elaborates on this flawed standard by stating"[t]here is no reason to believe that the precise moment when a Panel is established is the moment it begins its adjudication process".[287] At least one Panel has taken a different view. In *Argentina – Textiles and Apparel*, the Panel observed: "the Argentine measure under consideration was revoked before the Panel was established and its terms of reference set, i.e. before the Panel started its adjudicative process".[288]

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[279] Appellate Body Report, *US – Lead and Bismuth II*, para.71.
[280] Appellate Body Report, *Australia – Salmon*, paras. 225-226.
[281] Panel Report, *Chile – Price Band System*, para.7.112 (italics in original).
[282] Panel Report, *US – Wool Shirts and Blouses*.
[283] Panel Report, *Indonesia – Autos*.
[284] Information provided by Honduras as Exhibits HOND-40 to HOND-49.
[285] Second written submission of the Dominican Republic, 10 June 2004, para. 15.
[286] See e.g. Panel Report, *India – Autos*, para. 7.22; Panel Report, *Argentina – Textiles and Apparel*, para. 6.11; Panel Report, *US – Gasoline*, para. 6.19; Panel Report, *US –Wool Shirts and Blouses*, para. 6.2; Panel Report, *Canada – Wheat Exports and Grain Imports*, paras. 6.255, 6.256 and 6.258.
[287] Second written submission of the Dominican Republic, 10 June 2004, para. 15.
[288] Panel Report, *Argentina – Textiles and Apparel*, para. 6.13.

4.394 Honduras notes that in all the cases where a Panel chose not to examine a measure, the measure in question was terminated before the date of establishment of the Panel. That is not the situation in this case. In this case, the Selective Consumption Tax claims are within the terms of reference and this Panel is under a duty, deriving from Article 11 of the DSU, to assess those claims. In *Japan – Alcoholic Beverages II*, the Appellate Body held that a failure to address the full range of matters included in the terms of reference constituted an "error of law".[289] It has reiterated this principle in *Australia – Salmon*[290] and *Japan – Agricultural Products II*.[291]

4.395 Lastly, Honduras noted that the Dominican Republic requests an additional finding that the Selective Consumption Tax, as it stood at the date of the establishment of the Panel, does not result in any nullification and impairment of benefits to Honduras. Honduras noted that Article 3.8 of the DSU states the presumption of *prima facie* nullification or impairment of benefits in cases where there is an infringement of the obligations assumed under a covered agreement.

4.396 Turning to the Transitional Surcharge and the Foreign Exchange Fee, Honduras claims that the transitional surcharge and the foreign exchange fee constitute a charge imposed on or in connection with importation inconsistent with Article II:1(a) and (b) of the GATT.

4.397 Article II:1(b) must be construed in light of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994. Paragraph 1 of the Understanding provides that "the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision [Article II:1(b) of the GATT] shall be recorded in the Schedules of concessions annexed to GATT 1994 against the tariff item to which they apply…" Paragraph 2 of the Understanding clarifies that "the date as of which 'other duties or charges' are bound, for purposes of Article II of the GATT, shall be 15 April 1994".

4.398 Both parties agree that the transitional surcharge is an "other duty or charge" imposed on or in connection with importation within the meaning of the second sentence of Article II:1(b) of the GATT.

4.399 In addition, the Dominican Republic has acknowledged that "the transitional surcharge for economic stabilisation was introduced for the first time in June 2003" and that "it did not replace any previous similar or equivalent measure".[292] Furthermore, the Dominican Republic has likewise clarified that "[t]he only 'other duty or charge' in force on 15 April 1994 was the exchange fee …"[293], thus admitting that the transitional surcharge was not imposed on 15 April 1994.

4.400 With respect to the foreign exchange fee, it cannot be denied that it is a duty or charge. It is undisputed that the fee is imposed on imports, and therefore, it can properly be characterized as falling within "other duties or charges *of any kind* imposed on or in connection with … importation" (emphasis supplied) within the meaning of Article II:1(b), second sentence, of the GATT. Furthermore, both parties agree that it is currently imposed "… in excess of [the duties or charges] *imposed* on the date of [the GATT 1994]".

4.401 On the basis of the foregoing, the Panel should find that the transitional surcharge and the foreign exchange fee are inconsistent with Article II:1(b) of the GATT because they are "other duties or charges" within the meaning of Article II:1(b) of the GATT and are currently imposed "…in excess of [the duties or charges] imposed on the date of [the GATT 1994]".

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[289] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 26.
[290] Appellate Body Report, *Australia – Salmon*. paras. 224-226.
[291] Appellate Body Report, *Japan – Agricultural Products II*, paras. 111-112.
[292] Replies of the Dominican Republic to the questions addressed by the Panel, 27 May 2004, reply to question No. 47, para. 44.
[293] Ibid., reply to question No. 43, para. 40.

4.402 In its defence, the Dominican Republic has stated the following:

> "The Dominican Republic has already demonstrated, contrary to Honduras's assertions, that it did properly record the transitional surcharge and the foreign exchange fee as ODCs in its Schedule of Concessions on 14 September 1994, within the six-month period provided for by paragraph 7 of the Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994 (the "Understanding").* Honduras itself acknowledges that "no Member had notified objections to the Dominican Republic's list of 'other duties and charges' filed on 14 September 1994".* This recording must therefore be considered the properly recorded level of ODCs imposed by the Dominican Republic as of 15 April 1994. The Dominican Republic has also already shown that its transitional surcharge and foreign exchange fee are within the upper limit established by this recorded level of ODCs."[294] (footnotes omitted.)

4.403 Thus, the Dominican Republic argues that because it recorded (incorrectly in the view of Honduras) a certain specific level in its Schedule, it can levy any other duties or charges up to that level now. The Dominican Republic has agreed that the transitional surcharge did not even exist in 1994 and that the foreign exchange fee was only levied at a rate of 1.5 per cent in 1994. If this spurious line of argument is followed, there are several questions that would arise. The first question is: why would a Member record a duty or charge that did not even exist at the time or that existed at a significantly lower level than what it recorded? The second question is, as the Dominican Republic "uses up" 12 per cent (that is 10 per cent for the foreign exchange fee currently applied and 2 per cent for the transitional surcharge) – does that mean that in the future, the Dominican Republic can introduce new duties or charges up to the remainder of the present level? If the Panel were to accept such an approach, that would undermine the whole basis of commitments made in a Schedule of Concession and the requirement for transparency in recording.

4.404 The Dominican Republic has attempted to argue that it "did properly record the transitional surcharge and the foreign exchange fee as ODCs in its Schedule of Concessions on 14 September 1994, within the six-month period provided for by paragraph 7 of the Understanding…".[295] Throughout these proceedings, Honduras has demonstrated that the measure that the Dominican Republic recorded was the Selective Consumption Tax, an internal measure. It did not record the transitional surcharge or the foreign exchange fee. As the Understanding only applies to the recording of "other duties or charges", the fact that the Dominican Republic recorded an internal tax within the six-month provided in paragraph 7 of the Understanding is completely irrelevant. The transitional surcharge and the foreign exchange fee cannot be brought under the cover of the recording of the Selective Consumption Tax. More specifically, the Dominican Republic has claimed that "the transitional surcharge and the foreign exchange fee are within the upper limit established by this recorded level of ODCs".[296] However, as was clearly pointed out in the second submission of Honduras, the recording of the Selective Consumption Tax at a certain level does not give the Dominican Republic the authority to levy other types of duties or charges up to that level now. The Dominican Republic did not merely record a quantitative level for a general category of "ODCs". It specifically named the instrument '*Impuesto Selectivo en Aduanas*". The Dominican Republic has admitted that "[t]he heading *'Impuesto Selectivo en Aduanas'* in the list attached to [its] 14 September 1994 notification… is a mistake", and that "there is a correspondence between the recorded level of other duties or charges… and the [*Impuesto Selectivo en Aduanas*] in force on September 1994…".[297]

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[294] Second written submission of the Dominican Republic, 10 June 2004, para. 80.
[295] Ibid., para. 80.
[296] Ibid., para. 103.
[297] Replies of the Dominican Republic to questions addressed by the Panel, 27 May 2004, reply to question No. 42, para. 38.

Thus, the transitional surcharge and the foreign exchange fee were not "properly recorded" in the Dominican Republic's Schedule of Concessions.

4.405 Even assuming that the transitional surcharge and the foreign exchange fee were imposed on 15 April 1994, pursuant to paragraph 7 of the Understanding, the Dominican Republic had a period of six months from "the date of deposit of the instrument" referred to in that paragraph within which to inscribe the same in its Schedule of Concessions. That six-month period has long since expired, and, after the expiration of that period, the Dominican Republic was no longer authorized to add the transitional surcharge or the foreign exchange fee in its Schedule of concessions. This being the case, notwithstanding that the Dominican Republic had imposed the foreign exchange fee on 15 April 1994 at the rate of 1.5 per cent *ad valorem*, after the expiration of the six-month period, having failed to add the foreign exchange fee in its Schedule of Concessions, the continued imposition of the foreign exchange fee after that period at any level, including the present level of 10 per cent, is inconsistent with Article II:1(b) of the GATT. Article II:1(b) cannot be construed independently of the Understanding.

4.406 In its second submission, the Dominican Republic contends that "Honduras's challenge to the Dominican Republic's [other duties or charges] is barred by paragraph 4, second sentence, of the Understanding and therefore must not be allowed to proceed".[298] In Honduras view, this argument is based on an incorrect interpretation of the scope and coverage of paragraph 4.

4.407 In Honduras's view, paragraph 4 does not apply because what the Dominican Republic recorded under "other duties or charges" was an internal tax, not "other duties or charges" within the meaning of Article II:1(b). Even if the transitional surcharge and the foreign exchange fee were somehow to be covered by the recording of the Selective Consumption Tax, the conditions set out in paragraph 4 to make this provision applicable would still not be met.

4.408 As indicated in its first sentence, paragraph 4 applies only to "other duties or charges" imposed on "a tariff item [that had] previously been the subject of a concession". (The Dominican Republic omitted the first sentence of paragraph 4 when it cited that paragraph in paragraph 84 of its Second written submission.) Therefore, this provision does not apply to any product that has not been the subject of a previous concession. Furthermore, the three-year deadline only applies to the right to challenge the recording of an other duty or charge which was not in existence at the time of the original binding or which was recorded at a higher level than that of the previously bound level. It is only in these situations that other Members had a three-year period to challenge the existence or consistency with the previous bindings.

4.409 The situation contemplated under the exception in paragraph 4 is not relevant to this dispute, as Honduras has not made a claim on any "tariff item [that had] previously been the subject of a concession", i.e. prior to 15 April 1994. Paragraph 4 does not apply to a challenge of a recording of an "alleged other duty or charge" which was not in fact imposed as of 15 April 1994.

4.410 This is the situation in this case. Therefore, paragraph 5 is applicable. Paragraph 5 states that Members retain the right to challenge the consistency of a recording of an "other duty or charge" with a Member's rights and obligations under GATT 1994 at any time.

4.411 In further support of its arguments relative to the three-year prescriptive period, in paragraph 84 of its second written submission, the Dominican Republic quoted selected portions of paragraphs 7 to 10 of the paper entitled "Article II:1(b): Legal Questions, Note by the Secretariat, MTN.GNG/NG7/W/61, 16 November 1989" and presented the paper as Exhibit DR-49. Reading only the selected portions quoted by the Dominican Republic, one might be misled into concluding

[298] Second written submission of the Dominican Republic, 10 June 2004, para. 84.

that the three-year prescriptive period is applicable to this dispute. The Dominican Republic omitted the following wording in paragraph 7, which precedes the portion quoted by the Dominican Republic:

> (i) The point had been made that the inscription of ODCs in schedules would not establish their legality in terms of consistency with other GATT obligations, and that it should always remain possible for third countries to challenge the legal character of any particular charge… However it had also been suggested that …"
>
> (ii) [The Dominican Republic's selective quote starts with the portion immediately after this omitted portion: "… the consistency of a recorded charge with the obligation under Article II:1(b) … might be regarded as being established if it were not challenged within an agreed period, such as three years from the date of inscription…"]

4.412 Indeed, a close scrutiny of Exhibit DR-49 indicates that it is a Note prepared by the Secretariat to provide advice on "two issues of a legal nature arising from the proposal that 'other duties or charges' (ODCs) should henceforth be recorded in tariff schedules".[299] It is not part of the negotiating history of the Understanding nor does it constitute under Article XVI:1 of the Marrakesh Agreement a decision, procedure or customary practice followed by the CONTRACTING PARTIES to GATT 1947. Therefore, the probative value of this Exhibit must be questioned.

4.413 In any event, in the light of the clear language of paragraphs 4 and 5 of the Understanding which reflects the agreement of the Members, there is no need to examine secondary sources such as Exhibit DR-49.

4.414 In addition, the Dominican Republic contends that "any challenge to the recording or existence of [other duties or charges] must be brought under the Understanding, not under the GATT" as the right to challenge the recording or existence of [other duties or charges] is established by paragraph 4 of the Understanding"; and that "Honduras's challenges to the recording and existence of the transitional surcharge and foreign exchange fee as [other duties or charges] as of 15 April 1994 are therefore outside the terms of reference of the Panel and should be dismissed".

4.415 As earlier stated, paragraph 4 of the Understanding applies only to challenges to "other duties or charges" imposed on "a tariff item [that had] previously been the subject of a concession", and that paragraph 4 is not applicable to this dispute.

4.416 The Vienna Convention on the Law of Treaties provides that "[A] treaty shall 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"[300] and that "[T]he context for the purpose of the interpretation of a treaty shall comprise … (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty…"[301]

4.417 The Understanding is an agreement relating to the GATT 1994, specifically Article II:1(b) thereof, and was made in connection with the conclusion of the GATT 1994. It is therefore part of the context of GATT 1994, specifically Article II:1(b) thereof. Since a treaty interpreter has the obligation to interpret Article II:1(b) in accordance with the ordinary meaning given to its terms "in their context", among others, the references to Article II:1(b) in the terms of reference of the Panel necessarily include references to the Understanding. Thus, the Understanding is within the terms of reference of the Panel. In any event, the Dominican Republic has raised the recording of "other duties or charges" pursuant to the Understanding as its principal defence.

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[299] See "Article II:1(b): Legal Questions, Note by the Secretariat", *supra* note 187, para. 1.
[300] Vienna Convention on the Law on Treaties, Article 31.1.
[301] Ibid., Article 31.2.

4.418 As Honduras has demonstrated that the measure is inconsistent with Article II:1(b), it has also demonstrated that the measure is inconsistent with Article II:1(a).

4.419 Turning to the Dominican Republic defence in respect of the foreign exchange fee, Honduras notes that by way of an alternative defence, the Dominican Republic argued that the foreign exchange fee is an exchange measure justified by Article XV:9 of the GATT. In its oral statement, replies to the questions of the panel, and second written submission, Honduras has demonstrated that the foreign exchange fee is not justified under Article XV:9 of the GATT because:

- The foreign exchange fee is not an "exchange restriction" within the meaning of Article XV:9 of the GATT;[302]

- Even if the foreign exchange fee were determined to be an exchange restriction in the context of Article XV:9(a), its use is not in accordance with the Articles of Agreement of the IMF.[303]

4.420 As the party invoking an exception, it is incumbent on the Dominican Republic to demonstrate that its measure is justified under Article XV:9(a). It has not done so. In its second submission, the Dominican Republic confines itself to a discussion of Article XV:4 of the GATT, stating that Honduras is "erroneously trying to resurrect its claim under Article XV:4 [of the GATT]".[304] However, it is only in the event that the Dominican Republic were to successfully prove that its measure falls within Article XV:9(a) that Honduras would need to rebut by arguing that even if the measure is in accordance with Article XV:9(a), and consequently with the Articles of Agreement of the IMF, then Honduras would have to demonstrate that the measure nevertheless is inconsistent with Article XV:4. As Honduras considers that the Dominican Republic has not successfully established that its measure is justified by XV:9(a), there is no need for Honduras to raise Article XV:4 as a subsidiary claim. Furthermore, even though it does not bear the burden of proof on this issue, Honduras has demonstrated in Exhibit HOND-21(a), that there has been no notification from the IMF to the WTO to the effect that the Dominican Republic has been granted authorisation in order to levy the foreign exchange fee as an exchange action.

4.421 As Honduras had explained in the course of the First Substantive Meeting with the Panel, Honduras reserved its right to raise Article XV:4 not as a principal claim, but as a subsidiary claim, should the Dominican Republic be able to establish that the foreign exchange fee is justified under Article XV:9 of the GATT.

4.422 Finally, Honduras considers that the transitional surcharge and the foreign exchange fee as it applies to all products, including cigarettes, are within the mandate of the Panel. The reasons are the following: Article 6.2 of the DSU does not require a complainant to specify in its Panel request which are the products at issue; the request for consultations and the request for the establishment of the Panel make it clear that the challenge on the foreign exchange fee and the transitional surcharge referred to "imported goods" in general and therefore it is not necessary to specifically identify each and every product; unlike the other measures such as the bond requirement, the transitional surcharge and the foreign exchange fee are not product-specific. Based on the foregoing, Honduras requests the Panel to examine the WTO-consistency of the transitional surcharge as applied to all products including cigarettes.

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[302] Oral statement of Honduras at the First Substantive Meeting with the Panel, paras. 22 to 35; Second written submission of Honduras, 10 June 2004, paras. 196 to 198.

[303] Oral statement of Honduras at the First Substantive Meeting with the Panel, paras. 36-40; Second written submission of Honduras, 10 June 2004, paras. 199-203.

[304] Second written submission of the Dominican Republic, 10 June 2004, paras. 75-76.

V. ARGUMENTS OF THE THIRD PARTIES

A. CHILE

1. Introduction

5.1 Chile declares that, as indicated in Annex DR-5, it is a major exporter of cigarettes to the Dominican Republic, so that the tax regime applicable to cigarettes affects it directly. Moreover, it has a special systemic interest in the proper application of the provisions of the WTO Agreement.

5.2 Chile asserts that the tax regime applied by the Dominican Republic is complex, and similar to those which have been applied in other destination markets for Chilean cigarettes. In general, these tax schemes provide for a variety of measures, all of which are characterized by their lack of transparency and give considerable discretion to the authorities. Consequently, rather than considering each measure individually, these regimes should be examined as a whole. The regime in force in the Dominican Republic and which is challenged by Honduras is no exception to this rule. It consists of measures, such as differential taxes, excessive administrative requirements, bonds, and so forth, which add up to protection of the local industry.

5.3 Chile contends that the tax base applied to cigarettes was not determined on the basis of the value thereof, or of some objective, transparent and non-discriminatory element, but rather, using prices fixed by the authorities on the basis of unpublished price surveys. Moreover, it appeared that while the law – Article 367(b) of the Tax Code – established how the tax base should be determined (according to the retail selling price), the regulation – Article 3 of Regulation 79-03 – made it less transparent and more arbitrary. Added to which, there was another rule – General Rule 02-96 – that established a different formula for making the calculation. Consequently, the determination was ultimately left up to the administrative authorities through mechanisms lacking in transparency. Chile has taken note of the fact that this formula has now been abolished in favour of a single selective tax.

5.4 Chile stresses that tax schemes such as the one applied by the Dominican Republic must be examined in the light of the reality of the markets. For example, in many cases not only is the tax base determined using criteria lacking in transparency, but the selling prices of the cigarettes are fixed by the authorities, which means that the effect (discriminatory) of the tax – which is calculated without taking account of the sales price of the product – can be much greater.

5.5 Chile highlights the amount of discretion that appears to be given to the authority in implementing the Dominican Republic's tax policy in the fact that although the law (Article 376 of the Tax Code) requires the posting of a bond only for alcohol and tobacco products produced in the Dominican Republic, a decision of the authorities (Article 14 of Regulation 79-03) has extended the bond requirement to imported cigarettes.

2. The repealed measures

5.6 Chile notes that on the very day that the Panel was established, the Dominican Republic repealed two of the measures challenged by Honduras. That is, through the introduction of a single-rate tax determined on a single basis, the differential determination of the tax base for domestic and imported cigarettes was eliminated, as were the price surveys.

5.7 Chile suggests that, although it considers this legal reform to be a step forward towards the establishment of a transparent and non-discriminatory tax regime, there is nothing to prevent the Panel from ruling on the consistency of the measures in question with the WTO. As has been stated in the past:

> "...[i]n previous GATT/WTO cases, where a *measure* included in the terms of reference *was otherwise terminated* or amended after the commencement of the panel proceedings, panels have nevertheless made findings in respect of such a measure."[305]

5.8 Chile insists that the Panel must rule on the issues referred to it by the parties, in this case Honduras, in order to comply with one of the basic objectives of the WTO dispute settlement system, i.e. providing security and predictability to the multilateral trading system.

5.9 Chile argues that, although it seems the new methodology would guarantee equal treatment between domestically produced goods and imported goods, not only are there legal discriminations, but *de facto* discriminations as well, so that there could still be other instances of discriminatory treatment, for example in the way in which this new law is applied. Since it is still too early to make an assessment in this respect, given that the law was only recently adopted, Chile shall not engage in any analysis of the measures in this submission; indeed, their elimination clearly represents the best evidence of the view Chile shares with Honduras that they did in fact constitute unnecessary barriers to trade.

5.10 Chile highlights the fact that a significant portion of the arguments presented by the Dominican Republic in its written submission rest on the exception contained in Article XX(d) of the GATT 1994. In other words, that the requirement to affix stamps in the territory of the Dominican Republic and to post a bond are necessary to secure compliance with laws which are not inconsistent with the GATT. If these laws are inconsistent, the Article XX(d) exception cannot be invoked, as explained below.

3. GATT 1994 Article XX(d) exception

5.11 The Dominican Republic argues that if the Panel were to determine that the requirement to affix tax stamps on imported cigarettes in the territory of the Dominican Republic and the requirement that importers post a bond are inconsistent with Article III of the GATT 1994, they would nevertheless be justified under Article XX(d) of the GATT 1994.

5.12 Chile will confine itself, on this point, to expressing its views on the subparagraph in question, and not on the introductory paragraph of Article XX. In any case, if the Panel applies the Article XX exception logically – based on the first Appellate Body Report[306] – it must begin by examining the necessity stipulated in the subparagraph and conclude that the measures in question are not covered by that subparagraph, and that consequently there is no need for it to continue its analysis.

5.13 Article XX(d) states:

> "(d) *necessary* to secure compliance with laws or regulations which are not *inconsistent* with the provisions of this Agreement" (Emphasis added).

5.14 The Dominican Republic considers that the laws and regulations for which it is trying to secure compliance are the country's tax laws and regulations, particularly for the purpose of preventing tax evasion.[307] Chile considers that the measures are not necessary for that purpose.

4. Requirement to affix stamps in the territory of the Dominican Republic

5.15 As Honduras stated in paragraph 2 of its written submission, the general practice among WTO Members is to permit such stamps to be affixed in the territory where the cigarettes are

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[305] Panel Report, *Chile – Price Band System*, para. 7.6 (italics added and footnote omitted).
[306] Appellate Body Report, *US – Gasoline*, p. 18.
[307] First written submission of the Dominican Republic, 13 April 2004, paras. 102 and 143.

produced. In fact, this is what the Dominican Republic itself has established for other products. The requirement to affix the stamps in the territory of the Dominican Republic makes the procedure more cumbersome than necessary to comply with the legitimate objective, (e.g. practical problems associated with the unpacking and repacking of cigarettes); it increases costs; and it discourages imports. Chile insists that none of these can be considered to be normal costs associated with importation as the Dominican Republic claims. Nor can it be claimed that since this cost represents a very low percentage of the earnings of the importing company, there is no discrimination.

5.16 Chile further posits that it cannot be claimed that equal treatment does not involve discrimination. On the contrary, GATT/WTO jurisprudence recognizes that the prohibition of discrimination is an obligation not to treat similar situations differently or to treat different situations in the same way.[308]

5.17 The question Chile asks itself here is not whether or not the Dominican Republic is within its rights when it adopts measures necessary to secure compliance with its laws, regulations and other measures such as payment of taxes, but rather, whether or not the way in which this is being done discriminates between domestic and imported products. Given the difference in nature between them, the Dominican Republic's requirement that the stamps must in all cases be affixed in the territory of that Member (a) results in less favourable treatment for imported cigarettes as compared to domestic cigarettes; or (b) alters the conditions of competition in the market in question to the detriment of imported products.

5. Bond requirement

5.18 Chile argues that the Bond required by the authorities of the Dominican Republic to guarantee the payment of the Selective Consumption Tax and other taxes is not an effective measure for that purpose. Given that the importer must pay the full amount of the Selective Consumption Tax when importing the product, the bond loses its purpose, since there is nothing to guarantee. If the importer does not pay the tax upon entry of the products, the products cannot be cleared. In its written submission, the Dominican Republic repeatedly points out that the tax authorities may reassess the liquidation and payment of the Selective Consumption Tax (within a period of three years). Given, however, that the new legislation establishes a single and fixed rate of RD$0.48 per cigarette, reassessment by the Directorate General of Internal Taxes (DGII) would no longer be necessary, and hence, neither would the bond.

5.19 For all of these reasons, Chile considers the stamp and bond requirements to be unjustified under Article XX(d) of the GATT 1994 in that: (a) they are not measures necessary to secure compliance with the tax laws of the Dominican Republic; (b) those laws are inconsistent with the WTO.

6. Inconsistent legislation

5.20 Chile considers that the laws and regulations of the Dominican Republic are inconsistent with the WTO in determining the tax base for cigarettes imported from Honduras – without transparent and generally applicable criteria – differently than for domestically produced cigarettes, and on the basis of unpublished sales surveys. This being the case, the measure that would be necessary to secure compliance with the said law is not covered by Article XX(d) of the GATT 1994.

5.21 Chile considers that Honduras made a *prima facie* case that the said measures were inconsistent with Articles III:2 and X of the GATT 1994. The Dominican Republic has not refuted that claim. Moreover, it errs in paragraphs 106 and 146 of its written submission when it states that Honduras did not challenge the WTO consistency of the tax legislation. Honduras did do so, and that is exactly what this dispute is about.

[308] See Appellate Body Report, *EC – Tariff Preferences*, para. 153.

5.22 Chile insists that the fact the Dominican Republic revoked certain elements of its tax legislation applied to cigarettes that were challenged by Honduras does not relieve the Panel from ruling on their consistency with the WTO.

7. Other duties or charges

5.23 The Dominican Republic states that it bound, under the WTO, a list of "other duties or charges" applied to imports. That list, according to the Dominican Republic, can be said to include all of the duties and charges applied to imports to the extent that they do not exceed the 30 per cent binding in its Schedule XXIII. Consequently, the transitional surcharge on imports (2 per cent) and the foreign exchange fee are consistent with Article II:1(b) of the GATT 1994, second sentence, since together they do not exceed the 30 per cent bound rate.

5.24 Chile point outs that the Dominican Republic's Schedule XXIII contains a list of imported products subject to the *Impuesto Selectivo en Aduanas* (Selective Customs Tax). The Schedule makes no mention of the transitional surcharge on imports or the foreign exchange fee, or indeed any other tax. Consequently, the other "duty or charge imposed on or in connection with importation" bound by the Dominican Republic is the Selective Customs Tax.

5.25 Chile remarks that, although this Selective Customs Tax is not defined, it appears to be a certain tax which is (in the language of Article II:1(b), second sentence) "imposed on the date of this Agreement [the GATT] or... directly and mandatorily required to be imposed thereafter by the legislation in force in the importing territory [the Dominican Republic] on that date". Consequently, it is up to the Dominican Republic to show that the transitional surcharge on imports and the foreign exchange fee were applied at the date on which they were notified to the WTO or that they were directly and mandatorily required to be imposed thereafter by the legislation in force.

5.26 Chile considers that the Dominican Republic did not prove that the transitional surcharge on imports and the foreign exchange fee were equivalent to the Selective Customs Tax, and they were certainly not in force on the date of WTO notification, i.e. in 1994, since both of the measures were introduced last year. Nor did it identify the legislation in force on that date which directly or mandatorily required that the transitional surcharge on imports and the foreign exchange fee be imposed.

5.27 In Chile's view, the other duties and charges notified by WTO Members and included in their Schedules of Commitments are limited in two ways. Firstly, they are limited to the duty or charge specifically identified (in this case, a Selective Customs Tax), and secondly they are limited to the ceiling bound in each notification. Consequently, Members may not apply a charge or duty notified in excess of the maximum amount indicated nor, moreover, can they apply other duties or charges of another kind if they have not been notified and listed, even if their rates are lower than the bound level.

5.28 Finally, as pointed out by El Salvador and Nicaragua in their written submission, Chile is of the view that Honduras's challenge to the transitional surcharge on imports and the foreign exchange fee is not restricted to cigarettes alone. Both measures are in fact applicable to the whole tariff universe. Therefore, were the Panel to find that they are indeed "other duties or charges" properly recorded in the Schedule, they would only be so for the products specified in Schedule XXIII. For all other products, they would constitute duties or charges inconsistent with Article II.1(b) of the GATT 1994.

8. Conclusion

5.29 For the above reasons, Chile requests that the Panel, upon examining the consistency of the measures challenged by Honduras, take into account the context of the tax regime applied by the Dominican Republic to cigarettes.

B. CHINA

1. Introduction

5.30 In regard to consistency of the measures concerned with WTO obligations, China focuses its submission on the analytical approach established by WTO jurisprudence[309] and provisions related to Article II:1, Article III, Article XV and Article XX(d).

5.31 Below China will proceed to address each of these issues involved in different measures separately.

2. Selective Consumption Tax and Survey of Average Retail Prices

5.32 According to the submission presented by the Dominican Republic, these two measures were replaced by new ones through Law 3-04 which amended Article 367 and 375 of the Tax Code[310] on 9 January 2004, the same date on which the Panel for the present dispute was established and the terms of reference of the Panel were fixed.[311] China would like to briefly comment on the factors which the Panel may take into account in considering whether it should make findings regarding these two alleged "dead measures".

5.33 China notes that Panels differentiated their positions in past GATT/WTO cases with regard to the issue of whether a Panel should make findings for revoked measures. Several factors, including the timing of the amendment, revocation or termination of the measures challenged, the extent to which the measure was amended, and the relevance of revocation of the measure to the implementation stage of the dispute settlement process, have been taken into account by previous Panels.

3. The timing of the amendment, revocation, or termination of the measures challenged

5.34 China point outs that for the measures that had been withdrawn prior to the issuance of the Panel report, the Panel in *US – Wool Shirts and Blouses*, similar to the GATT Panels in *EEC – Dessert Apples* and *US – Canadian Tuna*, nevertheless made findings on those measures challenged.[312]

5.35 China remarks that, in contrast, the Panel in *Argentina – Textiles and Apparel* declined to examine measures that had been revoked "prior to establishment of Panel", since the Panel refused to engage in speculating whether the defendant would re-introduce the measure, and operated on the assumption that the defendant would carry out its WTO obligations in good faith.[313]

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[309] The Appellate Body stated that "[a]dopted panel reports are an important part of the GATT *acquis*... [and are] often considered by subsequent panels". See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 14.

[310] See first written submission of the Dominican Republic, 13 April 2004, paras. 19-25.

[311] Minutes of the WTO Dispute Settlement Body (DSB) Meeting on 9 January 2004, WT/DSB/M/162, circulated on 16 February 2004.

[312] See Panel Report, *US – Wool Shirts and Blouses*, para. 6.2.

[313] Panel Report, *Argentina – Textiles and Apparel*, paras. 6.10-14.

4. The extent to which the measure challenged has been changed

5.36 China notes that the Appellate Body in *Chile – Price Band System* chose to deal with the changes, after the establishment of the Panel, which amended the measure challenged "without changing its essence".[314]

5.37 Similarly, in *Brazil – Aircraft* the Appellate Body ruled on changes and amendments to the measure challenged before the establishment of the Panel (and after consultation), which did not change the essence of the measure.[315]

5. The relevance of any revocation of the challenged measure to the implementation stage of the dispute settlement process

5.38 In *Indonesia – Autos*, the complaint challenged the effectiveness of the revocation of one of the measures challenged. The Panel noted the practice of past GATT/WTO cases where Panels made findings in respect of a measure included in the terms of reference, which was otherwise terminated or amended after the commencement of the Panel proceedings.[316]

5.39 Bearing in mind the aforementioned factors considered by the Appellate Body and past Panels, China hopes the Panel could clarify the following preliminary questions before proceeding with any further examination of substantive issues with respect to these two measures which are included in the terms of reference of the Panel:

- the legal significance of the timing of the revocation, which took place simultaneously with the commencement of the Panel proceedings; and
- the extent to which the two measures have been amended.

6. The Foreign Exchange Fee

5.40 With regard to the foreign exchange fee, China would like to address the issue of whether the imposition of the foreign exchange fee complies with Article XV.

5.41 The core of Honduras's claim hinged upon the characterization of the foreign exchange fee as an "other duty or charge" within the meaning of Article II:1(b). In the footnote to paragraph 62 in its submission, Honduras considered it unnecessary for the Panel to decide "...whether the fee is an 'exchange action' or a 'trade action' within the meaning of Article XV:4 of the GATT". The Dominican Republic rebutted in its submission that "the transitional foreign exchange fee is an exchange restriction within the jurisdiction of the Fund, not a charge on imports within the jurisdiction of the GATT".[317]

5.42 China is of the view that, before proceeding with further examination on whether the imposition of the foreign exchange fee is inconsistent with the Dominican Republic's WTO obligations, it is necessary to consider whether the imposition of the foreign exchange fee obtains justification under Article XV:9(a) of the GATT 1994.

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[314] Appellate Body Report, *Chile – Price Band System*, paras. 136-139.
[315] Appellate Body Report, *Brazil – Aircraft*, para. 132.
[316] See e.g., Panel Report, *Indonesia – Autos*, para. 14.9.
[317] First written submission of the Dominican Republic, 13 April 2004, para. 193.

7. Relationship between Article XV:9 and Article XV:2, and the obligation to consult with IMF pursuant to Article XV:2

5.43 The negotiating history of the GATT provided that paragraphs 2, 4 and 9 of Article XV of the GATT 1994 served to avoid overlapping jurisdiction between IMF and GATT, although the WTO/GATT jurisprudence left the issue of whether Article XV:9(a) of the GATT serves as an exception to a Member's GATT obligations unanswered.[318] China considers that interpretation of Article XV:9 cannot be isolated from other paragraphs of Article XV, particularly Article XV:2 and Article XV:4. As upheld by the Appellate Body in *US – Gasoline*, it is required by the general rule of interpretation in the Vienna Convention to give meaning and effect to all the terms of the treaty in order to avoid reducing whole clauses or paragraphs of a treaty to redundancy or inutility.[319]

5.44 GATT jurisprudence has established the jurisdiction of the WTO forum over monetary measures with an effect on trade. The 1977 GATT Report on the Monetary Measures Applied by Italy (*Italian Measures*) addressed a monetary measure (requirement of deposit for payment abroad) that contributed to the stabilization of Italian currency and served for the establishment of a longer term economic stabilization policy. The measure was non-discriminatory in its nature and would be gradually phased out at that time. Although some GATT Contracting Parties recognized that the measure had been approved by the International Monetary Fund and by the European Communities, a working party with a term of reference restricted to Article XV was established for the examination of the trade effects of the measures which was a matter of direct concern to the GATT. The working party invited Italy to consider an early removal of foreign exchange measure and to replace this temporary measure by "comprehensive alternative measures to help restore equilibrium as indicated in the finding of the International Monetary Fund".[320] Despite this precedent, the extent to which Article XV:2 may require Panels to consider as "dispositive specific determinations of the IMF" has not yet been well clarified in GATT/WTO disputes.[321] In *Greece – Import Taxes*, the Panel suggested the CONTRACTING PARTIES address an inquiry to the IMF with regard to the issues of whether the tax in question (a) was a multiple currency practice, and (b) whether or not it was in conformity with the Articles of Agreement of the International Monetary Fund. The staff of the IMF participated in the discussion.[322] In contrast, the Appellate Body in *Argentina – Textiles and Apparel*, did not rule against the Panel's declination to consult with the IMF.[323] Similarly, the Panel in *India – Quantitative Restrictions* ruled that under Article 13.2 of the DSU a Panel enjoys discretion and significant authority as to whether or not to seek information from experts and from any other external source.

5.45 In China's view, the plain text of Article XV:2 provides that the WTO "shall accept" the IMF's factual findings within its competence relating to foreign exchange, monetary reserves and balances of payments, as well as its legal determination on the consistency of "actions by a contracting party in exchange matters" with the IMF's Articles.

5.46 The title of Article XV indicates that it deals with "exchange arrangements". However, China notes that there exist differences in the use of terms with regard to exchange arrangements in Article XV:2, Article XV:4 and Article XV:9. Specifically, Article XV:2 refers to the mandatory consultation requirement with the IMF on "actions [by a contracting party] in exchange matters"; Article XV:9 refers to the justifications of "exchange controls or exchange restrictions" in accordance

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[318] Report of the GATT Special Sub-Group, "Working Party on Quantitative Restrictions - Relations between the GATT and the International Monetary Fund ", adopted on 2,4 and 5 March 1955, BISD 3S/170, L/332/rev.1 and Addenda, p. 195, para. 8.

[319] Appellate Body Report, *US – Gasoline*, p. 23.

[320] See Report of the GATT Working Party on Italian Measures, adopted on 2 March 1977, BISD 24S/129-134, L/4442), January 1978, para. 13.

[321] See Panel Report, *India – Quantitative Restrictions*, para. 5.13. (The issue was not appealed). See Appellate Body Report, *India – Quantitative Restrictions*, para. 152.

[322] GATT Panel Report, *Greece – Import Taxes*, para. 10.

[323] Appellate Body Report, *Argentina – Textiles and Apparel*, paras. 84-85.

with IMF Articles, while Article XV:4 refers to "exchange actions" that may frustrate the intent of the GATT provisions. GATT/WTO jurisprudence is not clear on whether these differences connote a certain logic subordinate relationship of these terms, particularly between "exchange controls or exchange restrictions" under Article XV:9 in one category, and "actions in exchange matters" under Article XV:2 and "exchange actions" under Article XV:4 in the another category. In other words, it might be arguable whether the former category is a subset of the latter category.

5.47 By reviewing the provisions of Article XV, China further notes that Article XV:9 and Article XV:2, although by no means identical, are largely similar and, to some extent, in parallel:

5.48 Article XV:9 provides, in pertinent part, that:

> "Nothing…shall preclude…*exchange controls or exchange restrictions in accordance with* the Articles of Agreement of the International Monetary Fund or with that contracting party's special exchange arrangement with the [CONTRACTING PARTIES]"(underlining added)

5.49 Article XV: 2 provides, in relevant part, that:

> "… In such consultation, the [CONTRACTING PARTIES]…shall accept the determination of the Fund as to whether *action by a contracting party in exchange matters is in accordance with* the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange arrangement between that contracting party and the [CONTRACTING PARTIES]" (underlining added)

5.50 In view of the parallel terms of the language in the two provisions, and in the absence of any contrary indication in the context, China believes fulfilment of the requirements under Article XV:9(a) should correspond to satisfaction of requirements under Article XV:2. Further, taking into account the institutional allocation of expertise resulting from multilateral negotiations regarding trade and exchanges between the WTO and IMF, assuming *arguendo* that measures constituting "exchange controls or exchange restrictions" within the meaning of Article XV:9, is subset to the category of "actions in exchange matters" under Article XV:2, the Panel is obliged to consult with IMF with regard to the measure of the foreign exchange fee in this dispute pursuant to Article XV:2.

5.51 China considers that two issues, specifically, should be resolved through consultation with IMF with respect to (a) whether the imposition of the foreign exchange fee falls within the scope of "exchange matters", and in particular, constitutes certain kinds of "exchange controls or exchange restrictions", and (b) whether the imposition of the foreign exchange fee is "in accordance with" the Articles of Agreement of the International Monetary Fund.

8. The legal effect of the IMF-endorsed criterion to the WTO

5.52 The Dominican Republic argued that the foreign exchange fee constitutes an "exchange control or restriction within the meaning of Article XV:9(a)".[324] Having argued that the meaning of "exchange restriction" shall be interpreted in the light of the criterion established by the Executive Directors of the IMF on 1 June 1960[325], the Dominican Republic seems to assert that the Panel may apply this criterion directly in the present dispute to determine the characterization of the foreign exchange fee.

5.53 The IMF criterion cited by the Dominican Republic states that "[t]he guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current transactions

[324] First written submission of the Dominican Republic, 13 April 2004, para. 198.
[325] Ibid., para. 194.

under Article VIII, Section 2, is whether it involves a direct governmental limitation on the availability or use of exchange as such".[326]

5.54 China notes that the GATT/WTO regime, however, unlike that of the IMF, has never formally decided on how to distinguish between trade and exchange controls.[327]

5.55 China hopes that the Panel in the present case could clarify the issue of whether the aforesaid IMF-endorsed criterion, on the basis of which the IMF distinguishes trade and exchange matters, can be directly applied to the determination of whether the imposition of the foreign exchange fee falls within the scope of "exchange controls or exchange restrictions" under GATT Article XV:9(a).

9. Relationship between Article XV:9 and Article XV:4

5.56 Under Article XV:4, "[C]ontracting Parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement". Assuming *arguendo* that the foreign exchange fee is an IMF-consistent foreign exchange action which falls within the scope of Article XV:4, it might be argued that such measure is still actionable under the provision of Article XV:4.

5.57 In accordance with the burden of proof principle established in *US – Wool Shirts and Blouses*[328], it is for Honduras to establish a *prima facie* case of violation of Article XV:4 by the Dominican Republic. However, Honduras has chosen not to do so by stating it its first submission that it is unnecessary for the Panel to decide "whether the fee is an 'exchange action' or a 'trade action' within the meaning of Article XV:4 of the GATT".[329]

5.58 China hopes the Panel in the present dispute would clarify the relationship between Article XV:9 and Article XV:4 in examining of this dispute.

10. The stamp requirement

5.59 With regard to the stamp requirement, China would like to express its views regarding the requirements for the constitution of a violation under Article III:4, and discuss the possible justification for a breach of Article III:4 under Article XX(d) of GATT 1994 as follows:

(a) The parameters related to the "less favourable treatment" criterion

5.60 The Appellate Body has held that, for a violation of Article III:4 to be established, three elements must be satisfied: (a) the imported and domestic products at issue are "like products"; (b) the measure at issue is a "law, regulation, or requirement affecting internal sale, offering for sale, purchase, transportation, distribution, or use" of the like products; and (c) the imported products are accorded "less favourable treatment" than that accorded to like domestic products.[330]

5.61 Among these three criteria, China would like to make further comments on certain parameters related to the examination of the third criterion, i.e. whether in the present dispute, the imported

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[326] Decision of the International Monetary Fund No. 1034-(60)27, para. 1 (1 June 1960), in *Selected Decisions and Selected Documents of the International Monetary Fund* (Twenty-fifth Issue, 2000) p. 428, reprinted at de Vries & Horsefield, *The International Monetary Fund 1945-1965: Twenty Years of International Monetary Cooperation* (IMGF, 1969), vol. III, pp. 260-261, cited from the First written submission of the Dominican Republic, 13 April 2004, footnote 163.

[327] See 1981 Secretariat Background Paper on the consultation with Italy concerning the Italian deposit, BOP/W/51, p. 5, para. 14, cited in GATT, *Analytical Index: Guide to GATT Law and Practice*, updated Sixth Edtion, 1995, p. 435.

[328] Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 13-14.

[329] First written submission of Honduras, 16 March 2004, footnote to para. 62.

[330] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

products concerned are accorded "less favourable treatment" than that accorded to like domestic products. As upheld by the Appellate Body in *US – FSC* (Article 21.5 -EC), an examination of an alleged Article III:4 violation must be grounded in close scrutiny of the "fundamental thrust and effect of the measure itself".[331] The focus of the examination in this regard is the "modification of competition conditions".[332] In other words, an examination of whether the Dominican Republic accords "less favourable" treatment to imported products should hinge on whether the actual effect of the measure in question, if it exists, adversely changes or affects the equality of competitive opportunities in the relevant market to the detriment of imported products.

5.62 China is of the view that, although this general principle, which seeks to avoid protection to domestic production in the application of internal tax and regulatory measures, is not explicitly invoked in Article III:4, nevertheless, it "informs" that provision.[333] An examination of the "actual effect" of the measures in question on the competitive relationship is also guided by the "general principle" set out in Article III:1. In the present dispute, it becomes relevant to take into account the issues of whether or not the purpose of the stamp requirement is discriminatory or protective in favour of domestic products in the evaluation of its consistency with Article III:4.

(b) Justification under Article XX (d)

5.63 China suggests that, should the Panel find the stamp requirement inconsistent with relevant GATT/WTO provisions, it might also need to examine whether the measure is provisionally justified under Article XX(d), and whether the measure meets the requirements as set forth in the *chapeau* of Article XX.[334] The *chapeau* of Article XX makes it clear that it is the "measures", not the "legal finding of [violation], which are to be examined under Article XX (d)".[335]

5.64 In this submission, China would comment on the burden of proof and the analytical approach the Panel might consider in order to qualify a measure as "necessary" under Article XX (d).

(c) Burden of proof

5.65 China point outs that it has become a well-established rule that it is for the party invoking Article XX to demonstrate a *prima facie* case that the measure in question falls within one of the exceptions as specified in Article XX, and that it meets the requirements of the *chapeau* of Article XX.

5.66 For example, with regard to the burden of proof for individual paragraphs of Article XX, the Panel in *Canada – FIRA* held that "[s]ince Article *XX(d)* is an exception to the General Agreement it is up to Canada, as the party invoking the exception, to demonstrate that the purchase undertakings are necessary to secure compliance with the Foreign Investment Review Act".[336]

5.67 With regard to the burden of proof for the *chapeau* of Article XX, the defending party is required to establish to the Panel's satisfaction that the application of the measure does not constitute "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail". In *US – Gasoline*, the Appellate Body noted the difference between the burden of proof

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[331] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 215. Appellate Body Report, *Korea – Various Measures on Beef*, para.142.

[332] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

[333] Appellate Body Report, *EC – Asbestos*, para. 98.

[334] Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

[335] Appellate Body Report, *US – Gasoline*, p. 16. While the original statement refers to Article XX (g), the Appellate Body's reasoning relies on the *chapeau*, which applies equally to Article XX (g) and Article XX (d). The Appellate Body's reasoning must therefore also extend to Article XX (d). *See* Panel Report, *Argentina – Hides and Leather*, footnote 560.

[336] GATT Panel Report, *Canada – FIRA*, para. 5.20 (italics in original).

under the individual paragraphs of Article XX on the one hand, and the burden of proof under the *chapeau* of Article XX on the other, and found that the burden of proof for the *chapeau* was a "heavier" one. [337]

5.68 In the light of the above principle, it is up to the Dominican Republic, who invokes Article XX(d) in the present dispute, to demonstrate that there is no other alternative WTO-consistent or less WTO-inconsistent measure it could reasonably employ in order to secure the compliance with its domestic policy goals.

(d) Analytical approach for Article XX justification

5.69 The Appellate Body in *Korea – Various Measures on Beef* stressed that the reach of the word "necessary" is within a continuum of degrees of necessity, which is located "significantly closer" to the pole of "indispensable" than to the opposite pole of "simply making a contribution to".[338] The more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument.[339]

5.70 In China's view, along this continuum between "significantly closer to indispensable" and "simply making a contribution to", there may exist situations where a measure may be "necessary" to achieve the compliance pursuant to Article XX(d), and at the same time, achieve other objectives. By analogy, the necessity of the measure in question to secure compliance with the WTO-consistent laws and regulations need not amount to a "sole and exclusive" one.

5.71 Taking into consideration the relationship between the claimed policy objective of the measure and its "general design and structure"[340] and in order to fully assess the "necessity" of a measure along the continuum, Panels in the past have undergone a process of "weighing and balancing a series of factors which prominently include the contribution made by the compliance measure" on the one hand, and "the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports" on the other hand.[341]

5.72 In addition, whether an alternative less trade-restrictive measure is reasonably available is relevant to the determination of the degree of necessity. So far, numerous Panel and Appellate Body reports, which have examined the test of "necessity" under Article XX (d) of GATT, have come to the conclusion that a restrictive measure taken by a Member is not necessary if an alternative measure, which that Member could reasonably be expected to employ and which is not inconsistent with other GATT provisions, is available to it.[342] In order to decide whether a less trade-restrictive alternative measure is available, previous Panels took into account the specific facts of each individual case.

5.73 Finally, it could be argued, it is up to the Panel to decide, presuming that the stamp requirement were withdrawn, whether the Dominican Republic's regulatory goals to secure compliance with the Tax Code and prevent rampant cigarette smuggling would be satisfied.

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[337] Appellate Body Report, *US – Gasoline*, pp. 22-23.
[338] Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.
[339] Ibid., para. 162.
[340] Panel Report, *Argentina – Hides and Leather*, para.11.303.
[341] Appellate Body Report, *Korea – Various Measures on Beef*, para. 164.
[342] See, e.g. GATT Panel Report, *US – Section 337*, para. 5.26; GATT Panel Report, *Thailand – Cigarettes*, para. 75; Panel Report, *US – Gasoline*, para. 6.22-6.28; and Panel Report, *Argentina – Hides and Leather*, paras. 11.324-11.331.

11. Conclusion

5.74 As a third party to this dispute, China is not necessarily aware of the detailed contents and effects of several measures in question. In the light of the relevant WTO/GATT jurisprudence and the analytical approach with regard to the measures in question set forth above, China hopes the viewpoints and various issues it has raised may assist the Panel in its decision.

C. EL SALVADOR AND NICARAGUA

1. Introduction

5.75 In the light of the strong historical, legal and economic ties between the two countries and in view of their common status as third parties to the dispute *Dominican Republic – Measures Affecting the Importation and Sale of Cigarettes* (WT/DS302), El Salvador and Nicaragua have decided to make a joint contribution to the proceedings.

5.76 The different matters at issue in this dispute are of considerable systemic interest, and in some cases, of substantial interest, as shall be shown further on.

2. Legal aspects

5.77 In the paragraphs that follow, El Salvador and Nicaragua will present their views on the legal aspects of the measures in dispute.

(a) 2 per cent transitional surcharge on imports

5.78 In addressing this point, El Salvador and Nicaragua consider that it is important to refer to the fact raised by the Dominican Republic in its first written submission that Decree 646-03 of 30 June 2003 was revoked, and that a measure of equal effect was introduced by Law 2-04 of 4 January 2004. El Salvador and Nicaragua consider that the measure at issue, independently of the legal instrument containing it, continues to be the same, and its essential attributes have not been altered by the new law.

5.79 Consequently, to fully comply with its terms of reference, the Panel should analyse the measures at issue, i.e. Decree 646-03 and Law 2-04.[343]

5.80 At the same time, El Salvador and Nicaragua feel that it is also necessary to address the comments made by the Dominican Republic to the effect that the "transitional surcharge for economic stabilisation" of 2 per cent on the c.i.f. value of imports is duly covered by the reservation it made when it submitted an addition to its Schedule XXIII on 14 September 1994, under "other duties or charges". El Salvador and Nicaragua would like to examine the following points in this connection.

(i) Validity of the "transitional surcharge" as included in the Dominican Republic's Schedule XXIII under "other duties and charges"

5.81 Article II:1(b) of the GATT 1994 stipulates:

> "The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein. *Such products shall*

[343] Panel Report, *Argentina – Footwear (EC)*, paras. 8.24 and 8.45.

> *also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date*". (Emphasis added)

5.82 At the same time, paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994 states:

> "In order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, *the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of concessions annexed to GATT 1994* against the tariff item to which they apply. It is understood that such recording does not change the legal character of 'other duties or charges'". (Emphasis added)

5.83 Thus, both provisions establish the conditions or circumstances under which a duty or charge may be levied in addition to the ordinary customs duties in order to be valid. El Salvador and Nicaragua shall turn to these conditions or circumstances below in order to examine the validity of the Dominican Republic's assertion that the "transitional surcharge" applied to cigarettes is covered by the addition it made to its Schedule XXIII under "other duties and charges" on 14 September 1994.

(ii) Existence of the measure on 15 April 1994

5.84 A simple reading of Article II:1(b) of the GATT 1994, second sentence, reveals that for the levy of "other duties and charges" in addition to "ordinary customs duties" to be valid, one of the following circumstances must apply:

- They must be duties or charges that were imposed on the date of the Agreement (in this case, 15 April 1994); or
- They must be duties or charges directly and mandatorily required to be imposed by legislation in force in the importing territory on the date of the Agreement (in this case, 15 April 1994).

5.85 El Salvador and Nicaragua note that the "transitional surcharge" of 2 per cent on the c.i.f. value of imports does not comply with either of the circumstances set forth in Article II:1(b) of the GATT 1994, since neither of the measures by which the Dominican Republic imposed the said surcharge, in the past, or currently imposes it, was in force on 15 April 1994:

- Decree 646-03, enacted on 30 June 2003; and
- Law 2-04, enacted on 4 January 2004.

(iii) Recording of the measure in the Schedule of Concessions

5.86 A reading of paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994 reveals that the nature and level of any "other duties or charges" levied on bound tariff items must be recorded in the Schedules of Concessions annexed to the GATT 1994.

5.87 Needless to say, then, that the addition made by the Dominican Republic on 14 September 1994 to its Schedule XXIII, under "other duties or charges", makes no reference whatsoever to a measure whose nature or level is equal or similar to the nature and level of the "transitional surcharge for economic stabilisation" of 2 per cent on the c.i.f. value of imports.

5.88 In this connection, it should be noted that the addition made to the Dominican Republic's Schedule XXIII under "other duties or charges" refers only to '*lista de productos importados que pagan el Impuesto Selectivo en aduanas*" (list of imported products which pay the Selective Tax at customs), in which it indicates as the level of the charge an *ad valorem* rate determined as a percentage for each tariff item. This charge is, apparently, a selective consumption tax.

5.89 The two above points lead to the firm conclusion that despite its contentions to the contrary, the Dominican Republic's "transitional surcharge for economic stabilisation" is at no time covered by its entries in its Schedule of Concessions XXIII.

(b) Coverage of the measure as applied

5.90 In this second part of their analysis of the legal aspects of the "transitional surcharge", El Salvador and Nicaragua felt that it was extremely important to present their views on the coverage of goods falling within the scope of the measure at issue.

5.91 It was established above that the "transitional surcharge" is not covered by the Dominican Republic's entries in its Schedule of Concessions XXIII as it contends. Beyond that, however, the Dominican Republic has left a large void in its first written submission in its attempt to justify its transitional measure with respect to cigarettes only, and not with respect to the tariff universe to which the measure applies.

5.92 The Panel must examine the matter referred to it by Honduras which, with respect to the "transitional surcharge", can essentially be described as follows:

> "The Dominican Republic levies a transitional surcharge for economic stabilisation in accordance with Decrees 646-03 and 693-03, a surcharge which currently amounts to 2 per cent of the c.i.f. value of the *imported goods*. Honduras considers that the surcharge constitutes a charge imposed on or in connection with importation inconsistent with Article II:1(a) and (b) of the GATT".[344] (Emphasis added).

5.93 Thus, both Decree 646-2003 and Law 2-04 establish a transitional surcharge on the totality of goods in the tariff universe. Honduras has challenged the measure as such, without making any distinction in terms of a specific product. In this connection, the Appellate Body in the case *European Communities – Customs Classification of Certain Computer Equipment* notes that "Article 6.2 of the DSU does *not* explicitly require that the products to which the 'specific measures at issue' apply be identified." When Honduras submitted this measure for analysis by the Dispute Settlement Body, it never confined nor restricted its request for examination to the specific case of cigarettes, which means that the measure should be examined in respect of all products. At the same time, El Salvador and Nicaragua note that the Dominican Republic tried, and failed, to demonstrate the validity of its measure only in relation to cigarettes, which are included in the list that it annexed on 14 September 1994 to its Schedule of Concessions XXIII.

5.94 Furthermore, El Salvador and Nicaragua consider that the application of the measure to the tariff universe is inconsistent with the Dominican Republic's commitments under Article II:1(b) of the GATT.

5.95 Indeed, in the above paragraphs El Salvador and Nicaragua have shown that the "transitional surcharge" is a measure imposed by the Dominican Republic in violation of Article II:1(b) of the GATT in that it is applied to the products included in the Dominican Republic's Schedule XXIII, under "other duties and charges" added on 14 September 1994, as well as to the rest of the products of

[344] Request for the Establishment of a Panel by Honduras, *supra* note 2, para. 5.

the tariff universe. Consequently, the measure is also in violation of the General Principle laid down in Article II:1(a).[345]

5.96 It is on the basis of these legal arguments that El Salvador and Nicaragua consider the "transitional surcharge" for economic stabilization of 2 per cent on the c.i.f. value of imports applied by the Dominican Republic to be totally inconsistent with the Dominican Republic's obligations under the GATT.

3. Foreign exchange fee of 10 per cent imposed on imports

5.97 The Dominican Republic maintains in force a measure which establishes a levy in the form of a "foreign exchange fee" imposed on the value of imports.

5.98 El Salvador and Nicaragua have examined at length the arguments submitted by the Dominican Republic to the effect that this measure constitutes an "exchange measure" in accordance with the Articles of Agreement of the International Monetary Fund, and is therefore duly permitted under Article XV:9(a) of the GATT.[346]

5.99 It should be borne in mind, however, that the measure at issue retains the following characteristics:

- The foreign exchange fee is applied upon importation into the Dominican market;
- The foreign exchange fee is applied to the value of imports;
- The fee is charged by the customs authorities.

5.100 These characteristics of the "foreign exchange fee" clearly point to a different conclusion: far from being an "exchange measure" associated with the inherent characteristics of exchange transactions, as the Dominican Republic contends, it is a duty or charge levied in addition to the ordinary customs duties.

5.101 Also, the Dominican Republic bears the burden of proof with respect to its claim that the "foreign exchange fee" is an exchange measure that is justified under Article XV:9(a). Indeed, El Salvador and Nicaragua note that the various elements of that claim remain to be proved.

5.102 This calls for a number of immediate comments on the statement made by the Dominican Republic in its first written submission that "... even if the Panel finds that the exchange fee is not an exchange measure justified by Article XV:9(a), the claim that it is inconsistent with Article II:1 would fail since the rate of the exchange fee is within the level of the ODCs recorded by the Dominican Republic in its Schedule".[347]

5.103 In this connection, El Salvador and Nicaragua revert to the remarks made with respect to the Dominican Republic's right to impose other duties or charges in the light of its entries in its Schedule of Concessions:

[345] First written submission of Honduras, 16 March 2004, footnote 34 to para. 58.
[346] First written submission of the Dominican Republic, 13 April 2004, para. 201.
[347] Ibid., para. 189.

(a) The validity of the "foreign exchange fee of 10 per cent" in relation to the Dominican Republic's Schedule XXIII – "other duties or charges"

5.104 As already stated in this submission in the part concerning the "transitional surcharge", a simple reading of Article II:1(b) of the GATT, second sentence, reveals that for the levy of "other duties or charges" in addition to "ordinary customs duties" to be valid, one of the following circumstances must apply:

- They must be duties or charges that were imposed on the date of the Agreement (in this case, 15 April 1994); or
- They must be duties or charges directly and mandatorily required to be imposed by legislation in force in the importing territory on the date of the Agreement (in this case, 15 April 1994).

5.105 The "foreign exchange fee" is a measure applied by the Dominican Republic since 1991, and consequently, it was in force on 15 April 1994 at the time when the other duties and charges which could be applied in addition to the ordinary customs duties were bound. However it was never applied at its current rate of 10 per cent on the value of imports to the Dominican Republic.

5.106 Furthermore, the measure was never recorded in the list of "other duties or charges" that could be applied by the Dominican Republic in accordance with its Schedule of Concessions. In this connection, paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994 states that the nature and level of any "other duties or charges" levied on bound tariff items shall be recorded in the Schedule of Concessions annexed to the GATT 1994. The paragraph reads:

> "In order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, *the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of concessions annexed to GATT 1994* against the tariff item to which they apply. It is understood that such recording does not change the legal character of 'other duties or charges'". (Emphasis added)

5.107 In the light of the above and of the Dominican Republic's Schedule of Concessions as supplemented by "other duties or charges" on 14 September 1994, it quickly becomes clear that neither the foreign exchange fee itself, nor its level of application, were recorded by the Dominican Republic. As was previously mentioned, the entries recorded by the Dominican Republic refer to a selective customs tax, which is apparently a selective consumption tax.

5.108 Thus, having established that the "foreign exchange fee" imposed by the Dominican Republic is applied at a level different from that applied on 15 April 1994, and having found that neither the measure itself nor its level were ever recorded in the Dominican Republic's Schedule of Concessions, it can clearly be concluded that the said measure is a duty or charge levied in addition to the ordinary customs duties and is therefore inconsistent with the Dominican Republic's obligations under the GATT 1994.

(b) Coverage of the measure as applied

5.109 The Dominican Republic applies the "foreign exchange fee" to the totality of the tariff universe. El Salvador and Nicaragua note in this respect that the Dominican Republic has tried to justify its measure by stating that it was added to its Schedule of Concessions on 14 September 1994.

5.110 However, even if it turned out to be valid, this justification would cover the "foreign exchange fee" only for those tariff items included in the mentioned list that was added on

14 September 1994, and not for all of the products of the tariff universe. Here, as in the case of the transitional surcharge, the terms of reference given to the Panel by the DSB do not restrict examination of the measure to cigarettes and the Dominican Republic has therefore again left a large gap in its argument in attempting to justify the validity of the measure.

5.111 On the basis of the above considerations it can be said that the Dominican Republic has violated its obligations under Article II:1(b) of the GATT, and hence, it has also violated the general principle laid down in Article II:1(a) of the GATT.[348]

5.112 It is on the basis of these legal arguments that El Salvador and Nicaragua consider that the "foreign exchange fee" imposed by the Dominican Republic is a measure that is inconsistent with its obligations under the GATT.

4. Stamp requirements for cigarettes

5.113 The Dominican Republic requires that a stamp be affixed on cigarette packets in its territory pursuant to Article 37 of Decree 79-03, and Articles 1 and 2 of Decree 130-02.[349] This stamp requirement is a measure that applies to both domestic and imported products.[350]

5.114 Consequently, it is important to analyse this measure in the light of Article III:4 of the GATT, which states:

> "The products of the territory of any contracting party imported into the territory of any other contracting party 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".

5.115 Similarly, in connection with this provision, the Appellate Body in *Korea – Various Measures on Beef*, stated that:

> "For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the imported products are accorded 'less favourable' treatment than that accorded to like domestic products. Only the last element -'less favourable' treatment- is disputed by the parties and is at issue in this appeal".[351]

5.116 El Salvador and Nicaragua agree with the position stated by Honduras and shared with the Dominican Republic that for the purposes of this case, imported cigarettes and domestic cigarettes are like products.[352]

5.117 The second of the mentioned elements establishes that the measure at issue must be a law, regulation, or requirement affecting the sale, offering for sale, purchase, transportation, distribution or

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[348] First written submission of Honduras, 16 March 2004, footnote 34 to para. 58.
[349] Ibid., paras. 20 to 23.
[350] Ibid., paras. 75, and First written submission of the Dominican Republic, 13 April 2004, para. 37.
[351] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.
[352] First written submission of Honduras, 16 March 2004, paras. 72 to 74, and First written submission of the Dominican Republic, 13 April 2004, para. 32.

use of the products on the domestic market. The measure at issue complies with this condition, since the requirement to affix a stamp on cigarettes in the Dominican Republic is imposed by the Dominican Republic in order to sell those products. Specifically, in the case of imported cigarettes, Decree 130-02 stipulates that these products shall be placed in a bonded warehouse or warehouse under the Directorate General of Internal Taxes where the control stamps provided for by Law 2461 of 1950 shall be applied.

5.118 The third and last of the elements which, according to the Appellate Body, must be satisfied for a violation of Article III:4 to be established is that the imported products must be accorded "less favourable" treatment than that accorded to like domestic products. In the case of the measure at issue, the producers of cigarettes in the Dominican Republic can affix the stamp on the cigarette packet as part of the production and labelling process, while in the case of imported cigarettes, the cigarettes have to be taken to bonded warehouses or warehouses under the control of the Directorate General for Internal Taxes, the packages unpacked, the cellophane wrapping removed, the stamp affixed and the packages wrapped and packed once again.[353] For imported cigarettes, this process involves labour and capital costs in addition to those incurred in the case of domestic cigarettes, placing the former at a competitive disadvantage.[354]

5.119 Thus, though the measure may be applied according to the law both to domestic products and to imported products, in reality it results in less favourable treatment for imported products, and this constitutes a discrimination.

5.120 In the light of the above considerations, El Salvador and Nicaragua consider that the requirement to affix a stamp on cigarette packets exclusively in the territory of the Dominican Republic constitutes a violation of Article III:4 of the GATT.

5.121 El Salvador and Nicaragua also consider that this case has considerable systemic implications owing to the precedent that it could create with respect to measures that could be adopted for other products. If the Panel were to find that the requirement to affix stamps on cigarette packets exclusively in the territory of the Dominican Republic constitutes a GATT-consistent measure, it would be setting a precedent which would give rise to numerous abuses of the multilateral trading system that would be improperly justified by invoking a variety of problems parallel to the obligations of Members.

5.122 Having said this, El Salvador and Nicaragua do not deny the sovereign right of Member States to introduce, under the multilateral trading system, measures whose purpose is legitimate. However, the application of those measures must fully respect and comply with the obligations deriving from the commitments made by Members as part of that multilateral system.

5. Conclusions

5.123 El Salvador and Nicaragua consider that the current dispute is of considerable importance owing to its implications for trade relations with the Dominican Republic and for the proper functioning of the multilateral trading system in accordance with the commitments assumed by each WTO Member.

5.124 El Salvador and Nicaragua stated that in the foregoing submission they have established the factual and legal grounds for reaching the following conclusions:

- Regarding the "transitional surcharge of two per cent on imports", El Salvador and Nicaragua consider that the Dominican Republic has violated Article II:1(a) and

[353] First written submission of Honduras, 16 March 2004, para. 78.
[354] Ibid., para. 82.

II:1(b) of the GATT, since the measure is a "duty or charge" levied unjustifiably in addition to the ordinary customs duties.

- Regarding the "foreign exchange fee of 10 per cent on imports", El Salvador and Nicaragua consider that the Dominican Republic has violated Article II:1(a) and II:1(b) of the GATT, since the measure unjustifiably constitutes a "duty or charge" levied in addition to the ordinary customs duties.

- Regarding the "requirement to stamp cigarette packets in the Dominican Republic", El Salvador and Nicaragua consider that the Dominican Republic has violated Article III:4 of the GATT, since the application of that measure results, in practice, in less favourable treatment for imported products.

5.125 In the light of the above, El Salvador and Nicaragua requested the Panel to recommend that the Dominican Republic bring its measures into conformity with the respective provisions of the GATT.

D. EUROPEAN COMMUNITIES

1. Introduction

5.126 The European Communities stated that it intervenes in this case because of its systemic interest in the interpretation of fundamental provisions of the General Agreement on Tariffs and Trade 1994 (the "GATT"), in particular Article III. Therefore, the European Communities does not take a position on the specific facts of this case and the question of whether or not the challenged measures are WTO-consistent.

2. The transitional surcharge on imports

5.127 In its submission, Honduras argues that the transitional surcharge on imports is inconsistent with Article II:1(b) of the GATT. Moreover, in a footnote, Honduras maintains that, for this reason, the measure is also in breach of Article II:1(a) of the GATT.[355]

5.128 At the outset, the European Communities would note that it cannot agree with the statement made by Honduras that "Article II:1(a) of the GATT prohibits, in principle, duties and charges on bound items other than ordinary customs duties".[356] Rather, that Article mandates treatment no less favourable than that provided for in the relevant schedule. The same applies to Article II:1(b) second sentence of the GATT as is further corroborated by the *Understanding on the Interpretation of Article II:1(b)*.[357] The text of the schedule will therefore govern the question of the WTO-compatibility of the particular "other duties or charges" a Member imposes. To the extent that the transitional surcharge on imports is inconsistent *with the schedule*, it would be in violation of Article II:1(b) of the GATT and consequently, to this extent, also in breach of Article II:1(a) of the GATT.[358]

3. The foreign exchange fee

5.129 The foreign exchange fee, as the European Communities understands it, is imposed on the exchange of local currency into foreign currency which is necessary to pay for imported goods.[359]

[355] First written submission of Honduras, 16 March 2004, paras. 47 *et seq.*, footnote 34.
[356] Ibid., para. 2.
[357] Cf. Panel Report, *Chile – Price Band* System, para. 7.107.
[358] Appellate Body Report, *Argentina – Textiles and Apparel*, para. 45.
[359] First written submission of Honduras, 16 March 2004, paras. 15 *et seq.*; Dominican Republic first written submission, 13 April 2004, para. 193.

Honduras argues that this fee is contrary to Article II:1(b) of the GATT because it exceeds the levels of "other duties and charges" as inscribed by the Dominican Republic in its schedule.[360] The Dominican Republic defends the foreign exchange fee in the first place by referring to Article XV:9(a) of the GATT.[361]

5.130 The European Communities does not take a position on Honduras's allegation that the foreign exchange fee would be contrary to Article II:1(b) of the GATT. However, the European Communities would like to make some systemic comments on the interpretation of Article XV:9(a) of the GATT:

5.131 First of all, the European Communities notes that this provision, and Article XV of the GATT as a whole, are closely related to the IMF field of activity. Under Article XV:9(a) of the GATT WTO Members may use "exchange controls" or "exchange restrictions" consistent with IMF rules. Therefore, the interpretation of this provision should not be conducted in isolation from the relevant IMF concepts and rules. The GATT cannot be assumed to have restricted the scope for Members to adopt these exchange measures consistent with IMF rules.

5.132 That said, the European Communities would note that it appears that a "fee" is not necessarily an "exchange restriction" within the terms of Article XV:9(a) of the GATT. The ordinary meaning of the term "restriction" is "a limitation on action, a limiting condition".[362] Thus, while it is of course true that a fee would make foreign exchanges more expensive, this does not necessarily entail a limitation on the availability of foreign currencies. Thus, the exception under Article XV:9(a) of the GATT may not be pertinent in this case.

5.133 The European Communities would also note that Article XV:4 of the GATT provides that any "exchange action" shall not "frustrate the intent of the provisions of this Agreement". Clearly, not all "exchange actions" are exempted by virtue of Article XV:9(a) of the GATT. Care must be taken not to interpret this latter provision in a rather broad way to the detriment of the general principle under Article XV:4 of the GATT. To avoid such a conclusion, it appears, therefore, appropriate to give the notion of an "exchange restriction" under Article XV:9(a) of the GATT a meaning consistent with the actual terms used, with its immediate context and with the relevant IMF provisions.

5.134 In this context, the European Communities would also emphasise the objective and purpose of the WTO Agreements which aims at "expanding the trade in goods and services".[363] It would be contrary to this objective if the trade impact of certain foreign exchange actions were to escape the GATT rules by virtue of a too broad interpretation of the term "exchange restriction" under Article XV:9(a) of the GATT.

4. The requirement to affix tax stamps in the territory of the Dominican Republic

(a) Article III:4 of the GATT

5.135 The European Communities wishes to comment upon the legal test to be applied under Article III:4 of the GATT when assessing the question whether imported products are accorded "less favourable treatment" compared to the "like" domestic products. As is well established in the GATT/WTO jurisprudence, less favourable treatment can arise both from formally different and formally identical treatment of imports and like domestic products.[364] The fact that the requirement to

[360] First written submission of Honduras, 16 March 2004, paras. 59 *et seq*.

[361] First written submission of the Dominican Republic, 13 April 2004, paras. 190 *et seq*.

[362] *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. II, p. 2,569. The European Communities would note that this definition appears to be similar to the term "exchange restriction" as interpreted by the IMF, *cf*. First written submission of the Dominican Republic, 13 April 2004, para. 194.

[363] Agreement establishing the World Trade Organization, Preamble.

[364] Appellate Body Report, *Korea – Various Measures on Beef*, paras. 136, 137; GATT Panel Report, *US – Section 337*, para. 5.11.

affix the stamp in the Dominican Republic's territory is identical for importers and domestic manufacturers, therefore, does not exclude the possibility of *de facto* less favourable treatment.[365]

5.136 According to the Appellate Body in *Korea – Various Measures on Beef*, the relevant standard for a determination of "less favourable treatment" is whether the measure at issue accords "conditions of competition" that are less favourable for imports than for the like domestic goods.[366]

5.137 The European Communities would object to the Dominican Republic's attempt to narrow the obligation of national treatment in Article III:4 of the GATT by importing "so as to afford protection" into the criterion of "less favourable treatment". On the basis of "so as to afford protection to the domestic industry" in Article III:1 of the GATT, the Dominican Republic appears to advocate an additional requirement under Article III:4, which is that the measure has "protective application".[367]

5.138 Firstly, this attempt goes in the direction of advocating the "aims-and-effects" approach which has been explicitly rejected in the WTO jurisprudence.[368] A responding party can therefore not defend itself against the allegation of an Article III violation by insisting that its measure pursues entirely legitimate policies and is not inherently and intentionally discriminatory.

5.139 Secondly, while the Dominican Republic is right that the Appellate Body has acknowledged that Article III:1 of the GATT informs all of Article III, including its paragraph 4[369], this does not result in the additional requirement(s) for a violation of Article III:4 of the GATT as argued by the Dominican Republic. The Appellate Body has made it clear that the principle of Article III:1 of the GATT is already expressed in the requirement of "no less favourable treatment" in Article III:4 of the GATT. Where there is less favourable treatment of the group of like imports, there is automatically protection of the group of like domestic products:

> "The term 'less favourable treatment' expresses the general principle, in Article III:1, that internal regulations 'should not be applied… so as to afford protection to domestic production'. If there is less favourable treatment' of the group of 'like'

[365] In this context, it should be pointed out that one should not misunderstand the GATT Panel's reference in *US – Section 337*, to "cases where the application of formally identical legal provisions would in practice accord less favourable treatment to imported products *and a contracting party might thus have to apply different legal provisions* to imported products to ensure that the treatment accorded them is in fact no less favourable" (emphasis added). The remedy to abolish the *de facto* discrimination which arises from identical treatment need not necessarily and always introduce *different* treatment of imports and domestic products. There may also exist forms of identical treatment other than the discriminatory one that would remove any less favourable treatment.

[366] Appellate Body Report, *Korea – Various Measures on Beef*, para. 135. The Appellate Body's formulation, in para. 137 of that Report, "whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products" (compared to domestic goods) expresses the same idea, even though strictly speaking "modifies to the detriment of imports" is a correct standard only where there previously was no (such) discriminatory measure imposing a competitive disadvantage on imports. Where, however, the previous regulatory situation was equally or even more discriminatory, there would be no "modification" to the detriment of imports, but nevertheless a national treatment violation because the measure in question still "accords" less advantageous conditions of competition to imports. See also Panel Report, *Canada – Wheat Exports and Grain Imports*, para. 6.184: "the relevant requirement… must adversely affect the competitive opportunities of imported grain *vis-à-vis* like domestic grain".

[367] First written submission of the Dominican Republic, 13 April 2004, paras. 46, 51.

[368] Appellate Body Report, *EC – Bananas III*, para. 241; Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 27-28.

[369] Appellate Body Report, *EC – Asbestos*, para. 98; Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 18.

> imported products, there is, conversely, 'protection' of the group of 'like' domestic products".[370]

5.140 Thus, there is no need for an additional finding of the existence of what the Dominican Republic calls "protective application".

5.141 For this reason, the Dominican Republic also cannot defend itself with the argument that the costs imposed by its tax stamp measure are minimal and therefore result in no discriminatory or protective effect.[371] Indeed, according to established jurisprudence even a minimal difference in taxes may contravene Article III:2, first sentence, of the GATT as this provision contains no *de minimis* exception.[372] In addition, Article III of the GATT protects expectations of equal competitive opportunities, not of trade volumes.[373] This simultaneously shows the irrelevance of the Dominican Republic's argument that the volume of imports has actually increased despite the allegedly discriminatory trade practice.

5.142 Finally, the Dominican Republic's arguments regarding the need for effective enforcement of tax laws, the danger of forgery and tax evasion and the lack of reasonably available regulatory alternatives do not belong in the analysis of competitive conditions and thus of national treatment. In the event of an inconsistency with Article III of the GATT, such considerations would be relevant in the examination of a justification under Article XX:(d) of the GATT.

5.143 Regarding the analysis of the "conditions of competition" one would need to assess whether the measure imposes additional costs on imported products compared to those imposed on like domestic products. In contrast, additional costs which are not truly the result of the governmental measure, but of a free choice by the importer, would be irrelevant. In the latter case, the additional costs borne by imports as compared with the like domestic products would not be entailed by the governmental measure and they should, therefore, be ignored in the "less favourable treatment" analysis. The same is valid for those competitive disadvantages which are not the result of the measure, but of economic, geographic or cultural circumstances inherently connected with the sale of products in export markets.

5.144 In sum, Article III:4 of the GATT requires that one considers only those costs that are imposed by the challenged measure itself and to assess whether the result is a disadvantage for imports in their competitive relationship with the like domestic products.

5.145 In the present case, the European Communities would not exclude that the Dominican Republic's requirement to affix the tax stamps in its territory creates a higher burden for imports and thus a competitive disadvantage *vis-à-vis* like domestic products. The Panel would need to assess the extent to which the alleged additional costs are truly imposed on importers compared to domestic producers and not only an exaggerated description of necessary additional steps or costs that are self-imposed by the importer, for instance by inefficient production processes.

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[370] Appellate Body Report, *EC – Asbestos*, para. 100.

[371] First written submission of the Dominican Republic, 13 April 2004, paras. 45 and 53.

[372] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 23; GATT Panel Report, *Japan – Alcoholic Beverages I*, paras. 5.8, 5.11; GATT Panel Report, *US – Malt Beverages*, para. 5.26.

[373] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 16; GATT Panel Report, *US – Superfund*, para. 5.1.9.

(b) Article XX:(d) of the GATT

5.146 Assuming that the "tax stamp requirement" were to be found in violation of Article III:4 of the GATT the Panel would then be called upon to adjudicate on the Dominican Republic' argument that the measure is justified under Article XX(d) of the GATT.[374]

5.147 The European Communities believes that a tax stamp requirement pursues a legitimate objective under the GATT, i.e. the levy of taxes on cigarettes, and that a tax stamp is an appropriate means to secure compliance with such an objective. However, the European Communities would invite the Panel to consider whether the concrete measure applied by the Dominican Republic is "necessary" in terms of Article XX(d) of the GATT.

5.148 The Appellate Body gave an exhaustive interpretation of the term "necessary" under Article XX(d) of the GATT in the case *Korea – Various Measures on Beef*. Thus, an examination of this term,

> "involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports".[375]

5.149 The Appellate Body has further added that, in its view,

> "the weighing and balancing process [it has] outlined is comprehended in the determination of whether a WTO-consistent alternative measure which the Member concerned could 'reasonably be expected to employ' is available, or whether a less WTO-inconsistent measure is 'reasonably available'."[376]

5.150 In the case at hand, the European Communities would not contest that the tax stamp requirement is apt to achieve the compliance with the taxation of cigarettes in the Dominican Republic. However, Honduras contends that the tax stamp requirement has also a considerable adverse impact on the cost of importation due to the necessity to put the stamp on the cigarettes in the Dominican Republic. The European Community is not in a position to judge whether all the additional steps described by Honduras[377] would necessarily occur, but it seems clear that the Dominican Republic' tax stamp requirement, at least, entails some more manufacturing steps for imports compared to the situation in which the stamps could be affixed in the "home" factory of the producer of imported cigarettes. According to the Appellate Body jurisprudence, such an aspect should be taken into account when assessing the "necessity" of the measure under Article XX(d) of the GATT.

5.151 In the EC's view, the requirement of a "tax stamp" could in principle also be achieved in a way that would be less burdensome for imports into the Dominican Republic. Such alternative methodology could consist, for instance, of selling tax stamps to authorized producers who would be entitled to fix the stamps on the cigarettes packets during the manufacturing process. If properly designed, such a procedure could sufficiently guarantee that only original tax stamps would be used, thus securing the objective of the tax stamp, while avoiding an unnecessary doubling in the manufacturing process for importers.

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[374] See First written submission of the Dominican Republic, 13 April 2004, paras. 100 *et seq.*
[375] Appellate Body Report, *Korea – Various Measures on Beef*, para. 164.
[376] Ibid., para. 166.
[377] First written submission of Honduras, 16 March 2004, para. 78.

5.152 This being said, the European Communities does not contest the right of the Dominican Republic to choose its level of enforcement for its legitimate tax laws.[378] However, as in the case *Korea – Various Measures on Beef*, this argument is not a "blank cheque" to the Member invoking Article XX(d) GATT. Instead, it is for the Panel to balance and weight all the arguments put forward by the party relying on this defence.

5. The Selective Consumption Tax

5.153 The Dominican Republic argues that the Panel should dismiss the claim because it is moot given the enactment of the Law 3-04 which was published on 14 January 2004[379], that is after the establishment of the Panel, i.e. on 9 January 2004. Against this background, the European Communities considers that the Panel should conclude that the claim has become moot unless Honduras advances a special legal interest on why the Panel should still make a finding on this issue.

5.154 The European Communities is aware that the Panel's terms of reference form the jurisdictional basis for a case. For this reason, past Panels have been reluctant to dismiss a claim in case the underlying facts changed.[380] That said, in the EC's view, it is important to take into account the rationale of the dispute settlement system. For instance, Article 3.2 of the DSU provides that this system "serves to preserve the rights and obligations of Members". Moreover, Article 3.3 of the DSU refers to "measures taken by another Member" and Article 3.7 of the DSU second sentence stipulates that "the aim of the dispute settlement mechanism is to secure a positive solution to a dispute".

5.155 The European Communities considers that, in case a measure is withdrawn, the basis for a "dispute" does not exist any more.[381] In these circumstances, it would be for the complaining party to demonstrate why the dispute settlements proceedings should continue and to what extent its rights and obligations could still be affected. However, if the measure has simply become moot it is neither appropriate nor necessary any more for the Panel to make any findings on such a claim. Indeed, there would be no longer a "measure" which could "affect the rights and obligations" of another Member and, consequently, the case would be deprived of a "dispute".

6. The requirement to post a bond

5.156 The European Communities would insist that Article XI:1 of the GATT is not applicable to the bond requirement. This measure should be applied identically by both domestic manufacturers and importers ("*tanto por importadores como por fabricantes locales*").[382] As the Interpretative Note *Ad* Article III makes clear, such a measure falls under Article III of the GATT and not within the scope of Article XI of the GATT.

5.157 In support of its subsidiary claim under Article III:4 of the GATT, Honduras asserts that the bond, which is a specific one-off guarantee (RD$ 5 million per importer or domestic producer), burdens an importer with small market share much more than a domestic producer with large market share. Honduras also claims that the bond serves to guarantee the payment of the Selective

[378] First written submission of the Dominican Republic, 13 April 2004, para. 117.

[379] See Corrigendum to the First written submission of the Dominican Republic, letter of 23 April 2004.

[380] See GATT Panel Report, *EEC – Animal Feed Proteins*; Panel Report, *US – Wool Shirts and Blouses*, para. 6.2; Panel Report, *Indonesia – Autos*, para. 4.61. But see also, Panel Report, *Argentina – Textiles and Apparel*, para. 6.11 *et seq*. The European Communities however notes that each case presents its own particularities; thus, they may not necessarily constitute appropriate precedents.

[381] See also Article 3.7, fourth sentence, Dispute Settlement Understanding: "the first objective of the dispute settlement mechanism is usually to secure the *withdrawal of the measures concerned*" (emphasis added). Obviously, if the measure does not exist any more the dispute settlement procedure has already achieved its primary purpose.

[382] Decree 79-03, *supra* note 8, Article 14.

Consumption Tax, the actual burden of which depends on the quantities sold, such that the bond is not commensurate with the tax payable.

5.158 The European Communities would submit that the assessment whether the bond requirement *de facto* accords less advantageous competitive conditions to imported products than to the like domestic products should also take into account whether the bond requirement has a deterrent effect on potential domestic operators and importers. Domestic producers and also importers may be reluctant to set up business operations in the market of the Dominican Republic because of the bond requirement, with the result that that they do not actually exist on that market. When considering entry barriers resulting from the bond, it may be worth recalling that domestic producers must post the bond before starting production and importers (only) prior to importation.

5.159 The European Communities notes that while the parties have no disagreement about the "likeness" of the products in this case, i.e. cigarettes[383], it is nevertheless important to note that for the purpose of the determination of a "less favourable treatment" "domestic" and "imported" should be compared as respective "groups". Thus, the Appellate Body in *EC – Asbestos* held

> "A complaining Member must still establish that the measure accords to the group of 'like' *imported* products 'less favourable treatment' than it accords to the group of 'like' *domestic* products."[384]

5.160 Therefore, in order to determine whether imported products are treated less favourably than domestic products one has to compare the "groups" of the respective like products.[385] In the present case, it is not clear to the European Communities whether the bond requirement constitutes a "less favourable treatment" of the "group" of imported cigarettes compared to the "group" of cigarettes from the Dominican Republic. Indeed, in its claim Honduras only construes one example where an importer with a small market share is allegedly treated disadvantageously compared to a domestic producer with a big market share. Such an isolated example, however, is not sufficient to demonstrate that, under the terms of the decision *EC – Asbestos*, the "group" of imported products is treated less favourably than the "group" of domestic products. In other words, a single example, which might be purely anecdotal, tells nothing about the effects of the measure on the overall competitive relationship of imported and like domestic goods.

5.161 Furthermore, in order to make a *prima facie* case, it is not sufficient to rely for the determination of a "less favourable treatment" solely on the relative market share of importers as a group and domestic producers as a group. Honduras would also have to show that the imposition of a specific, fixed-amount bond results in a higher burden and a competitive disadvantage for the group of imported goods, as compared to the group of domestic like products.

5.162 As far as the Dominican Republic's defence on Article III:4 is concerned, in particular the relevance of "so as to afford protection" and "protective application" within "less favourable treatment", the European Communities would refer to its comments in connection to the tax stamp.

7. Conclusions

5.163 The European Communities considers that this case raises important questions on the interpretation of Article III of the GATT. While not taking a final position on the merits of the case, the Panel should carefully review the scope of the claims in light of the observations made in this submission.

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[383] First written submission of Honduras, 16 March 2004, para. 73 *et seq.;* First written submission of the Dominican Republic, 13 April 2004, para. 32.

[384] Appellate Body Report, *EC – Asbestos*, para. 100 (italics in original).

[385] See also Appellate Body Report, *Chile – Alcoholic Beverages*, para. 52.

E. GUATEMALA

1. Introduction

5.164 Guatemala stated that it would limit its comments to certain issues relating to the proper legal interpretation of various Articles of the GATT.

2. The stamp requirement for imported and domestic cigarettes

5.165 In paragraph 28 of its first written communication, the Dominican Republic states that:

> "There is nothing discriminatory about the stamp requirement specified in Article 37 of Decree No. 79-03 of 4 February 2003 and Article 2 of Decree 130-02 of 11 February 2002".

5.166 Further, in Paragraph 37, the Dominican Republic maintains that:

> "Accordingly to Article 37 of Decree 79-03, both the domestic producer and the importer of cigarettes are required to affix stamps in the presence and under the supervision of the DGII inspector".

5.167 Based on this reasoning, the Dominican Republic suggests that a Member may meet the requirement of Article III:4, by according to like products of any other Member, formally identical treatment to that it accords to its own like products.

5.168 Guatemala claims that the obligation of "treatment no less favourable" contained in Article III.4 is not, in essence, limited to *de jure* discrimination. Therefore, the term "treatment no less favourable" in Article III.4 of the GATT should be interpreted to include *de facto*, as well as *de jure*, discrimination.

5.169 More specifically, formally identical treatment shall be considered to be less favourable if it modifies the conditions of competition in the relevant market to the detriment of imported goods.

5.170 From that, and given the absence of *de jure* discrimination in the present case, the Panel should then turn to the question of whether the application of formally identical rules, nevertheless modified conditions of competition for importers.[386]

5.171 In its first written submission, Honduras claims that:

> "… by requiring that the tax stamp of cigarette packages be affixed in the territory of the Dominican Republic, the Dominican Republic accords treatment less favourable to imported cigarettes than that accorded to domestic cigarettes, in a manner inconsistent with Article III.4 of the GATT."[387]

5.172 For imported cigarettes, the stamp can only be placed on the cellophane of each cigarette packet after it is imported into the Dominican Republic, but prior to its sale. In contrast, domestic producers can place the stamp in their own premises without any adjustment or cost.

5.173 This, as Honduras affirms, derives in additional steps and costs, which as a result, modify the conditions of competition in the relevant market for imported cigarettes.

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[386] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.
[387] First written submission of Honduras, 16 March 2004, para. 69.

5.174 The cost of adjusting to this requirement linked with the fact that domestic producers do not have to undergo these additional steps, predominantly burdens importers, thus affecting the internal sale of imported cigarettes.

5.175 Therefore, the requirement to affix the stamp in the Dominican Republic discriminates against imported cigarettes by increasing the cost of imported cigarettes. This additional cost places imported goods in a disadvantageous competitive situation *vis à vis* the like domestic products.

5.176 Consequently, it can be concluded that the requirement to affix the stamp in the Dominican Republic modifies the conditions of competition for imported cigarettes in the Dominican Republic. This *de facto* discrimination reflects the less favourable treatment granted by Dominican Republic to imported cigarettes, thereby, violating Article III.4 of the GATT.

5.177 It is worth noting that the Dominican Republic recognizes that the non-discrimination obligation in Article III:4 "…requires Members to refrain from modifying or upsetting those conditions of competition to the detriment of importers in a manner that affords protection to the domestic producers."[388]

5.178 However, by stating that "the effect that the measure has on imports is negligible"[389], the Dominican Republic asserts, "(…) complying with the stamp requirement of the Dominican Republic can hardly have any commercial or protective discriminatory effect at all".

5.179 Guatemala rejects the notion advanced by the Dominican Republic that a discriminatory measure, in violation of Article III.4, is justified by the minimal adverse effects generated by such discrimination.

5.180 The contention that the effect of the measure is so small that its trade effects are negligible, minimal or nil, and thus, did not nullify or impair benefits under the GATT, is irrelevant due to two essential factors. On the one hand, the presumption of nullification or impairment following a *prima facie* violation operates as an irrefutable presumption (Article 3.8 of the DSU). On the other hand, Panels dealing with claims under GATT Article III have refined and clarified this notion. The GATT Panel on *US-Tobacco* noted:

> "…previous panels had rejected arguments of *de minimis* trade consequences and had found that the size of the trade impact of a measure was not relevant to its consistency with Article III [of GATT]".[390]

5.181 For the reasons above, Guatemala considers that the requirement to affix a stamp in the territory of the Dominican Republic is inconsistent with Article III:4 of the GATT.

3. The transitional surcharge on imports

5.182 In its first written submission, the Dominican Republic does not contest the fact that the transitional surcharge is an "other duty or charge" within the meaning of Article II:1 (b) of the GATT.[391]

5.183 Paragraph 1 of the Uruguay Round Understanding on the Interpretation of Article II:1(b) of the GATT 1994 ("the Understanding") reads:

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[388] First written submission of the Dominican Republic, 13 April 2004, para. 40.
[389] Ibid., para. 45.
[390] GATT Panel Report, *US – Tobacco*, para. 99.
[391] First written submission of the Dominican Republic, 13 April 2004, para. 172.

> "… in order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, the nature and level of any 'other duties or charges' levied on bound tariff items, as referred in that provision, shall be recorded in the Schedules and concessions annexed to GATT 1994 against the tariff item to which they apply. It is understood that such recording does not change the legal character of 'other duties or charges'."

5.184 According to the second paragraph of the Understanding:

> "… the date as of which "other duties or charges" are bound, for the purposes of Article II, shall be 15 April 1994. 'Other duties or charges' shall therefore be recorded in the Schedules at the levels applying on this date."

5.185 From the above, Guatemala would conclude that if "other duties or charges" were not recorded but are nevertheless levied, they are inconsistent with Article II:1(b), in light of the Understanding on the Interpretation of Article II:1(b).

5.186 Guatemala notes that the Dominican Republic did not record the transitional surcharge established by Article 2 of Decree 646-03 of 30 June 2003 in the "other duties and charges" column of its Schedule.

5.187 Guatemala is of the view that Article II:1(b) sets forth the legal obligation of contracting parties to refrain from the application of "other duties and charges" that were not specified in each country's Schedule.

5.188 Guatemalan exporters have assessed their competitive position on the basis of the inscribed duties and charges of the Dominican Republic. For that reasons, the transitional surcharge undermines the legitimate expectations upon which these actions were based and severely disrupts the trade conditions upon which Guatemalan exporters had relied.

5.189 Consequently, Guatemala agrees with Honduras that the Dominican Republic's transitional surcharge on imports is in violation of Article II:1(b) second sentence, because Dominican Republic failed to record it in the "other duties and charges" column of its Schedule, as it should have done in the light of the Understanding on Article II:1(b).

5.190 Finally, Guatemala notes that the Dominican Republic argues that its Schedule of Concessions contains "other duties and charges" up to the level of 30 per cent. Even if the recording was to be found WTO consistent for the products listed therein, the transitional surcharge, nevertheless, remains WTO inconsistent in its application to the rest of the products.

F. UNITED STATES

1. Introduction

5.191 The United States takes no position on the measures at issue. However, the United States does have a systemic interest in the analysis of two GATT 1994 provisions: Article III:4 and Article X:3. The United States offers the following thoughts.

2. Legal aspects

5.192 As the Panel knows, Article III:4 provides that products of the territory of a Member imported into the territory of another Member must be afforded treatment no less favourable than that accorded to like products of national origin in respect of laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use. Note *Ad* Article III of

GATT 1994 provides that such measures may be applied at the point of importation; application at the border does not alter the fact that the measure is an internal one.

5.193 The necessary consequence of Note *Ad* Article III is that under Article III:4, the border may be a locus of application for a Member administering laws, regulations, and requirements affecting the internal sale of imported and domestic goods. In this dispute, however, a question has arisen as to whether a measure results in the imported good being provided with treatment less favourable than that accorded to the like domestic product, simply because the measure is being applied in the territory of a Party – at the border. To put it another way: does Article III:4 in the context of this dispute require that a Member apply its measure in the territory of the exporting Member, rather than at the border?

5.194 Honduras appears to be arguing that because the Dominican Republic permits the tax stamp to be affixed on domestic cigarettes at the domestic production facility, the Dominican Republic must also allow the stamp to be affixed on *foreign* cigarettes at the foreign production facility – in other words, the Dominican Republic may not require the tax stamp to be affixed in the territory of the Dominican Republic.[392] Honduras thus alleges that the mere requirement that the tax stamp be affixed in the territory of the Dominican Republic results in discriminatory effects in the form of, *inter alia*, additional packaging steps and additional costs.

5.195 The gist of Honduras's argument therefore appears to be that Article III:4 may require that a Member apply a measure in the territory of the exporting Member, rather than at the border – and that the mere application of a measure at the border may result in a violation of Article III:4. The United States does not believe that Article III:4 can be so interpreted. Such an interpretation ignores Article III's recognition of the border as a permissible site of application. Indeed, a finding of a breach of Article III:4 cannot rest simply on where the measure is being applied to imported products.

5.196 Moreover, the fundamental purpose of Article III is not to eliminate every perceived differential between domestic and imported goods, even those incidental to the inherent differences between imported and domestic goods. Instead, as the Appellate Body counselled in *Japan – Alcoholic Beverages II*, the "fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures" and to ensure that such measures are not applied so as to afford protection to domestic production.[393] Rather, Article III:4 does not require *identical* treatment so long as the treatment afforded to imported products is no less favourable than the treatment afforded to domestic products. In other words, like imported and domestic products may be treated differently so long as the different treatment does not result in less favourable treatment for imported products.

5.197 The United States is aware that in considering the language of Article III:2, first sentence, the Appellate Body concluded that the analysis was simple – either taxes on the imported product are in excess of those on the domestic like product, or they are not. If the taxes are in excess, then the measure providing for those taxes is inconsistent with Article III:2, first sentence. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that "[e]ven the smallest amount of 'excess' is too much", and no trade effects or *de minimis* test is necessary.[394]

5.198 The Appellate Body's analysis of Article III:2, first sentence, however, is not automatically applicable to every provision of Article III. Indeed, the Appellate Body did not apply it to the second sentence of Article III:2 in that very same dispute.[395] The Appellate Body considered that:

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[392] See First written submission of Honduras, 16 March 2004, paras. 2 and 76 through 85.
[393] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 16.
[394] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 23.
[395] Ibid., pp. 26-27.

> "[T]here may be an amount of excess taxation that may well be more of a burden on imported products than on domestic 'directly competitive or substitutable products' but may nevertheless not be enough to justify a conclusion that such products are 'not similarly taxed' for the purposes of Article III:2, second sentence. We agree with the Panel that this amount of differential taxation must be more than *de minimis* to be deemed 'not similarly taxed' in any given case."[396]

5.199 Likewise, it cannot be assumed that the Appellate Body's Article III:2, first sentence, analysis is applicable to Article III:4. To the contrary, the Appellate Body in the *Korea – Various Measures on Beef* dispute noted that a measure might produce "incidental effects" but that such effects might not have "decisive implications" for an examination of whether the measure is inconsistent with Article III:4. In that dispute, the Appellate Body examined the existence of a "dual retail system" in Korea: one for imported beef, and a second for domestic beef. The Appellate Body stated:

> "[E]ven if we were to accept that the dual retail system 'encourages' the perception of consumers that imported and domestic beef are 'different', we do not think it has been demonstrated that such encouragement necessarily implies a competitive advantage for domestic beef. Circumstances like limitation of 'side-by-side' comparison and 'encouragement' of consumer perceptions of 'differences' may be simply incidental effects of the dual retail system without decisive implication of the issue of consistency with Article III:4."[397]

5.200 In short, the Appellate Body was reiterating that under Article III:4 like imported and domestic products may be treated differently so long as the different treatment does not result in less favourable treatment for imported products. Therefore, to the extent that the application of a measure at the border results in differential, "incidental effects", those incidental effects do not necessarily mean that an Article III:4 violation has occurred.

5.201 Finally, the United States would like to briefly comment on Honduras's argument regarding Article X:3. According to Honduras, the Dominican Republic's administration of its Selective Consumption Tax is inconsistent with Article X:3(a) because the Dominican Republic allegedly disregarded the actual retail selling price when determining the tax base. However, to the extent that Honduras relies on Article X:3(a) to challenge the substance of the Selective Consumption Tax, the United States wishes simply to note that Article X:3(a) concerns the administration of a measure, not the substance of the measure itself.

VI. INTERIM REVIEW

6.1 On 28 September 2004, both Honduras and the Dominican Republic informed the Panel that they have no comments on the interim report issued to the parties on 21 September 2004. None of the parties requested a meeting with the Panel on the interim report in due time. Accordingly, based on Article 15.2 of the DSU, the Panel's interim report became the Panel's final report. The Panel made editorial corrections in a few places.

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[396] Ibid., p. 27.
[397] Appellate Body Report, *Korea – Various Measures on Beef*, para. 141.

VII. FINDINGS

A. CLAIMS OF THE PARTIES

1. The claims of Honduras

7.1 Honduras has made claims in respect of five different measures: (i) the imposition of a 2 per cent transitional surcharge for economic stabilization on all imported goods is inconsistent with Article II:1(b) and, consequently, is also inconsistent with Article II:1(a) of the GATT 1994; (ii) the levying of a 10 per cent foreign exchange fee on all imports is inconsistent with Article II:1(b) and, consequently, is also inconsistent with Article II:1(a); (iii) the requirement that tax stamps be affixed to cigarette packets in the territory of the Dominican Republic under the supervision of the local tax authorities accords less favourable treatment to imported cigarettes and violates Article III:4 of the GATT 1994; (iv) the requirement that importers of cigarettes post a bond of RD$5 million at the time of importation is inconsistent with Article XI:1, or, in the alternative, is inconsistent with Article III:4 of the GATT 1994; and (v) the rules and practices used in determining the value of imported cigarettes as tax bases for the application of the Selective Consumption Tax (SCT), including the failure to publish the survey used to determine the SCT tax bases are inconsistent with Article III:2, Article X:3(a) and Article X:1 of the GATT 1994.

7.2 Honduras requests the Panel to recommend that the DSB request the Dominican Republic to bring these measures into conformity with the GATT 1994.

2. The defence of the Dominican Republic

7.3 The Dominican Republic does not disagree that the transitional surcharge is an "other duty or charge"(ODC). However, it argues that the Dominican Republic has recorded 30 per cent ODCs applied to cigarettes as of 15 April 1994 in its Schedule of Concessions. The 2 per cent transitional surcharge is well below the level of ODC recorded in the Schedule, and therefore, it is not inconsistent with Article II:1(b) and Article II:1(a) of the GATT 1994. The foreign exchange fee is an exchange restriction applied in accordance with Articles of Agreement of the International Monetary Fund and therefore is justified by Article XV:9(a) of the GATT 1994. Alternatively, the Dominican Republic claims that the foreign exchange fee is an "other duty or charge" and the application of a 10 per cent foreign exchange fee plus the 2 per cent transitional surcharge is not "in excess of" the level of 30 percent recorded ODCs on cigarettes in its Schedule, and therefore, the foreign exchange fee is consistent with Article II:1(b) and Article II:1(a) of the GATT 1994.

7.4 In respect of the tax stamp requirement, the Dominican Republic claims that Honduras has not established that the tax stamp requirement accords less favourable treatment to imported cigarettes and consequently, there is no violation of Article III:4. On the bond requirement, the Dominican Republic claims that the measure is an internal measure that falls under Article III:4, rather than under Article XI:1 and since it does not accord less favourable treatment to imported products, it is consistent with Article III:4. The Dominican Republic also claims that should the Panel find that the tax stamp requirement and the bond requirement are inconsistent with Article III:4, they are nevertheless justified by Article XX(d) of the GATT 1994 because they are both necessary to secure compliance with the Dominican Republic's Tax Code which itself is consistent with the GATT 1994 and that their application satisfies the requirements of the chapeau of Article XX.

7.5 As to the measure on the determination of the Selective Consumption Tax bases for imported cigarettes, including the publication of relevant surveys, the Dominican Republic claims that Articles 367 and 375 of the Tax Code have been amended by Law 3-04 which entered into force on 15 January 2004. As the amended Tax Code changed the essence of the old measure, the Dominican Republic contends that the claims that Honduras made with respect to the old measure are moot and should be dismissed by the Panel.

7.6 The Dominican Republic requests the Panel to dismiss all the claims made by Honduras in its submissions.

B. ORDER OF ANALYSIS

7.7 The Panel considers that Honduras has made claims under five separate measures in this dispute. The failure to publish the survey used to determine tax bases as prescribed in paragraph 2 of its panel request is not an independent measure, rather, it forms part of the rules and practices by which the Dominican Republic determines the Selective Consumption Tax base for imported cigarettes.

7.8 The Panel recalls the ruling of the Appellate Body in *Australia – Salmon*:

> "This aim [of the dispute settlement system] is to resolve the matter at issue and to 'secure a positive solution to a dispute'. To provide only a partial resolution of the matter at issue would be false judicial economy. A panel has to address claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings for purpose of prompt compliance by a Member with those recommendations and rulings...".[398]

7.9 As the five measures challenged by Honduras are all independent measures, the Panel is of the view that a solution could only be secured in this dispute by examining and making findings on each and every measure, although not necessarily on each claim. Leaving any one measure unaddressed would, in the view of the Panel, lead to a partial resolution of the dispute.

7.10 Accordingly, the Panel considers it appropriate to examine claims made by Honduras under each measure in the following order: (i) the imposition of transitional surcharge for economic stabilization; (ii) the levying of foreign exchange fee; (iii) the requirement that tax stamps be affixed to cigarette packets in the territory of the Dominican Republic; (iv) the requirement that importers of cigarettes post a bond of RD$5 million at the time of importation; and (v) the rules and practices in determining the value of imported cigarettes as tax bases for the application of the Selective Consumption Tax, including the failure to publish the survey used to determine the SCT tax bases.

C. THE IMPOSITION OF TRANSITIONAL SURCHARGE FOR ECONOMIC STABILIZATION

1. The measure at issue

7.11 The Dominican Republic imposes a surcharge on the importation of all goods under the name "transitional surcharge for economic stabilisation" (*recargo transitorio de estabilización económica*). This surcharge was first established by Article 2 of Decree 646-03 of 30 June 2003.[399] The surcharge rate is 2 per cent of the c.i.f. value of the imported goods.

7.12 Decree 646-03 was replaced by a new law after the date of the establishment of the Panel. The Dominican Republic informed the Panel that its Congress approved Law 2-04, which established a temporary 2 per cent surcharge on all goods imported into the Dominican Republic with a few exceptions.[400] This law entered into force on 15 January 2004, after the establishment of the Panel on 9 January 2004.[401] The rate of the surcharge provided by Law 2-04 is the same as the rate provided in the previous Decree. Article 4 of Law 2-04 also provides that the transitional surcharge shall expire, at the latest, on 31 December 2004.

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[398] Appellate Body Report, *Australia – Salmon*, para. 223.
[399] Decree 646-03, *supra* note 7.
[400] Law 2-04, *supra* note 60.
[401] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 45.

2. Introduction

7.13 Honduras claims that this transitional surcharge measure is inconsistent with Article II:1(b) of the GATT 1994. It also points out the consequential violation of Article II:1(a) in the text of a footnote in its first written submission. In light of the arguments and debates made by the parties during the Panel proceedings, the Panel considers it necessary to address a series of issues logically linked to the claim of inconsistency with Article II:1(b) of the GATT 1994 raised by Honduras. These issues include: (i) which legal instrument constitutes the measure to be examined by the Panel; (ii) whether the transitional surcharge is an "other duty or charge" under Article II:1(b) of GATT 1994; (iii) whether the surcharge has been properly recorded in the Schedule of Concessions of the Dominican Republic and the nature of the recorded measure; (iv) whether the right to challenge the recording expired three years after the incorporation of the Uruguay Round Schedule; (v) whether the surcharge is inconsistent with Article II:1(b); (vi) whether the measure is limited to cigarette products; and (vii) whether the surcharge is inconsistent with Article II:1(a).

3. Which legal instrument constitutes the measure to be examined by the Panel

(a) Arguments of the parties

7.14 Honduras claimed that Decree 646-03 of 30 June 2003 prescribed a "transitional surcharge for economic stabilization". Article 2 of the Decree requires that a 2 per cent surcharge, calculated on the c.i.f. value of all goods imported into the Dominican Republic be levied. Honduras indicates that this surcharge applies to both bound and unbound items.[402]

7.15 The Dominican Republic informed the Panel in its first written submission that Decree 646-03 is no longer in force. It has been replaced by Law 2-04 of 4 January 2004.[403] In its reply to panel questions, the Dominican Republic confirmed that Law 2-04 entered into force on 15 January 2004, the day following its publication, in accordance with Article 1 of the Dominican Republic Civil Code.[404]

7.16 Honduras argues that what is relevant for the Panel's terms of reference is the "transitional surcharge for economic stabilization" in substance rather than the legal acts in their original or modified forms. Therefore, the measure, "transitional surcharge for economic stabilisation", as provided in both Decree 646-03 and Law 2-04 should be analysed by the Panel.[405]

7.17 The Dominican Republic also confirmed that Law 2-04 has not changed the essence of the transitional surcharge measure as provided in Decree 646-03.[406] One minor change is the list of exceptions introduced by paragraph I to Article 1 of Law 2-04. The Dominican Republic considers that the measure that the Panel should examine is the 2 per cent surcharge mandated by Law 2-04, but only as it applies to cigarettes.[407]

(b) Analysis by the Panel

7.18 Decree 646-03 provides in Article 2 that "[a] transitional surcharge for economic stabilization shall be applied amounting to 2 per cent of the c.i.f. value of all goods under the tariff headings of the Harmonized Commodity Description and Coding System that are entered for consumption". Law 2-04 provides the following:

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[402] First written submission of Honduras, 16 March 2004, paras. 11-14.
[403] First written submission of the Dominican Republic, 13 April 2004, para. 180.
[404] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 45.
[405] Replies of Honduras to questions addressed by the Panel, replies to questions Nos. 6, 7 and 8.
[406] Replies of the Dominican Republic to questions addressed by the Panel, replies to questions Nos. 6 and 7.
[407] Ibid., replies to questions Nos. 7 and 8.

> "Article 1 A temporary surcharge of 2 per cent is hereby established on all goods imported into the Dominican Republic under the regime of customs clearance for consumption, included in the nomenclature of the Harmonized Commodity Description and Coding System.
>
> Paragraph I The following shall be exempted from this surcharge: final importation of goods for personal use that are duty-free under the special regimes on: passenger luggage, disabled persons, Dominican personnel abroad and diplomatic representatives accredited to the Dominican Republic. Also exempt are final imports not subject to import duties, made by institutions in the public sector, diplomatic and consular missions and international organizations. The same exemption shall apply to final imports of samples and parcels exempt from tariff duties."

7.19 It is clear to the Panel that Law 2-04 does not change the essence of the measure. The exception list in Paragraph I to Article 1 of Law 2-04 concerns only imports relating to: (i) goods for personal use by passengers, disabled persons and diplomatic representatives; (ii) goods imported by public institutions and diplomatic missions; and (iii) goods imported as samples or parcels that are exempted from paying tariff duties. The substance of the transitional surcharge for economic stabilization, i.e. the 2 per cent charge on the c.i.f. value of the imported products, is unchanged in the new legal instrument Law 2-04. It is the Panel's understanding that Honduras is challenging the measure as it affects commercial imports into the Dominican Republic, rather than the measure as it affects non-commercial imports exempted from paying the surcharge by Paragraph I to Article 1 of Law 2-04. In this sense, the Panel is of the view that there is no difference between the measure as provided in Decree 646-03 and that as provided in Law 2-04 with regard to the claim of Honduras in this dispute.

7.20 Given that the amendment was made after the Panel was established, the question is whether the Panel has the authority to examine the measure as provided by the new legal instrument – Law 2-04. In this respect, the Panel recalls that a number of previous panels have examined measures amended either after the consultation stage of dispute settlement proceedings, such as in *Brazil – Aircraft*, or, after the establishment of a panel, such as in *Chile – Price Band System*. The Appellate Body stated in *Chile – Price Band System* that

> "... generally speaking, the demand of due process are such that a complaining party should not have to adjust its pleadings throughout dispute settlement proceedings in order to deal with a disputed measure as a 'moving target'. If the terms of reference in a dispute are broad enough to include amendments to a measure... and if it is necessary to consider an amendment in order to secure a positive solution, to the dispute... then it is appropriate to consider the measure *as amended* in coming to a decision in a dispute" (emphasis original).[408]

7.21 The Panel considers that in this dispute, the terms of reference for this Panel refer to the transitional surcharge for economic stabilization measure, which is essentially the same as the measure amended by Law 2-04. The parties also explicitly agree that the amendment by Law 2-04 does not change the essence of the surcharge. The terms of reference of this Panel are broad enough to include the new law. The Panel also considers it necessary to examine Law 2-04 to secure a positive solution to the matter mandated to this Panel since Decree 636-03 has been replaced by Law 2-04. The Panel therefore considers that the measure to be examined is the transitional surcharge for economic stabilization measure as provided by the new legal instrument Law 2-04.

[408] Appellate Body Report, *Chile – Price Band System*, para. 144.

4. Whether the transitional surcharge is an "other duty or charge" under Article II:1(b) of the GATT 1994

(a) Arguments of the parties

7.22 Honduras claims that the surcharge is imposed on, or in connection with, the importation of all goods due to the fact that it is levied on the *c.i.f.* value of all goods included in the Harmonized Commodity Description and Coding System and which fall under the regime of custom clearance for consumption as provided by the Decree.[409] Honduras also argues that the obligation to pay the surcharge arises concurrently with the customs duty payable, and is thus an obligation separate from the obligation to pay the customs duty. Therefore, the surcharge is an "other duty or charge" within the meaning of Article II:1(b). Honduras indicates that for cigarette products, the bound rate of tariff duty for the Dominican Republic is 40 per cent, and the surcharge is imposed in addition to that duty.[410]

7.23 The Dominican Republic explains that it does not contest the fact that the transitional surcharge is an ODC within the meaning of Article II:1(b). However, the Dominican Republic disagrees with the argument by Honduras that the Dominican Republic has not recorded the ODCs into its Schedule of Concessions.[411]

(b) Analysis by the Panel

7.24 The Panel agrees with the parties that the surcharge as it is applied in Law 2-04 is imposed on, or in connection with, the importation of all goods with a few exceptions prescribed in paragraph I to Article 1 of Law 2-04. It is imposed on these imported products in addition to tariff duties on these products. It is clearly a border measure.

7.25 The surcharge is based on the value of the imported products, rather than any service rendered by the custom authorities. Therefore, it is not a fee or charge that falls under Article VIII of the GATT 1994. It is not an internal tax either since it does not apply to domestic products. To summarize, the surcharge is neither an ordinary customs duty, nor a charge or duty that falls under Article II:2 of the GATT 1994. The Panel agrees with the parties that as a border measure, the surcharge as prescribed in Law 2-04 is an "other duty or charge" within the meaning of Article II:1(b) of the GATT 1994.

5. Whether the surcharge has been properly recorded in the Schedule of Concessions of the Dominican Republic and the nature of the recorded measure

(a) Arguments of the parties

7.26 Honduras submits that the Dominican Republic did not record the transitional surcharge for economic stabilization in its Schedule of Concessions. In the view of Honduras, paragraphs 1 and 2 of the "Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994" require that WTO Members record all "other duties and charges" in their Schedule as applied as of 15 April 1994. The Dominican Republic did not record the surcharge as it did not exist at the date of 15 April 1994.[412]

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[409] First written submission of Honduras, 16 March 2004, para. 52.
[410] Ibid., paras. 50 and 51.
[411] First written submission of the Dominican Republic, 13 April 2004, para. 172.
[412] First written submission of Honduras, 16 March 2004, paras. 53-56.

7.27 The Dominican Republic responds that it did record ODCs applied to cigarettes as of 15 April 1994 in its Schedule.[413] On 14 September 1994, the Dominican Republic notified its addition of "other duties and charges" to its Schedule XXIII, which was circulated by the Preparatory Committee for the World Trade Organization to all Members in document G/SP/3 on 12 October 1994. In the circulated list, a rate of 30 per cent ODC was included for cigarette products under tariff heading 2402.[414]

7.28 The Dominican Republic submits that its notification was filed with the WTO Secretariat in accordance with paragraph 7 of the Understanding, within six months of the date of the deposit of its original Schedule on 15 April 1994. It also indicates that there was a cover note stating that "if no objection is notified to the Secretariat within thirty days from the date of this document, the rectifications to Schedule XXIII – Dominican Republic will be deemed to be approved and will be annexed to the Protocol Supplementary to the Marrakesh Protocol to the General Agreement on Tariff and Trade". In the view of the Dominican Republic, since no objection was raised by any WTO Member, the addition of the notified ODCs to its Schedule was therefore approved.[415]

7.29 Honduras contends however, that paragraph 1 of the Understanding requires that both the nature and the level of the ODCs be recorded in the Schedule and that both elements are bound. Moreover, as provided by paragraph 1 of the Understanding, the recording does not change the legal character of "other duties or charges".[416]

7.30 Honduras also argues that what the Dominican Republic actually inscribed into its Schedule was an internal tax as applied on 15 April 1994. The list added to the Schedule was entitled "*Lista de productos importados que pagan el Impuesto Selectivo en Aduanas*" (List of imported products subject to the Selective Tax at Customs), whereas chapter IV of its Law 11-92 in force on 15 April 1994 also contained a list of imported products subject to the Selective Consumption Tax, which was entitled "*Lista de productos importados que pagarán el Impuesto Selectivo en Aduanas*" (List of imported products subject to the Selective Tax payable at Customs). They both refer to "*Impuesto Selectivo*", that is, the Selective Consumption Tax. Moreover, the products listed in notification G/SP/3 and in Law 11-92 as well as the respective *ad valorem* tax rates for these products are identical. Honduras considers that the inscription of an internal tax into the Schedule has no legal effect. In the view of Honduras, if a Member has recorded an internal tax in its Schedule of Concessions, the recording does not change the nature of that tax into an "other duty or charge" under Article II:1(b) of the GATT1994.[417]

7.31 Honduras contends that the nature of the recorded "*Impuesto Selectivo*" is not the same as the surcharge measure currently applied. The "*Impuesto Selectivo*" is an internal tax while the surcharge is a border measure on the importation of all products. Therefore, in the view of Honduras, the Dominican Republic did not record the transitional surcharge as an ODC in its Schedule.[418] Honduras also argues that, in any event, the Dominican Republic could not have recorded the transitional surcharge due to the fact that the transitional surcharge was first imposed on 30 June 2003.[419] In the view of Honduras, the recording of an internal tax, which falls under Article III:2, does not change the nature of that tax into "other duties and charges" falling under Article II:1(b).[420]

7.32 The Dominican Republic submits, in its response to a question from the Panel, that the heading "*Lista de productos importados que pagan el Impuesto Selectivo en Aduanas*" of the list in

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[413] First written submission of the Dominican Republic, 13 April 2004, para. 172.
[414] Ibid., para. 181.
[415] Ibid., para. 182; Second written submission of the Dominican Republic, 10 June 2004, para.80.
[416] Second written submission of Honduras, 10 June 2004, paras. 165-166.
[417] Ibid., paras. 164-166; First oral statement of Honduras, paras. 8-10.
[418] First oral statement of Honduras, paras. 11-12.
[419] First oral statement of Honduras, para. 13.
[420] Second written submission of Honduras, 10 June 2004, paras. 166 and 171.

the notification of 14 September 1994 was a mistake. It admitted that there was correspondence between the recorded level of ODCs and the Selective Consumption Tax in force on 14 September 1994. However the level of ODCs recorded was never intended to substitute or replace the Selective Consumption Tax. What was covered under that heading was the level of ODCs that the Dominican Republic decided to record in its Schedule. The Dominican Republic argues that it reserved its right to impose ODCs up to that level.[421]

7.33 In response to this argument, Honduras contends that as the Dominican Republic acknowledged the mistake in the heading and the equivalence between the recorded levels of ODCs and the Selective Consumption Tax, the Dominican Republic has the burden of establishing the existence of another law as the basis of the ODCs applied as of 15 April 1994.[422]

(b) Analysis by the Panel

7.34 The Panel is aware of the fact that the Dominican Republic did notify the "Additions to Schedules Annexed to the Marrakesh Protocol to the GATT 1994" on 14 September 1994 and that the Preparatory Committee for the World Trade Organization circulated the document on 12 October 1994 as document G/SP/3. The cover note states that "if no objection is notified to the Secretariat within thirty days from the date of this document, the rectifications to Schedule XXIII – Dominican Republic will be deemed to be approved and will be annexed to the Protocol Supplementary to the Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994". There was no objection during the specified period of time and therefore, the Panel considers that the notification was deemed as approved.[423]

7.35 Under paragraph 7 of the Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994, any ODCs omitted from a Schedule at the time of deposit of the instrument incorporating the Schedule into GATT 1994 shall be added to it within six months of the date of deposit of the instrument. The Panel notes that this notification was made within six months of deposit of the instrument incorporating the Schedules of Concessions into GATT 1994 on the date of 15 April 1994, consistent with the requirement of paragraph 7 of the Understanding. Therefore, the recording of these additions in the Dominican Republic's Schedule of Concessions was procedurally appropriate and the additions have been deemed properly approved since no objections were raised by any Member.

7.36 The Panel also takes note of Honduras's argument that the Dominican Republic did not record the transitional surcharge into its Schedule since it did not exist on 15 April 1994. Rather, in the view of Honduras, what the Dominican Republic recorded was the Selective Consumption Tax as applied in 1994. In this regard, the Panel considers it necessary and appropriate to compare the list of products in the notification document (G/SP/3) and the list of imported products subject to the Selective Consumption Tax pursuant to the law in force in 1994. In this task, the Panel will use the evidence provided by the Dominican Republic in Exhibit- DR-19 as the basis of the ODC notification made by the Dominican Republic in 1994, and the evidence provided by Honduras in Exhibit-HOND-18 as the law governing the Selective Consumption Tax as applied in 1994 (Title IV of Law 11-92) since the Panel has noticed that the parties have not contested the accuracy or authenticity of these two items of evidence during the proceedings.

7.37 On the titles of the two product lists, the one in the notification "Additions to Schedules Annexed to the Marrakesh Protocol to the GATT 1994" in document G/SP/3 is named '*Lista de*

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[421] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 42.
[422] Second written submission of Honduras, 10 June 2004, paras. 169-170.
[423] See "Status of Additions and Rectifications of Market Access Final Schedules" in document PC/3 at 30 November 1994 and "Situation of Schedules of WTO Members" in document G/MA/W/23/Rev.1 at 6 June 2001. Both documents indicate that Document G/SP/3 (see *supra* note 61) was approved.

productos importados que pagan el Impuesto Selectivo en Aduanas", whereas the title of product list subject to the Selective Consumption Tax in 1994 according to chapter IV of Law 11-92 in force in 1994 was "*Lista de productos importados que pagarán el Impuesto Selectivo en Aduanas.*" Although the wording is slightly different, the meaning of the titles is one and the same, that is, "List of imported products subject to the Selective Tax payable at Customs". The Panel notes that although Title IV of Law 11-92 actually contained two separate products lists, one for domestic products and one for imported products, both imported and domestic products included in the two lists in chapter VI of Title IV of Law 11-92 were subject to the Selective Consumption Tax. Since the title of the product list in the G/SP/3 notification was the same as the title of the imported product list contained in Law 11-92, the Panel understands that the nature of the measure as reflected in the G/SP/3 notification was an internal tax, specifically, the Selective Consumption Tax.

7.38 With regard to the scope of the products included in the G/SP/3 notification, a comparison reveals that all the 70 tariff lines of products as listed in the G/SP/3 notification were actually included, in the meantime, in the list of imported products that were subject to the Selective Consumption Tax under Title IV of Law 11-92. The tax rates for these products in Law 11-92 were exactly the same as the *ad valorem* rates set for the corresponding products in the notification in document G/SP/3. The Dominican Republic has also admitted that there was a correspondence between the recorded ODC level and the level of Selective Consumption Tax in force on 14 September 1994. The tax in Title IV of Law 11-92 and the "duty" in the notification were all on *ad valorem* basis. The only difference is that 14 additional tariff lines of products listed under Title IV of Law 11-92 were not listed in the G/SP/3 notification, which concerns certain kinds of vehicles only. In evaluating these facts, the Panel considers that the tariff lines and the levels of rates in the G/SP/3 notification were all taken from the list of imported products and the rates thereof in Law 11-92, which was the law governing the Selective Consumption Tax as applied in 1994.

7.39 On the question of what ODC was actually applied at the time of the notification, the Dominican Republic admits in its response to questions from the Panel, that the only "other duties and charges" applied in 1994 was the 1.5 per cent foreign exchange fee. But it argues that the ODC notification in document G/SP/3 was different from the Selective Consumption Tax applied to imported products at that time. The heading of the product list in the 1994 notification was a mistake and the intention of the Dominican Republic was to reserve, through recording ODCs, the right to apply ODCs up to the reserved level.[424] It is clear to the Panel that the products on the notified list in G/SP/3 were only subject to the Selective Consumption Tax, not to an equal amount of additional "other duties and charges" back in 1994. Under such circumstance, the nature of the recorded measure has not been established to be an ODC by the Dominican Republic. In fact, these products in the notification list were only subject to a 1.5 per cent of foreign exchange fee pursuant to a Monetary Board Resolution in force in 1994, which, in the view of the Panel, was not specifically notified at that time.

7.40 As a result, the Panel's factual assessment is that the transitional surcharge did not exist in 1994 and that what the Dominican Republic notified in document G/SP/3 was the product list and the *ad valorem* Selective Consumption Tax rates as applied to these imported products under Law 11-92 in force in 1994. The Panel finds that although the Dominican Republic followed the appropriate procedure in making the notification and the notification was deemed approved after 30 days, the Dominican Republic actually notified its Selective Consumption Tax product list and the relevant rates under the name of "other duties and charges". In the Panel's view, the Dominican Republic has not proved its argument that the recorded measure is in fact in the nature of an "other duty or charge".

[424] Replies of the Dominican Republic to questions addressed by the Panel, replies to questions No. 42 and 43.

6. Whether the right to challenge the existence of the measure and the nature of the measure in the recording expired three years after the incorporation of the Uruguay Round Schedule

(a) Introduction

7.41 The Dominican Republic argues that neither the existence of the ODC as of 1994 nor the nature of the recorded measure can be legally challenged three years after the incorporation of the Uruguay Round Schedules of Concessions and that therefore, the notification in document G/SP/3 can serve as a legal basis to demonstrate the consistency of the surcharge and the foreign exchange fee measures with Article II:1(b), second sentence. The Panel is of the view that the answer to the issue of any limitation on the right of challenge can only be obtained by resorting to relevant paragraphs of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994 because it is the Understanding that governs the process of the recording of ODCs during and after the Uruguay Round. The Panel therefore will proceed by analysing relevant paragraphs of the Understanding that the parties invoked and debated during the proceedings.

(b) Arguments of the parties

7.42 The Dominican Republic argues that based on paragraphs 4 and 5 of the Understanding on the Interpretation of Article II:1(b), the right to challenge the existence and the consistency of the level of the ODCs with those actually applied as of 15 April 1994 expired three years after the deposit of the instrument incorporating its Schedule into the GATT 1994. Making reference to a Secretariat note on the negotiation of the Understanding during the Uruguay Round, the Dominican Republic submits that paragraph 4 of the Understanding provides a three-year limit to challenging either the existence or the recorded level of ODCs. Therefore, it contends that Honduras is barred from making the claim that the Dominican Republic did not record the transitional surcharge and the foreign exchange fee as ODCs into its Schedule and the claim that such ODCs did not exist as of 15 April 1994.[425]

7.43 The Dominican Republic also argues that the language of paragraph 1 does not preclude the recording of an ODC that did not exist in 1994 but which a Member wished to reserve for future use and that the "nature" and the "level" of a recorded ODC can only be challenged during the three-year period following the recording of an ODC in a Member's Schedule.[426]

7.44 The Dominican Republic contends that even if the recording or the existence could be challenged after the expiry of the three-year period, such a challenge must be brought under the relevant paragraphs of the Understanding. In the opinion of the Dominican Republic, given that Honduras has not made any claims under the Understanding in its request for the establishment of the panel, it may not be allowed to challenge the recording and the existence of the surcharge and the foreign exchange fee.[427]

7.45 The Dominican Republic therefore concludes that Honduras' argument that these measures are inconsistent with Article II:1(b) because they were not recorded in the Schedule of the Dominican Republic or because they did not exist as of 15 April 1994 must be dismissed by the Panel.[428]

7.46 However, Honduras argues that Article II:1(b), read together with the Understanding on the Interpretation of Article II:1(b), requires Members not to impose any ODCs in excess of those imposed on 15 April 1994. Paragraph 1 of the Understanding requires that Members record both the nature and the level of ODCs in their Schedules of Concessions and that both the nature and the level

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[425] Second written submission of the Dominican Republic, 10 June 2004, paras. 82-85.
[426] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 112.
[427] Second written submission of the Dominican Republic, 10 June 2004, para. 86.
[428] Second written submission of the Dominican Republic, 10 June 2004, para. 86.

recorded are bound.[429] Honduras argues that the recording of an internal tax in a Member's Schedule does not change the nature of that tax into an other duty or charge falling under Article II:1(b).[430]

7.47 Honduras also argues that the recording of the Selective Consumption Tax into the Schedule does not give the Dominican Republic the authority to levy other types of duties or charges up to that level today. The current transitional surcharge and the foreign exchange fee were not "properly recorded" in the Schedule.[431] In the view of Honduras, Schedules of Concessions may yield rights but they cannot diminish obligations under the GATT. In its opinion, allowing Members to record other duties or charges that were not imposed as of 15 April 1994 would diminish the rights of other Members under Article II:1(b).[432]

7.48 On the right to challenge recorded ODCs, Honduras argues that paragraph 5 of the Understanding provides that the recording of "other duties or charges" is without prejudice to their consistency with rights and obligations under GATT 1994 and that Members retain the right to challenge that consistency at any time.[433] Honduras considers that the sole exception to the right of challenge is paragraph 4 of the Understanding and the Dominican Republic has the burden of establishing that this exception applies to the surcharge and the foreign exchange fee.[434]

7.49 Honduras submits that paragraph 4 applies to "other duties or charges" imposed on bound items *which had been the subject of previous concessions.* In its view, the three-year limitation applies only to the challenge of the "existence of an ODC" *at the time of the original binding* of the item, as well as the challenge of the consistency of the level of ODCs *with the previously bound level.*[435] It does not apply to any product that has not been the subject of a previous concession. In this dispute Honduras is challenging a recording of an alleged ODC which was not in fact imposed as of 15 April 1994 at the end of Uruguay Round. Therefore, in the view of Honduras, paragraph 4 does not apply and paragraph 5 is applicable.[436]

7.50 Analysing the text of the second sentence of paragraph 4 of the Understanding, Honduras argues that the phrases *original binding* in relation to the challenge of non-existence of an ODC and *previously bound level* in relation to the challenge of consistency of the recorded level confirm that the subject matter of the two sentences in paragraph 4 is the same, that is, ODCs in respect of a tariff item that had previously been the subject of a concession.[437]

7.51 On the issue whether Honduras could challenge the recording of ODCs without making a claim directly under the Understanding in its panel request, Honduras argues that the Understanding is part of the context of Article II:1(b). Therefore, the references to Article II:1(b) in the panel request necessarily include references to the Understanding. Honduras also argues that in any event, the Dominican Republic as a defending party has raised the recording of ODCs pursuant to the Understanding as its principal defence.[438]

7.52 The Dominican Republic responds that the second sentence of paragraph 4 limits to three years the right of Members to challenge either the existence or the recorded level of an ODC regardless of whether or not the tariff item involved had been the subject of a previous concession.

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[429] Second written submission of Honduras, 10 June 2004, paras. 186 and 165.
[430] Ibid., paras. 171 and 166.
[431] Second oral statement of Honduras, para. 46.
[432] Second written submission of Honduras, 10 June 2004, paras. 187-188.
[433] Ibid., paras. 176-177.
[434] Ibid., para. 177.
[435] Ibid., para. 179.
[436] Second oral statement of Honduras, paras. 50 and 52.
[437] Replies of Honduras to questions addressed by the Panel, reply to question No. 113.
[438] Second oral statement of Honduras, para. 59.

In its view, only the first sentence of paragraph 4 refers to the situation where a tariff item has previously been the subject of a concession.[439]

7.53 In the opinion of the Dominican Republic, the wording in the second sentence of paragraph 4 "existed at the time of the original binding" contemplates only the situation of an initial event. Therefore, the phrase "original binding" includes not only situations where tariff items were subject to concessions prior to the Uruguay Round, but also situations where tariff items were initially subject to concessions in the Uruguay Round.[440]

(c) Analysis by the Panel

7.54 The Panel considers that the basic argument made by Honduras in this respect is that there is no valid recording in the Schedule of Concessions of the Dominican Republic that can be used as the legal basis for the application of the current surcharge measure since the measure did not exist as of 15 April 1994 and therefore, the current surcharge as an "other duty or charge" is in excess of what is recorded in the Schedule.

7.55 The Panel understands that Honduras has raised objections to the substantive validity of the recorded additions in the notification of the "Additions to schedules annexed to the Marrakesh Protocol to the GATT 1994" in document G/SP/3, specifically: (i) that the nature of the recorded measure was not an ODC within the meaning of Article II:1(b), but rather, an internal tax; and (ii) that such ODCs did not exist in 1994. The Dominican Republic then rebutted these objections on the following ground that such challenges or objections could only be raised within a three-year period after the incorporation of the Schedule into the GATT 1994 and that the three year period had expired. Under such circumstances, the Panel considers that it is obliged to first determine whether such challenges of or objections to the recording are permitted by Article II:1(b) and the Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994.

7.56 The core issue that the Panel has to explore is what aspects of the recording are subject to the limitation of the three-year challenge period under paragraph 4 of the Understanding and what aspects are still challengeable after the expiration of the three-year period. Paragraph 4 of the Understanding provides the following:

> "Where a tariff item *has previously been the subject of a concession*, the level of 'other duties or charges' recorded in the appropriate Schedule shall not be higher than the level obtaining *at the time of the first incorporation of the concession* in that Schedule. It will be open to any Member to challenge the existence of an 'other duty or charge', on the ground that no such 'other duty or charge' existed *at the time of the original binding of the item* in question, as well as the consistency of the recorded level of any 'other duty or charge' *with the previously bound level*, for a period of three years after the date of entry into force of the WTO Agreement or three years after the date of deposit with the Director-General of the WTO of the instrument incorporating the Schedule in question into GATT 1994, if that is a later date."(emphasis added)

7.57 It is clear to the Panel that the first sentence of paragraph 4 addresses the specific situation where a tariff item has been the subject of a "*previous*" concession, i.e. a concession made in any negotiating round "*before*" *or* "*prior to*" the Uruguay Round. The obligation in the first sentence is that the recorded level be no higher than the level bound at the time of *the first incorporation* of the item in the Schedule.

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[439] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 113.
[440] Ibid., reply to question No. 114.

7.58 In this regard, the Panel also notes that the *travaux préparatoires* confirm that the intention behind paragraph 4 is to prevent the breaching of earlier bindings in recording the ODCs as applied on 15 April 1994, which was the newly agreed applicable date for the recording of ODCs. In other words, the intention of paragraph 4 was to ensure that the level of ODCs recorded on the newly agreed date of 15 April 1994 would not be higher than any previously bound level of ODCs. A Secretariat note on "Article II:1(b) OF THE GENERAL AGREEMENT" circulated during the process of negotiation explained:

> "If it were felt desirable to achieve the fullest possible transparency and to minimize the technical complexity of the entries to be made in the Schedules, the Group might consider that for all bound items, whatever the date of their first incorporation into GATT Schedules, the applicable date should become the same. If it were decided that for example the date of the Uruguay Round Protocol should be the applicable date, all ODCs would be bound at the levels in force at the date of the Uruguay Round tariff protocol, *provided that these levels were not in themselves illegal – i.e., in breach of an earlier bindings*."[441] (emphasis added)

7.59 Although due to the complexity of the negotiating process, one can not really expect to find explicit positions by each Member on all the issues concerning the text of the Understanding, the Panel did find at least one document that clearly set out the view of one Member on relevant issues:

> "2. Having regard to the provisions of paragraph 2 of Article II, it is clear that the term 'other duties and charges' does not include internal tax, anti-dumping or countervailing duties, and fees or other charges commensurate with the cost of services rendered. ...
>
> 3. ...
>
> 4. Taking into consideration of the above-mentioned aspects, India is willing to support the following:
>
> > i) the date of the Uruguay Round Protocol should be the applicable date;
> >
> > ii) all the 'other duties and charges' should be bound at the levels in force on the date of the Uruguay Round Protocol, provided that those levels are not in themselves in breach of *earlier bindings* (emphasis added); and
> >
> > iii) for a period of three years following the date of the aforesaid Protocol there should be the possibility of challenging the recorded 'other duties and charges' on the basis of their inconsistency with *earlier bindings*."[442] (emphasis added)

7.60 Paragraph 2 of the Understanding is relevant to the interpretation of paragraph 4. Paragraph 2 provides:

> "The date as of which 'other duties or charges' are bound, for the purposes of Article II, shall be 15 April 1994. 'Other duties or charges' shall therefore be

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[441] See "Article II:1(b) of the General Agreement, Additional Note by the Secretariat", Negotiating Group on GATT Articles, MTN.GNG/NG7/W/53, 2 October 1989, para.15.

[442] See "Article II:1(B), Statement by the Delegation of India", MTN.GNG/NG7/W/56, 16 November 1989.

> recorded in the Schedules at the levels applying on this date. At each subsequent renegotiation of a concession or negotiation of a new concession the applicable date for the tariff item in question shall become the date of the incorporation of the new concession in the appropriate Schedule. However, the date of the instrument by which a concession on any particular tariff item was first incorporated into GATT 1947 or GATT 1994 shall continue to be recorded in column 6 of the Loose-leaf Schedules."

7.61 Reading paragraph 2 and the first sentence of paragraph 4 together makes clear: (i) that the obligation is to record the ODC levels applied as of 15 April 1994; (ii) for future renegotiation or negotiation of a concession, the applicable date for recording of ODCs will be the date of the incorporation of the new concessions into the Schedule; (iii) in case a previous *lower* level of ODC was bound *at the time of the original incorporation* of the item into the Schedule prior to the Uruguay Round, that earlier bound level shall be recorded rather than the level as applied on the date of 15 April 1994; (iii) if the level bound at the time of the original incorporation of the item was higher than that applied as of 15 April 1994, the level applied on 15 April 1994 shall be recorded and bound.[443] Such understanding is also confirmed by the *travaux préparatoires* as indicated in paragraphs 7.58 and 7.59.

7.62 The second sentence of paragraph 4 provides a limitation in time of the right to challenge the existence and the level of the ODCs recorded in the Schedule. In this regard, the three-year challenge period is limited to challenges based on: (i) the non-existence of a recorded ODC *at the time of the original binding of the item*; or (ii) the inconsistency of the recorded level of ODC *with the previous bound level.* The question is whether the second sentence can be interpreted separately from the first sentence of paragraph 4 in which the level of recorded ODC is required to be no higher than the level obtained at the time of *the first incorporation* of the item into the Schedule, *prior to* the Uruguay Round.

7.63 The Panel is of the view that the logic of the whole paragraph 4 is one and the same, that is, to prevent, in the process of the recording of ODCs during the Uruguay Round, the breach of earlier bindings made in previous rounds when concessions were first incorporated into the Schedules of Concessions. The three-year limitation on the right of challenge is prescribed precisely for the same general obligation, i.e. "no breach of earlier bindings" in the recorded level of ODCs.

7.64 The word "existence" in the second sentence of paragraph 4 should not be completely detached from the phrase "the consistency of the recorded level". Rather, in the Panel's view, they are closely linked to each other. Strictly speaking, if the previous bound level of the ODC prior to the Uruguay Round is "zero", then a challenge to the consistency of the recorded level of ODC with the previous bound level "zero" also constitutes a challenge to the "existence" of the ODC at the time of the original binging made prior to the Uruguay Round. To put it in other words, a challenge to the existence of an ODC at the time of the original binding is equivalent to a challenge to the consistency of the recorded level with a specific "zero" level of ODC that had been bound in a previous round. The Panel understands that under paragraph 4, it is intended that the comparison be made between the recorded level and the level "at the time of the original binding", which is also the time of "the first incorporation of the item" or, "the previous bound time". Legally speaking, these three different expressions written in the first and second sentence of paragraph 4 actually refer to the same time.

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[443] This understanding is confirmed by paragraph 26 of "Article II:1(b) of the General Agreement, Additional Note by the Secretariat", which stated that "[l]ooked from another point of view, an agreement that it should not be possible to restore ODCs to former bound levels, where these were higher than currently applied rates, would be beneficial in that it would introduce greater stability of charges and would further the objectives of trade liberalization; it would also create uniformity between obligations on new and existing bindings because the applicable date for both would be the same". See "Article II:1(b) of the General Agreement, Additional Note by the Secretariat", *supra* note 441.

7.65 The close relationship between a challenge to the existence and a challenge to the consistency in level, whereby the former challenge is logically one specific type of the latter, implies that both categories of challenges must be based on a comparison of the recorded ODC with the bound level (or existence) at the previous bound time, i.e. the time of the first incorporation of the item, which is also the time of the original binding of the item.

7.66 The ordinary meaning of the word "original" in the second sentence of paragraph 4 of the Understanding, read in its context means "first, earliest, early",[444] or, "existing or belonging at or from the beginning or early stage, primary, initial, innate",[445] all of which refer to the time *prior to* the time of the drafting of the Understanding in the Uruguay Round which is the time that the concession was first incorporated in previous rounds with respect to the tariff item concerned.

7.67 Therefore, the Panel finds that, the second sentence of paragraph 4 provides that the right to challenge the existence of the ODC at the time of *the original binding* of the item, i.e. *the time of the first incorporation of the item in a previous round*, and the right to challenge the consistency of the recorded level of the ODC with *the previous bound level*, that is, *the level bound at the time of the first incorporation of the item prior to the Uruguay Round*, expired three years after the entry into force of the WTO Agreement or three years after the deposit of the instrument incorporating the Schedule into the GATT 1994, whichever is later. For the Dominican Republic, the date of deposit of its instrument incorporating the Schedule into GATT 1994 is 7 February 1995.[446] Therefore, after 7 February 1998, no Member could challenge the Dominican Republic's recording of ODCs on the ground of the non-existence of the ODC in previous bound time when a tariff item was first incorporated in its Schedule or could challenge the consistency of the level with the previous lower bound level.

7.68 However, paragraph 4 only deals with challenges regarding the consistency of the level of the recorded ODC with the level applied at the time of the first incorporation of the item prior to the Uruguay Round and the existence of the ODC at that time. The possibility of all other challenges is addressed under paragraph 5 of the Understanding:

> "The recording of 'other duties or charges' in the Schedules is without prejudice to their consistency with rights and obligations under GATT 1994 *other than those affected by paragraph 4* (emphasis added). All Members retain their right to challenge, at any time, the consistency of any 'other duties or charges' with such obligations"

7.69 It is clear that paragraph 5 of the Understanding allows all types of challenges to be made based on all GATT articles, except those that fall under paragraph 4. One specific challenge made by Honduras is that *the recorded ODC did not exist as of 15 April 1994*, which, in the opinion of the Panel, is a challenge of *the existence* of the ODC *during the Uruguay Round*, rather than a challenge of existence of an ODC at the time of the original binding of the item, i.e. at the time of the first incorporation of the item prior to Uruguay Round. Therefore, it is not subject to the three-year limitation under the second sentence of paragraph 4 and the challenge is permitted by paragraph 5 of the Understanding.

7.70 The Panel recalls the fact that the surcharge has been applied since October 2003. It clearly did not exist as of 15 April 1994. The recording of a measure which did not exist as of 15 April 1994

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[444] *Concise Oxford Thesaurus*, Second Edition, 2002, p. 611.

[445] *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. II, p. 2,022.

[446] The "Notification of Acceptance" in document WT/Let/7 shows that the Dominican Republic deposited its acceptance of the Marrakesh Agreement with the Director-General of the WTO on 7 February 1995. This acceptance also serves as the instrument incorporating its Schedule of Concessions into GATT 1994.

is therefore not legally valid as it does not meet the obligation under paragraph 2 which requires that ODCs be recorded at the levels applied on 15 April 1994.

7.71 The Panel considers that the other specific challenge made by Honduras that *the nature of the recorded measure is not an ODC within the meaning of Article II:1(b)* is also clearly a challenge that falls outside of the scope of paragraph 4 and is therefore permitted by paragraph 5 of the Understanding.

7.72 In this regard, the Panel notes that paragraph 1 of the Understanding also provides: "... *the nature* and level of any 'other duties or charges' levied on bound tariff items, ... *shall be recorded* in the Schedules of Concessions annexed to the GATT 1994 against the tariff item to which they apply. It is understood that such *recording does not change the legal character* of 'other duties or charges' (emphasis added)". Based on this paragraph, the Panel understands that the recording of the nature of the measure is a necessary part of the recorded content and it also constitutes an element that is bound in the Schedule. Therefore, in case what was recorded is not in the nature or legal character of an ODC, the recording can not be invoked to justify a current ODC measure due to the difference in nature of the two measures.

7.73 In the Panel's view, a recording of the Selective Consumption Tax, i.e. an internal measure, into the Schedule, as the Dominican Republic did in 1994, does not change the recorded content into a legally valid "other duty or charge" that can be invoked to justify the currently applied surcharge and the foreign exchange fee, which are both in the nature of an ODC.

7.74 The Panel recalls the Dominican Republic's argument that, even if the recording could be challenged after three years, such challenge has to be brought under the relevant paragraphs of the Understanding. The Dominican Republic contends that, since Honduras failed to specify any paragraph of the Understanding in its Panel request, it cannot be allowed to bring the challenge.

7.75 On this point, the Panel considers that it was the Dominican Republic that invoked the recording of the ODCs in an exhibit presented together with its first written submission to justify its surcharge and foreign exchange fee measures.[447] Honduras then raised objections regarding the existence of the ODC back in 1994 and regarding the nature of the recorded measure, citing requirements in certain paragraphs of the Understanding. The Dominican Republic subsequently rebutted such objections arguing that paragraph 4 of the Understanding prohibits the challenge to the existence, nature and level of the recorded ODCs after the three-year time period expired. Honduras responded that paragraph 4 deals only with a specific situation where a tariff item had been bound prior to the Uruguay Round whereas the challenges raised by Honduras concerned the non-existence of ODC as of 15 April 1994 as well as the nature of the recorded measure in the Schedule, which are not within the scope of paragraph 4. The Panel notes that during the proceedings, both parties actually invoked the Understanding in support of their own arguments relating to the claim made by Honduras under Article II:1(b).

7.76 The Panel believes that as context for Article II:1(b) of the GATT 1994, it is relevant and in fact necessary to consider and to apply the relevant paragraphs of the Understanding for the purpose of the interpretation of Article II:1(b) in examining the claim of Honduras made under Article II:1(b). Moreover, since the Understanding was also actually invoked by both Honduras in explaining the applicable date and the content of the recording[448] and by the Dominican Republic in arguing the expiry of the right of challenge to the recording under paragraphs 4 and 5 of the Understanding[449], the Panel is obliged to address the arguments made by the parties concerning relevant paragraphs of the

[447] "Additions to Schedules Annexed to the Marrakesh Protocol to the GATT 1994, Schedule XXIII – Dominican Republic", *supra* note 61.

[448] First written submission of Honduras, 16 March 2004, paras. 53-58.

[449] Second written submission of the Dominican Republic, 10 June 2004, paras. 81-85.

Understanding in order to assess how relevant paragraphs of the Understanding contribute to the interpretation and application of Article II:1(b).

7.77 The Panel recalls that the panel in *India – Quantitative Restrictions* considered Article XVIII:B and the 1994 Understanding on Balance-of-payments Provisions in its analysis of the US claim under Article XVIII:11 of the GATT 1994, although both were *not* raised in the request for the establishment of that panel. The reason was that both Article XVIII:B and the 1994 Understanding are part of the context of Article XVIII:11 and that the defending party had invoked Article XVIII:B as a defence. The panel stated: "the defending party is not restricted in the provisions of the Marrakesh Agreement ... that it can invoke in its defence. In this circumstance, the Panel finds it relevant to consider the provisions of Article XVIII:B and the 1994 Understanding as part of the context in deciding on the claims of the United States [of inconsistency with Article XVIII:11 of the GATT] and to examine them in relation to the defence raised [under Article XVIII:B] by India."[450]

7.78 The situation in this dispute is similar to that in *India – Quantitative Restrictions*. Since the Understanding is part of the context of Article II:1(b) of the GATT 1994 and the Dominican Republic has actually invoked the Understanding to raise argument concerning the recording of ODCs and the expiry of the right of challenge to such recording, the Panel is in a position to address various arguments made by parties on the relevant paragraphs of the Understanding, i.e. to examine them in relation to the defence of the Dominican Republic and to the counter arguments by Honduras even though the Understanding was not included in the request for the establishment of the Panel. The Panel considers that the arguments that parties made under the Understanding are not independent of the claim or defence under Article II:1(b). Rather, in the Panel's view, they are closely linked to the claim and the defence under Article II:1(b). For these reasons, the Panel considers that it is permitted and in fact it is also necessary to address relevant paragraphs of the Understanding for its findings on the claim of inconsistency of the surcharge and the foreign exchange fee measures with Article II:1(b) of the GATT 1994.

7.79 On the other hand, the Panel is also aware that such assessment should be made only to the extent necessary for the Panel to make a finding under Article II:1(b) of the GATT 1994. The Panel is not authorized to make independent conclusions on the consistency of the surcharge measure or foreign exchange fee with any paragraphs of the Understanding since the paragraphs of the Understanding have not been specifically set out in the panel request as part of the mandate of this Panel.

7. Whether the surcharge is inconsistent with Article II:1(b) of the GATT 1994

(a) Arguments of the parties

7.80 Honduras argues that Article II:1(b), second sentence, read together with the Understanding, prohibits Members from imposing "other duties or charges" in excess of the binding recorded in the "other duties and charges" column of the Member's Schedule. Since the Dominican Republic did not record the 2 per cent surcharge into its Schedule, the surcharge, in the view of Honduras, is "in excess of" that set out in its Schedule. Therefore, it is inconsistent with the obligation under Article II:1(b) of the GATT 1994.[451] It is consequently also inconsistent with the general prohibition set out in Article II:1(a) of the GATT1994.[452]

7.81 The Dominican Republic contends it did record ODCs in its Schedule and that the properly recorded level of "other duties and charges" on cigarettes is 30 per cent. Since the total level of ODCs currently imposed on cigarettes by the Dominican Republic, including the transitional

[450] Panel Report in *India – Quantitative Restrictions*, paras. 5.18-5.19.
[451] First written submission of Honduras, 16 March 2004, paras. 57-58.
[452] Ibid., footnote 34.

surcharge, is less than 30 per cent, the transitional surcharge is consistent with Article II:1(b), second sentence.[453] Consequently, in the view of the Dominican Republic, there is no inconsistency of the surcharge with Article II:1(a) either due to the fact that Honduras's claim of inconsistency of the surcharge with Article II:1(a) is derived from the inconsistency of the surcharge with Article II:1(b).[454]

7.82 Honduras submits that the Dominican Republic actually inscribed its internal tax as applied on 15 April 1994 into its Schedule. Honduras considers that the inscription of an internal tax into the Schedule has no legal effect.[455] Honduras contends that the nature of the recorded "*Impuesto Selectivo*" is not the same as the surcharge measure currently applies. The "*Impuesto Selectivo*" is an internal tax while the transitional surcharge is a border measure on the importation of all products. Therefore, in the view of Honduras, the Dominican Republic had not properly recorded the transitional surcharge as an ODC in its Schedule.[456] Honduras argues that the recording of an internal tax which falls under Article III:2 does not change the nature of that tax into "other duty or charge" which falls under Article II:1(b).[457] It also argues that the Dominican Republic could not have recorded the transitional surcharge due to the fact that the transitional surcharge was first imposed on 30 June 2003.[458] Honduras therefore concludes that the transitional surcharge is inconsistent with Article II:1(b) as it has not been recorded in the Dominican Republic's Schedule of Concessions.[459]

7.83 Honduras also argues in its oral statement during the first substantive meeting of the Panel that the surcharge currently applied by the Dominican Republic is inconsistent with Article II:1(b) of the GATT because it is also imposed on *other products* not listed in the controversial notification of "Additions to Schedules Annexed to the Marrakesh Protocol to the GATT 1994, Schedule XXIII – Dominican Republic" in document G/SP/3.[460]

(b) Analysis by the Panel

7.84 The Panel recalls its previous factual findings in paragraph 7.40 that the Dominican Republic has actually recorded in its Schedule the Selective Consumption Tax as applied to selected imported products under Law 11-92 in force as of 15 April 1994. The fact that the Selective Consumption Tax was applied both to imported and domestic products makes it clear that it was in the nature of an internal tax. Article II:1(b) and Article II:2(a) make a distinction between an ODC that is subject to a bound requirement and an internal tax that is not subject to any bound requirement, but rather, subject to Article III requirements. Article II:2 also makes it clear that the two are mutually exclusive. If a measure is in the nature of an internal tax, it cannot be an ODC. Likewise, if a measure is in the nature of an ODC, it cannot be an internal tax. For these reasons, the Panel reconfirms its findings that the Dominican Republic has not established that the nature of the measure recorded in the Schedule of the Dominican Republic is an ODC measure within the meaning of Article II:1(b), rather than an internal tax measure, specifically, the Selective Consumption Tax measure.

7.85 The Panel recalls that in previous paragraphs, it has made the following findings: (i) the Dominican Republic has not established that the recorded measure is in the nature of an ODC and therefore it can not be invoked as a legal basis to justify the application of the transitional surcharge measure, which is an ODC measure under Article II:1(b);[461] (ii) the recording of a measure which did not exist as of 15 April 1994 is not legally valid as it failed to meet the requirement under paragraph 2

[453] First written submission of the Dominican Republic, 13 April 2004, para.183.
[454] Ibid., paras. 184-186.
[455] First oral statement of Honduras, paras. 8-9.
[456] Ibid., paras. 11-12.
[457] Second written submission of Honduras, 10 June 2004, paras. 166 and 171.
[458] First oral statement of Honduras, para. 13.
[459] Second written submission of Honduras, 10 June 2004, para. 172.
[460] First oral statement of Honduras, para. 14.
[461] See paras. 7.40, 7.73,and 7.25.

of the Understanding;[462] (iii) both the challenge to the existence of the ODC on the date of 15 April 1994 and the challenge to the nature of the recorded ODC are permitted by paragraph 5 of the Understanding.[463]

7.86 The Panel therefore finds that there is no legally valid recording of "other duties or charges" as required by the Understanding in the Dominican Republic's Schedule of Concessions. The recording of the Selective Consumption Tax, i.e. an internal tax, can not be used as legal basis to justify the current ODC measures, specifically, the transitional surcharge and the foreign exchange fee measures.

7.87 Article II:1(b) of the GATT 1994 provides:

> "The products described in Part I of the Schedule relating to any contracting parties. Which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempted from ordinary custom duties in excess of those set forth and provided therein. Such products shall also be exempted from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date."

Paragraph 2 of the Understanding on the Interpretation of Article II:1(b) provides more details on the bound date:

> "The date as of which 'other duties or charges' are bound, for the purposes of Article II, shall be 15 April 1994. 'Other duties or charges' shall therefore be recorded in the Schedules at the levels applying on this date."

Paragraph 7 of the Understanding provides:

> "'Other duties or charges' omitted from a Schedule at the time of deposit of the instrument incorporating the Schedule in question into GATT 1994 … , shall not subsequently be added to it and any 'other duties or charges' recorded at a level lower than that prevailing at the applicable date shall not be restored to that level unless such additions or changes are made within six months of the date of deposit of the instrument."

7.88 Reading Article II:1(b) together with paragraphs1, 2, 7 and 4 of the Understanding as context, the Panel considers that the obligation under Article II:1(b), second sentence is for Members to record in their Schedules, within six months of the date of deposit of the instrument, all ODCs as applied on 15 April 1994 unless those levels breach previous bound levels of ODCs.[464] In case any Member did not record the ODCs in the Schedule within six months of the date of deposit of the said instrument, the right to record it in the Schedule and to invoke it expired after six months. In the context of the recording requirements as prescribed in the Understanding, the meaning of Article II:1(b), second sentence is specifically that *imported products shall be exempted from all "other duties or charges" of any kinds in excess of those as validly recorded in the Schedule of the Member concerned*.

7.89 There is no legally valid recording of "other duties or charges" as required by the Understanding in the Schedule of Concessions of the Dominican Republic. For all legal and practical

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[462] See para. 7.70.
[463] See paras. 7.69 and 7.71.
[464] See also the findings of the Panel in para. 7.61

purposes, what was notified by the Dominican Republic in document G/SP/3 is equivalent to "zero" in the Schedule. The Panel finds that the surcharge as an "other duty or charge" measure is applied in excess of the level "zero" pursuant to the Schedule. Therefore, the surcharge measure is inconsistent with Article II:1(b) of the GATT 1994.

7.90 The fact that the surcharge and foreign exchange fee are currently applied to products *outside* the scope of those selected products as listed in G/SP/3 notification constitutes an additional reason for the Panel to find that they are inconsistent with Article II:1(b) because for these products outside the scope of the notified list, nothing has been recorded in the Schedule, whether legally valid or not. Therefore, any amount of surcharge or foreign exchange fee is actually "in excess of" the level of "zero" pursuant to the Schedule of the Dominican Republic.

8. Whether the measure is limited to cigarette products

(a) Arguments of the parties

7.91 Honduras argued in its oral statement during the first substantive meeting of the Panel that the surcharge currently applied by the Dominican Republic is inconsistent with Article II:1(b) of the GATT 1994. One reason given by Honduras for such claim is that the surcharge is imposed also on other products not listed in the controversial addition of ODCs in the Schedule of Concessions in 1994.[465]

7.92 Rebutting this argument of Honduras, the Dominican Republic contends that the product coverage with respect to the surcharge and foreign exchange fee measures has been limited to cigarettes from the early stage of the proceedings.[466] The Dominican Republic submits that Honduras claimed in its first written submission that the surcharge and the foreign exchange fee are inconsistent with Article II:1(b) as they apply to the bound item of cigarettes. The scope of the product coverage has therefore been confined to cigarettes.[467] Expanding this scope of product coverage would, in the view of the Dominican Republic, affect the right of the Dominican Republic to defend itself and undermine the principles of due process, equity and good faith.[468]

7.93 Honduras argues however, that the text of the Panel request with regard to transitional surcharge has an "all encompassing nature" and that its claims of violation of Article II:1(b) and Article II:1(a) are made with respect to any imported good. The panel request has put the Dominican Republic and third parties on notice that the claims are made with respect to all imported goods. Therefore, Honduras considers that the transitional surcharge, as it applies to products other than cigarettes, is within the mandate of the Panel.[469] Honduras submits that from the language in its request for the establishment of the Panel, the foreign exchange fee as it applies to products other than cigarettes is within the terms of reference of the Panel.[470]

(b) Analysis by the Panel

7.94 On the issue of whether the measure to be examined by the Panel is limited to the transitional surcharge as applied to cigarette products, i.e. excluding the examination of the application of the surcharge to other products, the Panel believes that it is necessary to analyse the text of the panel request to determine whether it is limited to the application of the surcharge to cigarette products.

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[465] First oral statement of Honduras, para. 14.

[466] Second written submission of the Dominican Republic, 10 June 2004, para. 94; First oral statement of the Dominican Republic, para. 62.

[467] Second written submission of the Dominican Republic, 10 June 2004, para. 95.

[468] Second written submission of the Dominican Republic, 10 June 2004, paras. 95, 96 and 89.

[469] Second written submission of Honduras, 10 June 2004, paras. 154-155.

[470] Ibid., paras. 189-190.

7.95 The request for the establishment of this panel provides:

> "The Dominican Republic levies a transitional surcharge for economic stabilization in accordance with Decrees 646-03 and 693-03, a surcharge which currently amounts to 2 per cent of the c.i.f. value of the imported goods. Honduras considers that the surcharge constitutes a charge imposed on or in connection with importation inconsistent with Article II:1(a) and (b) of the GATT."

7.96 On the measure of foreign exchange fee, the panel request provides similar language:

> "The Dominican Republic levies a foreign exchange fee in accordance with the Seventeenth Resolution of the Monetary Board dated 24 January 1991 as amended, *inter alia*, by... and the First Resolution of 22 October 2003. The fee is currently 10 per cent 'calculated on the value of the imports'. Honduras considers that this fee constitutes a charge imposed on or in connection with importation which does not meet the requirements laid down in Article II:1(a) and (b) of the GATT. Honduras also considers that the fee constitutes an exchange action frustrating the intent of the provisions of the GATT and that it is therefore inconsistent with Article XV:4 of the GATT."

7.97 It is clear to the Panel that the request describes the transitional surcharge for economic stabilization measure and the foreign exchange fee measure in a general manner without mentioning product coverage. The claim that Honduras made in respect of surcharge is that "the surcharge constitutes a charge ... inconsistent with Article II:1(a) and (b) of the GATT". The claim with respect to the foreign exchange fee is that "this fee constitutes a charge ... which does not meet the requirements laid down in Article II:1(a) and (b)". There is no specific indication of product coverage in the panel request with respect to these two measures.

7.98 The Dominican Republic argues that the product coverage with respect to the surcharge and the foreign exchange fee measures has been limited to cigarette products from the early stage of the proceedings. It notes that Honduras stated in its first written submission that these two measures are inconsistent with Article II:1(b) for the bound item of cigarettes. The Dominican Republic also pointed out that the title of this dispute refers only to cigarettes.

7.99 In this regard, a reading of paragraphs 50 and 51 of the first written submission of Honduras indicates that Honduras used the application of the surcharge measure on cigarette products to illustrate that the surcharge is applied to a bound item cigarettes *in addition to* the tariff duty on that item; therefore, it falls under Article II:1(b). Similarly, paragraphs 61 and 62 also explain that the foreign exchange fee applies to the bound item cigarettes in addition to its tariff rate; hence, it also falls under Article II:1(b). While these could be seen as arguments or examples used by Honduras to support its claims that the two measures in question fall under Article II:1(b) and that they are inconsistent with Article II:1(b), the Panel considers that it is not sufficient to conclude that these arguments or examples effectively limited the product scope of the two measures to cigarettes only. In fact, in the first written submission of Honduras, there are general claims that the 2% surcharge itself is inconsistent with Article II:1(b)[471] and that the foreign exchange fee itself is inconsistent with Article II:1(b).[472] For these reasons, the Panel considers that Honduras has not limited in its first submission, the product coverage of its claims on the surcharge and foreign exchange fee measures solely to cigarette products.

[471] First written submission of Honduras, 16 March 2004, para. 58.
[472] Ibid., paras. 66-67.

7.100 Such conclusion is further supported by the written replies to a Panel question by the third parties El Salvador and Nicaragua. Both of them argue that the panel request has put third parties on notice that the scope of products with regard to these two measures is not confined to cigarettes [473]

7.101 Even assuming that Honduras did focus its arguments more on cigarette products in its first written submission in arguing the inconsistency of the surcharge and foreign exchange fee measures, the fact that it made additional argument regarding other products not excluded by its Panel request during the first substantive meeting of the Panel, would have given the Dominican Republic sufficient opportunities to respond to it in its second written submission or during the second substantive meeting of the Panel. The Panel does not see how the opportunity to respond to such argument is limited in the proceedings. Therefore, the Panel considers that it has not been presented with a convincing case that a due process issue would arise if the Panel does not exclude from its consideration new arguments made by Honduras concerning other products at the first substantive meeting.

7.102 On the importance of the title of the dispute to the determination of the mandate of this Panel, the Panel is of the view that it is the panel request, rather than the title of the dispute that defines the terms of reference of the Panel. In fact, in some cases, the title of a dispute does not make any reference to the name of product at all.[474] In other cases, the title contains the names of certain products, but not all those products addressed in the dispute. In *Argentina - Textiles*, the products listed in the title of that case are "footwear, textiles, apparel and other items" , which did not preclude that panel from examining a separate "statistical tax measure" which was set out in the panel request and which was applied to *all* imported products.[475] Similarly, the *Argentina – Hides and Leather* panel also examined a separate value-added tax measure in respect of all imported products beyond those specified in the title of that dispute.[476] Therefore, the Panel considers that the title of the dispute is not relevant in determining the scope of product coverage under each measure set out in the panel request.

7.103 For these reasons, the Panel considers that the product coverage under both the transitional surcharge measure and the foreign exchange fee measure includes all imported products.

9. Whether the surcharge is inconsistent with Article II:1(a) of the GATT 1994

7.104 The Panel is aware that Honduras made arguments regarding Article II:1(a) only in a footnote, not in the text of its written submission. The Panel has already found in paragraphs 7.89 and 7.90 that the surcharge is inconsistent with Article II:1(b) of the GATT 1994. Under the guidance of the principle of judicial economy, the Panel considers it unnecessary to address the claim under Article II:1(a) for the resolution of this dispute. Therefore, it refrains from making any findings under Article II:1(a).

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[473] See Reply of El Salvador and Nicaragua to a question addressed by the Panel.

[474] For example, in *EC – Tariff Preferences* case, the fact that no product name was included in the title of the case did not prevent the panel from addressing the claim of violation of Article I:1 of GATT in respect of all products involved under the Drug Arrangement regime originating from beneficiary countries *vis-à-vis* those like products imported from other developing countries. See Panel Report, *EC – Tariff Preferences*, para. 7.60. In the *US – FSC* case, the absence of product name from the title of the case did not prevent the panel from examining claims under the Agriculture Agreement in respect of all agricultural products. See Panel Report, *US – FSC*, paras. 7.23-7.30.

[475] Panel Report, *Argentina –Textiles*, paras. 6.70-6.80.

[476] Panel Report, *Argentina – Hides and Leather*, paras. 11.104-11.191.

D. THE LEVYING OF THE FOREIGN EXCHANGE FEE

1. The measure at issue

7.105 The Dominican Republic imposes a foreign exchange fee (*comisión de cambio*) on all imports. This fee was originally introduced by the Seventeenth Resolution of the Dominican Republic's Central Bank Monetary Board dated 24 January 1991 and amended, *inter alia*, by the First Resolution of 27 September 2001, the First Resolution of 20 August 2002, and the First Resolution of 22 October 2003. The rate of the foreign exchange fee was 2.5 per cent when it was originally introduced. It was later changed to 1.5 per cent, 5 per cent, 4.75 per cent, and then to its current level of 10 per cent by the First Resolution of 22 October 2003. The current 10 per cent foreign exchange fee is calculated on the value of the imports at the selling exchange rate for foreign currency. The surcharge applies to both bound and unbound items. According to the First Resolution of the Monetary Board of 22 October 2003, the 10 per cent foreign exchange fee is transitional in nature and would be eliminated at a time when such elimination would not entail a negative impact on macroeconomic stability. The phasing out of this transitional foreign exchange fee in future would depend on the reform of the tax system currently under consideration and the economic stabilization negotiations with the IMF.[477]

2. Introduction

7.106 Honduras claims that the foreign exchange fee as an "other duty or charge" is inconsistent with Article II:1(b) of the GATT 1994. The Dominican Republic contends that the fee is an exchange restriction justified under Article XV:9(a). It states that should the Panel find to the contrary, it is nevertheless consistent with Article II:1(b) since it was recorded in the Schedule. Given its terms of reference and in light of the parties' claims and arguments during the proceedings, the Panel considers it necessary to examine the matter by analysing the following legal issues: (i) whether the foreign exchange fee is an ODC as recorded in the Schedule; (ii) whether the foreign exchange fee is inconsistent with Article II:1(b); (iii) whether the foreign exchange fee is an "exchange restriction" under Article XV:9(a); (iv) whether the fee is imposed "in accordance with" Articles of Agreement of the IMF; and (v) whether the measure is justified under Article XV:9(a) of the GATT.

7.107 As to the order of analysis of the claim made by Honduras and the defence made by the Dominican Republic, the Panel considers it necessary to first examine the claim of inconsistency of the fee with Article II:1(b). Both parties agree that Article XV of the GATT is an exception or an affirmative defence. The Panel agrees with this characterization of Article XV. That means that it serves as a justification for inconsistency with other provisions of the GATT. If there is no inconsistency with other GATT provisions in the first place, there is no need to have recourse to any affirmative defence for justification. Therefore, the Panel should begin its analysis with the claim under Article II:1(b) of the GATT 1994.

3. Whether the foreign exchange fee is an ODC as recorded in the Schedule of the Dominican Republic

(a) Arguments of the parties

7.108 Honduras argues that the foreign exchange fee is an "other duty or charge". It is imposed at the same time as ordinary customs duties and it is imposed on all imported goods, including both bound and unbound items.[478] Honduras considers that it is applied on the value of imports and at the

[477] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 54.
[478] First written submission of Honduras, 16 March 2004, para. 61.

time of importation and, as such, is a duty or charge other than "ordinary customs duties" imposed on, or in connection with, importation, within the meaning of Article II:1(b).[479]

7.109 Honduras argues that the Understanding requires that all duties or charges, other than ordinary customs duties, be recorded in Members' Schedules of Concessions and that the foreign exchange fee was not recorded in the Schedule of Concessions of the Dominican Republic.[480] In its view, the Dominican Republic had not recorded ODCs, including the foreign exchange fee, in its Schedule, just as it had not recorded the surcharge in its Schedule.[481] Honduras argues that Article II:1(b), second sentence read together with the Understanding, prohibits Members from imposing "other duties or charges" other than those recorded in the ODC column of that Member's Schedule after 15 April 1994. Therefore, the foreign exchange fee is inconsistent with Article II:1(b), second sentence.[482]

7.110 The Dominican Republic replies that the foreign exchange fee is consistent with Article II:1(b) because the Dominican Republic recorded a 30% level of ODCs applied to cigarettes products as of 15 April 1994. The Dominican Republic argues that, since the total level of ODCs applied to cigarettes product, including the 10% foreign exchange fee, is less than 30%, there is no inconsistency with Article II:1(b).[483]

7.111 Honduras argues, on the other hand, that the Dominican Republic did not record the foreign exchange fee in its Schedule, just as it did not record the surcharge measure in it Schedule. What the Dominican Republic had recorded was the "*Impuesto Selectivo*", i.e. an internal tax enforced at the border for certain imported products. The nature of the "*Impuesto Selectivo*" is different from the foreign exchange fee, which is a border measure imposed on the importation of *all* products.[484] Honduras considers that its arguments regarding the claim that the Dominican Republic did not record surcharges in its Schedule also apply to the claim that the Dominican Republic did not record the foreign exchange fee in its Schedule.[485]

7.112 The Dominican Republic argues that, even assuming that it did not properly record the transitional surcharge and the foreign exchange fee in its Schedule, paragraphs 4 and 5 of the Understanding prohibit Members from challenging the existence of the foreign exchange fee at the original binding time and from challenging the consistency of its level after the three-year period has expired. [486] The Dominican Republic considers that the fact Honduras has not invoked any paragraph of the Understanding in its panel request also prohibits it from making a challenge under the Understanding.[487]

(b) Analysis by the Panel

7.113 Although there is no definition of what constitutes an "other duty or charge" in the GATT 1994 and in the "Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994", the ordinary meanings of Article II:1(b) and Article II:2 make it clear that any fee or charge that is in connection with importation and that is not an ordinary customs duty, nor a tax or duty as listed under Article II:2 (internal tax, anti-dumping duty, countervailing duty, fees or charges commensurate with the cost of services rendered) would qualify for a measure as an "other duties or charges" under Article II:1(b).

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[479] Ibid., para. 63.
[480] Ibid., paras. 64-65.
[481] Second written submission of Honduras, 10 June 2004, para. 194.
[482] First written submission of Honduras, 16 March 2004, para. 65.
[483] First written submission of the Dominican Republic, 13 April 2004, paras. 202-205.
[484] First oral statement of Honduras, paras. 19-20.
[485] Second written submission of Honduras, 10 June 2004, para. 194.
[486] Second written submission of the Dominican Republic, 10 June 2004, paras. 84-85.
[487] Ibid., para. 86.

7.114 The *travaux préparatoires* concerning the Understanding confirm such interpretation. The Secretariat note on "Article II:1(b) :OF THE GENERAL AGREEMENT" stated:

> "4 The definition of ODCs falling under the purview of Article II:1(b) can only be done by exclusion –i.e. by reference to those categories of ODC not covered by it. It would be impossible, and logically fallacious, to draw up an exhaustive list of ODCs which do fall under the purview of Article II:1(b), since it is always possible for governments to invent new charges. Indeed, an attempt to provide an exhaustive list would create the false impression that charges omitted from it, or newly invented, were exempt from the II:1(b) obligation."[488]

7.115 The foreign exchange fee is imposed on imported products only and it is not an ordinary customs duty. It is computed on the value of imports, not on the cost of the services rendered by the customs authorities. Consequently, it is not a fee or charge that falls under Article VIII of the GATT. It is obviously not an anti-dumping or countervailing duty. Therefore, it is a border measure in the nature of an ODC within the meaning of Article II:1(b).

7.116 On the issue of whether the foreign exchange fee as an ODC has been recorded in the Schedules of Concessions of the Dominican Republic, the Panel notes that the parties made essentially the same arguments as they did on the issue of whether the surcharge measure has been recorded in the Schedule. The Panel therefore considers that the same analysis the Panel made with respect to the recording of the surcharge measure in paragraphs 7.37 to 7.40 also applies to the recording of the foreign exchange although the Panel notes that the foreign exchange fee did exist at the level of 1.5 per cent as of 15 April 1994.

7.117 Therefore, the Panel's overall factual assessment with respect to the recording of the foreign exchange fee measure is that the foreign exchange fee was applied at 1.5 per cent in 1994, but it was not recorded in the Schedule. What the Dominican Republic notified in document G/SP/3 was basically the products list and the *ad valorem* Selective Consumption Tax rates as applied to these imported products under Law 11-92 in force in 1994. It is clear that in fact these products were only subject to the Selective Consumption Tax, not to an equal amount of additional "other duties and charges" back in 1994.

7.118 The Panel has found in paragraph 7.40 that the Dominican Republic has actually recorded in its Schedule the Selective Consumption Tax as it applied to imported products as of 15 April 1994. The fact that the Selective Consumption Tax applied both to imported and domestic products makes it clear that it is in the nature of an internal tax. Article II:2(a) and Article II:1(b) make a distinction between an internal tax that is subject to Article III and an ODC that is subject to a bound requirement with the consequence that the two are mutually exclusive. If a measure is in the nature of an internal tax, it is not an ODC. If a measure is in the nature of an ODC, it is not an internal tax. For these reasons, the Panel finds that the Dominican Republic has not established that the nature of the measure recorded in the Schedule of the Dominican Republic is an ODC measure within the meaning of Article II:1(b) that could be invoked to justify the current ODC measure, the foreign exchange fee.

7.119 The Panel also considers that Honduras's challenge to the nature of the recorded measure is not prohibited by paragraphs 4 and 5 of the Understanding or by the fact of absence of invocation of the Understanding in its Panel request based on the same analysis as developed by the Panel in paragraphs 7.67, 7.71 and 7.78.

7.120 The Panel recalls that the foreign exchange fee is applied to all imported products, well beyond the selective products list in the G/SP/3 notification. As the Panel found in paragraph 7.103,

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[488] See "Article II:1(b) of the General Agreement, Additional Note by the Secretariat", *supra* note 441.

the foreign exchange fee as applied to products outside the scope of the products listed in the G/SP/3 notification, is within the Panel's terms of reference.

7.121 The Panel concludes for the reasons set out above, that there was no legally valid recording of any ODC measure as required by the Understanding in the Schedule of the Dominican Republic. For all legal and practical purposes, what was notified by the Dominican Republic in document G/SP/3 is equivalent to "zero" in the Schedule. The Panel finds that the foreign exchange fee is therefore applied in excess of the level of "zero" pursuant to the Schedule of the Dominican Republic and therefore is inconsistent with Article II:1(b) of the GATT 1994.

7.122 The Panel also considers that the application of foreign exchange fee to products other than those products listed in the G/SP/3 notification is in excess of the level of "zero" or "none" pursuant to the Schedule of the Dominican Republic, since nothing was recorded for these products, either as an ODC or otherwise.

4. Whether the exchange fee is an "exchange restriction" under Article XV:9 (a) of the GATT 1994

(a) Arguments of the parties

7.123 The Dominican Republic argues that the foreign exchange fee is an exchange measure justified by Article XV:9(a) of the GATT 1994. The Dominican Republic considers that Article XV:9(a) is an exception to other provisions of the GATT, including Article II. In its view, Members are entitled to use exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund.[489]

7.124 The Dominican Republic also argues that the foreign exchange fee is an "exchange restriction" because of the following features: it is prescribed by monetary authorities, not by trade or customs authorities; it applies to exchange actions, not to import transactions as such; and it is a charge on foreign exchange transactions imposed through the banking system, not a charge on import transactions levied by customs authorities.[490]

7.125 The Dominican Republic considers that the meaning of exchange restrictions is to be interpreted by the IMF. In this regard, it reminds the Panel of a Decision made by the Executive Directors of the Fund on 1 June 1960 stating that "[t]he guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current transactions under Article VIII, Section 2, is whether it involves a direct governmental limitation on the availability or use of exchange as such".[491] The Dominican Republic considers that the criterion for identifying an "exchange restriction" does not involve the motive behind a measure or the effect it produces.[492] The Dominican Republic considers that the foreign exchange fee is an "exchange restriction" because paragraph 12 of the Resolution of 24 January 1991 provides that the Central Bank will levy a percentage on foreign exchange transactions.[493]

7.126 The Dominican Republic argues that the foreign exchange fee is an "exchange restriction" because it is a direct governmental limitation on the availability or use of exchange as such. It qualifies as an "exchange restriction" since it effectively and legitimately requires all payments to be channelled through the banking system.[494]

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[489] First written submission of the Dominican Republic, 13 April 2004, para. 91.
[490] Ibid., para. 93.
[491] First written submission of the Dominican Republic, 13 April 2004, para. 94.
[492] Ibid.
[493] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 58.
[494] First written submission of the Dominican Republic, 13 April 2004, para. 198.

7.127 Honduras submits that Article XV:9(a) is an affirmative defence and the Dominican Republic bears the burden of establishing that the foreign exchange fee is justified under that Article.[495]

7.128 Honduras argues that in determining whether the measure is an "exchange restriction", it is legally irrelevant whether the measure is imposed by monetary authorities or by customs authorities.[496] The foreign exchange fee is ostensibly on foreign exchange transactions but it is computed on the value of imports at the selling rate of foreign exchange. Honduras considers that this is not different from the "transaction value" for the purpose of the imposition of customs duties. In the view of Honduras, the foreign exchange fee is nothing more than an import charge, a trade measure within the jurisdiction of the WTO, rather than an exchange measure under Article XV:9(a).[497] In the view of Honduras, the foreign exchange fee is a trade restriction as it is a restriction on the entry of products into the Dominican Republic and it is a barrier to trade as it adds to the cost of trade.[498]

7.129 Honduras also argues that the act that causes the imposition of the foreign exchange fee is "importation", not the purchase of foreign currency, and the amount of this fee is based on the value of imports.[499] Honduras considers that the foreign exchange fee does not apply to non-import related transactions, including: (i) transactions for non-import related service; (ii) non-import related payment made by the Dominican Republic residents; and (iii) remittances of dividends from companies located in the Dominican Republic. Honduras indicates that the Resolution of 20 October 2002 confirms that this fee does not apply to "payments of external debt; repatriation of capital, remittances of dividends, technology transfers, and payments for travel expenses and medical services; credit cards and all other services".[500]

7.130 Honduras emphasizes that the foreign exchange fee is not an "exchange restriction" because it is not a "direct ... limitation on the availability or use of exchange as such". In the view of Honduras, "as such" in relation to "limitation on the availability or use" means that the limitation must be on access to or the use of foreign exchange, as such, or *per se*. Honduras contends that the Dominican Republic has not established that the foreign exchange fee imposed a limitation on access to or use of foreign exchange *per se*. While the foreign exchange fee increases the costs of imports, the availability of foreign exchange to pay for imports remains unrestricted.[501]

(b) Analysis by the Panel

7.131 The Panel takes note that both parties agree that Article XV of the GATT 1994 is an exception or an affirmative defence. Although the two concepts are not identical, an exception can often be invoked as an affirmative defence. It is well established that under an exception provision, the burden is on the defending party to justify the consistency of its measure under the exception provision it invoked[502] Therefore, in this case, the Dominican Republic bears the burden to establish: (i) that the foreign exchange fee measure is an " exchange control or exchange restriction" within the meaning of Article XV:9(a); and (ii) that the measure is "in accordance with" the Articles of Agreement of the International Monetary Fund", as required by Article XV:9(a).

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[495] First oral statement of Honduras, para. 22.
[496] Ibid., para. 25.
[497] Ibid., para. 26.
[498] Replies of Honduras to questions addressed by the Panel, reply to question No. 10.
[499] Ibid., reply to question No. 9. Second written submission of Honduras, 10 June 2004, para. 192.
[500] Replies of Honduras to questions addressed by the Panel, reply to question No. 9.
[501] First oral statement of Honduras, para. 27. Second written submission of Honduras, 10 June 2004, para. 197.
[502] For the reasoning of the Appellate Body, see Appellate Body Report, *US – Wool Shirt and Blouses*, pp 15-16; Appellate Body Report, *EC – Tariff Preferences*, paras. 104-105; Appellate Body Report, *US – Gasoline*, pp22-23; and Appellate Body Report, *Turkey – Textiles*, para. 45.

7.132 The Panel is also aware of the argument of the Dominican Republic that the criterion for determining whether a measure is an "exchange restriction" is "whether it involves a direct governmental limitation on the availability or use of exchange as such", as set out by a Decision of the Executive Directors of the Fund in 1960 and the fact that Honduras does not disagree with this criterion. The Panel considers that, since Article XV:9 of the GATT exempts exchange restrictions measures that are applied in accordance with the Fund Articles, from obligations under other Articles of the GATT, the guiding principle that the IMF prescribed as the criterion for the determination of what constitutes an "exchange restriction" should be respected by this Panel. Therefore, the Panel should apply this criterion in its evaluation of the measure before it.

7.133 In assessing whether the foreign exchange fee constitutes an exchange restriction, parties disagree on whether the foreign exchange fee is a "direct limitation on the availability of foreign exchange as such". The Dominican Republic considers that the fee meets the criterion because paragraph 12 of the 1991 Resolution provides that the fee is to be levied on foreign exchange transactions. It implies that the focus is exchange transaction, not the act of importation. On the other hand, Honduras argues that the fee does not apply to payments of external debt, repatriation of capital, remittances of dividends, technology transfers, and payment for travel expenses and medical services, credit cards and all other services and it is calculated on the value of imports. The fee, in the view of Honduras, is actually caused by the act of importation and therefore is a trade restriction rather than an "exchange restriction".

7.134 The Panel considers it necessary to examine the specific aspects of the current foreign exchange measure to determine whether it is in fact imposed solely on import-related exchange transactions. In this regard, the Panel notes that the 1991 Resolution provides differently from that of the later Resolution.

7.135 A reading of the 1991 Resolution reveals the nature of foreign exchange fee as it was applied in 1991. Paragraph 12 provides: "the Central Bank shall charge users of official foreign exchange transactions and commercial banks, for the delegation of foreign exchange operations, the equivalent in Dominican Pesos (RD$) of two and a half per cent (2-1/2%) of the selling exchange rate applied to each transaction". This means that the fee was originally imposed on foreign exchange transactions conducted in both official and private foreign exchange markets through either the Central Bank or commercial banks. This Resolution actually required that the foreign exchange fee be paid for all kinds of foreign currency transactions, including both selling and purchasing transactions. This measure actually increased the cost for the use of foreign currency, *for all kinds of transactions* regardless of whether the transaction was related to importation. The Panel considers that the foreign exchange fee as it was applied in 1991 could be characterized as an exchange measure, as it is possible that the IMF would deem the increase of cost for the availability of foreign exchange as a means of "restriction" on the availability of the foreign currency. However, it is not necessary for the Panel to decide on the measure as it was applied in 1991. The measure to be examined by the Panel for the resolution of the dispute is the currently applied foreign exchange fee measure.

7.136 With regard to the currently applied foreign exchange fee measure, the Panel notes that the relevant provisions in the 1991 Resolution of the Monetary Board have been amended by later resolutions. On the issue of whether the fee is imposed on all types of transactions or solely on import-related transactions, the applicable rules are those under the Resolution of 20 August 2002. Paragraph 2 of this Resolution provides "exchange commissions shall henceforth no longer be applied to external debt service payments, capital repatriation, remittances of profits, technology transfers, sales for travel expenses and medical services, credit cards and other services".[503] The Dominican Republic confirms in its replies to a Panel question that "[t]he foreign exchange fee applies only to importation of goods. It does not apply to foreign exchange payments of non-import related services,

[503] The text of the First Resolution of the Monetary Board, dated 20 August 2002, was provided by Honduras as Exhibit HOND-3(c).

nor to foreign currency payments made by Dominican Republic residents, nor to remittance of dividends from companies located in the Dominican Republic".[504]

7.137 The Panel considers that the ordinary meaning of the "direct limitation on availability or use of exchange ... as such" means a limitation directly on the use of exchange itself, which means the use of exchange *for all purposes*. It cannot be interpreted in a way so as to permit the restriction on the use of exchanges that only affects importation. To conclude otherwise would logically lead to the situation whereby any WTO Member could easily circumvent obligations under Article II:1(b) by imposing a foreign currency fee or charge on imports at the customs and then conveniently characterize it as an "exchange restriction". Such types of measures would seriously discriminate against imports while not necessarily being effective in achieving the legitimate goals under the Articles of Agreement of the IMF. Therefore, the Panel finds that because the fee as currently applied is imposed only on foreign exchange transactions that relate to the importation of goods, and not on other types of transactions, it is not "a direct limitation on the availability or use of exchange as such".

7.138 The Panel takes note of the argument made by the Dominican Republic that the foreign exchange fee is approved by the IMF as a part of the stand-by arrangement between the IMF and therefore it is in accordance with the Articles of Agreement of the IMF.[505] The Panel notes that paragraph 2 of Article XV provides that:

> "In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or *foreign exchange arrangements*, they *shall consult* fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and *shall accept the determination* of the Fund *as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund*, or with the terms of a special exchange arrangement between that contracting party and the CONTRACTING PARTIES..."(emphasis added)

7.139 The Panel considered during the proceedings that it needed to seek more information on the precise legal nature and status of the foreign exchange fee measure in the stand-by arrangement between the IMF and the Dominican Republic. Secondly, since the Dominican Republic argues that the fee is an exchange restriction and it is imposed in accordance with the Articles of Agreement of the IMF, the Panel considered that it needed to consult with the IMF based on paragraph 2 of Article XV to verify such an argument for a determination by the Panel on whether the measure is justified under Article XV:9(a) of the GATT. The core issue in this regard is whether the foreign exchange measure constitutes an "exchange restriction" in the package of the stand-by arrangement. If the answer is positive, the next issue then is whether the foreign exchange fee is "in accordance with" the Articles of Agreement of the IMF and hence justified under Article XV:9(a) of the GATT 1994.

7.140 The Panel is also aware of the provision in paragraph 8 of the 1996 Agreement between the International Monetary Fund and the World Trade Organization that "The Fund shall inform in writing the relevant WTO body (including dispute settlement panels) considering exchange measures within the Fund's jurisdiction whether such measures are consistent with the Articles of Agreement of the Fund".

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[504] See, Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 9.

[505] First written submission of the Dominican Republic, 13 April 2004, paras. 199-201.

7.141 The Panel also recalls a similar situation in *Argentina – Textiles*, where an *ad valorem* statistical tax was imposed allegedly for fiscal performance purposes so as to obtain IMF financing to deal with a financial crisis. That panel in that instance did not consult with the IMF. The Appellate Body considered that that panel had good reason for not consulting the IMF because the statistical tax was not one of the "problems concerning monetary reserves, balances of payments or foreign exchange arrangements". However, it nevertheless stated that "it might perhaps have been useful for the Panel to have consulted with the IMF on the legal character of the relationship or arrangement between Argentina and the IMF in this case".[506]

7.142 Bearing these considerations in mind, the Panel requested information on 17 May 2004 from the IMF on the following two issues: (i) how the foreign exchange fee is being implemented by the Dominican Republic; (ii) whether the foreign exchange fee as currently applied by the Dominican Republic is an "exchange control" or "exchange restriction" under the Articles of Agreement of the IMF.

7.143 On the first issue, the IMF General Counsel replied that:

> "(a) The 'exchange commission' is levied under the legal authority of the Banco Central de la República Dominicana (BCRD). Since its introduction in January 1991, the commission has undergone a number of changes in the way that it is levied. Initially, the commission was payable on sales of foreign exchange and was calculated as a percentage of the selling rate.
>
> (b) Since August 2002, however, pursuant to the Agreement between the BCRD and the Directorate General for Customs (DGC) of August 22, 2002, the commission has been collected in its entirety by the DGC. Moreover, although the commission is still referred to as an "exchange commission" (because it is levied on the basis of the legal authority vested in the BCRD to charge a commission on sales of foreign exchange), the commission is no longer payable on sales of foreign exchange. Rather, it is payable as a condition for the importation of goods, and the amount of the commission is now calculated exclusively on the CIF valuation of the imported goods as determined by the DGC (Article 1 of the Agreement between the BCRD and the DGC). By Notice of Resolution No. 1 of the Monetary Board of October 22, 2003, the rate of the commission was increased to ten per cent in October 2003."[507]

7.144 On the second issue that the Panel requested information on, the reply states:

> "As applied since August 2002, the exchange commission is no longer a measure subject to Fund approval. As noted above, the commission is no longer payable on sales of foreign exchange. It is payable as a condition for the importation of goods and the amount to be paid is based on the CIF value of the imported goods (rather than the amount of foreign exchange sold to an importer for the payment of goods). As such, *it does not constitute a multiple currency practice or an exchange restriction* notwithstanding its label or the fact that the commission is charged on the basis of the legal authority vested in the BCRD to charge an exchange commission on sales of foreign exchange. For the same reasons, it is not an exchange control measure."(emphasis added)

7.145 The Panel fully agrees with the opinion of the IMF. For the reasons set out above by the Panel and considering the opinion expressed by the IMF, the Panel finds that the foreign exchange fee

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[506] Appellate Body Report, *Argentina – Textiles*, para. 65.
[507] Letter from the General Counsel of the International Monetary Fund, Annex D, *supra* note 6.

measure as it is currently applied by the Dominican Republic does not constitute an "exchange restriction" within the meaning of Article XV: 9(a) of the GATT 1994.

5. Whether the fee is imposed "in accordance with" Articles of Agreement of the IMF

(a) Arguments of the parties

7.146 The Dominican Republic argues that the foreign exchange fee is applied in accordance with the Articles of Agreement of the Fund as provided in Article XV:9(a). On 29 August 2003, The Dominican Republic concluded a stand-by arrangement with the Fund by which the Dominican Republic enforced, *inter alia*, a non-unified exchange rate system. The stand-by arrangement incorporated performance criteria calling for full unification of the dual exchange system by the end of 2003. The Fund approved the non-unified exchange rate system. However, due to its economic performance, the Dominican Republic was unable to fulfil its commitments made in the stand-by arrangement with the Fund and requested a waiver from the Fund in January 2004 for non-observance of the performance criteria, *inter alia*, on the unification of the foreign exchange market and for the continuous performance criteria regarding exchange rate restrictions and multiple currency practices. The Dominican Republic submits that the Executive Board of the Fund completed its first review and the Dominican Republic understands that the Fund approved the "exchange rate restrictions and multiple currency practices". The foreign exchange fee as an exchange rate restriction, or multiple currency practice, is applied by the Dominican Republic "in accordance with" the Fund Articles of Agreement. Therefore, in the opinion of the Dominican Republic, it is permitted under Article XV:9(a) of the GATT.[508]

7.147 The Dominican Republic argues that Article XV:9(a) does not oblige that a measure be "required" under the terms of a stand-by arrangement. In its view, to the extent that this fee is "permitted" under the terms of the standby arrangement, this fee is "in accordance with" the Articles of Agreement of the International Monetary Fund as provided by Article XV:9(a).[509] In the view of the Dominican Republic, the foreign exchange fee is justified under Article XV:9(a) of the GATT 1994 even if it is inconsistent with Article II:1(b).[510]

7.148 Honduras argues that even assuming the foreign exchange fee is an exchange restriction or multiple currency practice, it would be justified under Article XV:9(a) only if it is used "in accordance with" the Articles of Agreement of the IMF. Sections 2 and 3 of Article VIII of the Agreement provide that exchange restrictions or multiple currency practices respectively, cannot be imposed without the approval of the IMF. Honduras considers that the Dominican Republic has not provided evidence that the IMF has approved the foreign exchange fee measure either as an exchange restriction, or as a multiple currency practice.[511] Honduras argues that paragraph 3 of the Agreement between the International Monetary Fund and the World Trade Organization provides that the IMF "shall inform the WTO of any decisions approving restrictions on the making of payments or transfers for current international transactions, decisions approving discriminatory currency arrangements or multiple currency practices, and decisions requesting a Fund member to excise controls to prevent a large or sustained outflow of capital". Honduras submits that as of 6 May 2004, the IMF has made 31 notifications to the WTO involving 18 countries and there is no notification regarding the Fund approval of any measure taken by the Dominican Republic.[512] Honduras submits that the absence of

[508] First written submission of the Dominican Republic, 13 April 2004, paras. 199-201.
[509] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 63.
[510] First written submission of the Dominican Republic, 13 April 2004, para. 188.
[511] First oral statement of Honduras, para. 34; Second written submission of Honduras, 10 June 2004, para. 199.
[512] First oral statement of Honduras, para. 37; Second written submission of Honduras, 10 June 2004, para. 202.

such approval by the IMF is further confirmed by the WTO Secretariat on 5 May 2004 in response to a letter from Honduras requesting the information.[513]

7.149 Honduras points out that the IMF Press Release No. 04/23 of February 2004 states that "the Executive Board approved the Dominican Republic's request to waive the non-observance of ... continuous performance criteria concerning ... exchange rate restrictions and multiple currency practices". It argues that without establishing what "continuous performance criteria" concerning exchange rate restrictions and multiple currency practices have been waived, this statement cannot be used as an approval for the imposition of exchange restrictions or multiple currency practices. Moreover, Honduras contends that a waiver is not equivalent to an approval of the imposition of foreign exchange restriction or a multiple currency practices in the sense of Sections 2 and 3 of Article VIII of the Articles of Agreement of the IMF.[514] In its view, the Dominican Republic has not discharged its burden of establishing that the foreign exchange fee is imposed in accordance with the Articles of Agreement of the IMF in the context of Article XV:9(a).[515]

(b) Analysis by the Panel

7.150 In fact, the reply of the IMF General Counsel concludes that since the foreign exchange commission does not constitute an exchange restriction, "the issue of its consistency or inconsistency with the Funds Articles for purpose of paragraph 8 of the Co-operation Agreement does not arise". The Panel fully agrees with this statement.

7.151 The Panel considers that even if the foreign exchange fee does constitute an "exchange restriction", Article XV:9(a) requires that it has to be applied "in accordance with" Articles of Agreement of the IMF. In light of the parties' arguments in this regard, the Panel will analyse whether the Dominican Republic has discharged its burden of demonstrating that the foreign exchange fee is "in accordance with" the Articles of Agreement of the IMF.

7.152 The Dominican Republic refers only to an IMF news release. The Panel has not been presented with a copy of the formal Decision made by IMF. The Dominican Republic referred to this decision as a "waiver". It is not clear which provision of the IMF Articles of Agreement is the legal basis of the waiver and what is the legal basis to establish that the waiver was made in accordance with the Articles of Agreement. The Dominican Republic confirmed in its replies to questions that the waiver will be valid for three months.[516] As a result, the legal status of the waiver after the three-month period is not clear to the Panel.

7.153 On the substance of the IMF news release, the meaning of the language that the IMF "approved the Dominican Republic's request to waive the non-observance of ... continuous performance criteria concerning ... exchange rate restrictions and multiple currency practice" is not self-evident. Does it mean that the IMF waived the obligation for the Dominican Republic to completely unify the dual exchange markets and to form one unified exchange rate? Is the foreign exchange fee one component of the "exchange *rate* restrictions"? The Panel considers that the foreign exchange fee measure is independent of the dual exchange rates system. Even before the dual exchange rates are unified, the foreign exchange fee can be eliminated without changing the dual exchange rate system. It is also true that, even after the dual exchange rates are unified, the foreign exchange fee can still be imposed without changing the unified exchange rate market.

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[513] See Letter from the WTO Trade and Finance Division, dated 5 May 2004, submitted by Honduras as Exhibit- Hond-21(a). Second written submission of Honduras, 10 June 2004, para. 202.

[514] First oral statement of Honduras, paras. 35-36. Second written submission of Honduras, para. 201.

[515] Second written submission of Honduras, 10 June 2004, para. 203.

[516] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 63.

7.154 For these reasons, the Panel finds that the IMF waiver decision does not constitute a legal basis for the application of the foreign exchange fee measure and the Dominican Republic has not demonstrated that the foreign exchange fee is applied "in accordance with" the Articles of Agreement of the IMF.

6. Whether the measure is justified under Article XV:9(a) of the GATT 1994

7.155 The Panel considers that Article XV:9(a) as an exception provision has to be invoked and proved by the Dominican Republic to justify the inconsistency of the foreign exchange fee measure with the second sentence of Article II:1(b). As the Panel has already found that the measure does not constitute an "exchange restriction" within the meaning of Article XV:9(a) of the GATT 1994 and that the Dominican Republic has not demonstrated that it is "in accordance with" the Articles of Agreement of the IMF, the Panel concludes that the foreign exchange fee is inconsistent with Article II:1(b) and can not be justified under Article XV:9(a) of the GATT 1994.

E. OBLIGATION THAT STAMPS BE AFFIXED TO CIGARETTE PACKETS IN THE TERRITORY OF THE DOMINICAN REPUBLIC (THE TAX STAMP REQUIREMENT)

1. The measure at issue

7.156 Under Article 37 of the Decree 79-03 of 4 February 2003,[517] and under Decree 130-02 of 11 February 2002,[518] the Dominican Republic requires that a stamp be affixed to all cigarette packets in the territory of the Dominican Republic and under the supervision of the local tax authorities. This requirement applies both to domestic and imported cigarettes.

7.157 Article 37 of the Decree 79-03 of 4 February 2003 provides the following:

> "**ARTICLE 37. CONTROL OF TOBACCO PRODUCTS BY MEANS OF STAMPS**
>
> Domestic producers and importers of cigarettes and cigars shall affix a stamp to cigarette packets or cigar boxes at the time of production or importation. In the case of cigarettes, domestic production and importation shall be subject to the controls described in Paragraphs I, II and III of this article.
>
> **PARAGRAPH 1.** The stamps referred to in this Article shall be affixed to all cigarette packets, subject to the following controls:
>
> 1. Control of the receipt of stamps
>
> The stamps shall be issued by the Directorate-General of Internal Taxes only to persons or companies engaged in producing and marketing these products that are duly registered with the Directorate-General of Internal Taxes [DGII].
>
> For the purposes of control of stamps, the Directorate-General of Internal Taxes shall require previously authorized signatures to be produced and, to this end, it shall keep a register.
>
> Domestic producers and importers shall keep a ledger for the inventory of stamps that is duly authorized by the Directorate-

[517] Decree 79-03, *supra* note 8.
[518] Decree 130-02, *supra* note 9.

General of Internal Taxes, which may review and inspect the ledger where deemed appropriate. For this purpose, each producer shall maintain the following control of stamps received:

a) He shall apply to the DGII to purchase stamps and, after approval, shall pay the amount of the stamps with a certified cheque.

b) When the certified cheque is paid, the DGII shall issue a receipt of payment, which shall be recorded sequentially in the official ledger.

2. Control of the production process (transfer of finished product to warehouse)

Every producer must at his factory set up a pre-warehouse area for checking the daily production of cigarettes, which area shall be under the control of the Directorate-General of Internal Taxes.

These products shall be transferred to the warehouse for distribution to sales channels in the presence of tax inspectors, who shall verify and count the previous day's cigarette production, which will serve as the basis for issuing the stock movement (entry into warehouse) and an official invoice, which is recorded in the official ledger as an outward movement of stamps.

The following documents shall be entered in the official ledger:

a) Receipt of stamps;

b) stock movement (production) of the company;

c) official invoice of the outward movement of the day's production. At the end of each month, two communications will be sent to the Directorate-General of Internal Taxes on the movement of stamps, containing:

The entries in the official ledger;

the official invoices for the consignment of cigarettes;

the invoices for the purchase of stamps, plus the standard payment receipt.

d) any other document or record that the Tax Administration deems appropriate.

PARAGRAPH II. Cigarette imports shall be placed in the customs warehouse or in storage under the control of the Directorate-General of Internal Taxes, where the stamps shall be affixed and checked as stipulated below:

1. Control of the receipt of stamps

a) The importer shall apply to the DGII to purchase stamps and, after approval, shall pay the amount of the stamps with a certified cheque.

b) When a certified cheque is paid, the DGII shall issue a receipt of payment, which shall be recorded sequentially in the official ledger.

2. Control at customs warehouse or storage under the control of the Directorate-General of Internal Taxes

a) In the presence of tax inspectors, the importation of cigarettes shall be verified and counted and stamps shall be affixed to each packet depending on the packaging. After the stamps have been affixed, an official receipt shall be issued which will be entered in the official ledger as an outward movement of stamps.

b) At the end of each day, a communication shall be sent to the DGII with the movement of stamps, containing:

The entries in the official ledgers;

The official invoices for the consignment of cigarettes;

The invoices for the purchase of stamps, plus the standard payment receipt.

c) Any other document or record that the Tax Administration deems appropriate.

PARAGRAPH III. Under the terms of Article 380 of the Tax Code, the value of the stamps is defrayed by the tax payers and is not deductible from the Selective Consumption Tax."

7.158 The relevant parts of Decree 130-02 of 11 February 2002 provide the following:

"**ARTICLE 1.-** Local cigarette manufacturers shall, in national territory and under the supervision of the Directorate-General of Internal Taxes, affix the stamps provided for in Law No. 2461 of 18 July 1950 on Stamps and Stamped Paper.

ARTICLE 2.- Article 1 of this Decree shall also apply to imported cigars and cigarettes; such goods shall be stored in a bonded warehouse or depository under the control of the Directorate-General of Internal Taxes where the control stamps provided for by the aforementioned Law No. 2461 of 1950 shall be affixed."

7.159 The Panel will refer to the requirement that a stamp be affixed on cigarette packets in the territory of the Dominican Republic and under the supervision of local tax authorities, upon importation and even after customs clearance as the "tax stamp requirement".

2. Whether the tax stamp requirement accords less favourable treatment to imported products in a manner inconsistent with Article III:4 of the GATT 1994

(a) Arguments of the parties

7.160 Honduras argues that the tax stamp requirement accords less favourable treatment to imported cigarettes than that accorded to like domestic cigarettes, in a manner inconsistent with Article III:4 of

the GATT 1994. Honduras admits that the tax stamp requirement is applicable to both domestic and imported cigarettes and, as such, it is a formally identical treatment for both domestic and imported products.[519] However, in its view, the formally identical requirement of affixing stamps in the Dominican Republic results in additional steps and costs for importers of cigarettes.[520]

7.161 The Dominican Republic's first defence is that the tax stamp requirement does not accord less favourable treatment to imported cigarettes than that accorded to like products of national origin. In its opinion, the tax stamp requirement is not applied so as to afford protection to the domestic producers.[521] The imports of cigarettes from Honduras have increased significantly in 2003 and the first trimester of 2004, both in absolute volumes and in market share.[522] Any difference in the conditions of competition between imported and domestic products, in respect of compliance with the tax stamp requirement, would be a result of the inherent differences between imported and domestic products.[523] The Dominican Republic's alternative defence is that the tax stamp requirement is necessary to secure compliance with the Dominican Republic's tax laws and regulations. Therefore, should it be found *prima facie* to be inconsistent with Article III:4, the tax stamp requirement should benefit from the application of Article XX(d) of the GATT 1994 and be declared WTO-compatible.[524]

(b) Analysis by the Panel

7.162 Under Article III:4 of the GATT 1994:

> "The products of the territory of any contracting party imported into the territory of any other contracting party 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..."

7.163 The Appellate Body has stated that

> "[F]or a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the imported products are accorded 'less favourable' treatment than that accorded to like domestic products..."[525]

(c) Like product determination

7.164 There is no disagreement between the parties that imported and domestic cigarettes are "like products". As expressed by the Dominican Republic, "[l]ikeness of these products is not at issue in this dispute."[526]

7.165 Honduras has presented physical evidence of cigarettes exported to the Dominican Republic, as well as cigarettes domestically produced in the Dominican Republic.[527] From the available evidence, the Panel is satisfied that both imported and domestic cigarettes have similar physical

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[519] First written submission of Honduras, 16 March 2004, para. 76.
[520] Ibid., para. 77.
[521] First written submission of the Dominican Republic, 13 April 2004, para. 30.
[522] Ibid., para. 45. Oral statement of the Dominican Republic to the Panel, 11 May 2004, para. 45.
[523] First written submission of the Dominican Republic, 13 April 2004, paras. 4 and 39-42.
[524] Ibid., 97 and 100-140.
[525] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.
[526] First written submission of the Dominican Republic, 13 April 2004, para. 32.
[527] See physical evidence provided by Honduras, marked Exhibits HOND-23(a) to 23(c), HOND-24(a) to 24(c), HOND-25(a) to 25(n), HOND-26(a) to (26(c), and HOND-27(a) to 27(n).

properties, are made from similar materials, and have a similar presentation; they have the same end-use (i.e. they are smoked by consumers); and they are classified under the same tariff heading 2402.20.00. Available evidence presented by the parties also indicates that, within the general product description, cigarettes are presented to consumers distinguished by brands. Under the identification of these brands, and within specific price segments, cigarettes compete against each other and are interchangeable for consumers (that is, consumers may switch from one brand to another).

7.166 The Panel therefore is of the view that imported cigarettes and domestic Dominican Republic cigarettes are like products within the meaning of Article III:4 of the GATT.

(d) Law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use

7.167 Honduras argues that the fulfilment of the tax stamp requirement is a prerequisite for withdrawing imported cigarettes from the warehouse in order that they may be distributed and sold in the Dominican Republic and, therefore, affects the internal sale of imported cigarettes.[528]

7.168 The Dominican Republic replies that the tax stamp requirement does not affect the internal sale, offering for sale, or distribution of cigarettes. In its opinion, the requirement does not directly govern the conditions of sale or purchase of cigarettes, nor does it adversely modify the conditions of competition between domestic and imported products, to the detriment of imported products.[529]

7.169 With respect to whether the tax stamp requirement affects the "internal sale" of cigarettes, the Panel notes that, as stated by the Appellate Body, the ordinary meaning of the word "affecting" implies a measure that has "an effect on" and thus indicates a broad scope of application. In the words of the Appellate Body:

> "[W]e note that Article I:1 of the GATS provides that '[t]his Agreement applies to measures by Members affecting trade in services'. In our view, the use of the word 'affecting' reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term 'affecting' in the context of Article III of the GATT is wider in scope than such terms as 'regulating' or 'governing'."[530]

7.170 The Panel notes that, under Article 37 of the Decree 79-03 of 4 February 2003, "Domestic producers and importers of cigarettes and cigars shall affix a stamp to cigarette packets or cigar boxes at the time of production or importation".[531] The Dominican Republic states that no packet of domestic cigarettes may leave the production factories and enter the stream of commerce unless the tax inspector is satisfied that it bears a tax stamp. Likewise, no packet of imported cigarettes can leave the bonded warehouse unless the tax stamps are affixed to each cigarette packet in the presence of a tax inspector.[532]

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[528] First written submission of Honduras, 16 March 2004, para. 75.

[529] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 64. First written submission of Honduras, 16 March 2004, para. 66.

[530] Appellate Body Report, *EC – Bananas III*, para. 220.

[531] Decree 79-03, *supra* note 8.

[532] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 68, para. 75.

7.171 In light of the previous factors, the Panel considers that the tax stamp requirement is an internal regulation that affects the internal sale and offering for sale of cigarettes in the domestic market of the Dominican Republic within the meaning of Article III:4 of the GATT.

(e) Less favourable treatment

(i) Arguments of the parties

7.172 Honduras indicates that the tax stamp requirement modifies the conditions of competition for imported cigarettes in the Dominican Republic to the detriment of imported cigarettes and therefore treats imported cigarettes less favourably than the like domestic products.[533] Domestic producers of cigarettes may purchase tax stamps in advance and affix those stamps to cigarette packets in the course of their production process and prior to the final packaging of the product. For those domestic producers, the production process is therefore a continuous one, after which cigarettes may be sold on the domestic market.[534] For imported cigarettes, the affixing of the tax stamps in the territory of the Dominican Republic requires a separate process, after the cigarettes have been produced and packed in the exporting country. Foreign producers are not allowed to affix the stamp on their own premises abroad. This additional process requires re-opening the boxes and cartons of cigarettes, affixing the stamps to the individual cigarette packets (over the cellophane), and repackaging the cartons and boxes.[535] All these additional steps would require the importers to hire additional labour to carry out these tasks in the Dominican Republic while domestic producers would not have to undergo these additional steps. Honduras has provided physical evidence of cigarette packets as they are wrapped in different stages of the production and transportation processes, in order to highlight the additional steps that are undertaken in the territory of the Dominican Republic.[536]

7.173 Citing reports from private consultants, Honduras submits that the additional cost to importers from affixing the tax stamps in the territory of the Dominican Republic would be US$0.9 per thousand cigarettes, that is, 9.70 per cent of the c.i.f. average price, whereas it estimates that the cost to a domestic producer in the Dominican Republic would be around $0.01 per thousand cigarettes, that is, 0.1 per cent of the c.i.f. average cost. Honduras additionally indicates that the fact that stamps on imported cigarettes are placed over the cellophane detracts from the overall presentation of the final product, as compared to the presentation of domestic cigarette packets where stamps are placed on the packet during the production process before the cellophane wrap is applied.[537]

7.174 In the opinion of the Dominican Republic, the tax stamp requirement is applied equally to importers and to domestic producers. The Dominican Republic adds that Honduras has not presented any evidence to establish that the tax stamp requirement accords less favourable treatment to imported cigarettes, nor has it demonstrated that the measure has protective application. Therefore, in its view, Honduras has not established a *prima facie* case of inconsistency of the measure with Article III:4. In its view, Honduras has only submitted evidence to show that the importer bears certain costs as a result of its method of affixing stamps in the Dominican Republic. Those additional costs would be associated with compliance with non-discriminatory internal measures and would result from inherent differences in the normal conditions under which imported products compete with domestic products. They would be inevitably linked to the condition of imported products. The Dominican Republic further adds that many of the additional steps that Honduras has identified as a result of the tax stamp requirement are in fact either steps that domestic producers also have to perform (such as to manually cut tax stamps for each of the cigarettes packets before they can be affixed) or avoidable steps which

[533] First written submission of Honduras, 16 March 2004, para. 84.
[534] First oral statement of Honduras, para. 48.
[535] First written submission of Honduras, 16 March 2004, para. 78.
[536] Ibid., para. 79. See physical evidence provided by Honduras, marked Exhibits HOND-23(a) to 23(c), HOND-24(a) to 24(c), and HOND-25(a) to 25(n).
[537] First written submission of Honduras, 16 March 2004, paras. 81 and 82.

are the result of the technology used by the importer. In its view, the importer could avoid unpacking cigarettes from cartons before affixing stamps, if it packaged individual cigarette packets into boxes.

7.175 The Dominican Republic expresses its opinion that, even assuming that the cost estimates provided by Honduras are correct, and assuming further that they cannot be reduced by reasonable means, the effect that the tax stamp requirement has on importers is negligible. Based on Honduras's own estimates, it calculates that the annual cost of complying with the tax stamp requirement for the Honduran firm exporting cigarettes into the Dominican Republic would be US$65,641. This importer is part of the second largest tobacco company in the world with 15 per cent of the world market. The world sales of this tobacco company were over $37 billion in 2003. In the Dominican Republic's opinion, the measure is commercially irrelevant and lacks any protective effect, as demonstrated by the fact that imports by the Honduran firm into the Dominican Republic increased by more than 80 per cent in value in 2003, compared with the previous year.

7.176 Honduras rebuts the latter arguments by identifying the specific steps that both domestic producers and importers take in their production and packaging processes, and signalling the specific additional steps that in its view importers have to adopt as a direct result of the tax stamp requirement. Honduras has also produced a statement from the private exporter of cigarettes into the Dominican Republic, who claims that the wrapping is needed to avoid packets deteriorating during the manufacturing process and when the cartons are opened in the country of destination in order to affix the tax stamps. The exporter also claims that, without the wrapping, the packets would be exposed to environment conditions without the protection afforded by the cellophane, which would have an adverse effect on the product. Without proper wrapping, cigarettes would lose their firmness and moisture-holding properties and their visual quality, as well as being more prone to damage during transit. They would not therefore meet the quality standards acceptable to the consumers in the Dominican Republic.

7.177 The Dominican Republic also argues that the additional steps performed by importers are the result of inherent differences in the normal conditions under which imported products compete with domestic products, and as such they are inevitably linked to the condition of imported products. In its view, costs associated with compliance with legitimate regulatory policies and laws of an importing country should not be considered "additional costs". Those costs are an unavoidable consequence of trading goods across borders and a result of the geographical and jurisdictional circumstances that separate importers from domestic producers. It is incumbent on rational economic players to factor those costs into their total cost of production and to take the necessary steps to reduce the costs and thus increase their margin of profit.

7.178 Honduras replies that the additional costs result from the imposition of the tax stamp requirement and are not inherent costs that arise from doing business. In Honduras's view, the inherent costs of doing business would include freight charges and insurance premiums. Any costs incurred as a result of governmental action could not be considered "inherent costs".

7.179 Honduras claims additionally that the fact that the stamp on imported cigarettes is placed over the cellophane on each individual packet aesthetically detracts from the overall presentation of the final product. Cigarettes manufactured in the Dominican Republic are allowed to have the tax stamp added to the packet before the cellophane wrap is applied and during the production process. Stamps are uniformly affixed by machine under the cellophane wrapping of each individual packet of cigarettes. However, because of the tax stamp requirement, in the case of imports, such stamps are affixed manually on the cellophane wrapping of each individual packet to minimize costs. Inevitably, the result is not uniform and the risk of technical and other imperfections is increased. As a result, for purposes of final presentation to the end consumer, imported cigarettes are not as attractively packaged as domestic cigarettes and conditions of competition are distorted to the detriment of imported cigarettes at the point of sale to end consumers. Aesthetics are an important element in competition. Honduras admits that, through the use of a different technology, imported cigarettes

could also be packaged in a similar manner to domestic cigarettes, by unwrapping and rewrapping each individual packet, but this would entail substantial costs and investment.

(ii) Formally equal treatment

7.180 Both parties agree that the tax stamp requirement – i.e. the requirement that a tax stamp must be affixed on cigarette packets in the territory of the Dominican Republic and under the supervision of Dominican Republic tax authorities – applies to both domestic and imported cigarettes and is, as such, a formally identical requirement.

7.181 The Panel notes, however, that in the view of the complaining party, this formal equality itself results in less favourable treatment being accorded to imported cigarettes as compared to domestic cigarettes, since tax stamps may be affixed on packets of domestic cigarettes as part of the production process, while in the case of imported cigarettes an additional process has to be undertaken, which entails added costs.

7.182 The Panel agrees that the relevant test for whether a measure is consistent with Article III:4 of the GATT is not whether the measure accords a treatment which is formally the same for both imported and like domestic products, but rather whether it accords a treatment for imported products which is not less favourable than the one granted to like domestic products. In fact, as noted by a previous panel, there are cases in which formally equal rules may accord a treatment for imported products which is less favourable than the one granted to like domestic products:

> "[T]here may be cases where the application of formally identical legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded to them is in fact no less favourable …"[538]

7.183 The Panel thus considers that the fact that the tax stamp requirement is applied equally – i.e. in a formally identical manner – to domestic and imported cigarettes does not automatically make it compatible with Article III:4. The Panel then needs to look at whether that formally equal measure results in a treatment that is less favourable for imported cigarettes.

(iii) Additional steps

7.184 The Panel considers that there is evidence that there are some steps performed by importers, specifically associated with compliance with the tax stamp requirement, which are not necessary for domestic producers, i.e. those related to unpacking and repacking of boxes in order to affix the stamps. Domestic producers of cigarettes are able to affix tax stamps as part of their production process. They are thus relieved of having to unwrap cigarette packages in order to affix stamps and of later having to rewrap those packages.

7.185 The Panel also notes that it is satisfied with the evidence presented by Honduras on the reasons argued by the private exporter to why cigarettes cannot be exported between the countries concerned, either unpackaged (loose) or packaged but not over-wrapped in cellophane. The Panel finds no reason to doubt the technical explanation on the justification for wrapping the cigarette packages in cellophane. The evidence presented by Honduras coincides with the common knowledge that tobacco products are delicate and may lose their physical characteristics, including their moisture-retaining characteristics and visual appeal for consumers, if they are not conserved properly. Additionally, the Panel considers that it would not be reasonable to presume that a private exporter would engage in additional steps and assume additional costs in its production process without

[538] GATT Panel Report, *US – Section 337*, para. 5.11.

justification. The Panel is thus satisfied by the evidence that cigarettes could not be exported either loose or in unwrapped packets, without having the quality of the product altered. As a result, the affixation of tax stamps on individual packets in the territory of the Dominican Republic would require, in the case of imported cigarettes, that cigarette packages be unwrapped before the stamps are affixed, and later rewrapped.

7.186 For the preceding reasons, the Panel considers that Honduras has presented a *prima facie* case that the tax stamp requirement imposes on importers of cigarettes the burden of performing additional steps to those performed by domestic producers of the like products. The Dominican Republic has not shown that the additional steps undertaken by the importer are either avoidable, or the result of the technology used by importers. Rather, in the Panel's view, they are related to the tax stamp requirement itself.

(iv) Inherent differences in normal conditions of competition between imported and domestic products

7.187 The Panel does not consider that the Dominican Republic has demonstrated that the costs resulting from the tax stamp requirement can be considered as "inevitably linked to the condition of imported products". On the contrary, they are the result of a measure adopted voluntarily by a Member. The Dominican Republic could have chosen not to impose a tax stamp requirement, or to have imposed a different type of tax stamp requirement. The Panel therefore does not find that the measure is a necessary result from inherent differences in the normal conditions under which imported products compete with domestic products.

(v) Additional costs

7.188 The Panel notes that the Dominican Republic has not disputed Honduras's assertion that complying with the tax stamp requirement may imply additional costs for the importer of almost 10 per cent of the c.i.f. average price of the products, when the equivalent costs for domestic producers would be one hundredth of that amount, i.e. 0.1 per cent of the c.i.f. average price of the products.

7.189 The Panel is not convinced about the relevance of the comparison, suggested by the Dominican Republic, between the additional costs generated on importers by compliance with the tax stamp requirement and the world sales of those importers. Nor does it consider that the fact that those importers have increased their exports to the Dominican Republic necessarily means that the measure does not grant a less favourable treatment to imports.

7.190 The Panel recalls that the Appellate Body has stated that:

> "The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures… Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products… Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products."[539]

7.191 In light of the preceding arguments, the Panel considers that Article III:4 does not call for an examination of the impact of a measure on the global sales of a particular firm, but rather on the impact that the measure may have on the competitive conditions for imported products in relation to domestic products in the relevant market. In the present case, the relevant market would be that of cigarettes in the Dominican Republic. It is thus irrelevant whether the costs of complying with the measure may be negligible in relation to the global sales of an importer.

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[539] Appellate Body Report, *Japan – Alcoholic Beverages II*, p.16.

7.192 Similarly, the Panel is not persuaded by the argument concerning the increase of exports of cigarettes from Honduras to the Dominican Republic. Even if imports have increased, that fact does not *per se* exclude the possibility that conditions of competition between imported and domestic products in a particular market could still be affected. Arguably, imports could have increased even further, had the imported products not received a treatment that was less favourable than the one accorded to like domestic products.

(vi) Aesthetic presentation of the products

7.193 The Dominican Republic has not disputed Honduras's argument that placing the stamp on imported cigarettes over the cellophane on each individual packet aesthetically detracts from the overall presentation of the final product.[540] Honduras has provided physical evidence of packets of imported cigarettes after the affixation of the stamp in the Dominican Republic, as well as evidence of packets of domestic cigarettes, in order to highlight how, in its view, from an aesthetic standpoint, domestic cigarettes look better packaged than imported cigarettes.[541]

7.194 The Panel is satisfied with the evidence that from an aesthetic point of view, the tax stamp requirement results in imported cigarette packets having a less smooth presentation than like domestic cigarettes. The Panel is of the view that, other conditions being equal, a consumer may prefer a product that is more attractively packaged over one that is less attractively packaged. While the importer could surely engage in additional processes to produce a cigarette packet that is similarly presented to the like domestic product, this would in turn entail further additional costs and the less favourable treatment for imported products would thus still exist.

(vii) Less favourable treatment

7.195 In order to determine whether the requirement that tax stamps be affixed only in the territory of the Dominican Republic and under the supervision of tax authorities accords less favourable treatment to imported cigarettes than to like domestic products, the Panel is guided by the statement from the Appellate Body that the assessment should focus on examining "whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products".[542]

7.196 In this respect, the Panel finds that, although the tax stamp requirement is applied in a formally equal manner to domestic and imported cigarettes, it does modify the conditions of competition in the marketplace to the detriment of imports. The tax stamp requirement imposes additional processes and costs on imported products. It also leads to imported cigarettes being presented to final consumers in a less appealing manner.

7.197 The Panel notes that, in this case, the differences in the conditions between imported and domestic products mean that the Dominican Republic should not apply the tax stamp requirement in a formally identical manner that does not take those differences into account, since this would, in practice, accord less favourable treatment to imported products. On the contrary, the Dominican Republic could have chosen to apply the requirement in a different manner to imported products, to ensure that the treatment accorded to them is *de facto* not less favourable.

7.198 Therefore, for the reasons indicated above, the Panel concludes that the requirement imposed by the Dominican Republic that a tax stamp be affixed to all cigarette packets in its own territory and under the supervision of the local tax authorities accords less favourable treatment to imported

[540] See physical evidence provided by Honduras, marked Exhibits HOND-24(a) to 24(c), HOND-25(a) to 25(n), and HOND-27(a) to 27(n).
[541] See physical evidence provided by Honduras, marked Exhibits HOND-24(a) to 24(c), HOND-25(a) to 25(n), and HOND-27(a) to 27(n).
[542] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

cigarettes than that accorded to the like domestic products, in a manner inconsistent with Article III:4 of the GATT 1994.

(viii) Protective application

7.199 The Dominican Republic claims that Article III:1 has a particular contextual significance in interpreting Article III:4, so the Panel must consider whether the tax stamp requirement has a protective application, i.e. whether it is applied so as to afford protection to domestic producers. In its view, it is up to Honduras to provide evidence to demonstrate that the measure has protective application and Honduras has not submitted evidence to establish that the tax stamp requirement is applied so as to afford protection to domestic producers of cigarettes. The Dominican Republic considers that an examination of the design, architecture, and revealing structure of the requirement to affix a stamp in the territory of the Dominican Republic quickly reveals that the measure is not applied so as to afford protection to domestic producers.

7.200 Honduras replies by arguing that protection afforded to domestic production should not be a decisive element in establishing a violation of Article III:4. In its opinion, since Honduras has established that the tax stamp requirement accords "less favourable treatment" to imported cigarettes, the Panel should likewise conclude that the measure is applied "so as to afford protection to domestic production".

7.201 The Panel recalls in this respect the opinion of the Appellate Body:

> "[In order to prove inconsistency with Article III:4, a] ...complaining Member must ... establish that the measure accords to the group of 'like' *imported* products 'less favourable treatment' than it accords to the group of 'like' *domestic* products. The term 'less favourable treatment' expresses the general principle, in Article III:1, that internal regulations 'should not be applied … so as to afford protection to domestic production'. If there is 'less favourable treatment' of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products."[543]

7.202 Having reached the conclusion that the tax stamp requirement accords less favourable treatment to imported cigarettes than that accorded to like domestic products, the Panel thus finds that there is protection of the like domestic products. The Panel does not consider it necessary to make a separate and additional determination on whether the tax stamp requirement has protective application or is applied so as to afford protection to domestic producers of cigarettes. Indeed, the Appellate Body has expressed that:

> "Article III:4 does *not* specifically refer to Article III:1. Therefore, a determination of whether there has been a violation of Article III:4 does *not* require a separate consideration of whether a measure 'afford[s] protection to domestic production'."[544]

3. Whether the tax stamp requirement is justified under Article XX(d) of the GATT 1994

(a) Arguments of the parties

7.203 The Dominican Republic requests that, should the Panel find that the tax stamp requirement is inconsistent with Article III:4 of the GATT 1994, it should nonetheless find that the measure is justified by Article XX(d) of the GATT. In the Dominican Republic's opinion, the requirement is a measure that is necessary to secure compliance with the Dominican Republic tax laws and regulations, which themselves are consistent with the GATT, and to prevent smuggling of cigarettes.

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[543] Appellate Body Report, *EC – Asbestos*, para. 100.
[544] Appellate Body Report, *EC – Bananas III*, para. 216.

The tax stamp would serve as a mark to alert the Dominican Republic tax authorities that the applicable taxes have been collected and would ensure that cigarettes continue to enter the Dominican Republic through regular and legitimate channels of commerce, preventing smugglers from selling unstamped and undeclared cigarettes in the domestic market. The Dominican Republic argues that the collection of tax revenue (and, conversely, the prevention of tax evasion) is a most important interest for any country and particularly for a developing country such as the Dominican Republic. The Dominican Republic argues that there is international agreement that tax stamps are a legitimate, internationally recognized method to prevent the smuggling of cigarettes and the resulting loss of tax revenue. In its opinion, the effective enforcement of the measure requires the presence of inspectors from its tax authority, the *Dirección General de Impuestos Internos* (the Directorate General of Internal Taxes, DGII), at the production facilities of domestic producers and .at the facilities of importers of cigarettes at the time the stamps are affixed. The Dominican Republic has also expressed that there is evidence that allowing tax stamps to be shipped and affixed abroad would result in forgery of such tax stamps and smuggling of the products in question. The Dominican Republic argues that it has no reasonable GATT-consistent alternative for dealing with the problem of smuggling and tax evasion in the case of cigarettes. None of the possible alternatives can secure the same zero tolerance level of enforcement that the Dominican Republic has chosen to pursue with regard to tax collection and the prevention of cigarette smuggling, and to which it is entitled. One possible alternative would be to allow stamps to be affixed abroad. In the Dominican Republic's opinion, this would lead to smuggling, forgery and tax evasion. Another alternative is to have an inspector in each of the cities in the world in which cigarettes are or could be produced for export to the Dominican Republic, which could not be reasonably expected of the Dominican Republic. Moreover, in the Dominican Republic's view, the requirement is not applied in a manner that constitutes either arbitrary or unjustifiable discrimination between countries where the same conditions prevail, nor a disguised restriction on international trade.

7.204 Honduras replies to this defence by arguing that the Dominican Republic has not established that the tax stamp requirement is justified under Article XX(d) as is its burden, since Article XX(d) is an affirmative defence. In Honduras's view, the Dominican Republic has not demonstrated that the tax laws and regulations that would be enforced through the requirement are consistent with the GATT, nor has it demonstrated that the requirement is indeed a measure to secure compliance with those tax laws and regulations. Honduras further adds that, in its view, the Dominican Republic's Selective Consumption Tax, as described in Honduras's request for the establishment of a panel, is inconsistent with the Dominican Republic's obligations as set out in Articles III:2, III: 4, X:1 and X:3(a) of the GATT. Honduras argues additionally that the tax stamp requirement is not "necessary" to secure compliance with the tax laws and regulations of the Dominican Republic. Honduras argues that the Dominican Republic has less trade-restrictive alternatives available for use to enforce a tax stamp requirement. For example, Honduras mentions that, just as tax stamps are made available to domestic producers to enable them to affix the stamps in the course of the actual production process, they could also be made available to producers abroad for affixation on packets of cigarettes in the course of their own production process, prior to importation into the Dominican Republic. The authenticity of the stamps could be verified at the time of importation. Moreover, just as domestic producers are held accountable and are required to keep track of their inventory of tax stamps, the same conditions could be imposed on importers. As an added precaution, and as an alternative which is also less trade-restrictive, Honduras proposes that the Dominican Republic could resort to pre-shipment inspection and certification, through a reputable company, at the expense of the importer, in order to ensure that the tax stamps of the Dominican Republic are duly affixed to cigarettes in the exporting country. Finally, Honduras claims that the Dominican Republic has not demonstrated that the tax stamp requirement is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination.

(b) Article XX(d) of the GATT 1994

7.205 According to paragraph (d) and the *chapeau* of Article XX of the GATT 1994:

> "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 contracting party 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;"

7.206 As the Appellate Body has explained, the analysis of a measure under one of the paragraphs of Article XX is "two-tiered":

> "In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions -- paragraphs (a) to (j) -- listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under [in that case] XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX..."[545]

7.207 More specifically with relation to paragraph (d), the Appellate Body has also stated that:

> "For a measure... to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to 'secure compliance' with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Second, the measure must be 'necessary' to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met."[546]

7.208 The Panel will thus examine the Dominican Republic's arguments under Article XX(d), by looking first at whether the tax stamp requirement is necessary to secure compliance with the tax laws and regulations that have been identified by the Dominican Republic. Only if the Panel finds that the measure is necessary to secure compliance with the Tax Code of the Dominican Republic and therefore is provisionally justifiable under Article XX(d), would it proceed to examine whether it also meets the requirements of the *chapeau* of the Article, i.e. whether the different treatment constitutes a means of "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", or a "disguised restriction on international trade."

(c) Laws and regulations which are not inconsistent with the provisions of the GATT 1994

7.209 In order to be justified by paragraph (d) of Article XX of the GATT 1994, a measure needs to be "necessary" to secure compliance with laws or regulations which are not inconsistent with the provisions of the GATT. This in turn means that the Dominican Republic has to prove that three conditions are met: (i) that the tax laws and regulations (which would be enforced through the requirement) are not inconsistent with the GATT; (ii) that the tax stamp requirement is a measure to secure compliance with those tax laws and regulations of the Dominican Republic; and, (iii) that the tax stamp requirement is necessary to achieve that objective.

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[545] Appellate Body Report, *US – Gasoline*, p. 22.
[546] Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

7.210 The Panel notes that the Dominican Republic has claimed that the tax stamp requirement secures compliance with its tax laws and regulations generally, and more specifically with the provisions governing the Selective Consumption Tax. These tax laws and regulations have not been found to be inconsistent with provisions of the GATT. In the present case, Honduras has made claims against the Dominican Republic's laws and regulations governing the Selective Consumption Tax. However, those claims are limited to a specific aspect of those laws and regulations, namely the manner in which the Dominican Republic determines the value of imported cigarettes for the purpose of applying the Selective Consumption Tax. The tax stamp requirement is not specifically linked to that particular aspect of the laws and regulations.

7.211 In conclusion, the Panel considers that for the purpose of examining the Dominican Republic's arguments under Article XX(d), it may preliminarily assume that the tax laws or regulations, which would be enforced through the tax stamp requirement, are not inconsistent with the provisions of the GATT.

(d) "Necessary" to secure compliance with tax laws and regulations

7.212 The Panel will now examine whether the tax stamp requirement is "necessary" to secure compliance with the Dominican Republic's tax laws and regulations.

7.213 The Panel begins by recalling several statements made by the Appellate Body. On the one hand, the Appellate Body has clarified that, in order to be considered "necessary" to secure compliance, a measure does not need to be "indispensable". On the other hand, it should not just be simply "making a contribution to". In the words of the Appellate Body:

> "We believe that, as used in the context of Article XX(d), the reach of the word 'necessary' is not limited to that which is 'indispensable' or 'of absolute necessity' or 'inevitable'. Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term 'necessary' refers, in our view, to a range of degrees of necessity. At one end of this continuum lies 'necessary' understood as 'indispensable'; at the other end, is 'necessary' taken to mean as 'making a contribution to'. We consider that a 'necessary' measure is, in this continuum, located significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to'."[547]

7.214 The Appellate Body has also clarified that the necessity of a measure may also be examined in the light of factors such as: the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect (the more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument); the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue (the greater the contribution, the more easily a measure might be considered to be "necessary"); and, the restrictive impact of the measure on imported goods (a measure with a relatively small impact upon imported products might more easily be considered as "necessary" than a measure with intense or broader restrictive effects). Again, in the words of the Appellate Body:

> "In appraising the 'necessity' of a measure..., it is useful to bear in mind the context in which 'necessary' is found in Article XX(d). The measure at stake has to be 'necessary to ensure compliance with laws and regulations… , *including* those relating to customs enforcement, the enforcement of [lawful] monopolies… , the protection of patents, trade marks and copyrights, and the prevention of deceptive

[547] Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.

> practices'. (emphasis added) Clearly, Article XX(d) is susceptible of application in respect of a wide variety of 'laws and regulations' to be enforced. It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO-consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as 'necessary' a measure designed as an enforcement instrument... There are other aspects of the enforcement measure to be considered in evaluating that measure as 'necessary'. One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be 'necessary'. Another aspect is the extent to which the compliance measure produces restrictive effects on international commerce,[footnote omitted] that is, in respect of a measure inconsistent with Article III:4, restrictive effects *on imported goods*. A measure with a relatively slight impact upon imported products might more easily be considered as 'necessary' than a measure with intense or broader restrictive effects..."[548]

7.215 The Panel finds no reason to question the Dominican Republic's assertions in the sense that the collection of tax revenue (and, conversely, the prevention of tax evasion) is a most important interest for any country and particularly for a developing country such as the Dominican Republic. The Panel also notes that, although it has already found that the tax stamp requirement modifies the conditions of competition in the marketplace to the detriment of imported cigarettes, Honduras has still been able to export cigarettes to the Dominican Republic and, in fact, its exports have increased quite significantly over the last few years. So the Panel may assume that the measure has not had any intense restrictive effects on trade. Having said that, the Panel will focus its analysis on whether the tax stamp requirement is in fact *necessary* to secure compliance with the Dominican Republic tax laws and regulations and to prevent smuggling of cigarettes.

7.216 In support of its argument on the international recognition of tax stamps as a legitimate method to prevent the smuggling of cigarettes and the resulting loss of tax revenue, the Dominican Republic has cited a 2002 document from a non-governmental association, the International Conference on Illicit Tobacco Trade (ICITT)[549], as well as the World Health Organization (WHO) Framework Convention on Tobacco Control of 2003.[550] Both parties have agreed that these documents are not legally binding on them. The ICITT document points out that labelling "is particularly useful to constrain the distribution of contraband and as such is necessary to identify the manufacturer, country of origin/destination, and the legal status of the product (i.e. tax or duty paid or exempt)". The ICITT document identifies "tax stamps" as one practice available for the purpose of labelling. The WHO Framework Convention on Tobacco Control, which has not entered in force, calls upon Parties to "…ensure that all unit packets and packages of tobacco products and any outside packaging of such products are *marked* to assist Parties in determining the origin of tobacco products, and in accordance with national law and relevant bilateral or multilateral agreements, assist Parties in determining the point of diversion and monitor, document and control the movement of tobacco products and their legal status." The WHO Framework Convention also calls upon Parties to "monitor and collect data on cross-border trade in tobacco products, including illicit trade, and exchange information among customs, tax and other authorities, as appropriate". In the view of the Dominican Republic, properly enforced tax stamps are required to mark, monitor, and collect data regarding cross-border trade in cigarettes in accordance with the WHO Framework Convention.

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[548] Appellate Body Report, *Korea – Various Measures on Beef*, paras. 162-63.
[549] See International Conference on Illicit Tobacco Trade, *supra* note 46.
[550] See WHO Framework Convention on Tobacco Control, *supra* note 47 (emphasis added).

7.217 In light of the available information, the Panel does not disagree with the Dominican Republic's argument that tax stamps may be a useful instrument to monitor tax collection on cigarettes and, conversely, to avoid tax evasion. Indeed, as expressed by both parties, several countries have tax stamp regulations applicable to products such as matches, alcoholic beverages and tobacco products. As the Dominican Republic has noted, goods subject to tax stamp requirements tend to be mass-consumed products, that are susceptible to being smuggled. These products tend to be subject to high levels of taxes, which make them an important source of governmental revenue, but also make them more prone to smuggling.

7.218 Even admitting that tax stamps can generally be used to monitor tax collection, the specific tax stamp requirement in place in the Dominican Republic would still need to be justified. As mentioned, under the Dominican Republic's tax stamp requirement, tax stamps must be affixed in the Dominican Republic and under the supervision of the Dominican Republic tax authorities.

7.219 The Dominican Republic has argued that the effective enforcement of its legislation requires the presence of inspectors from its tax authority, the *Dirección General de Impuestos Internos* (the Directorate General of Internal Taxes, DGII), at the production facilities of domestic producers and the facilities of importers of cigarettes at the time the stamps are affixed. It has also expressed that there is evidence in the Dominican Republic that allowing tax stamps to be shipped and affixed abroad would result in forgery of such tax stamps and smuggling of the products in question. It has further added that it does not have the right nor the resources to relocate DGII officials to foreign countries to enforce its own domestic laws abroad. Such an alternative would not be sufficient for the Dominican Republic to achieve the zero tolerance level of enforcement that it has chosen to pursue with regard to tax collection and cigarette smuggling.

7.220 However, Honduras claims that there are other less-trade restrictive alternatives available to the Dominican Republic that would avoid illicit trade in tobacco products, such as allowing stamps to be affixed in the exporting country or permitting pre-shipment inspections.

(e) The presence of tax authority inspectors and the forgery of tax stamps

7.221 In the Dominican Republic's view, affixing stamps abroad may result in the forgery of tax stamps. When the stamps are affixed in front of a DGII agent, there is no risk of forgery, whereas allowing stamps to be affixed abroad has resulted, in the case of alcohol, in smuggling and tax evasion, as well as in forgery of tax stamps. The Dominican Republic has presented two sets of evidence related to smuggling in alcohol products, as support for its assertions.

7.222 As Exhibit DR-8, the Dominican Republic has submitted 'Evidence of forgery, smuggling, and tax evasion resulting from allowing the affixation of Dominican Republic tax stamps abroad for alcoholic beverages". The documents contain information on a batch of alcoholic beverages seized in a commercial establishment in July 2001, as well as a memo DAT-No. 46, dated 6 April 2004, signed by the person in charge of the Department of Alcohol and Tobacco of the DGII.[551] The Dominican Republic claims that this exhibit contains physical evidence of forged tax stamps for alcoholic beverages. However, these documents do not suggest that forgery of tax stamps was an element. The alcoholic drinks seized in July 2001 seem to have been smuggled from a neighbouring country. Forgery of tax stamps is not mentioned in the documents.

7.223 Memo DAT-No. 46, dated 6 April 2004, is also included as part of Exhibit DR-8. In that memo, the Department of Alcohol and Tobacco of the DGII explicitly states that only the National Treasury would be in a position to confirm whether a set of tax stamps were forged. The same memo expresses doubts on the validity of a group of ½ cent stamps, based on the fact that the stamps have a seven figure number, whereas since 2002 tax stamps have eight figure numbers and that the type of

[551] See information submitted by the Dominican Republic as Exhibit DR-8.

numbers printed on the stamps is different from the type of numbers usually delivered by the National Treasury. The Panel does not find, however, that this memo adds any conclusive elements as relate to the relationship between the seizure of alcoholic beverages and the possible forgery of tax stamps, since the seizure occurred in the year 2001, whereas the doubts expressed about the stamps refer to the format of stamps since 2002.

7.224 As Exhibit DR-29, the Dominican Republic has submitted "Further evidence of smuggling of alcoholic beverages into the Dominican Republic". The documents contain information on a batch of garlic and alcoholic beverages seized in March 2002. Again, nothing in these documents suggests that forgery of tax stamps was an element. Indeed, in this case, the merchandise seized was not only alcoholic beverages, but also garlic, which does not carry tax stamps.

7.225 The Dominican Republic claims that the manner in which the official records in the Dominican Republic are kept makes it difficult for the authorities to provide an overall or general assessment of the extent of forgery of tax stamps and smuggling of alcoholic beverages. However, it indicates that there is physical evidence of forged tax stamps for alcoholic beverages (contained, *inter alia*, in Exhibit DR-8). By contrast, there would be no evidence of forgery of tax stamps for cigarettes. The only difference between the two is that stamps for alcoholic beverages can be affixed outside the territory of the Dominican Republic, whereas stamps for cigarettes can only be affixed in the presence of inspectors from the tax authorities. Therefore, the Dominican Republic concludes that "not requiring that stamps be affixed in the presence of DGII inspectors leads to forgery of tax stamps. Conversely, requiring that tax stamps be affixed in the presence of DGII inspectors in the territory of the Dominican Republic would possibly eliminate and certainly reduce the likelihood of tax stamps being forged."[552]

7.226 Even assuming *arguendo* that Exhibit DR-8 contains evidence that forgery of tax stamps may occur, the Panel finds no supporting evidence in Exhibits DR-8 and DR-29 to the Dominican Republic's assertion that there is a causal link between allowing stamps to be affixed abroad and the forgery of tax stamps. The fact that two events may occur simultaneously (affixation of tax stamps abroad and forgery of tax stamps) does not necessarily imply that those two events are correlated, much less that they are causally linked. On the contrary, that same evidence seems to indicate that smuggling and tax evasion may occur even in products not usually subject to tax stamps (i.e. garlic), and to emphasize the importance of police enforcement of tax laws and regulations, even at the point of commercial establishments. While tax stamps may be a useful instrument for that enforcement, it does not necessarily follow that those stamps have to be affixed in the territory of the Dominican Republic and in front of a DGII agent. In the opinion of the Panel, the tax stamp requirement, as currently in place in the Dominican Republic, would only serve to guarantee that those tobacco products that enter legally into the country and go through the proper customs procedures will carry authentic tax stamps as a proof that the appropriate tax has been paid. That requirement, in and of itself, would not prevent the forgery of tax stamps, nor smuggling and tax evasion. From the evidence submitted by the Dominican Republic itself, the Panel would be inclined to believe that other factors, such as security features incorporated into the tax stamps (to avoid forgery of stamps or make it more costly) and police controls on roads and at different commercial levels (such as at the points of production, introduction into the country, distribution, and sale), may play a more important role in preventing the forgery of tax stamps, the tax evasion, and the smuggling of tobacco products.

(f) Alternative instruments

7.227 The Appellate Body has referred to the issue of the "necessity" of a measure in the presence of other reasonably available, less-GATT inconsistent, measures. In the words of the Appellate Body:

[552] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 74, para. 83.

> "In our Report in *Korea – Beef*, we addressed the issue of 'necessity' under Article XX(d) of the GATT 1994.[Footnote omitted] In that appeal, we found that the panel was correct in following the standard set forth by the panel in *United States – Section 337 of the Tariff Act of 1930*:
>
> > 'It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.'"[553]

7.228 Even assuming that the Dominican Republic has chosen to pursue a zero tolerance level of enforcement with regard to tax collection and cigarette smuggling, it is the Panel's opinion that the Dominican Republic, as the party raising this particular defence, has not discharged its duty to prove why other, reasonably-available, less-GATT inconsistent, measures would not be able to achieve that same level of enforcement. More specifically, the Dominican Republic has not proved why, for example, providing secure tax stamps to foreign exporters, so that those tax stamps can be affixed on cigarette packets in the course of their own production process and prior to importation into the Dominican Republic, would not be equivalent to the current tax stamp requirement in terms of allowing it to secure the same high level of enforcement with regard to tax collection and the prevention of cigarette smuggling. The Panel recalls that, as part of an alternative which would be less trade-restrictive, Honduras proposed that the Dominican Republic could resort to pre-shipment inspection and certification, through a reputable company, at the expense of the importer, in order to ensure that the tax stamps of the Dominican Republic are duly affixed to cigarettes in the exporting country. Honduras has presented as Exhibit HOND-29 a letter of 26 April 2004 from the representative of an international inspection and certification company which refers to the availability of those services.

7.229 The Panel notes additionally that the Dominican Republic argues that the requirement that a tax stamp be affixed to all cigarette packets in the territory of the Dominican Republic and under the supervision of the local tax authorities is necessary in order to secure a zero tolerance level of enforcement that the Dominican Republic has chosen to pursue with regard to tax collection and the prevention of cigarette smuggling, and to which it is entitled. The Dominican Republic, however, also admits that despite its efforts to curb the smuggling of cigarettes, its country is not exempt from this problem and has presented evidence that there are still documented cases of smuggling of cigarettes for retail in the Dominican Republic.[554] The Panel thus finds no evidence to conclude that the tax stamp requirement secures a zero tolerance level of enforcement with regard to tax collection and the prevention of cigarette smuggling.

7.230 Since the Dominican Republic has not proved why other, reasonably available, less-GATT inconsistent, measures would not be able to achieve that same level of enforcement that it has chosen to attain, it is the Panel's opinion that the Dominican Republic has not proven that the tax stamp requirement is a measure which is "necessary" to secure compliance with the Dominican Republic's tax laws and regulations.

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[553] Appellate Body Report, *EC – Asbestos*, paras. 171.

[554] Dominican Republic, First Written Submission to the Panel, 13 April 2004, para. 105. See also, information submitted by the Dominican Republic as Exhibit DR-16.

7.231 In light of the preceding considerations, and since the tax stamp requirement has not been found to be a "necessary" measure to secure compliance with the Dominican Republic's tax laws and regulations, the Panel does not need to analyse the elements contained in the *chapeau* of Article XX of the GATT 1994, i.e. whether the different treatment constitutes a means of "arbitrary or unjustifiable discrimination between counties where the same conditions prevail", or a "disguised restriction on international trade."

7.232 In conclusion, the Panel considers that the Dominican Republic has failed to establish that the tax stamp requirement is justified under Article XX(d) of the GATT 1994.

4. Conclusion

7.233 For the reasons indicated above, the Panel's overall conclusion with respect to the requirement that a tax stamp be affixed to all cigarette packets in the territory of the Dominican Republic and under the supervision of the local tax authorities is that the measure is, as such, inconsistent with Article III:4 of the GATT 1994 and that it is not justified under Article XX, paragraph (d) of the GATT 1994.

F. BOND REQUIREMENT FOR IMPORTERS OF CIGARETTES

1. The measure at issue

7.234 Under Article 376 of the Dominican Republic Tax Code[555] and Article 14 of Decree 79-03[556], the Dominican Republic imposes the requirement, for both importers and domestic producers of cigarettes, to post a bond (bond requirement).

7.235 According to Article 376 of the Dominican Republic Tax Code:

> "No alcohol and tobacco products may be manufactured in the Dominican Republic unless the person wishing to do so has previously registered and provided the Tax Administration with a bond to guarantee compliance with all of the tax liabilities established pursuant to this Chapter."

7.236 Article 14 (Bond) of Decree 79-03 extends the requirement to importers of cigarettes and sets the conditions for the bond:

> "For the purposes of Article 376 of the Tax Code, the amount of the bond shall be five million pesos (RD$5,000,000) indexed for inflation. Such a bond shall be posted with the DGII [*Dirección General de Impuestos*, Directorate General of Internal Taxes] both by importers and local manufacturers of alcoholic beverages, beers and tobacco products and shall be issued by an insurance company or banking institution accredited in the Dominican Republic."

7.237 The Panel will refer to this measure, as regulated in the Dominican Republic legislation, as the "bond requirement".

2. Main claims and defences

7.238 Honduras claims that the bond requirement is a restriction on the importation of cigarettes into the Dominican Republic that is inconsistent with Article XI:1 of the GATT 1994. Honduras argues alternatively that, should the Panel consider that the bond requirement is an internal measure,

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[555] Dominican Republic Tax Code, *supra* note 10.
[556] Decree 79-03, *supra* note 8.

rather than a restriction on importation, it should find that it is inconsistent with Article III:4 of the GATT, because it modifies the conditions of competition between imported and domestic cigarettes.

7.239 The Dominican Republic responds that the bond requirement is outside of the scope of Article XI:1 of the GATT, since it is neither a restriction nor a prohibition on the importation of cigarettes. In its opinion, the bond requirement is an internal measure that applies equally to imported and domestic cigarettes, rather than a measure on the importation of cigarettes. The Dominican Republic additionally claims that the bond requirement is also outside of the scope of Article III:4 of the GATT, because it does not affect the "internal sale, offering for sale, purchase, transportation, distribution or use" of imported cigarettes. Should the Panel consider that the bond requirement affects the internal sale, offering for sale, purchase, transportation, distribution or use of cigarettes, the Dominican Republic argues that it is nevertheless not inconsistent with Article III:4, because it does not accord less favourable treatment to imported cigarettes than that accorded to like domestic products. Finally, the Dominican Republic argues that, should the Panel find that the bond requirement is inconsistent with either Article XI:1 or Article III:4 of the GATT, it should also consider that it is justified by the general exception provided in Article XX(d) of the GATT, because it is necessary to secure compliance with Dominican Republic tax laws and regulations which are not inconsistent with the provisions of the GATT and it is consistent with the *chapeau* of Article XX.

7.240 Honduras rebuts the Dominican Republic's defence under Article XX(d) of the GATT. In its view, the Dominican Republic has not discharged its burden of establishing that the bond requirement is justified under Article XX(d), since it has not proven that the requirement is consistent with the provisions of the GATT, nor has it proven that the bond requirement is a measure to secure compliance with the Tax Code, including the Selective Consumption Tax, the ITBIS and the Income Tax. Finally, Honduras claims that the Dominican Republic has not proven that the bond requirement is necessary to secure compliance with the Selective Consumption Tax.

3. Whether the bond requirement is an import restriction inconsistent with Article XI:1 of the GATT 1994

(a) Introduction

7.241 Honduras has made alternative claims against the bond requirement under Article XI:1 and Article III:4 of the GATT. Since the latter claim is only relevant in the event that the Panel finds that the measure is not an import restriction, the Panel will begin by considering Honduras's claim under Article XI:1.

(b) Arguments of the parties

7.242 Honduras claims that the bond requirement is a restriction on the importation of cigarettes into the Dominican Republic that is inconsistent with Article XI:1 of the GATT 1994. Honduras argues that the measure falls under Article XI:1 of the GATT, rather than under Article III:4, based on two factors. First, in its opinion the bond requirement is related to "the opportunities for importation itself, i.e. entering the market". The bond is required for both domestic and imported cigarettes prior to their entry into the domestic market. In Honduras's view, the bond requirement is a condition for the importation of cigarettes, that is, importation would not be allowed unless the bond requirement were complied with. It therefore operates as a "restriction" within the meaning of Article XI:1 of the GATT. Second, Honduras considers that the bond requirement falls under Article XI:1 of the GATT, because the Dominican Republic has acknowledged that it does not affect the internal sale, offering for sale, or distribution of cigarettes and is therefore not subject to Article III:4.

7.243 The Dominican Republic responds that the bond requirement is outside of the scope of Article XI:1 of the GATT, since it is neither a restriction nor a prohibition on the importation of cigarettes. According to the Dominican Republic, Honduras's argument that the bond requirement is

within the scope of Article XI:1 is based on an incorrect assertion that the bond requirement is a "condition" for the importation of cigarettes into the Dominican Republic that applies "prior" to their importation. The Dominican Republic argues that, under its domestic law, compliance with the bond requirement is legally irrelevant to the clearance of imports at customs. There is no law or regulation in the Dominican Republic that states that the bond must be provided as a condition of, or prior to, the importation of cigarettes. Article 14 of Decree 79-03, which extends the bond requirement under Article 376 of the Dominican Republic Tax Code to importers of alcoholic beverages and tobacco products, does not state that the bond requirement is a condition for importation of such products, but only provides that importers and domestic producers of cigarettes alike must post a bond. However, Article 40 of Decree 79-03, which requires that importers of cigarettes obtain an import licence from the DGII and lists the conditions for obtaining the licence, does not include the posting of a bond as a condition.

7.244 The Dominican Republic adds that its customs authorities neither require nor check whether an importer has posted a bond before admitting cigarettes into the territory. In support of this assertion, the Dominican Republic has produced evidence to the effect that the firm *British American Tobacco República Dominicana*, the sole importer of cigarettes from Honduras had not posted a bond, nor had it been required by Customs to do so, yet it had been importing cigarettes from Honduras for several years.[557]

7.245 The Dominican Republic thus argues that the bond requirement is an internal measure that applies equally to imported and domestic cigarettes, rather than a measure "on the importation" of cigarettes. It recalls the statement from the panel in *EC – Asbestos*, to the effect that, when the applied measure leads to the same result for both the imported product and the like domestic product, it falls within the terms of Note *Ad* Article III and is therefore subject to Article III:4.

7.246 Finally, the Dominican Republic argues that, even assuming *arguendo* that the bond requirement is a measure "on the importation" of cigarettes, Honduras has not established that the measure prohibits or restricts the importation of cigarettes into the Dominican Republic. To this effect, the Dominican Republic again recalls the fact that the importer of cigarettes from Honduras has been allowed to import cigarettes into the Dominican Republic and other territories for the past two years, without having posted the bond. This would demonstrate that the authorities of the Dominican Republic do not require, either *de jure* or *de facto*, the posting of the bond as a pre-requisite for the admission of cigarettes into the territory of the Dominican Republic. The Dominican Republic concludes that the Panel should find that the bond requirement is not a measure on the importation of cigarettes and is consequently outside the scope of Article XI:1 of the GATT. Should the Panel find otherwise, the Dominican Republic requests it to rule that the bond requirement is not a prohibition or restriction on the importation of cigarettes into the Dominican Republic and therefore is not inconsistent with Article XI:1.

(c) Analysis by the Panel

7.247 According to Article XI:1 of the GATT:

> "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party."

[557] See Certification by the Director General of Customs and Certification by the Directorate General of Internal Taxes, *supra* note 120.

7.248 Article XI:1 of the GATT covers prohibitions and restrictions, other than duties, taxes or other charges, on the importation or the exportation of products. A previous WTO panel recalled some of the GATT/WTO precedents on Article XI:1 and declared that:

> "[T]he text of Article XI:1 is very broad in scope, providing for a general ban on import or export restrictions or prohibitions 'other than duties, taxes or other charges'. As was noted by the panel in *Japan – Trade in Semi-conductors*, the wording of Article XI:1 is comprehensive: it applies 'to all measures instituted or maintained by a [Member] prohibiting or restricting the importation, exportation, or sale for export of products other than measures that take the form of duties, taxes or other charges.'[Footnote omitted] The scope of the term 'restriction' is also broad, as seen in its ordinary meaning, which is 'a limitation on action, a limiting condition or regulation'."[558]

7.249 Although Article XI:1 of the GATT covers prohibitions and restrictions imposed on the importation and exportation of products, Honduras has clarified that its claim is that the bond requirement is a restriction on the importation of cigarettes. The Panel will thus seek to determine whether the bond requirement falls within the scope of Article XI:1 of the GATT, by looking at whether the measure is a restriction on the importation of cigarettes.

(d) The bond requirement as a restriction on importation

7.250 Honduras bases its argument that the bond requirement is a "restriction" within the meaning of Article XI:1 of the GATT in the assertion that the measure operates as a pre-condition for the importation of cigarettes.

7.251 In support of its claim, Honduras has quoted the statement of a previous panel, to the effect that:

> "The question of whether this form of measure [in the particular case, a trade balancing condition which did not set an absolute numerical limit on the amount of imports that could be made, but limited the value of imports that could be made to the value of exports that the signatory intended to make] can appropriately be described as a restriction on importation turns on the issue of whether Article XI can be considered to cover situations where products are technically allowed into the market without an express formal quantitative restriction, but are only allowed under certain conditions which make the importation more onerous than if the condition had not existed, thus generating a disincentive to import."[559]

7.252 The Panel agrees with the preceding statement, and recalls the following paragraph of the same report, in the sense that in order to find whether a particular measure can be described as a "restriction on importation", it is necessary to identify it as a condition that has a limiting effect on importation itself. In the words of that panel:

> "On a plain reading, it is clear that a 'restriction' need not be a blanket prohibition or a precise numerical limit. Indeed, the term 'restriction' cannot mean merely 'prohibitions' on importation, since Article XI:1 expressly covers both 'prohibition or restriction'. Furthermore, the Panel considers that the expression '*limiting condition*' used by the *India – Quantitative Restrictions* panel to define the term 'restriction' and which this Panel endorses, is helpful in identifying the scope of the notion in the context of the facts before it. That phrase suggests the need to identify not merely a

[558] Panel Report, *India – Quantitative Restrictions*, paras. 5.128-5.129.
[559] Panel Report, *India – Autos*, para. 7.269.

> condition placed on importation, but a condition that is limiting, i.e. that has a limiting effect. In the context of Article XI, that limiting effect must be on importation itself."[560]

7.253 From a factual standpoint, the Panel has received evidence that for at least two years the importer of Honduran cigarettes has been able to import into the Dominican Republic from Honduras and other origins, even without having posted the bond required by Article 14 of the Decree 79-03. Indeed, Dominican Republic imports of cigarettes from Honduras have increased significantly during the last two years, even though the importer had not posted a bond. The Panel does not find evidence to support Honduras's claim that importation is not allowed into the Dominican Republic unless the bond requirement is complied with.

7.254 By examining the Dominican Republic regulations which govern the bond requirement, the Panel is not convinced that the requirement is a limiting condition on the importation of cigarettes.

7.255 While the domestic regulations have extended to importers the bond requirement – originally applicable under Article 376 of the Tax Code only to manufacturers of tobacco products –, no domestic rule establishes that, in the absence of a bond, cigarettes would not be allowed in the country. If anything, the available evidence points to the contrary, that in practice cigarettes may be imported even if the importer has not posted a bond. The Dominican Republic has additionally declared that the failure of an importer to post a bond would lead to the imposition of sanctions for the non-compliance of formal tax obligations under Article 257 of the Tax Code, but not to the prevention of imports.

7.256 The Panel notes additionally that the bond requirement is imposed on both domestic producers and importers of cigarettes. In fact, the measure is more stringent on domestic producers, since in their case the bond requirement is an explicit condition for obtaining a licence. Indeed, under Article 8 (General provisions) of Decree 79-03, "[a]ny person, company or corporation wishing in the future to engage in the manufacture or importation of alcohol products, or the importation and manufacture of tobacco products and by-products, shall apply to the Directorate-General of Taxes for authorization to establish that kind of business". While Article 9 (General requirements for installing wineries and alcohol products and tobacco products factories) of Decree 79-03, specifies that "[a]ny manufacturer of the products specified in the preceding Article must comply with", *inter alia*, post a bond "in accordance with Article 14 of these Regulations", Article 40 (Register and licensing of importers) has no equivalent obligation for importers. Article 35 (Licence for manufacturers of tobacco products) of Decree 79-03 confirms that the bond is a requisite for domestic manufacturers wishing to obtain a licence:

> "Once the above-mentioned requirements have been fulfilled and the bond referred to in Article 14 of these Regulations has been posted by the person wishing to engage in the business of manufacturing tobacco products, the Directorate-General of Internal Taxes will issue an Official Tobacco Producer Licence. The licence shall be renewed each year by the producer or manufacturer."

7.257 The Panel notes that, in the case of imported cigarettes, the bond is not enforced either at the time or at the point of importation. Indeed, under Article 14 of the Decree 79-03, the bond is posted both by importers and local manufacturers with the Directorate General of Internal Taxes, and not with customs authorities. The Dominican Republic has informed that, after the bond is posted with the Directorate General of Internal Taxes, it is then sent to the National Treasury (*Tesorería Nacional)* for safekeeping. The Dominican Republic has added that it is not the customs authorities, but the internal tax authorities, who would verify that the bond has been posted.

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[560] Ibid., para. 7.270.

7.258 Most importantly, the Panel is not persuaded that the bond requirement is a restriction "on the importation" of cigarettes. Article XI:1 of the GATT does not cover any restriction, but only those restrictions that are instituted or maintained by any Member "on the importation" (or exportation) of products. In the expression "on the importation" – read in the context of an Article that is entitled "General Elimination of Quantitative Restrictions" –, the ordinary meaning of the word "on" suggests that it is a preposition denoting a relation.[561] In that sense, the expression "on the importation" would be akin to "with respect to the importation". Indeed, the panel on *India – Autos*, considering the ordinary meaning of the phrase "restriction on importation", reached a similar conclusion. "An ordinary meaning of the term '*on*', relevant to a description of the relationship which should exist between the measure and the importation of the product, includes 'with respect to', 'in connection, association or activity with or with regard to'.[562] In the context of Article XI:1, the expression 'restriction… *on importation*' may thus be appropriately read as meaning a restriction 'with regard to' or 'in connection with' the importation of the product."[563] Even if, *arguendo*, the bond requirement could be considered to be a limiting condition, the Panel still does not find evidence that it is a condition specifically related to the importation of cigarettes, nor that it is instituted or maintained "with regard to" or "in connection with" the importation of cigarettes.

7.259 The Panel finds support in its interpretation from the text of Note *Ad* Article III of the GATT. According to the first paragraph of this Note,

> "Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III."

7.260 The Panel thus considers that, under Note *Ad* Article III, even if a measure is collected or enforced at the time or point of importation, that does not mean it falls outside the scope of Article III, as long as it applies similarly to the imported product and to the like domestic product. In the present case, the measure is not even applied at the time or point of importation, which would make it more clearly fall under Article III.

7.261 With regard to the statement of a previous panel, to the effect that Article XI of the GATT applies in cases "where the opportunities for importation itself, i.e. entering the market, are affected"[564], the Panel considers that the expression "entering the market" was used by that panel as an expression equivalent to "importation itself". However, there are barriers to entry in a specific market that do not affect only imports but also domestic supply. In the Panel's view, not every measure affecting the opportunities for entering the market would be covered by Article XI, but only those measures that constitute a prohibition or restriction on the importation of products, i.e. those measures which affect the opportunities for importation itself.

7.262 The fact that the amount of the bond is the same for domestic producers and importers, creates an additional reason to doubt that it may constitute a restriction on imports. Any added requirement, particularly if it leads to significant costs, may constitute a barrier to entry in a specific market which may affect all possible entrants, not only importers. However, Article XI:1 of the GATT does not prohibit all barriers to entry into a market, but only those that constitute prohibitions or restrictions imposed on the importation or on the exportation of products.

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[561] *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. II, pp. 1,995-1,996.
[562] (*Footnote original*) Webster's New Encyclopedic Dictionary, 1994 ed.
[563] Panel Report, *India – Autos*, para. 7.257.
[564] Panel Report, *India – Autos*, para. 7.224.

7.263 Furthermore, the Panel does not consider that a requirement that creates costs which are not associated with sales (i.e. are decoupled from sales) would automatically create a disincentive to increase supply of a specific product. Quite the contrary, a supplier that has already taken the decision to enter a market and has incurred a fixed-amount payment would have the incentive to recover that cost by selling more. So, in principle, a bond for an amount that is not linked to sales may be less likely to constitute a restriction on imports. However, a bond for an amount which is tied to sales (such as seems to be suggested by Honduras) could serve as a disincentive to import. In fact, as the imports of cigarettes from Honduras have been increasing in the most recent years, the per unit cost of complying with the bond requirement, has been steadily decreasing. In conclusion, an added cost that is associated with the volume of sales of imported goods would be more likely to restrict imports as compared to a cost that is not linked to sales.

7.264 Honduras also argues that the bond requirement falls under Article XI:1 of the GATT, because, in its opinion, the Dominican Republic acknowledged that the requirement does not affect the internal sale, offering for sale, or distribution of cigarettes and is therefore not subject to Article III:4. The Panel, however, recalls that Honduras has made an alternative claim under Article III:4 of the GATT. Honduras has argued that, should the Panel consider that the bond requirement is an internal measure rather than a restriction on importation, it should find that it is inconsistent with Article III:4 of the GATT, because it modifies the conditions of competition between imported and domestic cigarettes. As a rebuttal to this specific alternative claim, the Dominican Republic argues that the bond requirement is outside the scope of Article III:4 because it does not affect the internal sale, offering for sale, or distribution of cigarettes. The Panel notes that Honduras itself has argued that parties are allowed to make alternative claims and to raise alternative defences and that the legal arguments presented by any party in support of a particular claim or defence cannot, and should not be, invoked against it in the assessment of an alternative claim or defence. The Panel thus considers that the legal argument presented by the Dominican Republic that the bond requirement does not affect the internal sale, offering for sale, or distribution of cigarettes, should only be analysed in the context of Honduras's alternative claim under Article III:4 of the GATT.

7.265 For the preceding reasons, and from the available evidence, the Panel is not persuaded by Honduras's argument that the bond requirement is related to the opportunities for importation itself of cigarettes into the Dominican Republic market. Nor is the Panel convinced that the requirement is a condition for the importation of cigarettes, that is, that importation would not be allowed unless the bond requirement had been complied with. The Panel therefore does not consider that there is evidence that the bond requirement operates as a restriction on the importation of cigarettes, within the meaning of Article XI:1 of the GATT.

7.266 In conclusion, the Panel considers that Honduras has failed to establish that the bond requirement imposed by the Dominican Republic operates as a restriction on the importation of cigarettes, in a manner inconsistent with Article XI:1 of the GATT 1994.

4. Whether the bond requirement accords less favourable treatment to imported products in a manner inconsistent with Article III:4 of the GATT 1994

(a) Arguments of the parties

7.267 Honduras claims that, should the Panel consider that the bond requirement does not fall under Article XI:1 of the GATT, then it should find that it is inconsistent with Article III:4, because it accords less favourable treatment to imported cigarettes than to the like domestic products. In the opinion of Honduras, the less favourable treatment results from the modification of the conditions of competition between imported and domestic cigarettes. The bond requirement creates a disincentive against importing cigarettes, as compared to buying from domestic producers, for any local buyer who wishes to purchase them for resale.

7.268 Honduras additionally argues that the bond requirement also accords less favourable treatment to importers in the context of the liability and payment for the Selective Consumption Tax. For both imported and domestic cigarettes, the bond requirement would be an accessory obligation related to a principal obligation – the payment of the Selective Consumption Tax. The Selective Consumption Tax on imported cigarettes is collected in its entirety upon importation. However, the Selective Consumption Tax on domestic cigarettes may be paid up to the twentieth day of the month following that in which the sale is made. Therefore, for domestic producers, there is a tax liability the non-payment of which the bond properly secures. However, for imported cigarettes, since the Selective Consumption Tax accrues and is immediately paid upon importation, there is no similar tax liability. Furthermore, domestic producers can collect the Selective Consumption Tax in advance as part of the purchase price paid by buyers. This accords domestic producers the opportunity to earn interest income on the Selective Consumption Tax for a period of 20-50 days. On the other hand, importers have to pay the Selective Consumption Tax in advance. This entails either financing costs or opportunity costs on the part of the importers.

7.269 Finally, Honduras claims that the required bond has been set at a fixed amount of RD$5million that must be posted by each importer and domestic producer. There is no direct relationship between the amount required to be guaranteed (i.e. the fixed amount of the bond) and the actual amount giving rise to the Selective Consumption Tax which is dependent upon variable factors such as monthly volumes of sales and variations in the retail selling price according to market factors. The two amounts are not commensurate.

7.270 The Dominican Republic responds that the bond requirement is an internal measure that applies equally to both imported and domestic products, but is nevertheless outside the scope of Article III:4 because it does not affect the "internal sale, offering for sale, purchase, transportation, distribution or use" of imported cigarettes. Importers of cigarettes are not precluded by the bond requirement from clearing the cigarettes through customs, selling or offering them for sale, transporting them, or distributing them within the territory of the Dominican Republic, nor are consumers in any way precluded by the bond requirement from buying or using the imported cigarettes. The Dominican Republic adds that, even assuming that the bond requirement does affect the internal sale, offering for sale, purchase, transportation, distribution, or use of imported cigarettes, it would not be inconsistent with Article III:4 since it does not accord to imported cigarettes treatment "less favourable than that accorded to like products of national origin". The Dominican Republic adds that, even assuming that the bond requirement does affect the internal sale, offering for sale, purchase, transportation, distribution, or use of imported cigarettes, it would nevertheless not be contrary to Article III:4 since it does not accord to imported cigarettes treatment "less favourable than that accorded to like products of national origin", because it is applied equally to domestic and imported cigarettes and does not modify the conditions of competition in the domestic market to the detriment of imported products. In its view, Honduras is challenging the timing of the payment of the Selective Consumption Tax, rather than the bond requirement itself.

(b) Analysis by the Panel

7.271 Under Article III:4 of the GATT:

> "The products of the territory of any contracting party imported into the territory of any other contracting party 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..."

7.272 The Appellate Body has stated that:

> "For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are 'like products'; that the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and that the imported products are accorded 'less favourable' treatment than that accorded to like domestic products..."[565]

(c) Like product determination

7.273 As mentioned before,[566] the Dominican Republic has admitted that "[t]here is no disagreement between the parties that imported and domestic cigarettes are 'like products'. Likeness of these products is not at issue in this dispute." The Panel has already assumed that imported cigarettes and domestic Dominican Republic cigarettes are like products within the meaning of Article III:4 of the GATT.

(d) Law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use

7.274 Honduras does not argue that the bond requirement affects the internal sale, offering for sale, purchase, transportation, distribution, or use of cigarettes. In fact, under its main claim under Article XI:1 of the GATT, it argued exactly the opposite, i.e. that the bond requirement does not affect the internal sale, offering for sale, purchase, transportation, distribution, or use of cigarettes, and therefore is not subject to Article III:4.

7.275 Honduras adds, however, that its arguments under Article XI:1 should not qualify in any way its claim under Article III:4. The statement that the bond requirement does not affect the internal sale, offering for sale, purchase, transportation, distribution, or use of cigarettes, and therefore is not subject to Article III:4, was only in comment on a point made by a third party that Article III, and not Article XI, applied to the measure. Honduras has clarified that it presents one set of facts to the Panel -not two-, upon which it makes alternative claims under Article XI:1 and Article III.4 of the GATT. In its view, parties are allowed to make alternative claims and to raise alternative defences and the legal arguments presented by any party in support of a particular claim or defence cannot, and should not be, invoked against it in the assessment of an alternative daim or defence. Thus, the legal arguments presented by Honduras to justify its claim under Article XI:1 of the GATT should not be invoked against it in assessing its alternative claim under Article III:4.

7.276 The Dominican Republic argues that, although the bond requirement is an internal measure that applies equally to both imported and domestic products, it is nevertheless outside the scope of Article III:4 because it does not affect the internal sale, offering for sale, purchase, transportation, distribution or use of imported cigarettes. Neither of these "specific transactions" covered by Article III:4 would be affected by the bond requirement under Article 14 of Decree 79-03. The Dominican Republic recalls that Honduras acknowledged that fact.[567] In the view of the Dominican Republic, importers of cigarettes would not be precluded by the bond requirement from clearing cigarettes through customs, selling or offering them for sale, transporting them, or distributing them within the territory of the Dominican Republic. Neither would consumers in any way be precluded by the bond requirement from buying or using the imported cigarettes. As evidence of its argument, the Dominican Republic recalls that the sole importer of cigarettes from Honduras, *British American Tobacco República Dominicana*, imported and sold cigarettes in the Dominican Republic for the past two years, despite not having posted a bond. The Dominican Republic concludes that, since the bond requirement is outside the scope of Article III:4, it cannot be contrary to that provision.

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[565] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.
[566] See *supra* Paragraph 7.164.
[567] See Second written submission of the Dominican Republic, 10 June 2004, para .34.

7.277 The Panel acknowledges that Honduras has presented alternative claims against the bond requirement and that it has expressly asked that the arguments it has presented under Article XI:1, should not qualify its alternative claim under Article III:4. The Panel sees no reason to disregard that request and will therefore not take into account at this point Honduras's statement that the bond requirement does not affect the internal sale, offering for sale, purchase, transportation, distribution, or use of cigarettes, and therefore is not subject to Article III:4.

7.278 As mentioned before, and with respect to whether the bond requirement affects the internal sale, offering for sale, purchase, transportation, distribution, or use of cigarettes, the Panel notes that, as stated by the Appellate Body, the ordinary meaning of the word "affecting" implies a measure that has "an effect on" and thus indicates a broad scope of application.[568] In light of the broad scope of application of the expression "affecting", under Article III:4 of the GATT it would not be necessary to prove that the bond requirement precludes importers from clearing cigarettes through customs, selling or offering them for sale, transporting them, or distributing them within the territory of the Dominican Republic. Nor would it be necessary to prove that the bond requirement precludes consumers from buying or using imported cigarettes. It would be enough to demonstrate that the measure has "an effect on" the internal sale, offering for sale, purchase, transportation, distribution, or use of cigarettes.

7.279 The Panel notes that, under Article 14 of Decree 79-03 of 4 February 2003, both importers and local manufacturers of tobacco products shall post a bond with the Directorate General of Internal Taxes. Under the evidence provided by the Dominican Republic, an importer or a local manufacturer of tobacco products who did not comply with the bond requirement, or any other formal obligation, would be subject to the application of sanctions such as fines. Any person wishing to engage in the internal sale, offering for sale and purchase of cigarettes in the domestic market of the Dominican Republic, as manufacturer or importer, would thus have to comply with the bond requirement or else run the risk of being the subject of internal sanctions.

7.280 In light of the previous factors, and of the broad scope of application of the expression "affecting" contained in Article III:4 of the GATT, the Panel considers that the bond requirement can be considered as an internal regulation that "affects" the internal sale, offering for sale and purchase of cigarettes in the domestic market of the Dominican Republic within the meaning of Article III:4 of the GATT.

(e) Less favourable treatment

(i) The disincentive against importing cigarettes

7.281 Honduras argues that the less favourable treatment results from the modification of the conditions of competition between imported and domestic cigarettes. The bond requirement would adversely modify the incentives for a local buyer who wishes to purchase imported cigarettes for sale. In its opinion, a company that sells cigarettes in the Dominican Republic has two options, either to buy from a domestic producer or to import. If that company were to purchase from a domestic producer, it would not have to post a bond. However, if that company were to import cigarettes, it would have to post a bond and thus incur additional costs. Therefore, there would be a built-in disincentive against importing cigarettes, as compared to buying from domestic producers.

7.282 The Panel is not persuaded by this argument, because Honduras is comparing operations at different commercial levels. According to the available information, the cigarette market in the Dominican Republic is dominated by a reduced number of suppliers, either domestic producers or importers. Three firms (two domestic producers and one importer) represented almost 100 per cent of the local market of cigarettes. Furthermore, the local importer of Honduran cigarettes in the Dominican Republic, *British American Tobacco República Dominicana*, is related with the

[568] See *supra* Paragraph 7.169. Appellate Body Report, *EC – Bananas III*, para. 220.

manufacturer. In the light of that evidence, in the example presented by Honduras, a more correct description would be that a local company that intends to sell cigarettes in the Dominican Republic would have two options, either to buy from a domestic producer or to buy from the importer. In neither case would it need to post a bond, since the posting of a bond is only required from manufacturers and importers. Alternatively, any new entrant in the market to supply cigarettes in the Dominican Republic, either as producer or as importer, would have to post a bond in an equivalent manner.

7.283 For the reasons expressed above, the Panel is not convinced by Honduras's argument that, for any local buyer who wishes to purchase cigarettes for sale, the bond requirement creates a disincentive against importing cigarettes, as compared to buying them from domestic producers.

(ii) The bond as a guarantee for inexistent tax liabilities

7.284 Honduras also argues that the bond requirement results in a less favourable treatment for imported cigarettes in the context of the liability that the bond would serve to cover. In its view, for both imported and domestic cigarettes, the bond requirement is a supplementary obligation related to the principal obligation which is the payment of the Selective Consumption Tax. However, with respect to imported cigarettes, the Selective Consumption Tax is collected in its entirety upon importation. On the other hand, for domestic cigarettes, the Selective Consumption Tax may be paid up to the 20th day of the month following that in which the sale is made. Therefore, for domestic producers, the bond serves as a security in the event that the tax obligation is not properly discharged, while for imported cigarettes, as the importers pay the full amount of the Selective Consumption Tax upon importation, there is no liability that the bond requirement would serve to secure.

7.285 The Dominican Republic responds that the fact that the importer is required to pay the Selective Consumption Tax upon importation does not mean that no tax liability can arise after cigarettes have cleared customs. It could be the case that the Selective Consumption Tax originally assessed at the time of importation may have been insufficient to cover the tax liability of the importer. As a result, the tax for a particular importer and transaction may have to be adjusted. Under the Dominican Republic law, its tax authorities retain the right to conduct reassessments and adjust the tax liability of any taxpayer, including importers and domestic producers equally, within three years after the initial payment of the relevant tax. The Dominican Republic claims that instances in which its tax authority has adjusted the amount of taxes due, after the tax had been paid, are frequent. The Dominican Republic adds that, although Article 376 of the Tax Code appears to refer only to the Selective Consumption Tax, in practice its tax authority treats the bond as a guarantee of compliance with other internal tax obligations incumbent on the domestic producer and the importer of cigarettes, including the tax on the transfer of goods and services ("ITBIS") (Articles 335 through 360 of the Dominican Republic Tax Code), and the income tax (Articles 267 through 334 of the Dominican Republic Tax Code).

7.286 The Panel will consider the argument presented by Honduras in the sense that there is no liability that the bond requirement would serve to secure, as well as the two responses from the Dominican Republic: (i) that the bond serves as a guarantee of tax liabilities in the event of latter reassessments and adjustments of the tax liability of taxpayers; and, (ii) that it serves as a guarantee of compliance with internal tax obligations other than the Selective Consumption Tax.

7.287 In support of its argument that tax liabilities may arise after cigarettes have cleared customs, since tax authorities retain the right to conduct reassessments and adjust the tax liability of any taxpayer, the Dominican Republic has referred to Article 21 of its Law 11-92, Dominican Republic Tax Code, as well as to Article 118 of its Law 3489. Article 21 of the Dominican Republic Tax Code, Law 11-92, reads as follows:

> "Article 21. LIMITATION PERIOD. The following are subject to limitation after a period of three years:
>
> (a) Actions by the Tax Authority to require sworn statements, question those made, demand tax payment and carry out *ex officio* estimates;
>
> (b) Actions for breach of this Code or the tax laws; and
>
> (c) Actions against the Tax Authority for recovery of taxes paid.
>
> PARAGRAPH.- Limitation as provided for in this Article shall run from the date of expiry of the deadline for submitting a sworn statement for tax payment purposes, not counting the date of tax payment or that of the submission of the sworn statement and, in the case of taxes not requiring submission of a sworn statement, from the day following expiry of the deadline for tax payment, unless otherwise provided."

7.288 Article 118 of the Dominican Republic Law 3489, as modified by the Law 68 of 31 December 1982, states the following:

> "Within a period not exceeding two (2) years counted from the date of payment established, customs collection offices may collect any duties and taxes due to the Tax Authority..."

7.289 In support of its argument, the Dominican Republic has presented a list of taxpayers that have had their taxes reassessed in the period from March 2003 to April 2004. According to that evidence, the Dominican Republic conducted 494 reassessments of taxes in that period. The Dominican Republic has also presented copies of letters from its customs authorities to different importers in which they are informed that the tax liabilities have been reassessed and that they should make the corresponding payments. In the list provided by the Dominican Republic, the firm *British American Tobacco República Dominicana*, the importer of cigarettes from Honduras, appears as one of the taxpayers that had their tax liabilities reassessed.

7.290 Honduras responds to this argument, by stating that, from the evidence presented by the Dominican Republic, it appears tax reassessments have been made with respect to unpaid customs duties and other charges, and not the Selective Consumption Tax. Therefore, there would be no evidence that the reassessments are necessary to cover shortfalls in the collection of the Selective Consumption Tax, nor that the bond requirement secures the payment of the Selective Consumption Tax after reassessments. Indeed, the reassessment of the tax liabilities of the importer of cigarettes from Honduras was related to the importation of merchandising material and not of tobacco products. Honduras also pointed to the fact that many of the taxpayers on the list of reassessments had not posted bonds.

7.291 As mentioned above, the Dominican Republic further argues that its tax authority treats the bond as a guarantee of compliance with internal tax obligations other than the Selective Consumption Tax, such as the tax on the transfer of goods and services ("ITBIS") and the income tax. The Dominican Republic acknowledges that there is no explicit provision in its legislation that authorizes the use of the bond as a guarantee of compliance for internal tax obligations other than the Selective Consumption Tax. Nevertheless, it declares that, in practice, and in exercise of its broad powers to ensure the proper and effective enforcement of the tax laws, the Dominican Republic tax authorities regard the bond as a guarantee of compliance for internal tax obligations other than the Selective

Consumption Tax. In support of its argument, the Dominican Republic has presented a copy of a written declaration to that effect from its Director General of Internal Taxes.[569]

7.292 In view of the preceding elements, the Panel finds that the evidence available does not support Honduras's assertion that there is no liability that the bond requirement would serve to secure. While the importers may pay in full at the moment of importation their obligations under the Selective Consumption Tax and other applicable taxes, the Dominican Republic has demonstrated that its tax authorities have the legal powers to reassess and eventually readjust the applicable tax liabilities for a period of up to three years. If a readjustment occurs as a result of a reassessment, then the importer may be asked to make a new payment. The bond would serve to guarantee this payment, if the importer does not pay in time. Even assuming *arguendo* the validity of Honduras's argument that there have been no reassessments for the payment of the Selective Consumption Tax on imports of cigarettes, that does not mean that those reassessments could not occur. A bond is a guarantee to avoid some of the damage that may result in the event that a particular situation may occur. The fact that a bond is not used, does not necessarily mean that a bond requirement is unjustified.

7.293 While the Dominican Republic has admitted that there is no explicit legal provision that authorizes the use of the bond as a guarantee of compliance for internal tax obligations other than the Selective Consumption Tax, the Panel finds that there is no reason to question its assertion that, in practice and in the exercise of its enforcement powers, the Dominican Republic tax authorities regard the bond as a guarantee of compliance for internal tax obligations such as the tax on the transfer of goods and services ("ITBIS") and the income tax.

7.294 For the reasons expressed above, the Panel is not convinced by Honduras's argument that the bond requirement results in a less favourable treatment for imported cigarettes, because for those cigarettes there is no liability that the bond requirement would serve to secure.

(iii) Fixed amount of the bond

7.295 Finally, Honduras claims that the less favourable treatment for imported cigarettes would also result from the fact that the required bond has been set at a fixed amount of RD$5million that must be posted by each importer and domestic producer. In its opinion, there would be no direct relationship between the amount required to be guaranteed (i.e. the fixed amount of the bond) and the actual amount giving rise to the Selective Consumption Tax which would be dependent upon variable factors such as monthly volumes of sales and variations in the retail selling price according to market factors. The two amounts would not be commensurate. Honduras suggests that, since two domestic manufacturers have a higher market share than the importer of Honduran cigarettes, the per unit cost of the bond (the result of dividing the cost of the bond by the number of cigarettes sold) would be higher for imported cigarettes than for domestic cigarettes.

7.296 The Dominican Republic responds that the bond amounts do not have to be linked to the potential tax liabilities of the producers or the importers, or to any other factors. In its opinion, no such link would be reasonable, especially since the underlying tax obligations that the bond is intended to secure are not discriminatory. The Dominican Republic argues that, provided that the amount and the terms of the bond requirement are non-discriminatory, and in the absence of evidence that demonstrates that the bond is applied in a discriminatory manner, that bond would not be contrary to Article III of the GATT.

7.297 The Panel is not convinced by the argument that, in and of itself, the fact that the amount of the bond is the same for domestic producers and importers, creates less favourable treatment for imported cigarettes than for the like domestic products. Honduras has not presented evidence to that

[569] See Letter from the Director General of Internal Taxes, *supra* note 39.

effect, other than the assertion that the per unit cost of the bond would be higher for imported than for domestic cigarettes.

7.298 The Panel recalls that the Appellate Body has declared that:

> "The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. … Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. … Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products."[570]

7.299 The Panel notes that, under the domestic regulations, the required bond must be issued by an insurance company or banking institution accredited in the Dominican Republic. The effective cost that the bond has on domestic producers and importers is thus the fee charged by the financial institution that issues the bond. According to the evidence provided by Honduras, in the specific case of the importer of cigarettes from that country, the annual fee charged by the insurance company that issued the bond was RD$84,000 (approximately US$1,873[571]). When divided by the annual imports of cigarettes made by that same company, the cost of the bond would be equivalent to RD$0.9 (or approximately 2 cents of a US dollar) per thousand cigarettes. That annual value is equivalent to 0.2 per cent of the value of cigarette imports made by the importer in the year 2003.[572] The Panel also notes that the cost of complying with the bond requirement has been diminishing for the importing company in the recent years, since its imports have increased while the bond amount has remained the same. Had the importer posted a bond in the years 2001 and 2002 for the same cost, the cost of that bond would have represented 0.64 per cent and 0.41 per cent, respectively, of the value of cigarette imports made by the importer in those two years.

7.300 By definition, any expense that is fixed (i.e. not related to volumes of production) may lead to different costs per unit among supplier firms. As long as the difference in costs does not alter the conditions of competition in the relevant market to the detriment of imported products, that fact in itself should not be enough to conclude that the expense creates a less favourable treatment for imported products.

7.301 In light of the preceding arguments, the Panel considers that Honduras has not presented evidence to support its argument that the different cost per unit generated by complying with the bond requirement has a detrimental impact on the competitive conditions for imported products in relation to domestic products in the Dominican Republic cigarette market.

(iv) Payment of the Selective Consumption Tax

7.302 Honduras also argues that the bond requirement accords less favourable treatment to imported products as a result of the timing for the payment of the Selective Consumption Tax. Honduras states that, with respect to imported cigarettes, the Selective Consumption Tax is collected in its entirety upon importation whereas, for domestic cigarettes, the tax may be paid up to the twentieth day of the month following that in which the sale is made. Both domestic producers and importers collect the Selective Consumption Tax from consumers at the time of the sale. This would accord to domestic producers the opportunity to earn interest income on the money they receive as payment of the Selective Consumption Tax for the period between the time of the purchase and the time they have to

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[570] Appellate Body Report, *Japan – Alcoholic Beverages II*, p.16.

[571] Exchange rate between the Dominican Republic Peso and the United States Dollar, as of 31 July 2004.

[572] Comments by Honduras on the Replies of the Dominican Republic to question No. 109 addressed by the Panel, 21 July 2004, para. 1.

remit that amount to the tax authorities. Importers, on the other hand, would have the added financial cost or opportunity cost of having to advance the money for payment of the tax.

7.303 The Dominican Republic responds that Honduras is challenging the timing of the payment of the Selective Consumption Tax, rather than the bond requirement itself. The difference in the timing would not explain how the bond *per se* affects the conditions of competition of importers. In the opinion of the Dominican Republic, the difference in the timing of the payment of the Selective Consumption Tax is not tied to or contingent on the bond and it is not within the terms of reference of the Panel. Moreover, the fact that domestic producers pay the Selective Consumption Tax after the sale of the cigarettes, while importers pay it at the time of importation, would not render the tax inconsistent with Article III of the GATT, since Note *Ad* Article III clarifies that Members may collect or enforce internal taxes or measures in the case of imported products at the time or point of importation.

7.304 According to the evidence presented by the parties, Article 369 of the Dominican Republic Tax Code provides that "[i]n the case of imported goods, the [Selective Consumption Tax] shall be assessed and paid concurrently with the corresponding customs duties...". With regard to domestic products, however, Article 368 of the Tax Code provides that "In the case of transfers and provision of services the tax shall be assessed and paid monthly... For the purposes of these articles, taxpayers shall submit a sworn statement of transfers and provision of services carried out in the preceding month... and shall simultaneously pay the tax. The submission of the sworn statement and the payment of the tax shall be effected within the time-limit laid down for the assessment and payment of the tax on the transfer of industrialized goods and services." Paragraph (c) of Article 353 of the Tax Code deals with the sworn statements and declares that "[t]he statement shall be filed in the course of the first twenty (20) days of each month, even if there is no tax to pay".

7.305 Since domestic producers can collect the Selective Consumption Tax as of the time of the sale of the packet of cigarettes, this accords them the opportunity to earn interest income on the money they receive as payment of the Selective Consumption Tax for the period, if any, between the time of the purchase and the time they have to remit that amount to the tax authorities. However, importers would have to assume the opportunity cost or financial cost of having to advance the money for payment of the tax.

7.306 The Panel recalls that, in its request for the establishment of the Panel, Honduras described its claim against the bond requirement in the following manner:

> "The Dominican Republic requires importers of cigarettes to post a bond pursuant to Article 14 of the Regulations. This requirement and the laws, regulations and practices implementing this requirement entail costs and administrative burdens hindering the importation of cigarettes and are therefore in the view of Honduras inconsistent with Article II:1(a) and (b) and Article XI:1 of the GATT, or - if they were deemed to be internal measures - inconsistent with Article III:2 and Article III:4 of the GATT."

7.307 Whether imported cigarettes may be accorded less favourable treatment than the like domestic products due to the difference in the time of payment of the Selective Consumption Tax is, in the opinion of the Panel, a different issue from the bond requirement, although the two may be tangentially related. Although the bond would serve as a guarantee for the payment of the Selective Consumption Tax and other liabilities, if there was any challenge against the conditions for payment of the tax, that challenge would not have to do with the bond requirement, but with the rules on the tax itself. The time of payment of the Selective Consumption Tax is not part of the bond requirement.

7.308 The claim on the bond requirement is part of the terms of reference of the Panel. There is, however, nothing in the request for establishment of the Panel that would lead to the conclusion that

the Panel would be asked to make any finding regarding the difference in timing of the payment of the Selective Consumption Tax between domestic producers and importers. The Panel therefore concludes that Honduras's claim regarding the different costs for domestic producers and importers arising from the time of payment of the Selective Consumption Tax is not directly related with the bond requirement and it is not within the Panel's terms of reference.

(v) Less favourable treatment

7.309 In order to determine whether the requirement that importers and domestic producers of cigarettes must post a bond accords less favourable treatment to imported cigarettes than to like domestic products, the Panel is guided by the statement from the Appellate Body in the sense that the assessment should focus on examining "whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products".[573]

7.310 In this respect, the Panel finds that the bond requirement is applied in an equal manner, both formally and in practice, to domestic and imported cigarettes. The Panel considers that Honduras has not demonstrated how the identical treatment accorded to domestic and imported cigarettes in respect of the bond requirement modifies the conditions of competition to the detriment of imported products.

7.311 In conclusion, the Panel considers that Honduras has failed to establish that the bond requirement imposed by the Dominican Republic accords less favourable treatment to imported cigarettes than that accorded to the like domestic products, in a manner inconsistent with Article III:4 of the GATT 1994.

5. Whether the bond requirement is justified under Article XX(d) of the GATT 1994

(a) Arguments of the parties

7.312 The Dominican Republic requests that, should the Panel find that the bond requirement is inconsistent with Article III:4 of the GATT 1994, it should nonetheless find that the measure is justified by Article XX(d) of the GATT. In the Dominican Republic's opinion, the requirement is a measure that is necessary to secure compliance with the Dominican Republic tax laws and regulations, which are themselves consistent with the GATT. The bond is required to secure the payment of a tax with respect to only certain products, i.e. alcoholic beverages and cigarettes, because of the risk of smuggling of these products. The tax stamp would serve as a mark to indicate to Dominican Republic tax authorities that the applicable taxes have been collected and would ensure that cigarettes continue to enter the Dominican Republic through regular and legitimate channels of commerce, thus preventing smugglers from selling unstamped and undeclared cigarettes in the domestic market. Moreover, in the Dominican Republic's view, the requirement is not applied in a manner that constitutes either arbitrary or unjustifiable discrimination between countries where the same conditions prevail, nor a disguised restriction on international trade. The Dominican Republic also argues that there are no reasonable alternatives to the bond requirement available to secure the same level of compliance with the Selective Consumption Tax for cigarettes.

7.313 Honduras replies to this defence by arguing that the Dominican Republic has not established that the bond requirement is justified under Article XX(d) as is its burden, since Article XX(d) is an affirmative defence. In Honduras's view, the Dominican Republic has not demonstrated that the tax laws and regulations that would be enforced through the requirement are consistent with the GATT, nor has it demonstrated that the requirement is indeed a measure to secure compliance with those tax laws and regulations. Honduras argues additionally that the bond requirement is not "necessary" to secure compliance with the tax laws and regulations of the Dominican Republic. The Selective Consumption Tax is imposed on many products, and the bond is only required for tobacco and

[573] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

cigarettes. In its opinion, if the bond were necessary to secure compliance with the Selective Consumption Tax, then presumably, it should be applied to all products subject to the tax. It adds that, if all imported products have to pay the Selective Consumption Tax upon importation at the border, there is no justification why the bond requirement on imported cigarettes is necessary to secure compliance with a Selective Consumption Tax that has already been paid.

(b) Article XX(d) of the GATT 1994

7.314 According to paragraph (d) and the *chapeau* of Article XX of the GATT:

> "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 contracting party 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;"

7.315 An analysis under the Article XX(d) defence raised by the Dominican Republic would only be relevant if the Panel had found that the bond requirement is inconsistent with Article X:1 of the GATT 1994 or, alternatively, with Article III:4. Since the Panel has not found the bond requirement to be inconsistent with either one of those articles, it does not need to consider the Article XX(d) defence argued by the Dominican Republic.

6. Conclusion

7.316 For the reasons indicated above, the Panel is unable to accept Honduras's claims under Article XI:1 of the GATT 1994, and its alternative claims under Article III:4, against the requirement that importers and domestic producers of cigarettes must post a bond.

G. DETERMINATION OF THE TAX BASE FOR THE PURPOSE OF THE APPLICATION OF THE SELECTIVE CONSUMPTION TAX TO CERTAIN IMPORTED CIGARETTES

1. The measure at issue

7.317 The Dominican Republic levies a Selective Consumption Tax on certain products, such as cigarettes. By the date of establishment of the Panel, the Selective Consumption Tax was charged on cigarettes at a 50 per cent *ad valorem* rate.

7.318 By the date of establishment of the Panel, under the Dominican Republic legislation, there were three different rules under which the tax base for cigarettes could have been determined by the authorities, for the purpose of applying the Selective Consumption Tax: (i) Under the rule contained in Article 367(b) of the Dominican Republic Tax Code, the tax base for domestic cigarettes would be the retail selling price obtained from average-price surveys conducted by the Dominican Republic Central Bank, whereas the tax base for imported cigarettes would be the retail price used for the nearest similar product on the domestic market, that is to say the closest substitute; (ii) Under Article 3 of Decree 79-03 (Regulation on the Implementation of Section IV of the Tax Code), the tax base for both domestic and imported cigarettes would be calculated on the basis of the average market price according to the Central Bank's survey, however for new tobacco products not appearing in the

survey on which the retail sale price was determined, the tax base would be the price of the nearest like product in the local market; or (iii) Under Article I of General Rule 02-96 issued by the Directorate General of Internal Taxes of the Dominican Republic, the tax base would be the retail price, determined by increasing the list price (excluding cash and trade discounts, grants and the like) by 20 per cent.

7.319 According to Honduras, in practice, the tax for domestic cigarettes was based on the average retail selling price of each brand, as provided in a survey of the average prices conducted by the Central Bank of the Dominican Republic whereas, by contrast, the tax base for imported cigarettes was calculated on the value of the "nearest similar product on the domestic market." Honduras concludes that this difference in approach resulted in certain lower-priced imported cigarettes being taxed at a rate higher than the one which would have corresponded according to their actual selling price and, in consequence, at a rate that was higher than the rate applied to the like domestic products, which sold for the same retail selling price.

7.320 To support its claim, Honduras has provided information on the retail selling price of different brands of cigarettes sold in the Dominican Republic market and the respective level of tax paid by each brand (during the period 17 March 2003 – 1 August 2003):

Brand	Retail Selling Price	Selective Consumption Tax paid
Marlboro (Domestic)	RD$ 26.00	RD$ 7.73
Nacional (Domestic)	RD$ 24.00	RD$ 7.36
Kent (Domestic)	RD$ 22.00	RD$ 6.54
Belmont (Imported)	RD$ 20.00	RD$ 6.13
Viceroy (Imported)	RD$ 18.00	RD$ 6.54
Líder (Domestic)	RD$ 18.00	RD$ 5.34

2. Whether imported cigarettes were taxed in excess of the like domestic products in a manner inconsistent with Article III:2, first sentence, of the GATT 1994

(a) Arguments of the parties

7.321 Honduras claims that, under the rules in force on the date of establishment of the Panel, the Dominican Republic determined the tax base for cigarettes in a manner that resulted in certain lower-priced imported cigarettes being taxed at a rate higher than the one which would have corresponded according to their actual selling price.

7.322 Honduras argues that the Dominican Republic taxed domestic cigarettes based on the average retail selling price of each brand, as provided in a survey of the average prices conducted by the Central Bank of the Dominican Republic whereas, by contrast, the tax base for imported cigarettes was calculated on the value of the "nearest similar product on the domestic market." Honduras concludes that this difference in approach resulted in certain lower-priced imported cigarettes being taxed at a rate higher than corresponded according to their actual selling price and, in consequence, at a rate that was higher than the rate applied to the like domestic products, which sold for the same retail selling price.

7.323 Honduras states that its claims in relation to the determination of the tax base for the purpose of application of the Selective Consumption Tax are two-fold. On the one hand, Honduras claims that the Dominican Republic established the tax base for certain imported cigarettes on the basis of what it determined to be the retail selling price of the "nearest similar product", whereas it established the tax base for domestic cigarettes on their actual retail selling prices obtained from average-price surveys conducted by the Central Bank. In this sense, the claim is directed against the rules for the

determination of the tax base for cigarettes, contained in Article 367(b) of the Dominican Republic Tax Code. On the other hand, Honduras also claims that in practice the Dominican Republic authorities have taxed lower-priced imported cigarettes at a rate higher than the one which corresponded according to their actual selling price, which has meant that certain imported cigarettes have been taxed at a higher rate than the like domestic products which were sold for the same retail selling price as the imported products. This latter claim is directed to the administration of the tax laws.

7.324 The Dominican Republic replies that Honduras's claims are moot, since they are based on an outdated version of Article 367 of the Tax Code of the Dominican Republic. Law 3-04, published on 14 January 2004, amended Articles 367 and 375 of the Tax Code and established a specific and identical tax base and tax rate for the Selective Consumption Tax on imported and domestic cigarettes – i.e. RD$0.48 per cigarette. Thus, under the current Article 367 of the Tax Code, the retail price of cigarettes is no longer relevant for determining the tax base of the Selective Consumption Tax. Rather, the tax base is now determined on the basis of the number of cigarette packets transferred or imported. Also, the "nearest similar product in the domestic market" plays no role in the determination of the tax base. The Panel should thus abstain from making findings or issuing recommendations to the WTO Dispute Settlement Body, regarding laws and practices of the Dominican Republic that have been withdrawn because a recommendation in these circumstances would constitute a legal error and would be devoid of purpose, because there is no evidence that the measures are still in place or have lingering effects, because there is no evidence that the Dominican Republic will reintroduce the withdrawn measures, and because the measures were revoked before the Panel began its adjudication process.

7.325 Honduras replies in turn that, when the Panel was established, the provisions that constitute the basis for Honduras's claims were in force. The Panel is competent, and indeed has the legal obligation, to examine the measures existing as of that date, since the "matter" before a panel is determined by its terms of reference. Honduras claims that it has made a *prima facie* case, which the Dominican Republic has not rebutted. In its opinion, the Dominican Republic has acknowledged that, for determining the nearest similar product to imported cigarettes, it used criteria other than the retail selling prices. These criteria were not stated in any of the regulations governing the Selective Consumption Tax.

7.326 The Dominican Republic explains that the reason why imported *Viceroy* cigarettes were taxed at a higher rate than domestic *Líder* cigarettes during 2003, is because its tax authorities determined that the nearest similar cigarettes to the imported *Viceroy* in the domestic market were *Marlboro*, and not *Líder*. The Dominican Republic authorities considered that the pricing policies of the importer could not, by themselves, be relied on to determine the nearest similar product in the domestic market and therefore used other factors, including the declared customs value of the imported cigarettes. This determination was based on the customs value officially declared by the importer of *Viceroy* during the year 2002 and part of 2003. According to the declared customs values, the average prices of *Viceroy* in the first eight months of 2003 were higher than the average prices for cigarettes of the brand name *Belmont* and *Kent* by 10 per cent and 5.8 per cent, respectively. In the year 2002, according to the declared customs value of the same importer, the average price of *Viceroy* cigarettes was 15.8 per cent and 9.1 per cent higher than the average retail prices for *Belmont* and *Kent*, respectively. The Dominican Republic argues that, given the disparity and inconsistency in the information provided by the importer, the tax authorities determined that the nearest similar product in the domestic market for *Viceroy* cigarettes was *Marlboro*. In its opinion, the pricing policy for *Viceroy* cigarettes constitutes an anti-competitive practice on the part of the importer, which could be subject to an anti-dumping investigation.

(b) Analysis by the Panel

7.327 Under the first sentence of Article III:2 of the GATT:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products."

7.328 The Appellate Body has stated that there are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence.[574]

(c) Like product determination

7.329 With respect to the likeness of the product, the Panel is aware that the finding that a product is alike under Article III:4, does not necessarily make it alike under Article III:2, first sentence. In this respect, the Panel keeps in mind the statement of the Appellate Body that:

> "No one approach to exercising judgement will be appropriate for all cases. The criteria in *Border Tax Adjustments* should be examined, but there can be no one precise and absolute definition of what is 'like'. The concept of 'likeness' is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply. We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of 'likeness' is meant to be narrowly squeezed."[575]

7.330 The Panel finds that imported cigarettes can generally be considered as like products to domestic Dominican Republic cigarettes within the meaning of the first sentence of Article III:2 of the GATT. Indeed, the available evidence demonstrates that both imported and domestic cigarettes have similar physical properties; they are made from similar materials; have a similar presentation; they have the same end-use (i.e. they are smoked by consumers); and they are classified under the same tariff heading 2402.20.00.

7.331 However, for the purpose of the analysis within the first sentence of Article III:2 of the GATT, a narrowly construed interpretation of the likeness requirement, would require the Panel to additionally consider the fact that, within the general product description, cigarettes are presented to consumers distinguished by brands. Under the identification of these brands, cigarettes compete within specific price segments against each other. The distinction between different price segments may be particularly important for the analysis under Article III:2 of the GATT, since the Selective Consumption Tax was applied on an *ad valorem* basis, i.e. was related to the price of the product.

7.332 The Dominican Republic has argued that its tax authorities determined that the nearest similar cigarettes to the imported *Viceroy* in the domestic market were those distinguished with the brand *Marlboro*, and not *Líder*. This argument would be equivalent to expressing that imported *Viceroy* cigarettes were not similar to domestic *Líder*, but rather to domestic cigarettes *Marlboro*. The Dominican Republic justified this determination by arguing that its custom authorities considered that the *Viceroy* cigarettes were similar in quality to domestic higher-priced *Marlboro* and *Kent*, and not to the lower-priced *Líder*, since the declared customs value of *Viceroy* cigarettes was higher than the price of *Líder* and even of *Marlboro* and *Kent.* In the Dominican Republic's opinion, prices of

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[574] Appellate Body Report, *Canada – Periodicals*, pp. 22-23.
[575] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21.

cigarettes are a function of their quality and therefore the higher-priced *Viceroy* cigarettes were not similar to *Líder*. In the words of the Dominican Republic, "[t]he declared customs value of the imported cigarettes was... a factor used by the authorities of the Dominican Republic to compare the domestic and the imported cigarettes and determine which was the most similar product to the imported cigarettes in the domestic market..."[576]

7.333 The Panel agrees with the Dominican Republic that quality is an important factor in the determination of the likeness of products. However, it does not think that values declared by importers for customs purposes can be the only factor used in order to determine the quality of a product. The Dominican Republic admits that the imported *Viceroy* cigarettes had the same retail selling price as the domestic *Líder* cigarettes. The Panel believes that, if prices of a product are to be considered as a function of their quality, then the actual price of the product in the marketplace should be in principle more relevant than the value declared in customs.

7.334 The Dominican Republic has argued that the pricing policies of the importer were "inconsistent and incongruous", but it has not presented any evidence of reasons why the retail selling price of *Viceroy* cigarettes should have been disregarded for the determination of the likeness of the product, other than the fact that the price did not match with the value declared in customs. There is no evidence either to support the Dominican Republic's argument that the pricing policy for *Viceroy* cigarettes is an anti-competitive practice on the part of the importer.

7.335 In light of the above, the Panel does not find that the possible discrepancy between the retail selling price information and the declared customs value for *Viceroy* cigarettes is *per se* a factor that indicates that the retail selling price is irrelevant as a factor to determine the likeness of those imported cigarettes to the domestic products.

7.336 In conclusion, the Panel finds that imported cigarettes can generally be considered as like products to domestic Dominican Republic cigarettes within the meaning of the first sentence of Article III:2 of the GATT. When analysing the application of the Selective Consumption Tax, the Panel will consider as products "alike" to the imported cigarettes, those domestic cigarettes that were sold at a similar price and, more specifically, will consider that *Viceroy* cigarettes imported in the Dominican Republic are alike to domestic *Líder* cigarettes.

(d) The application of the Selective Consumption Tax to imported cigarettes

7.337 The Panel will begin by considering the Dominican Republic's argument that the amendments incorporated into the Dominican Republic legislation through Law 3-04 would prevent the Panel from making findings or issuing recommendations regarding the application of the Selective Consumption Tax to certain imported cigarettes. Only if the Panel decides to disregard that argument, would it then move to consider the substantive claims raised by Honduras in the sense that the Dominican Republic taxed imported cigarettes in excess of the like domestic products in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

(e) Amendments to the Dominican Republic Tax Code

7.338 The Dominican Republic does not rebut the substance of Honduras's claims regarding the application of the Selective Consumption Tax to certain imported cigarettes. Its main response has been that those claims are moot, since they are based on an outdated version of Article 367 of the Tax Code of the Dominican Republic.

7.339 From the available evidence, the Panel is aware that, on 14 January 2004, Law 3-04 which amended Articles 367 and 375 of the Tax Code, was published in the Dominican Republic Official

[576] Dominican Republic, Reply to Questions 151-156 from the Panel, 14 July 2004, para. 51.

Gazette (*Gaceta Oficial*). As a result of the amendments, a specific and identical tax base and tax rate were established for the Selective Consumption Tax on imported and domestic cigarettes – i.e. RD$0.48 per cigarette. The Dominican Republic has also indicated that the amendments introduced by Law 3-04 entered into force on 15 January 2004, the day following the publication of the Law, in accordance with Article 1 of the Dominican Republic Civil Code.

7.340 The Panel notes that the entry into force of the amendments incorporated to the Dominican Republic Tax Code occurred after 9 January 2004, date of the establishment of the Panel.

7.341 The Panel believes that the fact that the Dominican Republic Tax Code was modified does not automatically mean that the Panel should abstain from analysing Honduras's claims regarding the application of the Selective Consumption Tax to certain imported cigarettes. Indeed, the Panel will consider whether the amendments incorporated to the measure by the Dominican Republic prevent it from making findings on Honduras's claims in this regard.

7.342 Some previous panels have refrained from making findings on measures terminated before the establishment of those panels.[577] In the *Argentina – Textiles and Apparel* case, the panel declined to rule on a measure that was "revoked before the Panel was established and its term of reference set, i.e. before the Panel started its adjudication process"[578], even though the measure was included in that panel's terms of reference. The *Argentina – Textiles and Apparel* panel cited to that effect the statement of the Appellate Body that the aim of dispute settlement is not:

> "to encourage either panels or the Appellate Body to 'make law' by clarifying existing provisions of the WTO Agreement outside the context of resolving a particular dispute. A panel need only address those claims which must be addressed in order to resolve the matter in issue in the dispute'."[579]

7.343 In the present case, however, the amendments to the measure did not occur before, but after the date of the establishment of the Panel (9 January 2004). Indeed, the Dominican Republic has informed the Panel that Law 3-04 entered into force on 15 January 2004, that is after the terms of reference of the Panel had been approved by the WTO Dispute Settlement Body. Under those terms of reference, in the light of its duties contained in Article 11 of the Dispute Settlement Understanding, and in the absence of an agreement from the parties to terminate the proceedings as regards this contested measure, the Panel considers that it would be inappropriate to abstain from making findings with respect to the application of the Selective Consumption Tax to certain imported cigarettes. Indeed, several panels have reached a similar conclusion, when examining measures terminated before or during the panel process.[580]

7.344 For these reasons, the Panel does not find that the amendments incorporated by the Dominican Republic to Articles 367 and 375 of the Tax Code, through Law 3-04, prevent it from making findings on Honduras's claims with respect to the application of the Selective Consumption Tax to certain imported cigarettes.

(f) Determination of the tax base for cigarettes under Dominican Republic legislation

7.345 Since the Panel has decided not to abstain from making findings with respect to the application of the Selective Consumption Tax, it will now look at Honduras's claims with respect to

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[577] See, for example, Panel report, *US – Gasoline*, and Panel Report, *Argentina – Textiles and Apparel*.
[578] Panel report, *Argentina – Textiles and Apparel*, para. 6.13.
[579] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19.
[580] See, for example, Panel Report, *US – Certain EC Products*; Panel Report, *US – Wool Shirts and Blouses*; Panel Report, *Indonesia – Autos*; Panel Report, *Chile – Price Band System*; and, Panel Report, *Canada – Wheat Exports and Grain Imports*.

the Dominican Republic legislation, before Law 3-04 entered into force, to find whether that legislation subjected imported cigarettes to a Selective Consumption Tax in excess of that applied to like domestic products.

7.346 The Panel recalls that the Appellate Body has established a strict standard for the term "in excess of" under Article III:2, first sentence:

> "The only remaining issue under Article III:2, first sentence, is whether the taxes on imported products are 'in excess of' those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. Even the smallest amount of 'excess' is too much. 'The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard.' "[581]

7.347 Before Law 3-04, the Selective Consumption Tax on cigarettes in the Dominican Republic was imposed on an *ad valorem* basis. In an *ad valorem* system, the payable tax at any given time is a function of the tax rate and of the tax base. Honduras has not presented a claim against the rate at which the Selective Consumption Tax was charged on cigarettes. Instead, Honduras claims that, under the rules in force before Law 3-04, the Dominican Republic determined the tax base for cigarettes in a manner that resulted in certain imported cigarettes being taxed at a rate higher than the one that corresponded according to their actual selling price.

7.348 As mentioned[582], under the Dominican Republic legislation, there were three different rules under which the tax base for cigarettes could be determined by the authorities, for the purpose of applying the Selective Consumption Tax. The general rule was contained in Article 367(b) of the Dominican Republic Tax Code. Under this rule, the tax base for domestic cigarettes was the retail selling price obtained from average-price surveys conducted by the Dominican Republic Central Bank, whereas the tax base for imported cigarettes was the retail price used for the nearest similar product on the domestic market, that is to say the closest substitute. This rule created two different methods to calculate the tax base, one applicable to domestic cigarettes and one applicable to imported cigarettes.

7.349 Decree 79-03 contained the Regulation on the Implementation of Section IV of the Dominican Republic Tax Code. Under Article 3 of the Decree 79-03, the tax base for both domestic and imported cigarettes was calculated on the basis of the average market price according to the Central Bank's survey, however for new tobacco products not appearing in the survey on which the retail sale price was determined, the tax base was the price of the nearest like product in the local market. As was the case in the rule contained in Article 367(b) of the Dominican Republic Tax Code, Article 3 of the Decree 79-03 created two different methods to calculate the tax base. However, the methods were not dependent on whether cigarettes were domestic or imported, but rather on whether the cigarettes had appeared in the survey on which the retail sale price was determined.

7.350 Finally, General Rule 02-96 issued by the Directorate General of Internal Taxes of the Dominican Republic contains special regulations for the determination of the tax base for the Selective Consumption Tax on alcohol, beer and tobacco products. According to Article I of General Rule 02-96, the tax base of tobacco products would be the retail price, determined by increasing the list price (excluding cash and trade discounts, grants and the like) by 20 per cent. There was only one method to calculate the tax base of cigarettes and no distinction between domestic or imported products.

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[581] Appellate Body Report, *Japan – Alcoholic Beverages II*, p.23. See also, Panel Report, *Argentina – Hides and Leather*, para. 11.243.

[582] See *supra* Paragraph 7.318

7.351 As regards the legislation, the Panel finds that only Article 367(b) of the Dominican Republic Tax Code created any distinction in the treatment between domestic and imported cigarettes. That treatment, however, did not lead *per se* to imported cigarettes being subject to internal taxes in excess of those applied to like domestic cigarettes. It only meant that, while the tax base for domestic cigarettes would be the retail selling price obtained from the average-price surveys, the tax base for imported cigarettes would be determined on the basis of the retail price for the nearest similar product (closest substitute) on the domestic market. There is no reason to presume that the determination of the nearest similar product would lead to imported cigarettes being charged a tax in excess to that applied to domestic cigarettes.

7.352 Furthermore, the Panel assumes that the rules contained in the Dominican Republic Tax Code would have been interpreted in the light of the implementing regulations, such as those contained in the Decree 79-03 - Regulation on the Implementation of Section IV of the Dominican Republic Tax Code and in General Rule 02-96 issued by the Directorate General of Internal Taxes. Under the regulations implementing the Tax Code, the tax base would only be determined on the price of the nearest like product in the local market in the case of new tobacco products not appearing in the respective survey. Neither these regulations, nor General Rule 02-96, distinguished between imported and domestic cigarettes. The Dominican Republic has furthermore declared that the method actually applied for the determination of the tax base of cigarettes was the one contained in General Rule 02-96.

7.353 In light of the above, the Panel finds no evidence that the Dominican Republic legislation for the determination of the base for the Selective Consumption Tax, before the entry into force of Law 3-04, subjected imported cigarettes to internal taxes in excess of those applied to like domestic products.

(g) Determination in practice of the tax base for cigarettes

7.354 The Panel will now turn to the question of whether, in practice and before Law 3-04 entered into force, the Dominican Republic authorities have taxed lower-priced imported cigarettes at a rate higher than the one which would have corresponded according to their actual selling price, which has meant that those imported cigarettes have been subject to taxes in excess of those applied to the like domestic products.

7.355 Honduras argues that the Dominican Republic taxed domestic cigarettes based on the average retail selling price of each brand, as provided in a survey of the average prices conducted by the Central Bank whereas, by contrast, the tax base for imported cigarettes was calculated on the value of the "nearest similar product on the domestic market." Honduras concludes that this difference in approach resulted in certain lower-priced imported cigarettes being taxed at a rate higher than the one which would have corresponded according to their actual selling price and, in consequence, at a rate that was higher than the rate for the like domestic products, which sold for the same retail selling price.

7.356 The Dominican Republic does not dispute the fact that certain imported cigarettes have been taxed at a rate higher than would have corresponded according to their selling price and, in consequence, at a rate that was higher than the rate imposed on the domestic products which sold for the same retail selling price. The Dominican Republic argues, however, that the situation occurred because its tax authorities considered that the retail selling price information provided by the importer was not reliable and decided that the nearest similar cigarettes to the imported ones were from a domestic brand that sold at a different selling price.

7.357 According to the available evidence, during the year 2003, the retail selling prices for imported cigarettes under the brand *Viceroy* and domestic cigarettes under the brand *Líder* were the

same, i.e. RD$18 per packet.[583] However, these cigarettes were not taxed on the same basis. While each packet of *Viceroy* cigarettes paid RD$6.54 in Selective Consumption Tax, a packet of *Líder* only paid RD$5.34. That means that, while the actual tax burden for *Viceroy* cigarettes was 36.33 per cent of its retail selling price, for *Líder* it was 29.66 per cent.

7.358 In light of the preceding considerations, the Panel concludes that there is evidence to indicate that, during the year 2003, the Dominican Republic authorities imposed the Selective Consumption Tax on certain imported cigarettes in excess to the rates applied on the like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT.

(h) Recommendations regarding the measure found to be inconsistent

7.359 As it has concluded that the Dominican Republic has acted in a manner inconsistent with Article III:2, first sentence, the Panel will consider if it should make any recommendations to the WTO Dispute Settlement Body regarding whether the Dominican Republic should bring its measures into conformity with its obligations under the GATT 1994.

7.360 In this regard, the Panel recalls that, as of 14 January 2004, Law 3-04 amended Articles 367 and 375 of the Dominican Republic Tax Code. As a result of the amendments, the *ad valorem* system previously in force for the application of the Selective Consumption Tax was replaced by a specific and identical tax base and tax rate on imported and domestic cigarettes.

7.361 The measure contested by Honduras, and found by the Panel to be inconsistent with Article III:2, first sentence of the GATT, relates to the determination of the tax base for imported cigarettes and was only relevant when the Selective Consumption Tax was charged on an *ad valorem* basis. Indeed, the amendments incorporated by the Dominican Republic in its Tax Code change the essence of the measure challenged by Honduras. Under the new legislation, the Selective Consumption Tax on cigarettes is not levied on an *ad valorem* basis, but on a specific amount (RD$0.48 per cigarette), without distinguishing between imported and domestic cigarettes. The new law would prevent the situation under which certain imported cigarettes were taxed at a higher rate than the like domestic products.

7.362 In conclusion, the Panel clarifies that its findings in relation with the determination of the tax base for the application of the Selective Consumption Tax to certain imported cigarettes refer to the Dominican Republic Tax Code before it was amended by Law 3-04 of January 2004. The amendments enacted through Law 3-04 have changed the essence of the regulations used to determine the tax base for the Selective Consumption Tax on cigarettes from that of the challenged measure. The new legislation falls outside of the terms of reference of the Panel.

7.363 Since the measure, as analysed by the Panel, is no longer in force, the Panel does not find it appropriate to recommend to the WTO Dispute Settlement Body that it make any request to the Dominican Republic regarding this measure.

3. Conclusion

7.364 For the reasons indicated above, the Panel's overall conclusion is that, during the year 2003, the Dominican Republic imposed in practice a Selective Consumption Tax on certain imported cigarettes in excess of the rates applied to the like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

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[583] See price information provided by the parties. First written submission of Honduras, 16 March 2004, p. 12. Attestations of the retail selling price for cigarettes with the brand *Viceroy* and copy of an invoice for cigarettes with the brand *Líder*, provided by Honduras as Exhibit HOND-9. Retail selling price by name brand of cigarettes (2003), provided by the Dominican Republic as Exhibit DR-34.

H. ADMINISTRATION OF PROVISIONS GOVERNING THE SELECTIVE CONSUMPTION TAX, IN PARTICULAR WITH RESPECT TO DETERMINATION OF THE "NEAREST SIMILAR PRODUCT ON THE DOMESTIC MARKET"

1. The conduct at issue

7.365 As explained above, the Dominican Republic levies a Selective Consumption Tax on certain products, such as tobacco cigarettes. By the date of establishment of the Panel, and before the Dominican Republic Tax Code was amended through Law 3-04 of January 2004, the Selective Consumption Tax was charged on cigarettes at a 50 per cent *ad valorem* rate.

7.366 Before the amendments to the Tax Code, the Dominican Republic legislation contained three different rules under which the tax base for cigarettes could have been determined by the authorities, for the purpose of applying the Selective Consumption Tax: (i) Under the rule contained in Article 367(b) of the Dominican Republic Tax Code, the tax base for domestic cigarettes would be the retail selling price obtained from average-price surveys conducted by the Dominican Republic Central Bank, whereas the tax base for imported cigarettes would be the retail price used for the nearest similar product on the domestic market, that is to say the closest substitute; (ii) Under Article 3 of the Decree 79-03 (Regulation on the Implementation of Section IV of the Tax Code), the tax base for both domestic and imported cigarettes would be calculated on the basis of the average market price according to the Central Bank's survey, however for new tobacco products not appearing in the survey on which the retail sale price was determined, the tax base would be the price of the nearest like product in the local market; or (iii) Under Article I of General Rule 02-96 issued by the Directorate General of Internal Taxes of the Dominican Republic, the tax base would be the retail price, determined by increasing the list price (excluding cash and trade discounts, grants and the like) by 20 per cent.

7.367 The determination of the nearest similar domestic product in the Dominican Republic market was important in order to apply the Selective Consumption Tax on imported cigarettes. Indeed, the determination of the "nearest similar product" was relevant for the imposition of the Selective Consumption Tax on imported cigarettes, at least under the rules contained in Article 367(b) of the Dominican Republic Tax Code and in Article 3 of Decree 79-03 (Regulation on the Implementation of Section IV of the Tax Code).

7.368 However, neither Article 367(b) of the Tax Code, nor Article 3 of the Regulation 79-03, nor Article I of the General Rule 02-96, contained any rules on how the "nearest similar product" with respect to imported cigarettes would be determined.

7.369 Honduras's claim in this regard is that the Dominican Republic failed to establish and apply transparent and generally applicable criteria for determining the value of imported cigarettes and, in particular, failed to establish and apply such criteria for the identification of the "nearest similar" product in the domestic market. The measure at issue is thus an alleged omissive conduct on the part of the Dominican Republic.

2. Whether the Dominican Republic administered the provisions governing the Selective Consumption Tax in an unreasonable manner

(a) Arguments of the parties

7.370 Honduras claims that, in the absence of rules, the Dominican Republic authorities had wide scope to determine the "nearest similar product" for the purpose of applying the Selective Consumption Tax on imported cigarettes. According to Honduras, the Dominican Republic authorities administered the provisions governing the Selective Consumption Tax in a manner that is not reasonable; in particular, with respect to determination of the "nearest similar product on the

domestic market". Honduras submits that there is no adequate reason for the Dominican Republic to have disregarded the actual retail selling price of domestic *Líder* cigarettes when determining the tax base for imported *Viceroy* cigarettes. As stated above, both *Viceroy* and *Líder* have the same retail selling price. Honduras concludes that the failure to establish and apply transparent and generally applicable criteria for determining the value of imported cigarettes, in particular the failure to establish and apply such criteria for the identification of the "nearest similar" product in the domestic market, constitutes an unreasonable administration of the provisions governing the Selective Consumption Tax and is inconsistent with Article X:3(a) of the GATT.

7.371 The Dominican Republic replies that Honduras's claim is moot, since it is based on an outdated version of Article 367 of the Tax Code of the Dominican Republic. Law 3-04, published on 14 January 2004, amended Articles 367 and 375 of the Tax Code and established a specific and identical tax base and tax rate for the Selective Consumption Tax on imported and domestic cigarettes – i.e. RD$0.48 per cigarette. The determination of the "nearest similar product" is no longer relevant for determining the tax base of the Selective Consumption Tax. Rather, the tax base is now determined on the basis of the number of cigarette packets transferred or imported. The Panel should abstain from making findings or issuing recommendations to the WTO Dispute Settlement Body, regarding laws and practices of the Dominican Republic that have been withdrawn, because a recommendation in these circumstances would constitute a legal error and would be devoid of purpose, because there is no evidence that the measures are still in place or have lingering effects, because the measures were revoked before the Panel began its adjudication process and because there is no evidence that the Dominican Republic will reintroduce the withdrawn measures.

(b) Analysis by the Panel

7.372 Under Article X:3(a) of the GATT 1994:

> "Each [Member] shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article."

7.373 In turn, the "laws, regulations, decisions and rulings" described in paragraph 1 of Article X are as follows:

> "Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any [Member], pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use."

7.374 The Appellate Body has clarified that Article X deals with "the *publication* and *administration* of 'laws, regulations, judicial decisions and administrative rulings of general application', rather than [with] the *substantive content* of such measures".[584]

7.375 In order to analyse the claim presented by Honduras under Article X:3(a) of the GATT, the Panel would have to determine: (a) whether the provisions governing the Selective Consumption Tax are part of the "laws, regulations, decisions and rulings" of the kind described in Article X:1 of the GATT; and, if so, (b) whether the Dominican Republic has not administered those provisions in a uniform, impartial and reasonable manner, in particular with respect to determination of the "nearest similar product on the domestic market".

[584] Appellate Body Report, *EC – Poultry*, para. 115.

(c) Laws, regulations, decisions and rulings described in Article X:1 of the GATT

7.376 The relevant provisions as regard the claim raised by Honduras are those contained in Article 367(b) of the Dominican Republic Tax Code, in Article 3 of the Decree 79-03 and in Article I of General Rule 02-96. Al of these provisions relate to the application of the Selective Consumption Tax.

7.377 The Panel finds that these provisions can be considered to be covered by the description contained in Article X:1 of the GATT. They are indeed: (a) laws or regulations, (b) made effective by the Dominican Republic, and, (c) pertaining to rates of taxes.

(d) Reasonable administration

7.378 Honduras's claim centres on an alleged omissive conduct on the part of the Dominican Republic, constituted by its failure to comply with a positive obligation, that of administering its laws and regulations, of the kind described in Article X:1, in a uniform, impartial and reasonable manner.

7.379 The Panel agrees that a Member may act in a manner inconsistent with its obligations under the covered WTO agreements, not only by adopting a particular positive conduct, but also by failing to adopt a conduct, i.e. by an omission, when the relevant rule imposes an obligation to adopt a specific action.

7.380 The Dominican Republic has admitted that, before the approval of Law 3-04, there were three different provisions under which the tax base for cigarettes could have been determined, for the purpose of applying the Selective Consumption Tax, namely: Article 367(b) of the Tax Code, Article 3 of the Decree 79-03 and Article I of General Rule 02-96.[585] Each one of these provisions contained a different methodology for the determination of the tax base.

7.381 Despite the existence of these three different provisions, the Dominican Republic has declared that, in practice, the methodology used prior to Law 3-04, to determine the tax base for the Selective Consumption Tax on domestic cigarettes, followed General Rule 2-96.[586] Under General Rule 2-96, the tax base should have been, for both imported and domestic cigarettes, the retail price determined by increasing the list price (excluding cash and trade discounts, grants and the like) by 20 per cent. General Rule 2-96 made no distinction between imported and domestic cigarettes. The Selective Consumption Tax on both imported and domestic cigarettes would be based on their respective retail selling price. General Rule did not contemplate the possibility of using a "nearest similar product" in the domestic market, in order to determine the tax base on imported cigarettes.

7.382 However, the available evidence and the Dominican Republic's own admission is that its authorities used a different methodology in order to determine the tax base for imported cigarettes. According to the Dominican Republic, "[t]he amount of the Selective Consumption Tax per cigarette packet that was applied to the imported product was equal to the amount of the tax that applied to the domestic cigarette".[587] The Dominican Republic thus admits that it used a "nearest similar product" in the domestic market in order to determine the tax base for imported cigarettes. While both Article 367(b) of the Tax Code and Article 3 of the Decree 79-03 would allow for the use of a "nearest similar product", the Dominican Republic has not argued that it relied on either of these provisions. Indeed, the methodologies contained in both Article 367(b) of the Tax Code and Article 3 of the Decree 79-03 were based on average-price surveys conducted by the Dominican Republic Central Bank. The Dominican Republic has admitted that it had never issued such surveys, "due to

[585] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 97, para. 121.
[586] Ibid., reply to question No. 98, para. 122.
[587] Ibid.

the unbridled inflation unleashed by the macroeconomic crisis experienced by the Dominican Republic in recent years".[588]

7.383 Under Article X:3(a) of the GATT, Members must administer the provisions described in Article X:1 "in a uniform, impartial and reasonable manner". Honduras's claim is that the Dominican Republic administered the provisions governing the Selective Consumption Tax in an unreasonable manner. The Panel considers that the obligation under Article X:3(a) of the GATT is that Members administer the provisions covered by that Article in a uniform manner, in an impartial manner, and in a reasonable manner. These are not cumulative requirements. A member may thus act in a breach of its obligations under Article X:3(a) of the GATT, if it administers the provisions in an unreasonable manner, even if there is no evidence that that Member has also administered the provisions in a non-uniform manner or in a partialized manner. The Panel will thus limit its analysis to Honduras's claim, that is, whether the Dominican Republic administered the provisions in an unreasonable manner.

7.384 The Panel recalls furthermore that the reasonableness required by Article X:3(a) does not refer to the laws and regulations, but to the administration of those laws and regulations.

7.385 Read in the context of Article X, which is entitled "Publication and Administration of Trade Regulations", the ordinary meaning of the word "reasonable", refers to notions such as "in accordance with reason", not irrational or absurd", "proportionate", "having sound judgement", "sensible", "not asking for too much", "within the limits of reason, not greatly less or more than might be thought likely or appropriate", "articulate".[589]

7.386 In the present case, the requirement of reasonableness, turns on the question of whether it may be considered reasonable that the Dominican Republic administered the provisions governing the Selective Consumption Tax, in particular with respect to the determination of the tax base for the application of the tax on cigarettes, and the use in this regard of the "nearest similar product on the domestic market", in a manner that was not clearly supported by any particular rule in force at the time.

7.387 By its own admission,[590] it is clear that the Dominican Republic did not clearly support its determination of the tax base for the application of the Selective Consumption Tax on imported cigarettes on any one of the three methodologies contained in the legislation in force at the time. Furthermore, the Dominican Republic authorities disregarded the actual retail selling price of cigarettes to determine the "nearest similar product on the domestic market". The Dominican Republic has argued that the decision to disregard the retail selling price was taken based on the value declared at customs by the importer. In its own words, "[t]he authorities of the Dominican Republic relied on several factors, including the declared customs value of the imported cigarettes, whenever there was evidence that the pricing policies of the importer alone could not be relied on to determine the nearest similar product in the domestic market".[591] However, there is no evidence that the decision was based on any particular provision of the Dominican Republic law in force at the time. Indeed, the Dominican Republic legislation does not appear to grant discretion to the authorities to deviate from the methods described, nor does it grant discretion to disregard retail selling prices and to favour customs-declared values. There is furthermore no evidence that the Dominican Republic authorities notified the importers about the alleged discrepancy between the customs value and the selling price information, nor about the motivation for its decision to disregard retail selling prices.

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[588] Ibid., reply to question No. 104, para. 129.

[589] *The New Shorter Oxford English Dictionary*, *supra* note 52, Vol. II, p. 2,496.

[590] See Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 100, para. 124-125.

[591] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 103, para. 128.

7.388 The Panel thus finds that the manner in which the Dominican Republic administered the provisions governing the Selective Consumption Tax, in particular with respect to the determination of the tax base for the application of the tax on cigarettes, and the use in this regard of the "nearest similar product on the domestic market", was unreasonable. The fact that the Dominican Republic authorities did not support its decisions regarding the determination of the tax base for imported cigarettes by resorting to the rules in force at the time and that they decided to disregard retail selling prices of imported cigarettes, is not "in accordance with reason", "having sound judgement", "sensible", "within the limits of reason", nor "articulate".

(e) Recommendations regarding the conduct

7.389 As it has concluded that the Dominican Republic acted in an unreasonable manner, the Panel will consider if it should make any recommendations to the WTO Dispute Settlement Body regarding whether the Dominican Republic should bring its conduct in conformity with its obligations under the GATT 1994.

7.390 In this regard, the Panel notes that this claim, too, is based on the situation that existed in the Dominican Republic before Law 3-04 amended Articles 367 and 375 of the Dominican Republic Tax Code. As a result of the amendments, the *ad valorem* system previously in force for the application of the Selective Consumption Tax was replaced by a specific and identical tax base and tax rate on imported and domestic cigarettes.

7.391 The conduct contested by Honduras relates to the determination of the tax base for imported cigarettes and was only relevant when the Selective Consumption Tax was charged on an *ad valorem* basis. Indeed, the amendments incorporated by the Dominican Republic in its Tax Code change the essence of the measure challenged by Honduras under this claim, too. Under the new legislation, the Selective Consumption Tax on cigarettes is not levied on an *ad valorem* basis, but on a specific amount (RD$0.48 per cigarette), without distinguishing between imported and domestic cigarettes. The new law would prevent the situation under which the Dominican Republic authorities determined the tax base for the application of the tax on cigarettes and used a "nearest similar product on the domestic market".

7.392 In conclusion, the Panel clarifies that its findings in relation with the unreasonable administration of the provisions governing the Selective Consumption Tax refer to the situation that existed before the Dominican Republic Tax Code was amended by Law 3-04 of January 2004.

7.393 Since the conduct, as analysed by the Panel, no longer persists, the Panel does not find it appropriate to recommend to the WTO Dispute Settlement Body that it make any request to the Dominican Republic regarding this conduct.

3. Conclusion

7.394 In conclusion, the Panel finds that the Dominican Republic administered the provisions governing the Selective Consumption Tax, in particular with respect to the determination of the tax base for the application of the tax on cigarettes, and the use in this regard of the "nearest similar product on the domestic market", in a manner that was unreasonable and therefore inconsistent with Article X:3(a) of the GATT 1994.

I. PUBLICATION OF SURVEYS USED TO DETERMINE THE VALUE OF CIGARETTES FOR THE PURPOSE OF APPLYING THE SELECTIVE CONSUMPTION TAX

1. The conduct at issue

7.395 As explained above[592], under the Dominican Republic legislation, before the Tax Code was amended through Law 3-04 of January 2004, the base for the application of the Selective Consumption Tax on cigarettes was to be established through average-price surveys conducted by the Dominican Republic Central Bank. Indeed, Article 367(b) of the Dominican Republic Tax Code established that the tax base for domestic cigarettes was the retail selling price obtained from average-price surveys conducted by the Dominican Republic Central Bank, whereas the tax base for imported cigarettes was the retail price used for the nearest similar product on the domestic market, that is to say the closest substitute. Both the tax base of domestic and imported cigarettes would thus ultimately be based on these average-price surveys. Article 3 of Decree 79-03 stated that the tax base for both domestic and imported cigarettes was to be calculated on the basis of the average market price according to the Central Bank's survey.

7.396 Honduras's claim in this regard is that the Dominican Republic failed to publish, or make otherwise available to importers, any of these surveys. The measure at issue is thus an alleged omissive conduct on the part of the Dominican Republic.

2. Whether the Dominican Republic failed to publish, or make otherwise available to importers, the average-price surveys conducted by the Dominican Republic Central Bank

(a) Arguments of the parties

7.397 Honduras claims that the Dominican Republic failed to publish, or make otherwise available to importers, the average-price surveys of cigarettes conducted by the Dominican Republic Central Bank. These surveys were to be used to determine the retail selling price for cigarettes and thus to determine the tax base for the application of the Selective Consumption Tax on cigarettes. Honduras therefore argues that the information contained in the surveys was of critical importance to traders. As a result of the failure to publish these surveys, traders were not apprised of the basis upon which their products would be taxed. Honduras concludes that the failure to publish, or make otherwise available to importers, the average-price surveys is inconsistent with Article X:1 of the GATT.

7.398 The Dominican Republic replies that Honduras's claim is moot, since it is based on an outdated version of Article 367 of the Tax Code of the Dominican Republic. Law 3-04, published on 14 January 2004, amended Articles 367 and 375 of the Tax Code and established a specific and identical tax base and tax rate for the Selective Consumption Tax on imported and domestic cigarettes – i.e. RD$0.48 per cigarette. The Central Bank average-price surveys of cigarettes are no longer relevant for determining the tax base of the Selective Consumption Tax. Rather, the tax base is now determined on the basis of the number of cigarette packets transferred or imported. The Dominican Republic adds that it had never issued such surveys, nor relied on them to determine the tax base on cigarettes, due to the inflation experienced by the Dominican Republic in recent years.[593] In its opinion, the Panel should abstain from making findings or issuing recommendations to the WTO Dispute Settlement Body, regarding the publication of the Central Bank average-price surveys, because a recommendation in these circumstances would constitute a legal error and would be devoid of purpose.

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[592] See *supra* Paragraph 7.318

[593] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 104, para. 129.

(b) Analysis of the Panel

7.399 Under Article X:1 of the GATT 1994:

> "Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any [Member], pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them."

7.400 As mentioned before, the Appellate Body has clarified that Article X deals with "the *publication* and *administration* of 'laws, regulations, judicial decisions and administrative rulings of general application', rather than [with] the *substantive content* of such measures".[594]

7.401 In order to analyse the claim presented by Honduras under Article X:3(a) of the GATT, the Panel would have to determine: (a) whether the average-price surveys of cigarettes conducted by the Dominican Republic Central Bank are part of the "laws, regulations, judicial decisions and administrative rulings of general application" of the kind described in Article X:1 of the GATT; and, if so, (b) whether the Dominican Republic did not promptly publish those surveys in such a manner as to enable governments and traders to become acquainted with them.

(c) Laws, regulations, judicial decisions and administrative rulings of general application

7.402 Honduras has argued that the Dominican Republic's Central Bank average-price surveys of cigarettes are part of the regulations or administrative rulings of general application pertaining to the determination of the Selective Consumption Tax. Therefore, in its view, the survey is a component of the legislation on the Selective Consumption Tax, covered by Article X:1 of the GATT.

7.403 The Dominican Republic has responded that the surveys were not a law, a regulation, a judicial decision, nor an administrative ruling. In its opinion, the surveys are therefore outside of the scope of Article X of the GATT.

7.404 The Panel considers that the average-price surveys of cigarettes conducted by the Dominican Republic Central Bank would clearly not be either laws, regulations or judicial decisions. Laws and regulations are general acts with a legal content issued by state authorities invested with normative powers. Judicial decisions are pronouncements with the force of *res judicata* issued by judicial authorities as a result of a legal process. The Central Bank surveys would not fit in any of those categories.

7.405 Had the Central Bank average-price surveys been used, under the Dominican Republic legislation they would have provided the authorities with the tax base for the application of the Selective Consumption Tax on cigarettes. The Panel thus finds that, while the surveys may have not been, in themselves, administrative rulings of general application, they would constitute an essential element of an administrative ruling: the determination of the tax base for cigarettes.

7.406 In other words, the establishment of the tax base for cigarettes, and not the surveys in themselves, may be considered as an administrative ruling of general application. Once the Dominican Republic authorities had determined the tax base for cigarettes at a specific amount, that ruling would be applicable for the importation of all cigarettes within the description, until a new tax

[594] Appellate Body Report, *EC – Poultry*, para. 115.

base had been set. The Central Bank average-price surveys would be a part of the administrative ruling. Indeed, an essential part, since under the Dominican Republic legislation, the tax base for cigarettes would be obtained through the surveys.

7.407 In order to become acquainted with the process of establishing the tax base for the application of the Selective Consumption Tax on cigarettes, governments and traders would be entitled to obtain information on the results of the survey, as well as on the methodology used in order to conduct the survey.

7.408 In conclusion, the Panel finds that, under the Dominican Republic legislation before the Tax Code was amended through Law 3-04 of January 2004, the average-price surveys of cigarettes conducted by the Dominican Republic Central Bank were part of the administrative determination of the tax base for cigarettes, and as such were covered by the scope of "administrative rulings of general application" described in Article X:1 of the GATT.

(d) Prompt publication of the Central Bank average-price surveys

7.409 Honduras has claimed that the Dominican Republic failed to publish, or otherwise make available to importers, any of the average-price surveys of cigarettes. As a result, traders were not apprised of the basis upon which their products would be taxed.[595]

7.410 The Dominican Republic admits that the surveys were not published, nor made otherwise available, since they were never issued, nor relied on in order to determine the tax base on cigarettes. The Dominican Republic adds that, due to the high levels of inflation experienced in recent years, "the average retail prices in a survey by the Central Bank would have been an inadequate basis on which to determine the tax base of the Selective Consumption Tax, both for imported and domestic products".[596]

7.411 Honduras has responded that "[t]he fact that the country was experiencing high levels of inflation made the survey exercise all the more useful, and its publication necessary to make the taxpayers acquainted with the conditions under which the Selective Consumption Tax is applied".[597]

7.412 There is thus no controversy among the parties that the Central Bank average-price surveys of cigarettes were not published by the Dominican Republic. Indeed, Honduras has provided evidence that an importing firm requested the Dominican Republic authorities for a copy of the surveys.[598]

7.413 The Panel does not contest the Dominican Republic's argument that, in a high inflation situation, a survey of prices may provide an inadequate basis on which to determine the tax base of the Selective Consumption Tax. Even assuming that, however, the Panel notes that the average-price surveys were mandatorily required by the Dominican Republic legislation in order to determine the base for the application of the Selective Consumption Tax to cigarettes.

7.414 The Panel thus considers that, under its Article X:1 obligations, the Dominican Republic should have either published the information related to the Central Bank average-price surveys of cigarettes or, alternatively, publish its decision to not conduct these surveys and to resort to an alternative method, in such a manner as to enable governments and traders to become acquainted with the method it would use in order to determine the tax base for the Selective Consumption Tax on cigarettes.

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[595] First written submission of Honduras, 16 March 2004, paras. 30, 40, 108, and 110.

[596] Replies of the Dominican Republic to questions addressed by the Panel, reply to question No. 104, para. 129.

[597] Replies of Honduras to questions addressed by the Panel, reply to question No. 134.

[598] See information provided by the Dominican Republic as Exhibit HOND-17.

(e) Recommendations regarding the conduct at issue

7.415 As it has concluded that the Dominican Republic failed to publish the information related to the Central Bank average-price surveys of cigarettes, the Panel will consider if it should make any recommendations to the WTO Dispute Settlement Body regarding whether the Dominican Republic should bring its conduct in conformity with its obligations under the GATT 1994.

7.416 In this regard, the Panel notes that this claim is also based on the situation that existed in the Dominican Republic before Law 3-04 amended Articles 367 and 375 of the Dominican Republic Tax Code. As a result of the amendments, the *ad valorem* system previously in force for the application of the Selective Consumption Tax was replaced by a specific and identical tax base and tax rate on imported and domestic cigarettes.

7.417 The conduct contested by Honduras relates to the determination of the tax base for imported cigarettes and was only relevant when the Selective Consumption Tax was charged on an *ad valorem* basis. Indeed, the amendments incorporated by the Dominican Republic in its Tax Code change the essence of the measure challenged by Honduras through this claim, too. Under the new legislation, the Selective Consumption Tax on cigarettes is not levied on an *ad valorem* basis, but on a specific amount (RD$0.48 per cigarette), without distinguishing between imported and domestic cigarettes. The Central Bank average-price surveys of cigarettes would become irrelevant under the new law, as the means to determine the tax base for the application of the tax on cigarettes.

7.418 In conclusion, the Panel clarifies that its findings in relation with the publication of the information related to the Central Bank average-price surveys of cigarettes refer to the situation that existed before the Dominican Republic Tax Code was amended by Law 3-04 of January 2004.

7.419 Since the conduct, as analysed by the Panel, no longer persists, the Panel does not find it appropriate to recommend to the WTO Dispute Settlement Body that it make any request to the Dominican Republic in this regard.

3. Conclusion

7.420 In conclusion, the Panel finds that the Dominican Republic failed to publish promptly, and in such a manner as to enable governments and traders to become acquainted with it, the information related to the Central Bank average-price surveys of cigarettes. This conduct was inconsistent with the Dominican Republic's obligations under Article X:1 of the GATT 1994.

VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 The Panel concludes as follows:

(a) The Dominican Republic has recorded its Selective Consumption Tax measure into its Schedule but it has not established that such measure is in the nature of an "other duty or charge" within the meaning of Article II:1(b) of the GATT 1994. Therefore, the recording of this measure cannot be used to justify the consistency of the current ODC measures (i.e. the transitional surcharge for economic stabilization and the foreign exchange fee) with the provisions of Article II:1(b) of the GATT 1994;[599]

[599] See paras. 7.40 and 7.73.

(b) The transitional surcharge for economic stabilization applied by the Dominican Republic is an "other duty or charge" and such surcharge is inconsistent with the provisions of Article II:1(b) of the GATT 1994;[600]

(c) The foreign exchange fee applied by the Dominican Republic is an "other duty or charge" and such fee is inconsistent with the provisions of Article II:1(b) of the GATT 1994;[601]

(d) The inconsistency of the Dominican Republic's foreign exchange fee with the provisions of Article II:1(b) of the GATT 1994 cannot be justified under Article XV:9(a) of the GATT 1994 because such fee does not constitute an exchange restriction within the meaning of Article XV:9(a) and the Dominican Republic has not demonstrated that the fee is "in accordance with" the Articles of Agreement of the IMF;[602]

(e) The requirement by the Dominican Republic that a tax stamp be affixed to all cigarette packets in its territory and under the supervision of the local tax authorities is inconsistent with Article III:4 of the GATT 1994 and is not justified under Article XX, paragraph (d), of the GATT;[603] and,

(f) Honduras has failed to establish that the requirement by the Dominican Republic that importers and domestic producers of cigarettes must post a bond is inconsistent with Article XI:1 of the GATT 1994 or, alternatively, with Article III:4.[604]

8.2 The Panel recommends that the Dispute settlement Body request the Dominican Republic to bring these inconsistent measures as listed above into conformity with its obligations under the GATT 1994.

8.3 The Panel additionally concludes that, with relation to the situation existing at the time of the establishment of the Panel, and before Law 3-04 entered into force in the Dominican Republic:

(a) Honduras has failed to establish that the Dominican Republic legislation for the determination of the tax base for the Selective Consumption Tax, before the entry into force of Law 3-04, subjected imported cigarettes to internal taxes in excess of those applied to like domestic products;[605]

(b) During the year 2003, the Dominican Republic imposed the Selective Consumption Tax on certain imported cigarettes in excess of the rates applied to the like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994;[606]

(c) Before Law 3-04 entered in force in January 2004, the Dominican Republic administered the provisions governing the Selective Consumption Tax, in particular with respect to the determination of the tax base for the application of the tax on cigarettes, and the use in this regard of the "nearest similar product on the domestic

[600] See paras.7.25, 7.86 and 7.90.
[601] See paras. 7.115, 7.121 and 7.122.
[602] See paras. 7.145, 7.154 and 7.155.
[603] See paras. 7.198, 7.232 and 7.233.
[604] See paras. 7.265, 7.266, 7.311 and 7.316.
[605] See para 7.353.
[606] See paras. 7.358 and 7.364.

market", in a manner that was unreasonable and therefore inconsistent with Article X:3(a) of the GATT 1994;[607]

(d) Before Law 3-04 entered in force in January 2004, the Dominican Republic failed to publish the information related to the Central Bank average-price surveys of cigarettes, in a manner inconsistent with Article X:1 of the GATT 1994.[608]

With relation to the conclusions in the preceding paragraph, the Panel abstains from making any recommendations to the Dispute Settlement Body, since the measures are no longer in force.

[607] See paras. 7.388 and 7.394.
[608] See para. 7.420.

ANNEX A

REQUEST FOR THE ESTABLISHMENT OF A PANEL

WORLD TRADE ORGANIZATION

WT/DS302/5
9 December 2003

(03-6517)

Original: Spanish

DOMINICAN REPUBLIC – MEASURES AFFECTING THE IMPORTATION AND INTERNAL SALE OF CIGARETTES

Request for the Establishment of a Panel by Honduras

The following communication, dated 8 December 2003, from the Delegation of Honduras to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

On 8 October 2003, Honduras requested consultations with the Dominican Republic pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and Article XXII:1 of the General Agreement on Tariffs and Trade 1994 (the GATT) concerning certain measures by the Dominican Republic affecting the importation and internal sale of cigarettes. This request was circulated to Members on 13 October 2003 in Document WT/DS302/1, G/L/645. The Dominican Republic and Honduras held consultations in Geneva on 4 November 2003 with a view to reaching a mutually satisfactory solution to this issue. Unfortunately, the consultations failed to settle the dispute.

The specific measures at issue which are of concern to Honduras are the following:

1. The Dominican Republic applies special rules, procedures and administrative practices to determine the value of imported cigarettes for the purpose of applying the Selective Consumption Tax in accordance with Article 367 of its Tax Code, Article 3 of Decree 79-03 - Regulations Governing the Application of Title IV of the Tax Code (the Regulations), and Article I of General Rule 02-96. In certain instances the value of imported cigarettes is considered to be equal to the value of the "nearest similar" product in the domestic market. Honduras considers that these special rules, procedures and administrative practices discriminate against imported cigarettes and therefore violate Article III:2 and Article III:4 of the GATT. Honduras further considers that the failure to establish and apply transparent and generally applicable criteria for determining the value of imported cigarettes, in particular the failure to establish and apply such criteria for the identification of the "nearest similar" product in the domestic market, cannot be reconciled with the requirements set out in Article X:3(a) of the GATT.

2. The Dominican Republic does not publish the surveys conducted by the Central Bank that are to be used according to Article 367 of the Tax Code and Article 3 of the Regulations to determine the value of cigarettes for the purpose of applying the Selective Consumption Tax. Honduras considers that the failure to publish the surveys is inconsistent with Article X:1 of the GATT.

3. The Dominican Republic accords conditions of competition to imported cigarettes that are less favourable than those accorded to domestic cigarettes by requiring, pursuant to Article 37 of the Regulations, Articles 1-3 of Decree 130-02 and Article 3 of Law 858 as amended or corrected by Laws 190 and 368, that stamps be affixed to cigarette packages in the territory of the Dominican Republic. Honduras considers that this requirement and the related administrative practices violate Article III:4 of the GATT.

4. The Dominican Republic requires importers of cigarettes to post a bond pursuant to Article 14 of the Regulations. This requirement and the laws, regulations and practices implementing this requirement entail costs and administrative burdens hindering the importation of cigarettes and are therefore in the view of Honduras inconsistent with Article II:1(a) and (b) and Article XI:1 of the GATT, or - if they were deemed to be internal measures - inconsistent with Article III:2 and Article III:4 of the GATT.

5. The Dominican Republic levies a transitional surcharge for economic stabilization in accordance with Decrees 646-03 and 693-03, a surcharge which currently amounts to 2 per cent of the c.i.f. value of the imported goods. Honduras considers that the surcharge constitutes a charge imposed on or in connection with importation inconsistent with Article II:1(a) and (b) of the GATT.

6. The Dominican Republic levies a foreign exchange fee in accordance with the Seventeenth Resolution of the Monetary Board dated 24 January 1991 as amended, *inter alia*, by the First Resolution of 27 September 2001, the First Resolution of 20 August 2002, and the First Resolution of 22 October 2003. The fee is currently 10 per cent "calculated on the value of the imports". Honduras considers that this fee constitutes a charge imposed on or in connection with importation which does not meet the requirements laid down in Article II:1(a) and (b) of the GATT. Honduras also considers that the fee constitutes an exchange action frustrating the intent of the provisions of the GATT and that it is therefore inconsistent with Article XV:4 of the GATT.

In view of the above considerations, and in conformity with Articles 4.7 and 6 of the DSU and Article XXIII:2 of the GATT, Honduras hereby requests the Dispute Settlement Body to establish a Panel to examine the matters set forth above.

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ANNEX B

WORKING PROCEDURES

DOMINICAN REPUBLIC – MEASURES AFFECTING THE IMPORTATION AND INTERNAL SALE OF CIGARETTES (WT/DS302)

WORKING PROCEDURES FOR THE PANEL

1. In its proceedings the Panel shall follow the relevant provisions of the Dispute Settlement Understanding (DSU). In addition, the following working procedures shall apply.

2. The panel shall meet in closed session. The parties to the dispute, and interested third parties, shall be present at the meetings only when invited by the Panel to appear before it.

3. The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential. Where a party to a dispute submits confidential information to the Panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.

4. Before the first substantive meeting of the Panel with the parties, and in accordance with the timetable established for the process, the parties to the dispute shall transmit to the Panel written submissions in which they present the facts of the case and their arguments.

5. At its first substantive meeting with the parties, the Panel shall ask the party which has brought the complaint to present its case. Subsequently, at the same meeting, the party against which the complaint has been brought shall be asked to present its point of view.

6. All third parties which have notified their interest in the dispute to the Dispute Settlement Body shall be invited to present their views during a session of the first substantive meeting of the Panel set aside for that purpose. All such third parties may be present during the entirety of this session.

7. Formal rebuttals shall be made at a second substantive meeting of the Panel. The party complained against shall have the right to take the floor first, to be followed by the complaining party. The parties shall submit, prior to that meeting and in accordance with the timetable established for the process, written rebuttals to the Panel.

8. The Panel may at any time put questions to the parties and ask them for explanations either in the course of a meeting with the parties or in writing. Written replies to questions shall be submitted in accordance with the timetable established for the process or, if such were the case, at the date decided by the Panel.

9. The parties to the dispute and any third party invited to present its views shall make available to the Panel and the other party or parties a written version of their oral statements not later than the day after the conclusion of the meeting where the oral statement was presented.

10. In the interest of full transparency, the presentations, rebuttals and statements referred to in paragraphs 5 to 7 shall be made in the presence of the parties. Moreover, each party's written submissions, including responses to questions put by the Panel, comments on the descriptive part of the report and comments on the interim report, shall be made available to the other party or parties.

11. The parties' and third parties' replies to questions, and the parties' comments on each other's replies to questions will be attached to the Panel report as annexes.

12. The parties and third parties shall provide the Panel with an executive summary of the facts and arguments as presented to the Panel in their written submissions and oral presentations within 10 days following the delivery to the Panel of the written version of the relevant submission. The executive summaries of the written submissions to be provided by each party should not exceed 10 pages in length each and the executive summaries of the oral presentations should not exceed 5 pages in length each. The summary to be provided by each third party shall summarize their written submission and oral presentation, and should not exceed 5 pages in length. The executive summaries shall not in any way serve as a substitute for the submissions of the parties in the Panel's examination of the case. However, the Panel may incorporate the executive summaries provided by the parties and third parties in the arguments section of its report, subject to any modifications deemed appropriate by the Panel.

13. A party shall submit any request for a preliminary ruling not later than its first submission to the Panel. If the complaining party requests such a ruling, the respondent shall submit its response to the request in its first submission. If the respondent requests such a ruling, the complaining party shall submit its response to the request prior to the first substantive meeting of the Panel, at a time to be determined by the Panel in light of the request. Exceptions to this procedure may be granted by the Panel upon a showing of good cause.

14. Parties shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttal submissions or answers to questions. Exceptions to this procedure may be granted by the Panel upon a showing of good cause. In such cases, the other party shall be accorded a period of time for comment, as appropriate.

15. To facilitate the maintenance of the record of the dispute, and to maximize the clarity of submissions, in particular the references to exhibits submitted by parties, it is suggested that parties sequentially number their exhibits throughout the course of the dispute. For example, exhibits submitted by the Dominican Republic could be numbered DOM-1, DOM-2, etc. If the last exhibit in connection with the first submission was numbered DOM-5, the first exhibit of the next submission thus would be numbered DOM-6.

16. The parties to the dispute have the right to determine the composition of their own delegations. The parties shall have the responsibility for all members of their delegations and shall ensure that all members of the delegation act in accordance with the rules of the DSU and the Working Procedures of this Panel, particularly in regard to confidentiality of the proceedings.

17. Following issuance of the interim report, the parties shall have the opportunity, in accordance with the timetable established for the process, to submit written requests to review precise aspects of the interim report and to request a further meeting with the Panel. Following receipt of any written requests for review, in cases where no further meeting with the Panel is requested, the parties shall have the opportunity, within a time-period to be specified by the Panel and in accordance with the timetable established for the process, to submit written comments on the other parties' written requests for review. Such comments shall be strictly limited to commenting the other parties' written requests for review.

18. The following procedures, regarding the service of documents, shall apply:

(a) Each party and third party shall serve its submissions directly on all other parties, including the third parties, and confirm that it has done so at the time it provides its submission to the Panel.

(b) The parties and the third parties shall deliver their written submissions by 5:30 p.m., local Geneva time, on the deadline dates established by the Panel, unless a different time is set by the Panel.

(c) The parties and third parties shall provide the Panel with 10 paper copies of all their submissions, including their replies to questions, written version of oral statements and their executive summaries. All these copies shall be filed with Mr. Ferdinand Ferranco at the WTO Secretariat (Office 3154, Telephone 022 739 5683).

(d) At the time they provide paper copies of their submissions, the parties and third parties shall also provide the Panel with an electronic copy of all their submissions on a diskette to be delivered to Mr. Ferdinand Ferranco or as an e-mail attachment in a format compatible with that used by the Panel to be sent to the Secretariat (e-mail: DSRegistry@wto.org, with a copy to Mr. Jorge Castro (e-mail: jorge.castro@wto.org), Mrs. Xuewei Feng (email: xuewei.feng@wto.org), and Mrs. Tessa Bridgman (tessa.bridgman@wto.org).

(e) Parties and third parties shall provide the Panel with written versions of their oral statements by noon, local Geneva time, of the first working day following the date of the statements.

(f) Each party shall serve the executive summaries mentioned in paragraph 12 directly on the other party and confirm to the Secretariat that it has done so. Subparagraphs (d) and (e) above shall apply to the service of executive summaries.

(g) The Panel will endeavour to provide the parties with an electronic version of the descriptive part, the interim report and the final report, as well as of other documents as appropriate. When the Panel transmits to the parties or third parties both paper and electronic versions of a document, the paper version shall constitute the official version for the purposes of the record of the dispute.

ANNEX C

QUESTIONS FROM THE PANEL TO THE IMF

WORLD TRADE ORGANIZATION
ORGANISATION MONDIALE DU COMMERCE
ORGANIZACIÓN MUNDIAL DEL COMERCIO

Direct line: (+41 22) 739
Direct fax: (+41 22) 739

Mr. Rodrigo Rato
Managing Director
International Monetary Fund
Washington, DC

Geneva, 17 May 2004

Dear Mr. Rato,

I am writing on behalf of the Panel established by the Dispute Settlement Body of the World Trade Organization on 9 January 2004, at the request of Honduras, to examine measures imposed by the Dominican Republic on the importation and internal sale of cigarettes.

Pursuant to the terms of Paragraph 8 of the 1996 Agreement between the International Monetary Fund and the World Trade Organization, the Panel kindly requests the International Monetary Fund to provide information on how the "*Comisión Cambiaria a las Importaciones*" (previously called "C*omisión de Cambio*" and originally introduced by the Monetary Board of the Dominican Republic's Central Bank on 24 January 1991) is being implemented by the Dominican Republic.

The Panel also requests the Fund to provide its views on whether the "*Comisión Cambiaria a las Importaciones*", as currently applied by the Dominican Republic, is considered to be an "exchange control" or "exchange restriction" under the Articles of Agreement of the International Monetary Fund.

The Panel would be most grateful if the Fund could respond to these requests by no later than the 31 May 2004, so that any information provided by the Fund may be taken fully into account in our own proceedings on this matter.

Thank you for your kind co-operation on this matter.

Yours sincerely,

Elbio Rosselli
Chairman of the Panel

ANNEX D

RESPONSE FROM THE IMF TO THE PANEL

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

June 25, 2004

Mr. Elbio Rosselli
World Trade Organization
Centre William Rappard
Rue de Lausanne 154
CH – 1211 Geneva 21
Switzerland

Dear Mr. Rosselli:

I am writing in response to your letter dated May 14, 2004, requesting a response from the Fund under Paragraph 8 of the Cooperation Agreement between the Fund an the WTO to the questions raise by the Panel that was established on January 9, 2004 in order to examine measures imposed by the Dominican Republic on the importation an internal sale of cigarettes.

1. You have asked that the Fund provide information as to how the "Comisión Cambiaria a las Importaciones" (the "exchange commission") is being implemented by the Dominican Republic. Based on both our review of the relevant regulations and our consultations with the authorities of the Dominican Republic, we can advise you as follows:

(a) The "exchange commission" is levied under the legal authority of the Banco Central de la Republica Dominicana (BCRD). Since its introduction in January 1991, the commission has undergone a number of changes in the way that it is levied. Initially, the commission was payable on sales of foreign exchange and was calculated as a percentage of the selling rate.

(b) Since August 2002, however, pursuant to the Agreement between the BCRD and the Directorate General for Customs (DGC) of August 22, 2002, the commission has been collected in its entirety by the DGC. Moreover, although the commission is still referred to as an "exchange commission" (because it is levied on the basis of the legal authority vested in the BCRD to charge a commission on sales of foreign exchange), the commission in no longer payable on sales of foreign exchange. Rather, it is payable as a condition for the importation of goods, and the amount of the commission is now calculated exclusively on the CIF valuation of the imported goods as determined by the DGC (Article 1 of the Agreement between the BCRD and the DGC). By Notice of Resolution No. 1 of the Monetary Board of October 22, 2003, the rate of the commission was increased to ten percent in October 2003.

2. You have also asked whether the exchange commission, as currently applied by the Dominican Republic, is considered by the Fund to be an "exchange control" or "exchange restriction" under the Articles of Agreement of the International Monetary Fund.

As applied since August 2002, the exchange commission is no longer a measure subject to Fund approval. As noted above, the commission is no longer payable on sales of foreign exchange. It is payable as a condition for the importation of goods and the amount to be paid is based on the CIF

value of the imported goods (rather than the amount of foreign exchange sold to an importer for the payment of goods). As such, it does not constitute a multiple currency practice or an exchange restriction notwithstanding its label or the fact that the commission is charged on the basis of the legal authority vested in the BCRD to charge an exchange commission on sales of foreign exchange. For the same reasons, it is not an exchange control measure.

In light of the above, the Fund has determined that the exchange commission is not an exchange measure. Therefore, the issue of its consistency with the Fund's Articles for purposes of Paragraph 8 of the Cooperation Agreement does not arise.

Very truly yours,

François Gianviti
General Counsel