13 October 1987

JAPAN - CUSTOMS DUTIES, TAXES AND LABELLING PRACTICES ON IMPORTED WINES AND ALCOHOLIC BEVERAGES

Report of the Panel adopted on 10 November 1987
(L/6216 - 34S/83)

1. INTRODUCTION

1.1 In a communication dated 22 July 1986, the European Communities requested consultations with Japan under Article XXII:1 on Japanese customs duties, taxes and labelling practices on imported wines and alcoholic beverages (L/6031).

1.2 In a further communication dated 31 October 1986, the European Communities stated that consultations between the EEC and Japan on 4 August and 29 September 1986 had not resulted in a satisfactory settlement and that the Community wished to refer the matter to the CONTRACTING PARTIES in accordance with Article XXIII:2 (L/6078). At the Council meeting on 5-6 November 1986, the Community requested that a panel be established and that, in view of the magnitude of the injury being sustained and the urgency of obtaining a settlement, the CONTRACTING PARTIES apply the "urgency procedure" provided for in paragraph 20 of the Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance of 1979 (BISD 26S/214) by calling upon the panel to deliver its findings within a three-month period (C/M/204, item 19). Japan replied that an examination under Article XXIII:2 would not help to produce a practical solution to the politically delicate and difficult process of tax reform in Japan and that, for these reasons, Japan could not accept the establishment of a panel. Argentina, Austria, Australia, Canada, Chile, Finland, New Zealand, the United States and Yugoslavia reserved their rights to make a presentation to a panel and to participate in a panel proceeding on this matter (C/M/204, item 19; C/M/205, item 3; C/M/206, item 7). At the Council meeting on 21 November 1986, the Community again requested establishment of a panel with the traditional terms of reference and application of the procedures concerning accelerated work of panels. Japan considered that consultations had not been exhausted and that recourse to Article XXIII:2 and to the "urgency procedure" was inappropriate pending the outcome of the tax reform examination by the Japanese Government in December 1986. At the Council meeting on 4 February 1987, the Council agreed to establish a panel as follows (C/M/206, item 7):

Terms of reference

"To examine, in the light of the relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by the European Communities in document L/6078 and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or in giving the rulings provided for in Article XXIII:2."

Composition

Chairman: Mr. M. Tello

Members: Mr. D. Bondad
Mr. C. Kauter

At the same Council meeting, the representative of Japan outlined measures proposed by his Government in December 1986 as part of the overall reform of Japan's tax system. With regard to the liquor tax, the measures envisaged, inter alia, the abolition of the ad valorem tax, the reduction of the specific tax and the abolition of the grading system for whisky. Regarding the customs tariff on alcoholic beverages, Japan had informed the Community of its intended unilateral tariff rate reduction of 30 per

cent in principle. As for labelling, a self-imposed standard covering various items had been established by the Japanese wine industry in response to the Community's requests. He added that despite having been repeatedly asked, the Community had yet to explain the extent to which these new measures were satisfactory and what matters it still considered unsolved. Japan asked the Community to make such an explanation as early as possible, prior to or at the beginning of the panel proceedings (C/M/206, item 7).

1.3 The Panel met with the parties on 18 February, 28 April and 15 June 1987. At the meeting on 28 April, the Panel also heard presentations from Argentina, Canada, Finland, the United States and Yugoslavia. Their views are summarized below in paragraph 4. The Panel decided to send a questionnaire to the parties to the dispute as well as to those third contracting parties which had made use of their right to present their views to the Panel, inviting them to submit additional written information to the Panel. The Panel submitted its report to the parties to the dispute on 22 September 1987.

2. FACTUAL ASPECTS

Liquor Tax System of Japan

2.1 In 1940, the Liquor Tax Law was enacted in Japan. It classified alcoholic beverages into 9 categories and set the tax rates on each category of alcoholic beverages. The "grading system" was introduced to miscellaneous liquors in 1943. Although liquor taxes were basically specific taxes based on quantity, an ad valorem tax was introduced in 1962 to some of the special grade sake, wines and special grade whiskies, of which the price exceeded a certain threshold. This ad valorem tax system was expanded to apply to the lst grade and 2nd grade whiskies in 1971. The revenue from the liquor tax was the third most important revenue source after the income tax and corporation tax in 1985, amounting to 4.9 per cent of total tax revenue.

2.2 The tax system in Japan pursues the objective that taxation should be made according to the ability, on the part of tax bearers, to pay tax ("tax-bearing ability"). In the case of the liquor tax, the tax rates of various liquors are determined not only in accordance with their alcohol contents and other qualities but also by taking into account the tax-bearing ability of prospective consumers. The Japanese Liquor Tax Law classifies liquors into 10 categories. Six categories are further classified into 13 sub-categories and, in the case of sake and whisky/brandy, into three additional grades (see Annex I). The various categories have been defined in Article 3 of the Japanese Liquor Tax Law (see Annex II). Higher tax rates are applied to what are considered to be high-quality high-priced liquors, while lower rates are applied to what are considered low-quality low-priced liquors mainly consumed by those in the lower income brackets (see Annex III reproducing the specific tax rates on the main liquors). The same tax rate is applied to the liquors of the same quality, regardless whether imported or produced in Japan. There is no category where only imported products are subject to taxation. For most of the categories or grades, the standard alcohol content and corresponding standard specific tax rate are set. To the extent that the alcohol content exceeds the standard level, they are subject to increased rates, In certain categories, reduced rates can be applied if alcohol content is below the standard.

2.3 Distilled liquors are comprised of three categories: shochu, whisky/brandy, and spirits (such as vodka, gin and rum). These classifications are based on criteria such as raw materials used and manufacturing method applied. For each category, the current tax rates are determined by taking account, inter alia, of their quality and alcohol content, the pattern and trend of consumption, the tax burden between different categories of liquors, and the objective of imposing higher rates on high-quality high-priced products so that consumers bear a tax burden commensurate with their tax-bearing ability.

2.4 Sake, whisky and brandy are classified into three different grades: special, first and second grade. The grading system for whisky and brandy is based on standards such as the mixture ratio of malt whisky, grain whisky, pure brandy, and the alcohol content of whisky and brandy. The grading system pursues the objective of levying a high tax for high-quality and high-priced whiskies/brandies and an appropriately lower tax in regard to low quality and low priced whiskies/brandies largely drunk by people in the lower income bracket. The grades apply regardless of whether whiskies/brandies are domestic or imported. In fiscal year 1985, 83 per cent of special grade whiskies/brandies, 99.9 per cent of first grade whiskies/brandies and 100 per cent of second grade whiskies/brandies taxed in Japan were Japanese products.

2.5 Ad valorem taxes are applied on special grade sake, special, first and second grade whiskies/brandies, wines, spirits and liqueurs in cases where the price exceeds a certain threshold set for each category of alcoholic beverage (the thresholds and tax rates are reproduced in Annex IV). The ad valorem tax is not levied on liquors in five categories out of ten, such as mirin and beer. The non-taxable threshold of the ad valorem tax is determined based on the manufacturer's selling price for domestic products or the CIF and customs duty amount for imported products. For the main alcoholic beverages, the ad valorem tax is applied to 6.5 per cent of special grade sake, 8.7 per cent of wine and 9.2 per cent of special grade whisky, respectively in volume terms.

2.6 An overall review of the tax system has recently been made in Japan and bills for reforming the tax system have been submitted to the Diet. The proposed reforms of the liquor tax include, inter alia: introduction of a sales tax on alcoholic beverages, which is an excise tax of the same type as the value added tax widely seen in other countries; abolishment of the present ad valorem tax; abolishment of the grading system; abolishment of the present tax rate differentiation within the same categories of wine, liqueurs and spirits; a substantial reduction of specific tax rates for special grade whisky and brandy; the current 2nd grade whisky and brandy will come under the spirits category.

LABELLING

2.7 Japanese bottles of wines, whiskies and brandies currently bear labels using English, French or German terms, such as "Chateau" or "Reserve" or "Village". Japan has enacted various legal regulations in order to prevent the use of trade names in such a manner as to misrepresent the true origin of a product, including the Law for the Prevention of Unfair Competition, the Act against Unjustifiable Premiums and Misleading Representations, a range of "fair competition codes" voluntarily laid down by each industry concerned pursuant to Article 10 of the latter Act and approved by the Fair Trade Commission, and the Law concerning Liquor Business Association and Measures for Securing Revenue of Liquor Tax.

3. MAIN ARGUMENTS

A. Arguments by the European Communities

3.1 The European Communities requested the Panel to find that:

(a) The Japanese system of taxation was discriminatory with regard to imported alcoholic beverages in contravention of the provisions of Article III:1 and 2. The discrimination was due to:

- the absence of uniformity in the Japanese system of taxing alcoholic beverages, which was characterized by a differing tax-assessment basis depending on established product-categories and which amounted to penalizing imported products vis-a-vis domestic producers;

- the application of surprisingly different rates for similar products, based on a classification which resulted in a distinctly heavier levy on imported products than on domestic products;

- practices of the Japanese administration aimed at subjecting imported products to the highest taxation;

- the aggravating impact of extremely high customs duties.

(b) Wines and alcoholic beverages imported into Japan did not enjoy adequate protection as regards origin marking. Bearing in mind the provisions of Article IX:6 and the many representations made to the Japanese authorities on the matter, the Community considered that Japan had not fulfilled its obligations, in terms of those provisions, to co-operate with a view to preventing trade names of wines and alcoholic beverages originating in the Community from being used, under current practices in Japan, in such manner as to misrepresent the true origin of the products.

The Community specified that its claim referred to wines (including champagne and other sparkling wines, bottled wines, sherry and other fortified grape wines, vermouth and other wines of fresh grapes flavoured with aromate extracts), spirits, alcohol and distilled alcoholic beverages (including bottled whisky and brandy, gin, rum, other distilled alcoholic beverages and liqueurs).

ARTICLE III

3.2 The European Communities claimed that the Japanese system of taxing alcoholic beverages was contrary to Article III: 1, 2 in several respects:

(a) Categorization: Many alcohol taxation systems differentiated between broad categories of liquor such as brewed drinks (e.g. beer), fermented drinks (e.g. wine) and distilled beverages (e.g. whisky). The Japanese classification, however, unlike other systems, made a fundamental distinction between "Western-style" liquors and Japanese "traditional" alcoholic beverages (such as mirin, sake and shochu). These Japanese products had been differentiated for tax purposes as carefully defined separate product categories on the pretext of their traditional character. As a result, "traditional" had become virtually synonymous for "domestic", as confirmed by the extremely low level of imports in the traditional categories, and some domestic products fell into tax categories different from essentially similar competitive and substitutable products imported from the European Communities. Where raw materials and manufacturing processes were not sufficiently distinctive to differentiate "traditional" products, product definitions had been written so as to exclude imported products similar to the traditional products. For example, shochu was similar to vodka; but the shochu category for tax purposes excluded spirits filtered with a birch charcoal filter, which prevented vodka from qualifying for the favourable shochu tax rates. There was no reason in a rational tax system to tax similar products differently merely because they were made by slightly different production methods or from different raw materials (e.g. Whisky diluted with other spirits differently from undiluted whisky). Even though not all of the so-called "traditional" products were made by traditional processes or from traditional ingredients (e.g. Type A shochu) and patterns of consumption now resembled those existing in other developed countries, the artificial differentiation of separate tax categories protected "traditional" domestic products and consumption patterns and was in breach of Article III:1 and 2.

There was also a marked lack of uniformity in the minimum specific tax rates applicable to alcoholic beverages. For instance, the tax per litre on "Western-style" spirits such as gin and vodka was four to seven times higher than the tax on shochu. The tax on a litre of imported special grade whisky was respectively 41 and 26 times higher than the tax on a litre of Type B shochu and Type A shochu. As a result the tax alone on a litre of imported whisky or brandy was twice the retail price

of a litre of shochu. The mass volume market for spirits was thus protected for the domestic product shochu by a tax-determined-price mechanism, as had been recognized in the following statement recently made in a Japanese tax review:

> "The liquor tax has the effect of creating gaps in price competitiveness among liquor types. The result is an artificial ranking of shochu as a popular liquor and whisky as a high class liquor" (in: Taxation Accounting, 23rd January 1987).

The "traditional" categories (e.g. shochu) benefited from rates which were disproportionately low in comparison with the categories in which there were competitive or substitutable imported products (e.g. gin, vodka, special grade whisky). The extremely detailed and artificial 10 separate tax categories and 13 sub-categories and their very disproportionate tax rates were arbitrary and resulted in different tax treatment of imported and domestic like products or competitive and substitutable products contrary to Article III:1 and 2.

(b) Grading: The classification of whiskies and brandies into three "grades", with significantly different tax rates applied to them, resulted in discriminatory tax treatment of imported and domestic like products contrary to Article III:2. The grading system applicable to whisky and brandy was totally unlike the system applicable to the domestic product sake: Grading of whisky and brandy was mandatory, by raw material and alcohol content, and automatic (i.e. imported products being automatically graded as special grade unless proved otherwise). By contrast, grading of sake was voluntary and by taste, i.e. sake producers could choose whether to submit their products for grading and whether to be subject to the higher rates of tax applicable to graded sake. The system of grading applied to whisky and brandy had the effect of classifying almost all imported whisky and brandy in the special grade, which was by far the most highly taxed grade. This resulted from the fact that special grade included all pure malt and pure grain whiskies and that in all main whisky producing countries a whisky to be certified as such had to be wholly cereal-derived. The same applied to brandy based on similar criteria. The result was that all whisky and brandy imported from the Community was submitted to a tax rate greatly in excess of that applied to like Japanese first and second grade whiskies and brandies, the minimum tax rate on special grade being over seven times higher than the tax rate on second grade whisky. EC imports of lst grade whisky and brandy represented less than 0.1 per cent of total first grade volume and there were no EC imports of 2nd grade products. The grading system thus placed all Community whisky in an artificial luxury category and allowed more than half of the domestic production to benefit from more favourable tax treatment under the second and first grades artificially created for this purpose.

(c) Ad valorem taxes: On some categories, covering basically the traditional products (sake, shochu, mirin), the liquor tax was levied through a specific tax rate only (fixed rates per litre) or almost exclusively (e.g. less than 0.1 per cent of all sake was subject to ad valorem taxation). On the "Western-style" categories, a specific tax rate applied up to a fixed base price of the product (e.g. a specific tax at Yen 60.4 per litre on standard wines up to a "tax barrier" of Yen 1,080 per litre); above this non-taxable threshold of ad valorem tax, a series of very high ad valorem rates, different for various products, replaced the specific tax without any correlation to the specific rates applicable to the same category nor in proportion to alcohol content (e.g. an ad valorem tax of 50 per cent on a bottle of wine with a taxable value of Yen 1,081, more than 8 times higher than the specific tax). Once the threshold had been exceeded, the tax rates became up to 8 times higher than the specific rate on wines, 4 times higher on liqueurs and 2 times higher on spirits. This resulted in tax discrimination among "like products" within categories (e.g. wines, liqueurs and spirits of the same category with prices above or below the "tax barrier") as well as among competitive and substitutable alcoholic beverages of different categories. It first discriminated against like Community products since the application of very high levels of import duties on alcoholic beverages and their inclusion in the taxable value used for applying the threshold ("tax barrier") above which the ad valorem tax was payable,

resulted in submitting a much greater proportion of imported products to the disadvantageous ad valorem rate. Secondly, the distinction drawn between traditional products and "Wester-style" products as to the application of an ad valorem rate provided for a more advantageous treatment for a whole sector of the local production where there was no fear of direct foreign competition, due to the careful definition of the "traditional" beverages. The existing gap in specific tax rates between competitive or substitutable products such as whisky, brandy, or spirits on the one hand and shochu on the other hand had therefore been considerably increased. The Community considered that this lack of uniformity in the tax treatment of alcoholic beverages and the selectivity in the application of ad valorem tax was designed solely to afford protection to domestic production and contravened the principles set forth in Article III:1 and, in the light of the interpretative note to paragraph 2, Article III:2 second sentence. Since prices for shochu and ungraded sake could vary considerably and the comparatively lower prices of shochu resulted also from the lower taxation on shochu compared to other distilled beverages, the absence of ad valorem taxation on these products could not be convincingly justified by their price levels.

(d) Calculation of price for tax purposes: There were different methods of calculating ad valorem tax for imported and domestic products. In the case of imports, the tax base was usually the CIF cost plus duty. Importers had no choice as to the method of calculation. For domestic products, there were two methods and producers could choose whichever was the most favourable of them: The manufacturer's selling price to wholesalers, excluding tax, or the retail price less trade margins less tax (the so-called "fixed subtraction ratio system"). Although the latter method was officially described as a "special case", applicable when the retail price was known, in practice it was almost always used. This allowed domestic producers to choose effective tax values for domestic products which could lead to the application of more advantageous rates for domestic products when different ad valorem tax rates were provided as was the case for special grade brandy and whisky. For example, as regards special grade domestic whisky an ad valorem rate such as 164 per cent could apply, whereas for similar imported products only 150 per cent and 220 per cent rates could apply. The difference in the methods of calculation of price for the purpose of assessing ad valorem tax thus led to the possibility of more advantageous treatment for the domestic producers and could result in the imposition of taxes on imported products in excess of like domestic products. This more advantageous treatment in the calculation of price offered to domestic products constituted a breach of Article III:4 and also of the prohibition of "indirect" tax discrimination in Article III:2 when the differing taxation methods resulted in discriminatory tax burdens.

(e) Taxation according to extract content: Another feature of the Japanese system which discriminated between "like" products in violation of Article III:2 was the method of assessment based on extract or non-volatile ingredient content. In the category of "liqueurs" (which were universally recognized as being sweetened and flavoured alcoholic beverages and which therefore had as one would expect a high non-volatile ingredient content) two specific rates of tax were applied according to both alcohol and extract content. This system ensured that almost all Community liqueurs were subject to the higher rate of specific tax whilst some Japanese liqueurs were able to benefit from a lower specific rate (one third of the rate on most Community liqueurs) together with a lower ad valorem rate (50 per cent as opposed to 100 per cent) and a much lower increment per degree of alcohol (9.780 yen per 1 per cent over 13 per cent compared with 24.5 yen per 1 per cent over 15 per cent in the higher rate category). Most Community liqueurs were made to traditional formulae with a fairly high flavouring content. Japanese products had been designed by manufacturers who were aware of the substantial tax advantage for products with an extract content below the 15 per cent extract level. The Community considers that taxation according to extract content was artificial and irrational and discriminated against imports contrary to Article III:2.

(f) Economic and social consequences: According to the European Communities, the high rates of tax on imported alcoholic beverages reduced their availability at points of sale and their choice by the average consumer, and distorted competition amongst alcoholic beverages on the Japanese market.

The structure of the tax system influenced the pattern of consumption and clearly did not correspond to the so-called "principle of taxation according to tax-bearing ability". For example, beer which was the beverage consumed in by far the greatest volume by all sections of the population was the second most highly taxed beverage in terms of tax per litre of alcohol. Artificial and arbitrary criteria for assessment of quality were used to justify large tax differentials. In 1985, the spirit shochu, which accounted for approximately 20.4 per cent by volume of consumption of pure alcohol, raised 2.4 per cent of revenue on alcohol whilst special grade whisky accounted for 7.5 per cent of volume of pure alcohol but 15.1 per cent of revenue. Since there was also a substantial divergence in tax per litre of alcohol on different products varying from 2,036 Yen to 53,133 Yen, the Japanese tax system and its wide range of specific tax rates on equivalent products did not appear to be based on social or public health grounds either. The wording of Article III:2 and GATT practice indicated that different tax treatment of imported and domestic products contrary to Article III:2 could not be justified by tax policy considerations. The only questions which needed to be decided under Article III:2 were whether the tax on imported products was in excess of that on like domestic products and whether the internal tax afforded protection to domestic production. The reasons why a national tax system provided protection or discriminated against imported goods were irrelevant.

(g) The proposed tax reform: In the view of the European Communities, the proposed tax reform would not remove the existing tax discrimination and could even aggravate the differential tax treatment of "traditional" and other spirits. It was uncertain whether this or another tax reform proposal would ever be examined or adopted by the Diet. It should, therefore, not be taken into account in the deliberations of the Panel.

3.3 According to the European Communities, the purpose of Article III was to secure for imports the opportunity to compete on equal terms with domestic products. This had been recognized in the finding of the recent panel report on US-taxes on petroleum that "Article III: 2 first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products" (L/6175, paragraph 5.1.9). Article III:2 imposed a two-fold obligation: not to apply directly or indirectly to imported products internal taxes in excess of those applied to like domestic products; and not to apply internal taxes to imported or domestic "directly competitive or substitutable" products in such a way as to afford protection to domestic production. It had been recognized in GATT practice that the term "like product" should be interpreted on a case-by-case basis taking into account the product's end-uses in a given market, consumers' tastes and habits, and the product's properties, nature and quality (BISD 18S/102). It had also been established that minor but clearly perceptible differences in taste, colour and other properties did not prevent products qualifying as "like products" (BISD 28S/112). Tariff classification also provided a useful starting point for determining what might be "like products". The Communities considered the following products to be "like products" within the meaning of Article III:2 (see Annex V):

- All Community whiskies and all Japanese whiskies, whose respective minimum genshu contents and grades had varied over time.

- All Community and all Japanese grape brandies.

- All Community and all Japanese fruit brandies.

- All Community and all Japanese still wines.

- All Community and all Japanese sparkling wines.

In all the above product group)ups there was considerable variation in taste, smell and colour but the similarities between products within each group were such that each was recognized as

"a well defined and single product" (BISD 28S/102, paragraph 4.7) whisky, brandy, still wine or sparkling wine. According to the Japanese liquor tax law, second grade whisky, although it contained neutral spirits, must resemble pure malt or grain whisky in flavour, colour and other properties. Differences in prices and "quality" (e.g. alcohol content for whisky, brandy and liqueurs) did not create different types of product.

- Vodka and shochu.

3.4 The interpretative note to Article III:2 made it clear that the second sentence of Article III:2 extended the prohibition to discrimination between directly competitive or substitutable products. It was well established that the concept of "directly competitive or substitutable" products was much wider and could cover also products with different origins, contents and tariff rates but substitutable in terms of their end use, such as apples and oranges, or skimmed milk and vegetable protein products (BISD 25S/49). All distilled liquors in bottled form were competitive in terms of price and substitutable in terms of their end use within the meaning of the interpretative note to Article III:2 and presented a choice to consumers of drinks with a relatively high alcoholic content. For instance, shochu was blended in various proportions with whisky and brandy precisely because the products were compatible and substitutable. All products classified as liqueurs in the Japanese tax classification also presented a choice to the consumer and had to be considered directly competitive and substitutable products.

3.5 According to the European Communities, Article III:2 first sentence had been violated by the following tax practices:

- Whiskies, grape brandy and certain fruit brandies were affected by the grading system applied to the whisky/brandy category which applied a much higher level of taxation to these products not mixed with neutral spirits.

- All Community wines, spirits and liqueurs which were subject to the "mixed" system of specific tax and ad valorem tax applied below and above a tax barrier were prejudiced by the operation of ad valorem taxes (including the different methods of calculating value for tax purposes).

- The alcoholic beverages falling in categories for which tax was determined by extract content (sparkling wine and especially liqueurs) were discriminated against in comparison with like products with a fractionally lower flavouring and sugar content.

The Communities considered that Article III:2 prohibited also indirect or de facto discrimination and that the use of "genshu" content as the basis for the taxation of whisky and brandy was a blatant example of the serious de facto discrimination concealed in the Japanese tax system. Whisky and brandy diluted with neutral spirits or alcohol but flavoured to retain the characteristics of the product were almost exclusively Japanese products. Determining rates of taxation according to the dilution factor was therefore an indirect way of distinguishing between Japanese and imported products. If tax criteria were based on characteristics typical of almost entirely domestically produced products, whether traditional or not, such product differentiation could result in indirect tax discrimination inconsistent with Article III:2. For instance, the almost exclusively domestically produced spirit shochu benefited from favourable tax differentials of between 1/7 (shochu B/other neutral spirits) and 1/41 (shochu B/special grade whisky) in comparison with all other spirits, some of which were "like products" and all of which were competitive and substitutable. The huge tax differential between second-grade Japanese whisky/brandy and even the cheapest Community whisky/brandy inevitably led to a large difference in retail price which put standard imported whisky outside the price range of the majority of private consumers and of lower grade Japanese whisky/brandy. The existence of also some imported goods in the less heavily taxed category (e.g. imported shochu representing 0.4 per cent of domestic

production), or of some domestic goods in the more heavily taxed category, could not justify the tax discrimination among like products.

3.6 The Communities considered that a difference in taxation between "like" products based on different categories for tax purposes could certainly not be justified under Article III on the mere fact that there were domestic goods in all tax categories. More specifically, such a situation should be ruled as contrary to Article III:2 when the following conditions were met:

- there was substantial production by the domestic industry of products in the less heavily taxed categories;

- all or a very high proportion of imported products were in the categories subject to the higher rates of tax;

- the criteria used for differentiating between the tax categories of products were artificial, arbitrary and not based on any objective differences which would justify or necessitate a different treatment on social, health or economic grounds (other than protectionist considerations which would be contrary to GATT principles); and

- in every pair of tax categories which result in applying different treatment to "like" products, the effective tax rates in practice applicable to imported products were very much higher, and not merely slightly higher, than the tax rates applicable to the corresponding category composed largely of domestic products.

The same reasoning applied to "competitive or substitutable" products.

3.7 The Community considered that the lack of uniformity in the Japanese tax system applying to the alcoholic beverages market was designed solely to afford protection to domestic production. It contravened the principles set forth in Article III:1 and, in the light of the interpretative note of paragraph 2, the obligation stated in the second sentence of Article III:2. The unequal taxation of directly competitive or substitutable products had a protective effect. Article III:2 second sentence was violated by the fact that:

- All distilled liquors (whisky, brandy, gin, vodka, etc.) which were directly competitive with shochu were affected by the system of categorization which permitted shochu to benefit from extremely favourable taxation in comparison with other spirits.

- All Community products in categories which were subject to ad valorem taxation were at a disadvantage in comparison with Japanese "traditional" products which were only obliged to be subject to specific taxes.

Article IX:6

3.8 In the view of the European Communities, Japanese legislation and practice in the field of wines and spirits labelling had not proved adequate to restrain labelling practices which misled consumers as to the origin of products. Article IX:6 did cover not only the usurpation of a specific regional or geographical name but also the way in which a trade name could mislead as to geographical or regional origin. Japanese rules for the production and commercialization of wines and spirits were in a large part based on codes of conduct established on a voluntary basis by the industry concerned. The "Self-Imposed Rules of the Wine Industry" and the "Standards for the Domestic Wine Labelling" had no legal character whatsoever as they had not been approved by the Fair Trade Commission. The government could not, therefore, ensure the respect of these rules by the imposition of sanctions. Only

recently had the industry agreed to indicate "imported wine used" printed on the label in the case where imported wine was blended with domestic wine. Wines bottled in Japan, which might contain as much as 95 per cent imported bulk wine or which could be produced on the basis of imported must, needed bear no indication of the proportions or the source of ingredients. As regards whisky, ingredients were listed but the percentages or the use of neutral spirits were not indicated. Japanese brandy sometimes contained alcohol not made of grapes. Japanese brandy producers used such indications as "V.S.O.P.".

Japanese spirits and wines were labelled in a European style, in a European language with European symbols. Japanese manufacturers used in their labelling French words, French names, German script and other devices with a clear implication that the product was in some sense of European origin. In the case of wines, only recently did the main label indicate the name of the "producer", maintaining however a degree of ambiguity as to his precise activities. A survey made by the EEC in 1986 had indicated that some 45 per cent of Japanese consumers questioned were misled by use of foreign lettering on wine and spirit labels and had mistakenly thought that Japanese wine bottles were of French origin. Given the importance of the label in the case of wines and spirits, the Community had made representations to the Japanese Government in order to obtain the introduction of adequate legislation. It was to be noted that this labelling situation contrasted strikingly with the scope of the Community regulations in the field of labelling of wines and spirits or with the very tight regulations existing in japan for products such as food or pharmaceutical products. It was not customary to write labels on domestically produced bottles designed to be sold on the local market in a foreign language. The only response given up to now by Japan had been the adoption of "self-imposed" rules by the wine industry as regards the country of origin and the content of the product. Nothing had been done as regards spirits. The Community considered that this only partially and inadequately answered its request. In effect it considered that only the adoption of effective legislation could be considered as an adequate Japanese response to its request under the terms of Article IX:6. The Community drew the attention of the Panel to the importance of giving Article IX:6 its full meaning, especially regarding the need for a contracting party to act by means of a state measure to remedy a situation which is detrimental to another contracting party.

B. Arguments by Japan

3.9 Japan requested the Panel to find that Japan's liquor tax did not discriminate between domestic and imported alcoholic beverages and was not applied in such a way as to afford protection to domestic production inconsistent with Article III:1 and 2. Japan had also met its obligations under Article IX:6 by taking necessary measures to prevent misrepresentation of the true origin of alcoholic beverages which might be caused by labelling.

ARTICLE III

3.10 Japan claimed that its system of taxing alcoholic beverages was fully consistent with Article III:1 and 2.

(a) Categorization: The tax categories had been established in accordance with clear and objective criteria such as raw materials used and manufacturing method applied, and did not make any distinction between domestic and imported products. For each category, the current tax rates had been minutely determined not only by their alcohol contents but also by taking account of various factors such as quality and alcohol content, the pattern and trend of consumption, and the aims of balancing the tax burden between different categories of liquors and of imposing higher tax rates on high-quality, high-priced products so that consumers bear a tax burden commensurate with their purchasing power. For example, a relatively higher tax burden was carried by special grade whisky which had an established image as high-class liquor, and a lower tax burden by shochu which was considered low-class liquor

and mainly consumed by persons in low income brackets. The same tax rate was applied to the liquors of the same quality, regardless whether imported or produced in Japan. The existing tax rates were appropriate and consistent in terms of the fundamental Japanese taxation principle of "taxation according to the tax-bearing-ability". The question of how a liquor tax was imposed was a matter to be decided by each individual country. Other countries had also adopted tax systems under which liquors, including distilled liquors, were classified into categories with different tax rates applied. Besides, "Western-style" liquors, generally called "Yoshu" (foreign liquors) in Japan, did not mean that they were foreign products, but simply meant that their historical origin was not in Japan. As a matter of fact, 91 per cent of the whiskies consumed in Japan was domestically produced, and of the special grade whiskies, 83 per cent of that consumed in Japan was produced in Japan. Of the spirits which included vodka, gin, rum, etc. under the japanese Liquor Tax Law, 94 per cent was produced in Japan (in FY 1985). On the other hand, as for shochu which was regarded by the EC as japanese traditional liquor, a certain volume was imported from abroad including the EC countries, and the tax rate was exactly the same as that on shochu produced in Japan. (The quantity of imported shochu had been 1,821 kl in FY 1984 and 2,562 kl in FY 1985).

Article III:1 and 2 did not prohibit the establishment of differences in internal taxes among like products or among directly competitive or substitutable products. Article III:1 and 2 only stipulated that imported products must not be subject to internal taxes in excess of those applied to like domestic products and that internal taxes must not be applied to directly competitive or substitutable imported or domestic products so as to afford protection to domestic production. As long as internal taxes were non-discriminatory between domestic and imported products, and were not applied so as to afford protection to domestic production, establishing differences in tax rates based on the national tax system, even among like products or directly competitive or substitutable products, did not constitute an infringement of obligations under GATT. There was no category where only imported products were subject to taxation. In order to undertake an accurate comparison of taxation levels among different liquors, it was necessary to compare not only tax rates among different kinds of liquors but also to take into account such factors as their prices and alcohol content. For instance, compared on the basis of alcohol content, the tax rate on special grade sake was much higher than spirits and liqueurs, though it was lower than special grade whisky. It was also 7.6 times higher than tax rate on wine. The taxation level on wine was lower than second grade sake, which was a typical popular liquor along with shochu. From this viewpoint, it was incorrect to assume that Japan' s taxation level on "traditional" categories was in general lower than that on "Western-style" liquors. In order to levy taxes according to tax-bearing-ability on each category of liquors, the ratio of liquor tax to retail price of liquors had been traditionally used as an indicator in setting the tax-burden for each category. The reasonableness of this method was confirmed by the fact that ad valorem tax was also computed as a percentage of the price. A simple comparison of amounts of specific tax was misleading. As the table below indicated, the differences in terms of the ratio of liquor tax burden to the retail price were not so great as the tax rate differences among grades might suggest. The ratio on Scotch whisky, which the EC alleged was subject to discriminatory treatment, was actually lower than those on the lst grade and 2nd grade Japanese whiskies.

Table: Ratio of Liquor Tax Burden to Whisky's Retail Price
(Source: Submission by Japan)

	Retail Price (A)	Liquor Tax Amt. (B)	(B)/(A)
(Domestic Product)			
Special grade (760ml, 43%)	3,170 yen	1,594.55 yen	50.3%
1st grade (720ml, 40%)	1,620 yen	728.20 yen	45.0%
2nd grade (640ml, 37%)	670 yen	189.56 yen	28.3%
(Imported Product)			
Special grade (750ml, 43%)	8,000 yen	1,573.57 yen	19.7%
Special grade (750ml, 43%)	4,000 yen	1,573.57yen	39.3%

(b) Grading: The grading system was based on the circumstances of production and consumption of whiskies/brandies in Japan. It was applied to sake and whiskies/brandies which run a wide range of quality, and was based upon the principle that liquor tax should be levied according to the tax-bearing ability. It clearly classified the grades according to objective standards such as the mixture ratio of malt whisky or grain whisky (and pure brandy in the case of brandy), and the alcohol content of whiskies. This grading system equally applied to domestic and imported products. The grading system was designed to levy a high tax for high-quality and high-priced whiskies and an appropriately lower tax in regard to the whiskies largely drunk by people in the lower income bracket. Imported whiskies could be sold as first or second grade whiskies, if overseas manufacturers exported products matching the Japanese situation of consumption. This grading system was established in 1943 to seek financial resources in wartime by levying high taxes on high-quality and high-priced liquors and imports of whisky were not considered then in view of the environment at that time. Therefore, it was clear that it had not been in the minds of those who had introduced the system to discriminate against imported products. 83 per cent of special grade whiskies taxed in 1985 had been domestic products. This fact clearly illustrated that the grading system did not either protect domestic products or discriminate against imported products. The establishment of different rates of tax even among like products based on each country's legitimate tax system did not constitute an infringement of GATT obligations. Due to the differences in quality, alcohol content, prices and consumption patterns, special and second grade whiskies could not be considered like products.

(c) Ad valorem tax: The ad valorem tax system supplemented the demerit of the specific tax that the tax amount remained the same regardless of the prices of the products. To offset this, the ad valorem tax had been introduced in those classifications where a great difference existed in market prices, regardless of whether products were "traditional" domestic liquors or "Western-style". For instance, special grade sake which the EC called "traditional" liquor, having a wide range of price, had the ad valorem tax applied. On the other hand, for beer which came under the category which the EC called as "Western-style" alcoholic beverages, having a narrow range of price, the ad valorem tax was not applied. The system was designed to achieve a fair distribution of the tax burden among the beverages of the same category of liquors and was not applied to the disadvantage of imported products. It

attempted to alleviate the retrogressive effect inherent in indirect taxes and to ensure equity in tax burden sharing. Each contracting party retained the right to adopt a national tax system which in its judgment was rational, as long as it did not infringe the relevant GATT provisions. A situation that "Western-style" liquors were more frequently subject to ad valorem tax compared with "traditional" liquors was a mere result of the fact that liquor categories running through a wide range of price variations were more frequently found in the "Western-style" liquors than in "traditional" liquors. As for wine and whisky which were main liquors imported from the EC, the imported volumes subject to ad valorem tax were 2,563 kl and 2,126 kl, respectively in Fiscal Year 1985. Both figures were smaller than those of domestic wine and domestic special grade whisky, of which the volumes subject to ad valorem tax were 3,625 kl and 10,570 kl, respectively in the same year. Moreover, in FY 1985, the percentages of volume subject to ad valorem tax in each liquor category were as follows: 7.3 per cent for domestic wine; 11.9 per cent for imported wine; 8.9 per cent for domestic special grade whisky; and 10.7 per cent for imported special grade whisky. These figures clearly indicated that the application of ad valorem tax did not discriminate against imported products, nor did ad valorem tax afford protection to domestic production.

(d) Calculation of price for tax purposes: The ad valorem tax for imported products was easily calculated, for the CIF & customs duty for imported products could be easily grasped and the tax was derived simply by multiplying the tax rate to the price. The calculation of the ad valorem tax for domestic products, however, required considerable work, because the liquor tax had already been included in the price of the transaction (therefore, in calculating the ad valorem tax amount, it would be necessary to deduct the liquor tax amount from the price in order to obtain the correct tax base), and in case of sales to special clients such as a wholesaler with capital affiliation, careful consideration was needed to calculate correctly an ordinary sales price. Therefore, to avoid an increased work load, the tax base could be calculated on the basis of the retail price. If the retail prices were made known to the public by newspapers or other media, the tax base would be derived based on those retail prices, upon confirmation by the tax authorities, after deducting from the retail prices a portion (fixed rate) for the margin of the wholesalers and other distributors, transport charges, etc. This fixed rate was determined based upon the result of market research on the actual transactions. The tax base computed this way was meant to be equivalent to the manufacturer's selling price defined as the tax base. There was no discrimination between domestic and imported products, and no actual difference in tax base between domestic and imported products arose because of this "fixed subtraction system" for the assessment of the tax base for domestic products. It was quite common also in EEC countries that, in the case of indirect taxes, the tax base of imported products included the customs duties. The application of the intermediate tax rate on domestic special grade whisky had no relation to the "fixed subtraction system" and was used as a means of adjustment necessitated by the fact that transactions of liquors in Japan were usually made on the basis of the price including the liquor tax. An intermediate tax rate higher than the specific tax rate was applied in case where the transaction price after deducing ad valorem tax did not reach the non-taxable threshold, although the transaction price after deducing specific tax exceeded the non taxable threshold. This adjustment allowed the gap between the transaction price and the threshold to be collected in full as tax.

(e) Taxation according to extract content: According to Japan, the EEC's claim that "almost all imported liqueurs were subject to the higher rate of (specific) tax because of their higher extract content", was contradicted by facts. Imported liqueurs were divided into, on the one hand, "quality liqueurs", the higher tax group, and, on the other hand, "other liqueurs", the lower tax group on a roughly 50-50 basis. Some 70 per cent of "quality liqueurs" were domestic products. Most "other liqueurs" were fundamentally different from "quality liqueurs" in terms of not only their quality, such as alcohol content, but also use. As such there was no direct competitiveness nor substitutability, let alone likeness, between the two types of liqueur. Consequently, it was rational to classify "quality liqueurs" into different categories in view of the principle of Japan's liquor tax that the different tax rates would apply according

to the types of liquors. And in the respective category the same tax rate was applied equally to both the domestic products and the imported ones.

(f) Economic Consequences: Japan pointed out that, even though the share of imported liquors was less than 1 per cent of Japan's liquor market, it should be noted that the share of beer accounted for 65 per cent of the total consumption of liquor and sake for 18 per cent in Japan's liquor market. The total share of these two categories of liquor amounted to 83 per cent. The share of imported products in whiskies and wine, which were of interest to the EEC, had been drastically increased since the liberalization of their imports (February 1970 for wine, and January 1971 for whiskies). As a result, the share of imported whisky accounted for 14.6 per cent in Japan's market of special grade whisky; the shares of imported wine and special grade brandy accounted for 31.5 per cent and 38.2 per cent, respectively, both of which represented a considerable proportion of Japan's market.

Japan did not agree with the EEC's claim that, as a result of prices being raised by the high liquor tax levied on EEC products, the distributors frequently decided against imported products and, thus, the consumer's choice was limited in terms of the point of sale as well as of price. The causes for raising the retail price of EC-produced whiskies were rather due to the fact that imported whiskies had been regarded by consumers as high quality and precious goods and the exporters and distributors of these goods had been following a high price policy, taking advantage of consumers' perceptions. In fact, the margin of imported special grade whiskies during the course of distribution was 60 to 70 per cent of the retail price, which was fairly high in comparison with domestic special grade whiskies of which the margin was usually around 30 per cent.

The ratio of the tax to retail price (tax burden rate to retail price) was nearly 20 per cent for premium imported whisky and nearly 40 per cent for standard imported whisky, of which the tax burden ratio to retail price was fairly low in comparison with domestic special grade whisky of which the ratio was about 50 per cent. As such, the price of imported whiskies was determined largely by the sales policy of agents who often introduced large distribution margins (some of them were requested to do so by the exporters of the products). The setting of retail prices was also closely linked with "commodity images" formed over the years. As for special grade whisky, each company tried to set its prices at a high level in order to maintain and strengthen the "image" of a high quality liquor, thereby securing a large margin. However, in the case of shochu, it was impossible to set the prices high, even if manufacturers desired to have large margin, since shochu was widely perceived as a popular and cheap liquor. Thus, the high production cost and the high quality "image", as well as the large margin, made whisky more expensive than shochu.

3.11 As regards the interpretation of Article III:1 and 2, Japan believed that, since there existed a substantial domestic production of products which were almost identical with the products of the EC and both imported and domestic products were subject to the same taxation, there was no discrimination in violation of GATT Article III: 1 and 2. Article III:2, first sentence, did not require a contracting party to apply the same internal tax rate to all like products, if imported and almost identical domestic products were equally taxed and there was substantial domestic production of these almost identical products. Nor did Article III:2, second sentence, prohibit any favourable taxation on any domestic product which might be directly competitive with or substitutable for an imported product, if equal taxation was actually assured between the imported product and the like domestic product which was domestically produced in substantial quantities. The question of likeness, direct competitiveness or substitutability of imported and domestic products did not have to be examined under this interpretation as long as the importing country's tax system did not discriminate between imported and domestically produced goods of the same tax category and as long as there was substantial domestic production in all the tax categories and, even if there was no substantial import of products in some tax categories, import of such products was neither prohibited not limited and production was possible in other countries.

In the view of Japan, this interpretation was supported by the drafting history of Article III:2. The reports of the 1948 Havana Conference relating to Article 18 (i.e. Article III of GATT) mentioned that

> "The Sub-Committee was in agreement that under the provisions of Article 18 regulations and taxes would be permitted which, while perhaps having the effect of assisting the production of a particular domestic product (say, butter) are directed as much against the domestic production of another product (say, domestic oleomargarine) of which there was a substantial domestic production as they are against imports (say, imported oleomargarine)." (Reports of Committees and Principal Sub-Committees, UN Conference on Trade and Employment, 1948, P. 64; GATT Analytical Index, Article III at p. 17).

This interpretation had been confirmed by the Swedish delegation at the 9th session of the CONTRACTING PARTIES in 1954-55. The GATT Panel report on EEC -measures on animal feed proteins, in examining whether the EEC's quantitative restrictions afforded protection to domestic production in terms of Article III:1 and 5, had likewise "noted that, although globally about 15 per cent of the EEC apparent consumption of vegetable protein was supplied from domestic sources, not all the individual products subject to the EEC measures were produced domestically in substantial quantities" (BISD 25S/65). The EEC's assertion that GATT Article III:2 required a contracting party to apply the same tax-rate on all like products, did not seem appropriate and was contradicted also by the case-law of the EC Court of Justice relating to Article 95 of the EEC Treaty which had almost the same wording as Article III:2 of GATT. In the case of Hansen and Balle, for instance, the Court had held with respect to Article 95:

> "At the present stage of its development and in the absence of any unification or harmonization of the relevant provisions, Community law does not prohibit Member States from granting tax advantages, in the form of exemption from or reduction of duties, to certain types of spirits or to certain classes of producers". (European Court Reports 1978, p. 1806).

Among the series of decisions given by the EC Court of Justice on distilled liquor taxes in 1980 in circumstances where distilled liquor taxes imposed by France, Italy and Denmark were lower on their domestic distilled liquor (brandy, grappa, aquavitte, respectively) and were higher on imported distilled liquor (whisky, rum, etc.), the following findings of the Court deserved attention in the view of Japan:

> "the legitimacy of certain differentiations concerning the taxation of alcohol was only recognised for the purpose of enabling the maintenance of productions or enterprises which otherwise would no longer be profitable, owing to the increase of the cost of production; on the other hand, such tax exemption or tax reduction in favour of certain products are valid only if these measures do not hide a discrimination due to the origin of the products taxed or if they do not have a protective character… the Italian fiscal system is characterized by the fact that the most typical of the national products are in the most favoured fiscal category, while two sorts of products which are nearly entirely imported from other member states are more heavily taxed… This means that this practice in reality hides a discrimination against imported products." (Text quoted from the Japanese submission).

At the 1947 preparatory conference at Geneva, the following explanation had been given of the second sentence of GATT Article III:2:

> "Let us suppose that some country in its negotiations has secured the binding of the duty on oranges. Country A gets a binding on the duty of oranges from Country B. Now, Country B after that can proceed to put on an internal duty of any height at all on oranges, seeing that

> it grows no oranges itself. But by putting on that very high duty on oranges, it protects the apples which it grows itself. The consequence is that the binding duty which Country A has secured from Country B on its oranges is made of no effect, because in fact the price of oranges is pushed up so high by this internal duty that no one can buy them. The consequence is that the object of this binding is defeated." (Document EPCT/A/PV.9, at p. 7).

The case envisaged here was one where there was no domestic production of like products (i.e. oranges). In the 1947 Geneva draft, the provision which corresponded to the current second sentence of GATT Article III:2 had been written in such a way as to have it applied when there was no substantial domestic production of like products:

> "In cases in which there is no substantial domestic production of like product of national origin, no contracting parties shall apply new or increased taxes on the products of the territories of other contracting parties for the purpose of affording protection to the production of directly competitive or substitutable products which are not similarly taxed; and existing internal taxes of this kind shall be subject to negotiation for their reduction or elimination."

The Geneva draft had been revised at the Havana Conference the following year. Though the expression "In cases in which there is no substantial domestic production of like product of national origin" had been deleted in the process, the Havana Report said the following:

> "The recommended text differs considerably in form from the Geneva text but has been changed substantially in only one respect. The second sentence of paragraph 1 of the Geneva draft provided that existing internal taxes which afford protection to directly competitive or substitutable products in cases in which there was no substantial domestic production of the like product could be maintained, subject to negotiation for their elimination or reduction in the manner provided for in Article 17. The Sub-Committee recommended their outright elimination"… (Reports of Committees and Principal Sub-Committees, UN Conference on Trade and Employment, 1948, p. 61).

When the aforementioned interpretation was applied to Japan's liquor tax system, there was no inconsistency with Article III: 2 second sentence as there was substantial domestic production of like products for all the EC products in question. In fact, 91 per cent of the whiskies consumed in Japan was domestically produced, and of the special grade whiskies, 83 per cent of that consumed in Japan was produced in Japan. Of the spirits which included vodka, gin, rum, etc. under the Japanese Liquor Tax Law, 94 per cent was produced in Japan (FY 1985).

3.12 Regarding Article III:1 and 2, Japan believed that it was not necessary to examine the question of likeness, competitiveness, and substitutability in this case. Only in case of a different interpretation of Article III:1 and 2 had the likeness, competitiveness or substitutability of the EC and Japanese alcoholic beverages to be examined. There was no precise definition of the term "like products" and the problems arising from the interpretation of this term should be examined on a case-by-case basis. In the view of Japan, the various elements to consider in judging whether likeness exists among certain products included their price, property, image, pattern of consumption and end-use. There existed no likeness, direct competitiveness or substitutability among the products complained of by the EEC. As was mentioned in 3.10(b) above, the differences in quality, product images and prices of the various grades of whisky/brandy led to distinctive user classes and consumption patterns, and the various grades were not "like" products. Also, as was explained in 3.1(e) above, "quality liqueurs" and "other liqueurs" were fundamentally different in terms of their use and their alcohol content, so that there was no competitiveness nor substitutability, let alone likeness, between these two types of liqueur. Concerning shochu and spirits such as vodka, the latter were generally strong distilled liquors with 40 to 50 per cent of alcohol content while the former normally sold was a liquor with 20 to 25 per cent of alcohol

content which was extremely low as a distilled liquor. Shochu was largely consumed in the limited areas and drunk by being diluted with hot water so as to reduce its alcohol content to almost the same level as that of sake. Thus, shochu and vodka could not be regarded as either "like" products or "directly competitive or substitutable" products in view of their different alcohol contents and uses by consumers.

Article III:2 did not prohibit the use of a taxation method for imported products different from that for like domestic products unless the differing taxation methods resulted in a heavier tax burden on imported products than on domestic like products. As long as GATT was not violated every contracting party retained the right to adopt a tax system that was in its own judgment rational.

Article IX:6

3.13 With respect to labelling, Japan maintained that the EEC's arguments -that the ingredients of wine and whisky, their origin and percentages should be indicated on the label - had no relevancy in relation to GATT Article IX:6. In order to verify an alleged infringement of Japan's obligations under Article IX:6, the EC should first specify what trade names of EC products were being used by Japan's domestic products, and what distinctive regional or geographical names protected by the laws of the EC members were being infringed. However, the EC had not clarified these matters in its submission to the Panel. And the EC's submission did not clarify whether the indications of labelling in Japan were to be considered as trade names provided for in the provision of Article IX:6. Moreover, the indications of the ingredients of wine and whisky and the percentages of contents on the label were irrelevant to the said obligation under the provision of Article IX:6. Japan maintained that the provision of Article IX:6 stipulated the cooperative obligation to prevent misrepresentation as to the true origin and did not require specific measures with penalties to this end. The use of distinctive regional or geographical names was regulated for beverages of japanese origin, since Japan acceded in 1965 to the Madrid Agreement and the use of these names was regulated by the Law for the Prevention of Unfair Competition which contained penal provisions. Consequently, there existed in fact no alcoholic beverages produced in Japan which had such appellations. As appropriate legal measures were thus in force and were firmly observed in Japan to prevent the misrepresentation as to the country of origin, Japan did not violate Article IX:6. The labelling system in Japan consisted not only of self-imposed rules of the industry but also of a range of additional legal controls described in the Japanese submission. Thus, the labelling of alcoholic beverages was regulated no less strictly than that of other food products. For instance, the Law and the Cabinet Order concerning Liquor Business Association and Measures for Securing Revenue of Liquor Tax provided that the name of the manufacturer, the place of manufacturing premise, etc. must be indicated in a conspicuous manner in Japanese lettering at a legible location of the container for any alcoholic beverages domestically produced. It was common in many countries other than Japan to use for domestically produced alcoholic beverages labels written in languages other than their own. Article IX:6 aimed at protecting "trade names", which did not go so far as to protect a total "image" of a certain product such as "French wine", and did not require each contracting party to prohibit generally the use of certain styles and languages of other contracting parties regarding its products. The Fair Trade Commission's "Notification on Misleading Representations concerning the Country of Origin of Goods" did not prohibit representations where "all or the principal part of the literal description is made in foreign lettering", but banned such representations that were "likely to make it difficult for consumers to distinguish the goods as domestically made". The Commission applied the notification in order to have the domestic origin of the product clearly indicated, e.g. by having the manufacturer's name marked clearly in Japanese. In addition to the above-mentioned legal regulations, the wine industry in Japan, taking into account the requests of the EC, had established the self-imposed rules on labelling of domestic wine. Since the establishment of the rule, the names of the manufacturer had been indicated clearly in Japanese lettering on the main labels of domestic wines in accordance with the rule. The polls conducted by the Fair Trade Commission in 1984 and 1986 had shown that very few consumers had ever mistaken domestic wines for imported ones on account of the labels. Thus, Japanese consumers were not misled as to the origin of the products. With regard

to spirits, the fair competition code, which had been established in accordance with the provision of Article 10 of the Act against Unjustifiable Premiums and Misleading Representations, provided that representations using the terms "Scotch", "Bourbon", "Irish" and "Canadian", which were internationally famous as the names of whisky-producing areas, should not be used. As a result, there existed no whiskies produced in Japan which had such appellations.

4. SUBMISSIONS BY INTERESTED THIRD PARTIES

4.1 Argentina

Argentina expressed its general concern at the Japanese customs duties and taxes on wine and alcoholic beverages, notably the discriminatory treatment of bottled wine exported from Argentina, which had caused very high consumer prices and had limited the export opportunities of Argentina.

4.2 Canada

Canada stated that imported whisky and domestic Japanese whisky should qualify as "like products" in terms of GATT Article III:2 because of their similar uses and characteristics. At the very least, Japan's special, first and second grades of whisky could be considered "directly competitive and substitutable products" in the sense of Article III:2. The routine classification of imported whisky in the "special grade" category and its taxation at a rate approximately seven times higher than the tax applied to the "second grade" whisky limited sales of Canadian whisky to Japan and afforded protection to domestic production inconsistent with Article III:2 first or second sentence, depending on whether the grades of whisky were held to be "like" products in terms of the first sentence or "directly competitive or substitutable" products in terms of the second sentence of Article III:2.

4.3 Finland

Finland stated that the negative impact of the Japanese alcohol taxation system extended to a number of products not specifically mentioned in the EEC complaint such as imported vodka. Finland had found it difficult to expand its exports of vodka to Japan due to tough competition with the Japanese product "shochu" which benefited from a more favourable internal tax treatment that openly discriminated against vodka and could only be explained as resulting from intentional protection of the competing product shochu. Vodka and shochu should be considered as "like" products in terms of Article III:2 because they were both white/clean spirits, made of similar raw materials, and their end uses were identical: either as straight "schnaps" type of drinks or in various mixtures. At the very least, vodka and shochu would have to be considered "directly competitive or substitutable" products in terms of Article III: 2. The difference of the liquor tax on vodka and shochu (both of an alcohol content of 40 per cent in volume) was at present 31.3 per cent. This different tax treatment was in violation of both Article III:2 first sentence and second sentence. The Japanese liquor tax system was an example of how "indirect tax discrimination" in the meaning of Article III:2 could be effectuated.

4.4 United States

4.4.1 The United States shared the concern of the European Community that Japan's categorization and taxation of distilled spirits and wine discriminated against western style alcoholic beverages by taxing them as luxury items differently from traditional and competitive Japanese beverages. Most other countries had just three tax classes for alcoholic beverages (i.e. malt beverages, wine and distilled spirits) and, if at all, provided for different tax rates within individual tax classes on the basis of alcohol content. In Japan, the tax differentiations based on class, grade, extract levels and alcohol content were used to tax western style beverages higher than the domestic products. For example, for each additional one per cent of alcohol, special grade whisky (western style) was taxed an additional 45

yen/litre, while second grade whisky (Japanese style) was taxed only an additional 36 yen/litre. For each additional one per cent of alcohol of the distilled spirit shochu, a Japanese beverage competing in the spirits market, the tax increased just 2.8 yen/litre for Group B shochu having an alcoholic content of between 26-31 per cent and 10.1 yen/litre for Group B shochu having and alcoholic content greater than 31 per cent. For Group A shochu having an alcoholic content of between 26 and 31 per cent, the tax increased by only 4.4 yen/litre for each additional one per cent of alcoholic content and increased by 16.8 yen/litre for Group A shochu having an alcoholic content exceeding 31 per cent. The method used by Japan for grading whisky into three categories with different specific taxes, barrier prices and ad valorem tax rates was arbitrary and had the effect of discriminating against US exports in favour of competitive domestic products. Even a low-priced US whisky was classified as a luxury good in Japan and taxed at a high rate. The different tax categories, specific tax rates and ad valorem taxes, combined With high tariffs, placed semi-sweet wines, wine coolers and imported still wines at an artificial price disadvantage.

4.4.2 The United States imposed taxes on all distilled spirits at the same rate and treated all distilled spirits as "like products" for tax purposes. In GATT practice, the term "like product" had been defined in a flexible case-by-case manner taking into account the facts of the particular case and the rationale for the like product test in GATT Article III, namely to avoid discrimination against imports. Tariff classifications had been found not to be determinative of the "like product" question (BISD 28S/102). With regard to Article III:2, the United States would not insist that all distilled spirits be considered like products. In the United States' view:

a) all grades within a given category (whisky, brandy, sake) were like products;

b) the subcategory of "spirits similar to whisky in colour, flavour and other properties" were like products to whisky;

c) type A shochu and type B shochu were like products;

d) the two subcategories of mirin were like products;

e) shochu and "spirits" were like products; and

f) all bottled unsweetened still wines were like products.

The United States pointed out that the Japanese tariff system did not distinguish between the various grades of whisky that were used for tax purposes. In order to avoid classifying shochu as a "spirit", which was more highly taxed, Japan had developed an artificial definition of shochu which distinguished it from similar western style spirits. For example, shochu could not:

- be made from malt or fruit (such as whisky, brandy and certain spirits);

- be filtered with charcoal (such as vodka);

- be made from sugar cane and distilled at less than 95 per cent alcohol (such as rum);

- have other ingredients added at the time of distillation (such as gin).

Japan had distinguished shochu from other spirits on the basis of seemingly minor differences. By contrast, Japan had combined other spirits such as gin, vodka, rum, etc. into a single category of "spirits", uniformly taxed at a high rate. To the extent that these spirits were "like" products for purpose of taxation, it would appear that shochu should be included in the spirits category.

4.4.3 The test for a "directly competitive or substitutable product" appeared to encompass products which were not sufficiently similar as to be "like" but which were similar in end use and were price sensitive. Beer, wine and distilled spirits competed directly with each other and were substitutable, primarily because they were all alcoholic beverages. But substitution occurred more readily within, rather than between, different categories of alcoholic beverages. At a minimum, the United States would consider all distilled spirits (including shochu, sake compound, whisky and spirits) as directly competitive and substitutable. Moreover, wine coolers were directly competitive and substitutable not only with bottled still wine, but also with other low and medium priced beverages, such as shochu which was popularly mixed with fruit juice as a cocktail.

4.4.4 In the United States' view, the following Japanese tax practices affecting exports from the United States violated Article III:2, first sentence:

- taxation of different grades of whiskies or spirits with properties similar to whisky at different tax rates;

- an inconsistent system of taxation of bottled unsweetened still wine, whereby wines priced below a barrier price were taxed at a specific rate, while wines priced above the barrier were subject to an ad valorem tax;

- taxation of the various subcategories of shochu at rates lower than the rates applicable to spirits.

Even though the United States did not consider it necessary to demonstrate that tax discrimination between "like" products afforded protection to domestic production, the United States did present data on their protective trade effects in case the Panel should determine that any of these alcoholic beverages were not "like" but "directly competitive or substitutable". The United States took the position that Japan's tax system violated Article III:1 and the second sentence of Article III:2 with respect to wine coolers and semisweet wines, which it considered directly competitive with and substitutable for, shochu; and in the event the Panel did not consider all still wines or all whiskies or shochu and spirits to be "like products", with respect to still wines, whiskies, and shochu/spirits.

4.5 Yugoslavia

Yugoslavia pointed out that recent changes of Japanese customs duties on wine had reduced the preferential margin under the Generalized System of Tariff Preferences and thereby also the sales opportunities of Yugoslav wine to Japan. This had brought about a sharp decline in Yugoslav exports of bulk wine to Japan. Yugoslav exporters had also raised objections concerning the calculation and collection of the internal tax, testing and certification procedures in Japan. Yugoslavia expressed the hope that in considering the Yugoslav concerns the Panel would take into account paragraphs 5 and 23 of the 1979 Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance (BISD 26S/210).

5. FINDINGS AND CONCLUSIONS

5.1 The Panel began the examination of the matter referred to it by noting that the dispute over Japanese taxes on imported wines and alcoholic beverages was due to the diverging views of the European Communities and japan on the interpretation of GATT Article III:1 and 2, which reads:

> "1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture,

processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production."

"2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1."

The interpretative note to Article III:2 adds as follows:

"A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed."

5.2 The Panel noted that this part of the complaint by the European Communities consisted of a cluster of complaints relating to a large number of alcoholic beverages, liquor categories and subcategories, liquor tax rates and taxation methods. The examination of these complaints in the light of Article III raised certain general questions relating to the interpretation of this GATT Article, on the answering of which the Panel findings would necessarily depend. The Panel considered it therefore appropriate to clarify first certain general questions common to these various complaints regarding Article III:2.

5.3 The Panel noted the view of the European Communities that Article III:2 should be construed in accordance with its clear wording to the effect that it required, first, a product comparison so as to determine what are "like products" or "directly competitive or substitutable products", and, second, a fiscal comparison in order to determine whether imported products were taxed in excess of like domestic products or were subject to internal taxes affording protection to domestic production of directly competitive or substitutable products.

5.4 The Panel then considered the contrary view argued by Japan that, because each contracting party remained free to classify products for tax purposes, the "likeness" or "directly competitive or substitutable" relationship of imported and domestic products were legally not relevant to the interpretation of Article III:2 if

a) imported and domestic products were taxed in a non-discriminatory manner, regardless of their origin, within one and the same product category defined by a contracting party for tax purposes, and

b) there was both domestic production and importation of products within the product category defined for tax purposes.

5.5 The Panel carefully examined these two divergent interpretations of Article III:2 and reached the following conclusions:

a) The text of the first sentence of Article III:2 clearly indicates that the comparison to be made is between internal taxes on imported products and those applied… to like domestic products". The wording "like" products (in the French text: "products similaires") has been used also in other GATT Articles on non-discrimination (e.g. Article I:1) in the sense not only of "identical" or "equal" products but covering also products with similar qualities (see, for instance, the 1981 Panel Report on Tariff Treatment by Spain of Imports of Unroasted Coffee, BISD 28S/102, 112).

b) The context of Article III:2 shows that Article III:2 supplements, within the system of the General Agreement, the provisions on the liberalization of customs duties and of other charges by prohibiting discriminatory or protective taxation against certain products from other GATT contracting parties. The Panel found that this context had to be taken into account in the interpretation of Article III: 2. For instance, the prohibition under GATT Article I:1 of different tariff treatment for various types of "like" products (such as unroasted coffee, see BISD 28S/102, 112) could not remain effective unless supplemented by the prohibition of different internal tax treatment for various types of "like" products. Just as Article I:1 was generally construed, in order to protect the competitive benefits accruing from reciprocal tariff bindings, as prohibiting "tariff specialization" discriminating against "like" products, only the literal interpretation of Article III:2 as prohibiting "internal tax specialization" discriminating against "like" products could ensure that the reasonable expectation, protected under GATT Article XXIII, of competitive benefits accruing under tariff concessions would not be nullified or impaired by internal tax discrimination against like products. It had therefore been correctly stated in another Panel Report recently adopted by the CONTRACTING PARTIES that "Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products" (L/6175, paragraph 5.1.9). And it had been for similar reasons that, during the discussion in the GATT Council of the panel report on Spain's restrictions on the domestic sale of soyabean oil which had not been adopted by the Council, several contracting parties, including Japan, had emphasized "with regard to Article III:4 that the interpretation of the term 'like products' in the Panel Report as meaning 'more or less the same product' was too strict an interpretation" (C/M/152 at page 16).

c) The drafting history confirms that Article III:2 was designed with "the intention that internal taxes on goods should not be used as a means of protection" (see: UN Conference on Trade and Employment, Reports of Committees, 1948, page 61). As stated in the 1970 Working Party Report on Border Tax Adjustments in respect of the various GATT provisions on taxation, "the philosophy behind these provisions was the ensuring of a certain trade neutrality" (BISD 18S/99). This accords with the broader objective of Article III "to provide equal conditions of competition once goods had been cleared through customs" (BISD 7S/64), and to protect thereby the benefits accruing from tariff concessions. This object and purpose of Article III:2 of promoting non-discriminatory competition among imported and like domestic products could not be achieved if Article III:2 were construed in a manner allowing discriminatory and protective internal taxation of imported products in excess of like domestic products.

d) Subsequent GATT practice in the application of Article III further shows that past GATT panel reports adopted by the CONTRACTING PARTIES have examined Article III: 2 and 4 by determining, firstly, whether the imported and domestic products concerned were "like" and, secondly, whether the internal taxation or other regulation discriminated against the imported products (see, for instance, BISD 25S/49, 63; L/6175, paragraph 5). Past GATT practice has clearly established that "like" products in terms of Article III:2 are not confined to identical products but cover also other products, for instance if they serve substantially identical end-uses (see L/6175, paragraph 5.1.1).

The Panel concluded that the ordinary meaning of Article III:2 in its context and in the light of its object and purpose supported the past GATT practice of examining the conformity of internal taxes with Article III:2 by determining, firstly, whether the taxed imported and domestic products are like" or "directly competitive or substitutable" and, secondly, whether the taxation is discriminatory (first sentence) or protective (second sentence of Article III:2). The Panel decided to proceed accordingly also in this case.

5.6 The CONTRACTING PARTIES have never developed a general definition of the term "like products" in Article III:2. Past decisions on this question have been made on a case-by-case basis after examining a number of relevant factors. The working party report on border tax adjustments,

adopted by the CONTRACTING PARTIES in 1970, concluded that problems arising from the interpretation of the terms "like" or "similar" products, which occurred some sixteen times throughout the General Agreement, should be examined on a case-by-case basis using, inter alia, the following criteria: the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; and the product's properties, nature and quality (BISD 18S/102, paragraph 18). The GATT drafting history confirms that "the expression had different meanings in different contexts of the Draft Charter" (EPCT/C II/65, page 2). Subsequent GATT practice indicates that, as stated in respect of GATT Article I:1 in the 1981 Panel Report on the Tariff Treatment applied by Spain to Imports of Unroasted Coffee, "neither the General Agreement nor the settlement of previous cases gave any definition of such concept" (BISD 28S/102, III). The Panel was aware of the more specific definition of the term "like product" in Article 2:2 of the 1979 Antidumping Agreement (BISD 26S/172) but did not consider this very narrow definition for the purpose of antidumping proceedings to be suitable for the different purpose of GATT Article III:2. The Panel decided, therefore, to examine the table of "like products" submitted by the EEC (see Annex V) on a product-by-product basis using the above-mentioned criteria as well as others recognized in previous GATT practice (see BISD 25S/49, 63), such as the Customs Cooperation Council Nomenclature (CCCN) for the classification of goods in customs tariffs which has been accepted by Japan. The Panel found that the following alcoholic beverages should be considered as "like products" in terms of Article III:2 in view of their similar properties, end-uses and usually uniform classification in tariff nomenclatures:

- imported and Japanese-made gin;

- imported and Japanese-made vodka;

- imported and Japanese-made whisky (including all grades classified as "whisky" in the Japanese Liquor Tax Law) and "spirits similar to whisky in colour, flavour and other properties" as described in the Japanese Liquor Tax Law;

- imported and Japanese-made grape brandy (including all grades classified as "brandy" in the Japanese Liquor Tax Law);

- imported and Japanese-made fruit brandy (including all grades classified as "brandy" in the Japanese Liquor Tax Law);

- imported and Japanese-made "classic" liqueurs (not including, for instance, medicinal liqueurs);

- imported and Japanese-made unsweetened still wine;

- imported and Japanese-made sparkling wines.

The Panel agreed in this respect with the arguments submitted to it not only by the European Communities but also by other important producing countries of wines and distilled spirits that gin, vodka, whisky, grape brandy, other fruit brandy, certain "classic" liqueurs, still wine and sparkling wine, respectively, were recognized not only by governments for purposes of tariff and statistical nomenclature, but also by consumers to constitute "each in its end-use… a well defined and single product intended for drinking" (BISD 28S/102, 112, paragraph 4.7). The Panel also agreed in this respect with the finding of an earlier panel report adopted by the CONTRACTING PARTIES that minor differences in taste, colour and other properties did not prevent products qualifying as "like products" (BISD 28S/102, 112).

5.7 The Panel did not exclude that also other alcoholic beverages could be considered as "like" products. Thus, even though the Panel was of the view that the "likeness" of products must be examined

taking into account not only objective criteria (such as composition and manufacturing processes of products) but also the more subjective consumers' viewpoint (such as consumption and use by consumers), the Panel agreed with the arguments submitted to it by the European Communities, Finland and the United States that Japanese shochu (Group A) and vodka could be considered as like" products in terms of Article III:2 because they were both white/clean spirits, made of similar raw materials, and their end-uses were virtually identical (either as straight "schnaps" type of drinks or in various mixtures). Since consumer habits are variable in time and space and the aim of Article III:2 of ensuring neutrality of internal taxation as regards competition between imported and domestic like products could not be achieved if differential taxes could be used to crystallize consumer preferences for traditional domestic products, the Panel found that the traditional Japanese consumer habits with regard to shochu provided no reason for not considering vodka to be a "like" product. The Panel decided not to examine the "likeness" of alcoholic beverages beyond the requests specified in the complaint by the European Communities (see Annex V). The Panel felt justified in doing so also for the following reasons: Alcoholic drinks might be drunk straight, with water, or as mixes. Even if imported alcoholic beverages (e.g. vodka) were not considered to be "like" to Japanese alcoholic beverages (e.g. shochu Group A), the flexibility in the use of alcoholic drinks and their common characteristics often offered an alternative choice for consumers leading to a competitive relationship. In the view of the Panel there existed - even if not necessarily in respect of all the economic uses to which the product may be put - direct competition or substitutability among the various distilled liquors, among various liqueurs, among unsweetened and sweetened wines, and among sparkling wines. The increasing imports of "Western-style" alcoholic beverages into Japan bore witness to this lasting competitive relationship and to the potential products substitution through trade among various alcoholic beverages. Since consumer habits vis-a-vis these products varied in response to their respective prices, their availability through trade and their other competitive inter-relationships, the Panel concluded that the following alcoholic beverages could be considered to be "directly competitive or substitutable products" in terms of Article III:2, second sentence:

- imported and Japanese-made distilled liquors, including all grades of whiskies/brandies, vodka and shochu Groups A and B, among each other; - imported and Japanese-made liqueurs among each other;

- imported and Japanese-made unsweetened and sweetened wines among each other; and

- imported and Japanese-made sparkling wines among each other.

5.8 Having compared the imported and domestic alcoholic beverages in order to determine their "likeness" or "directly competitive or substitutable" relationship, the Panel next proceeded to a comparison of the fiscal burdens on these products. The Panel noted that the first sentence of Article III:2 prohibited the direct or indirect imposition of "internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products". The Panel noted that the wording of this prohibition of tax discrimination was strict. It had been applied in GATT practice also in a strict manner, for instance as prohibiting even very small tax differentials amounting to US dollar 0.0002 per litre of imported petroleum (see the panel report adopted by the CONTRACTING PARTIES on US taxes on petroleum, L/6175) and as excluding a de minimis. argument based on allegedly minimal trade effects (see L/6175, paragraphs 5.1.2 to 5.1.9). The Panel further found that the wording "directly or indirectly" and "internal taxes… of any kind" implied that, in assessing whether there is tax discrimination, account is to be taken not only of the rate of the applicable internal tax but also of the taxation methods (e.g. different kinds of internal taxes, direct taxation of the finished product or indirect taxation by taxing the raw materials used in the product during the various stages of its production) and of the rules for the tax collection (e.g. basis of assessment).

5.9 The Panel then examined the European Communities' contention (see above paragraph 3.5) that Japanese internal taxes on whiskies, brandies, still wines, sparkling wines, spirits and liqueurs imported from the EEC were in excess of those applied to like Japanese products, and reached the following conclusions:

a) Whiskies and brandies subject to the grading system: The Panel noted that the Japanese specific tax rates on imported and Japanese whiskies/brandies special grade (2,098,100 yen/kl) were considerably higher than the Japanese specific tax rates on whiskies/brandies first grade (1,011,400 yen/kl) and second grade (296,200 yen/kl). The Panel was unable to find that these tax differentials corresponded to objective differences of the various distilled liquors, for instance that they could be explained as a non-discriminatory taxation of their respective alcohol contents. The Panel further found that, as a result of this differential taxation of "like products", almost all whiskies/brandies imported from the EEC were subject to the higher rates of tax whereas more than half of whiskies/brandies produced in Japan benefited from considerably lower rates of tax. The Panel concluded, therefore, that (special and first grade) whiskies/brandies imported from the EEC were subject to internal Japanese taxes "in excess of those applied... to like domestic products" (i.e. first and second grade whiskies/brandies) in the sense of Article III:2, first sentence.

b) Wines, spirits and liqueurs subject to the "mixed" system of specific tax and ad valorem tax: The Panel noted that imported and domestic wines, whiskies, brandies, spirits and liqueurs were subject to ad valorem taxes in lieu of the specific tax when the manufacturer's selling price (CIF and customs duty for imported products) exceeded a specified threshold (see Annex IV). The Panel was of the view that a "mixed" system of specific and ad valorem liquor taxes was as such not inconsistent with Article III:2, which prohibits only discriminatory or protective taxation of imported products but not the use of differentiated taxation methods as such, provided the differentiated taxation methods do not result in discriminatory or protective taxation.

The Panel noted that the ad valorem taxes were not applied to all liquor categories such as the traditional Japanese products shochu, mirin and sake (first and second grades). The Panel was unable to find that the differences as to the applicability and non-taxable thresholds of the ad valorem taxes were based on corresponding objective product differences (e.g. alcohol contents) and formed part of a general system of internal taxation equally applied in a trade-neutral manner to all like or directly competitive liquors (e.g. "alcohol taxes" equally applied to all alcoholic beverages). The Panel was of the view that "like" products do not become "unlike" merely because of differences in local consumer traditions within a country (e.g. consumption of shochu mainly in specific regions within Japan) or differences in their prices, which were often influenced by external government measures (e.g. customs duties) and market conditions (e.g. supply and demand, sales margins). The Panel was convinced that such an interpretation would run counter to the objective of Article III:2 to avoid that discriminatory or protective internal taxation of imported products would distort price competition with domestic like or directly competitive products, for instance by creating different price and consumer categories and hardening consumer preferences for traditional home products.

The Panel concluded from the preceding findings that - since liquors above the non-taxable thresholds were subjected to ad valorem taxes in excess of the specific taxes on "like" liquors below the threshold (e.g. ad valorem tax rates up to 8 times higher than the specific tax rates on wines, 4 times higher than the specific tax rates on liqueurs and 2 times higher than the specific tax rates on spirits) - the imposition of ad valorem taxes on wines, spirits and liqueurs imported from the EEC, which are considerably higher than the specific taxes on "like" domestic wines, spirits and liqueurs, was inconsistent with Article III:2, first sentence.

c) The different methods of calculating ad valorem taxes on imported and domestic liquors: The Panel shared the view expressed by both parties that Article III:2 does not prescribe the use of any specific method or system of taxation. The Panel was further of the view that there could be objective reasons proper to the tax in question which could justify or necessitate differences in the system of taxation for imported and for domestic products. The Panel found that it could be also compatible with Article III:2 to allow two different methods of calculation of price for tax purposes. Since Article III:2 prohibited only discriminatory or protective tax burdens on imported products, what mattered was, in the view of the Panel, whether the application of the different taxation methods actually had a discriminatory or protective effect against imported products. The Panel could therefore not agree with the European Community's view that the mere fact that the so-called "fixed subtraction system" was available only for domestic liquors constituted in itself a discrimination contrary to Article III:2 or 4. Nor could the Panel agree with the EEC submission that the mere possibility of exceptional tax rates available only for domestic whiskies/brandies provided sufficient evidence of tax discrimination contrary to Article III:2. The Panel shared the doubts expressed by the European Community that the deduction from the retail price of a uniform 30 per cent non-taxable allowance (designed to cover trade profits, manufacturer's rebate and manufacturer's delivery charges) must not necessarily result in what would have been the manufacturer's selling price. Yet, the Panel did not dispose of sufficient evidence for concluding that the application of this simplified method of tax base assessment had actually resulted, or was likely to result, in tax discrimination against liquors imported into Japan.

d) Taxation according to extract content: The Panel recalled its earlier finding that imported and Japanese-made sparkling wines, as well as imported and Japanese-made "classic" liqueurs, were "like products", respectively and that minor differences in taste, colour and other properties (including different alcohol contents) did not prevent products qualifying as "like products". It followed from the clear wording of Article III:2 that imported liquors "shall not be subject… to internal taxes… in excess of those applied… to like domestic products". The Panel was of the view that this unqualified wording must not necessarily mean that there could never be any circumstances in which different tax treatment of "like products" was compatible with the General Agreement. The Panel noted, for instance, that GATT Article II:2,a permitted the non-discriminatory taxation "of an article from which the imported product has been manufactured or produced in whole or in part", and that such a non-discriminatory alcohol tax on like alcoholic beverages with different alcohol contents could result in differential tax rates on like products. The Panel further noted that, pursuant to the "general exceptions" listed in Article XX, Article III:2 must not be construed "to prevent the adoption or enforcement by any contracting party of measures… (b) necessary to protect human, animal or plant life or health" (Article XX: (b)); non-discriminatory measures under this exception clause might also entail differential tax rates on like products. The Panel noted that Japan's specific and ad valorem tax rates on liqueurs and sparkling wines differed according to alcohol and extract contents and that Japan considered these differential taxes to be compatible with Article III:2 regardless of their justifiability as a non-discriminatory internal taxation of these ingredients equally applied to all products with such ingredients, and regardless of their justifiability under any of the exception clauses of GATT Article XX. The Panel noted also the contrary view of the EEC "that taxation according to extract content is artificial and irrational and discriminates against imports contrary to Article III:2" because it ensured "that almost all Community liqueurs are subject to the higher rate of specific tax whilst some Japanese liqueurs are able to benefit from a lower specific rate (one third of the rate on most Community liqueurs) together with a lower ad valorem rate (50 per cent as opposed to 100 per cent) and a much lower increment per degree of alcohol (9.780 yen per 1 per cent over 13 per cent compared with 24.5 yen per 1 per cent over 15 per cent in the higher rate category)". Having found that

- liqueurs and sparkling wines with high raw material contents, imported into Japan, were subject to internal taxes in excess of those applied to like domestic liqueurs and sparkling wines with lower raw material contents (see Annexes III and IV), and that

- this differential taxation of like products depending on their extract and raw material content had not been, and apparently could not be, justified as resulting from a non-discriminatory internal tax on the raw material content concerned or as justifiable under any of the exception clauses of the General Agreement,

the Panel concluded that this imposition of higher taxes on "classic" liqueurs and sparkling wines with higher raw material content was inconsistent with Article III:2, first sentence.

5.10 The Panel next turned to examining the European Community's contention (see above paragraph 3.7) that the Japanese liquor taxes were inconsistent with Article III:2, second sentence, because

- distilled liquors (whisky, brandy, gin, vodka, etc) which were directly competitive with shochu were affected by the system of categorization which permitted shochu to benefit from extremely favourable taxation in comparison with other spirits; and

- Community products in categories which were subject to ad valorem taxation were at a disadvantage in comparison with Japanese "traditional" products which were only obliged to be subject to specific taxes.

5.11 The Panel recalled its findings that distilled liquors, including all grades of shochu types A and B, were "directly competitive or substitutable products" in terms of the interpretative note to Article III:2 (see above paragraph 5.7). The Panel noted that shochu was not subject to ad valorem taxes and that the specific tax rates on shochu were many times lower than the specific tax rates on whiskies, brandies and other spirits. The Panel noted that, whereas under the first sentence of Article III:2 the tax on the imported product and the tax on the like domestic product had to be equal in effect, Article III:1 and 2, second sentence, prohibited only the application of internal taxes to imported or domestic products in a manner "so as to afford protection to domestic production". The Panel was of the view that also small tax differences could influence the competitive relationship between directly competing distilled liquors, but the existence of protective taxation could be established only in the light of the particular circumstances of each case and there could be a de minimis. level below which a tax difference ceased to have the protective effect prohibited by Article III:2, second sentence. The Panel found that the following factors were sufficient evidence of fiscal distortions of the competitive relationship between imported distilled liquors and domestic shochu affording protection to the domestic production of shochu:

- the considerably lower specific tax rates on shochu than on imported whiskies, brandies and other spirits (see Annex III);

- the imposition of high ad valorem taxes on imported whiskies, brandies and other spirits and the absence of ad valorem taxes on shochu;

- the fact that shochu was almost exclusively produced in Japan and that the lower taxation of shochu did "afford protection to domestic production" (Article III: 1) rather than to the production of a product produced in many countries (say, butter) in relation to another product (say, oleomargarine, as in the example referred to by Japan in paragraph 3.11 above);

- the mutual substitutability of these distilled liquors, as illustrated by the increasing imports into Japan of "Western-style" distilled liquors and by the consumer use of shochu blended in various proportions with whisky, brandy or other drinks.

Since it has been recognized in GATT practice that Article III:2 protects expectations on the competitive relationship between imported and domestic products rather than expectations on trade volumes (see L/6175, paragraph 5.1. 9), the Panel did not consider it necessary to examine the quantitative trade effects of this considerably different taxation for its conclusion that the application of considerably lower internal taxes by Japan on shochu than on other directly competitive or substitutable distilled liquors had trade-distorting effects affording protection to domestic production of shochu contrary to Article III:1 and 2, second sentence.

5.12 The Panel next examined the contention of the EEC that wines, whiskies, brandies, other spirits and liqueurs imported from the EEC and subject to ad valorem tax were at a disadvantage in comparison with Japanese "traditional" products which were only subject to specific taxes. The Panel noted that the "traditional" Japanese liquors sake (first and second grade), sake compound, shochu and mirin were. not subject to ad valorem taxes and that the grading of sake was voluntary so that less than 0.1 per cent of all sake was subject to ad valorem taxation. The Panel recalled its findings that shochu and other distilled liquors were "directly competitive or substitutable" products in terms of the interpretative note to Article III:2. The Panel further recalled its finding that the application of higher internal taxes on imported whiskies, brandies and other spirits than on shochu afforded protection to the domestic production of shochu contrary to Article III:1 and 2, second sentence.

The Panel noted that the European Communities had not specified whether and why they considered sake, sake compound and mirin to be "directly competitive or substitutable" products in relation to wines of fresh grapes or to distilled spirits and liqueurs imported from the EEC. The Panel noted that rice wine (sake) and wines of fresh grapes were classified under separate headings in the CCCN nomenclature. The Panel did not exclude that there could be a directly competitive or substitutable" relationship between sake, sake compound, mirin and liquors imported from the EEC into Japan. The Panel did, however, consider it neither necessary nor appropriate to decide on this question because, in any case, the Panel had not been presented sufficient evidence to determine whether and to what extent wines and other liquors imported from the EEC had actually been subjected to higher tax burdens than domestic sake, sake compound or mirin affording protection to the domestic production of these latter products.

5.13 Having concluded that whiskies, brandies, other distilled spirits, liqueurs, still wines and sparkling wines imported into Japan were subject to discriminatory or protective Japanese taxes contrary to Article III:2, the Panel examined whether these discriminatory or protective taxes could be justified by the argument submitted by Japan that the tax differentials were designed to realize the basic Japanese tax policy objective of "taxation according to tax-bearing ability" of the respective consumers. The Panel agreed with the submissions of both parties that Article III:2 does not impose an obligation on contracting parties to adopt a specific tax system or specific taxation methods. Nor does a finding of an inconsistency of a tax with Article III:2 oblige the contracting party to reduce the tax on the imported product, as it could also remove any discriminatory or protective effect by raising the tax on the domestic product concerned. The General Agreement also explicitly permits 'imposing at any time on the importation of any product… a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part" (Article II:2,a), for instance a charge on the alcohol component of imported liquors equivalent to a non-discriminatory internal alcohol tax. The "general exceptions" provided for in GATT Article XX might also justify internal tax differentiations among like or directly competitive products, for instance if "necessary to protect human… or plant life or health (Article XX, b). The Panel found, therefore, that the General Agreement reserved each contracting party a large degree of freedom to decide autonomously on the objectives, level, principles and methods of its internal taxation of goods.

The Panel noted the Japanese submission that, for instance, the grading system for whisky was "based on the circumstances of production and consumption of whiskies in Japan", and that generally "taxes on liquors are levied according to the tax-bearing ability on the part of consumers of each category of liquor". The Panel was of the view that the use of product and tax differentiations with the view of maintaining or promoting certain production and consumption patterns could easily distort price-competition among like or directly competitive products by creating price differences and price-related consumer preferences which would not exist in case of non-discriminatory internal taxation consistent with Article III:2. The Panel noted that the General Agreement did not make provision for such a far-reaching exception to Article III:2, and that the concept of "taxation according to tax-bearing ability of prospective consumers" of a product did not offer an objective criterion because it relied on necessarily subjective assumptions about future competition and inevitably uncertain consumer responses. The Panel was of the view that a national policy of "taxation according to tax-bearing ability" did not necessitate discriminatory or protective taxation of imported products and could be pursued by each contracting party in many ways in compliance with Article III:2. A national policy of promoting the domestic production of certain goods could likewise be pursued in conformity with the General Agreement (e.g. by means of production subsidies) without discriminatory or protective taxation of imported goods. The Panel concluded therefore from the text, system and objectives of the General Agreement that, even though each contracting party retained broad freedom as to its internal tax policy also in respect of its internal taxation of goods, the General Agreement did not provide for the possibility of justifying discriminatory or protective taxes inconsistent with Article III:2 on the ground that they had been introduced for the purpose of "taxation according to the tax-bearing ability" of domestic consumers of imported and directly competitive domestic liquors.

5.14 The Panel then examined the European Community's claim that Japan had violated its obligation under GATT Article IX:6 to "cooperate... with a view to preventing the use of trade names in such manner as to misrepresent the true origin of a product, to the detriment of such distinctive regional or geographical names of products of the territory of a contracting party as are protected by its legislation", and to "accord full and sympathetic consideration to such requests or representations as may be made by any other contracting party regarding the application of the undertaking set forth in the preceding sentence to names of products which have been communicated to it by the other contracting party". The Panel noted from the drafting history relating to Article IX:6 that it had been agreed that the text of Article IX:6

> "should not have the effect of prejudicing the present situation as regards certain distinctive names of products, provided always that the names affixed to the products cannot misrepresent their true origin. This is particularly the case when the name of the producing country is clearly indicated. It will rest with the governments concerned to proceed to a joint examination of particular cases which might arise if disputes occur as a result of the use of distinctive names of products which may have lost their original significance through constant use permitted by law in the country where they are used". (Reports of Committees and Principal Sub-Committees, UN Conference on Trade and Employment, 1948, p. 79).

The Panel noted that the Japanese Law and Cabinet Order concerning Liquor Business Association and Measures for Securing Revenue of Liquor Tax stipulated that "Any manufacturer of liquors must indicate, at a legible location of the container of liquors... which are shipped out from the manufacturing premise..., the name of the manufacturer, the place of the manufacturing premise..., the capacity of the container..., the category of liquors..., the grade of liquors and the following matters according to the category of liquors, in a conspicuous manner", including the alcohol content in the case of wine, whisky, brandy, spirits and liqueurs. The Panel examined a large number of labels, photos, wine bottles and packages submitted by the EEC as evidence. The Panel found that this evidence seemed to confirm the Japanese submission to the Panel that the labels on liquor bottles manufactured in Japan indicated their Japanese origin.

5.15 The Panel examined the view of the European Community that the use of French words, French names, of other European languages and European label styles or symbols by japanese manufacturers continued to mislead Japanese consumers as to the origin of the liquors, and that the indication of a Japanese manufacturer did not clarify his precise activities because, for instance, wines bottled in Japan could contain as much as 95 per cent imported bulk wine. The Panel inferred from the wording of Article IX:6 that it was confined to an obligation to "cooperate with each other with a view to preventing the use of trade names in such manner as to misrepresent the true origin of a product, to the detriment of such distinctive regional or geographical names of products of the territory of a contracting party as are protected by its legislation". The Panel noted that there was no definition of a "trade name" in the General Agreement, and that there were differences in the laws of various countries as to what might constitute a trade name. The Panel did not consider it necessary to define the term "trade name" in this case for the following reasons: Article IX:6 was designed to protect "distinctive regional or geographical names of products of the territory of a contracting party as are protected by its legislation". The Panel did not dispose of evidence and was unable to find that the use by Japanese manufacturers of labels written partly in English (in the case of whisky and brandy) or in French (in the case of wine), the use of the names of varieties of grapes (such as "Riesling" or "Semillon"), or the use of foreign terms to describe Japanese spirits ("whisky", "brandy") or Japanese wines ("chateau", "reserve", "vin rose") had actually been to the detriment of "distinctive regional or geographical names of products" produced and legally protected in the EEC. Nor could the Panel find that Japan - given, for example, its participation in the Madrid Agreement for the Repression of False or Deceptive Indications of Source on Goods and its internal laws and regulations on labelling and on the protection of distinctive regional or geographical names (such as "Armagnac" or "Chianti") - had failed to meet its obligation to cooperate pursuant to GATT Article IX:6.

5.16 The Panel recalled the established GATT principle that "where there is an infringement of the obligations assumed under the General Agreement, the action is considered prima facie to constitute a case of nullification or impairment" (BISD 26S/216). Having found that whiskies, brandies, other distilled spirits, liqueurs, still wines and sparkling wines imported into Japan were subject to discriminatory or protective Japanese taxes contrary to Article III:2, the Panel concluded that these taxes inconsistent with Article III:2 had to be presumed to cause nullification or impairment of benefits accruing to the European Community under the General Agreement. The Panel noted the Japanese submission that imports of these liquors into Japan had considerably increased since the 1960's. The Panel shared, however, the view expressed in another panel report adopted by the CONTRACTING PARTIES that an increase in imports could not refute the presumption that discriminatory or protective taxes inconsistent with Article III:2 had impaired the competitive benefits protected under Article III:2 because, inter alia, an increase in imports did say nothing about what the trade might have been in the absence of the inconsistent trade restrictions (see the Panel Report on US Taxes on Petroleum, L/6175, paragraphs 5.1.6 to 5.1.10).

5.17 The Panel therefore suggests that the CONTRACTING PARTIES recommend that Japan bring its taxes on whiskies, brandies, other distilled spirits (such as gin and vodka), liqueurs, still wines and sparkling wines in conformity with its obligations under the General Agreement.

ANNEX I: Classification of Liquors

The Japanese Liquor Tax Law classifies liquors into 10 categories and 13 subcategories and grades.

	Categories	Subcategories	Grade
Liquors (defined as any beverage having an alcohol content of not less than one degree (the Japanese Liquor Tax Law, Article 2).	Sake		Special grade First grade Second grade
	Sake compound		
	Shochu	Shochu (group A)	
		Shochu (group B)	
	Mirin	Mirin (group A)	
		Mirin (Group B)	
	Beer		
	Wines	Wine	
		Sweet wine	
	Whiskies	Whisky	Special grade First grade Second grade
		Brandy	
	Spirits		Special grade First grade Second grade
		Spirits	
		Raw material alcohol	
	Liqueurs		
	Other Liquors	Sparkling liquor	
		Powdered liquor	
		Other miscellaneous liquor	

Source: Submission by Japan.

Annex II: TRANSLATION OF PART OF THE JAPANESE LIQUOR TAX LAW

Source: Submission by Japan.

ARTICLE 3 DEFINITION OF TERMS

1. The expression "alcoholic content" shall mean, the amount of ethyl alcohol (volume percentage) contained in liquor at a temperature of 15 degrees C. 2. The expression "extract content" shall mean the amount of unvolatile ingredients (gram) contained in 100 cm3 of liquor at a temperature of 15 degrees C.

3. The expression "seishu" shall mean liquors which are made by:

(a) fermenting rice, malted rice and water and then filtering them.

(b) fermenting rice, water, and the raw materials such as lees of seishu, malted rice or any of those listed in the government ordinance (but liquors which fall under categories (a) and (c) are excluded here) and then filtering them, provided that the total weight of the materials listed in the government ordinance shall not exceed that of rice (including malt rice).

(c) adding lees of seishu to seishu and then filtering them.

4. The expression "Gosei-Seishu (sake compound)" shall mean liquors which can be made from alcohol (including liquors which fall under the subsequent item except the part concerning the alcoholic content and at the same time whose alcoholic content is from 36 per cent to 45 per cent both inclusive, but excluding liquors to which any material other than water is added - the same applies for the following except item (9) and article 8 - (3)), shochu (excluding those to which any material other than water is added - the same applies for (6) and (8)), seishu, and grape sugar or any of the other raw materials listed in the government ordinance, and whose taste, colour and other properties are similar to those of seishu (with regards to liquors for which rice or any product purely or partially made from rice is used as raw material, the total weight of rice - including rice used as sole or partial ingredient for such a product as being used to make liquors - should not exceed 5 per cent of the weight of liquor when it is calculated, setting the alcoholic content at 20 per cent).

5. The expression "shochu" shall mean liquors made by distilling alcoholic substance (including those to which water is added, and those produced, as being provided in the government ordinance, by adding water, sugar (the sugar here is limited to those kinds listed in the Group 2 and 3 under Paragraph (1) of Article 2 of the Sugar Consumption Tax Law) or any of the other materials listed in the government ordinance excluding those which have an extract content of 2 per cent or over but excluding those listed below) and the alcoholic content of which is 45 per cent and less (but below 36 per cent for those produced by a continuous distillation machine - which can remove fusel oil, aldehyde and some other impurities while distilling a continuous flow of alcoholic substances; the same applies to the following).

(a) liquors made purely or partially from germinated cereals or fruits (including dried or boiled fruits and condensed juice of fruits, excluding dates and any other materials listed in the government ordinances the some applies to the following)

(b) liquors filtered through charcoal of white birch or any other materials listed in the government ordinance

(c) liquors which are made purely or partially from products containing saccharide (excluding sugar listed in the Group 1 - type A of Article 2-1-(1) of the Sugar Consumption Tax Law) with an alcoholic content of less than 95 per cent at the time of discharge in the process of distillation of alcoholic substances.

(d) liquors produced by adding an exudate of another material to alcohol generated by distilling alcoholic substances.

6. The expression "mirin" shall mean liquors which are produced by:

(a) adding shochu or alcohol to rice and malted rice and then filtering them

(b) adding mirin or any of the other products listed in the government ordinance to rice, malted rice and shochu or alcohol and then filtering them

(c) adding shochu or alcohol to mirin

(d) adding the lees of mirin to mirin and then filtering them.

7. The expression "beer" shall mean liquors which are produced by:

(a) fermenting malt, hops and water

(b) fermenting malt, hops, water and rice or any of the other materials listed in the government ordinance provided that the total weight of the materials listed in the ordinance does not exceed 50 per cent of the weight of malt.

8. The expression "wines" shall mean the liquors listed below whose extract content is below 21 degrees (but no limit is set for the extract content of liquors which come under (a) below)

(a) Liquors produced by fermenting fruits themselves or fruits plus water

(b) Liquors produced by adding saccharide, in accordance with the ordinance, to fruits or fruits plus water, and then fermenting them

(c) Liquors produced by adding water, calcium carbonate or any of the other types of anti-acid agents listed in the government ordinance to fruits or fruits to which saccharide is added is accordance with the government ordinance, and then fermenting them (excluding liquors which fall under (a) and (b) above)

(d) Liquors produced by adding brandy (defined in (d) to (g) of the subsequent item), alcohol, spirits (defined in the first item of the subsequent article and limited to those listed in the government ordinance), shochu (these hereinafter referred to as "brandies" in this item), saccharide, flavouring, colouring or water to liquors listed in (a) to (c) of this item. If brandies are added, the total alcoholic content of the additive - if brandies have already been added, the alcoholic content of such previous additives is also included - should not exceed 90 per cent of the alcoholic content of the liquors made by adding them: the same applies to the following (e))

(e) Liquors made by soaking certain plants in the liquors listed in (a) to (d) above to let the plants' exudate mingle in such liquors or by adding drug, and made by adding brandies, saccharide, flavouring, colouring or water to the liquors made as above.

9. The expression "whiskies" shall mean liquors which are listed below. As for the liquors listed in (a), (b), (d), (e) and (g), however, those which fall under the categories of (b), (c) and (d) of item 5 but those liquors which are stipulated otherwise by the government ordinance are not included here.

(a) Liquors produced by distilling an alcoholic substance which is saccharified and fermented from germinated grain and water, or by distilling an alcoholic substance which is obtained by saccharifying and fermenting grain with the aid of germinated grain and water.

(b) Liquors produced by distilling alcoholic substances made from germinated grain and other materials provided that if the alcoholic substance is made from a mixture of materials containing germinated grain and fruits the weight of the germinated grain is greater than that of the fruits; and that the weight of germinated grain is not less than 20 per cent of the weight of all the materials except water as far as the alcoholic content of the alcoholic substance at the discharging stage of distillation is not less than 940. Those liquors which fall under (a) above are excluded here.

(c) Liquors produced by adding alcohol, spirits, shochu, flavouring, colouring or water to whisky malt (defined in (a) and (b) above: the same applies to the following) and whose flavour, colour, and other properties are similar to those of whisky malt.

(d) Liquors produced by distilling an alcoholic substance which is fermented from fruits (excluding squeezed ones: the same applies to the following) or from fruits plus water, or by distilling wine (defined in Article 4 (1), and excluding ones made from squeezed fruits).

(e) Liquors produced by distilling an alcoholic substance made from fruits and other materials provided that the weight of the fruits is not less than 15 per cent of the weight of all the materials except water. Liquors which come under (b) and (d) above are excluded.

(f) Liquors produced by adding alcohol, spirits, shochu, flavouring, colouring or water to brandy malt (defined in (d) and (e) above: the same applies to the following) and whose flavour, colour, and other properties are similar to those of brandy malt.

(g) Liquors produced by distilling lees of wine or an alcoholic substance fermented from squeezed fruits or lees of wine or from these plus saccharide, calcium carbonate, any of other materials listed in the government ordinance, or water, or liquors produced by adding alcohol, spirits, shochu, flavouring, colouring or water to the liquors produced as above and whose flavour, colour and other properties are similar to those of brandy malt.

10. The expression "spirits" shall mean liquors which do not fall under any of the items from 3 to 9 and whose extract content is less than 2 per cent (excluding those liquors which contain malt (but not products made by distilling an alcoholic substance made partially from malt: the same applies to the following) as an ingredient, and at the same time are sparkling).

11. The expression "Liqueurs" shall mean liquors made from liquors and saccharide or other materials (including liquors but excluding materials stipulated otherwise by the ordinance) which contain an extract content of 20 or higher (excluding those which come under 3 to 9, those which include malt as an ingredient and at the same time are sparkling, and powdered liquor which when dissolved contains alcoholic content of 10 or higher as mentioned in the first paragraph of Article 2).

12. The expression "miscellaneous liquors" shall mean liquors which are included in none of the following categories: sake, sake compound, shochu, mirin, beer, wines, whiskies, spirits and liqueurs.

Annex III: Specific Tax Rates on the Main Liquors

Category	Sub-Category, etc.		Specific Tax: Alcohol Content (°)	Specific Tax: Rate (yen/kl)
Sake		special grade	15.0	570,600
		first grade	15.0	279,500
		second grade	15.0	107,900
Sake compound	-		15.0	81,600
Shochu	group A		25.0	78,600
	group B		25.0	50,900
Mirin	group A		13.5	74,100
	group B		22.0	63,500
Beer	-		-	239,100
Wines	Wine		-	60,400
	Sweet wine		12.0	117,300
Whiskies	whisky	special grade	43.0	2,098,100
		first grade	40.0	1,011,400
		second grade	37.0	296,200
	brandy	special grade	43.0	2,098,100
		first grade	40.0	1,011,400
		second grade	37.0	296,200
Spirits	spirits		37.0	361,800
Liqueurs	for those having an alcohol content of 15% or higher and extract content of 21 per cent or higher		15.0	367,000
	the others		12.0	117,300
	sparkling liquor	The ratio of the malt to the raw material 67%~	-	239,100
		The ratio of the malt to the raw material 25%~ 66%	-	164,500
		The ratio of the malt to the raw material less than 25%	-	89,900

Source: Submission of Japan.

Category	Sub-category, etc.		Ad Valorem Tax: Nontaxable Threshold (yen/L)	Ad Valorem Tax: Tax (%)
Sake	special grade		710	150
Wines	Wine		1,080	50
	Sweet wine		870	50
Whiskies	whisky	special grade	1,400	150
		first grade	1,110	100
		second grade	570	65
	brandy	special grade	1,400	150
		first grade	1,300	85
		second grade	650	60
Spirits	spirits		540	100
Liqueurs	alcohol content of 15 per cent or higher and extract content of 21 per cent or higher		1,230	100
	other		1,230	50

Note: 1. In the case where the manufacturers' selling price (CIF + customs duty for imported products) exceeds the nontaxable threshold, the ad valorem tax is applied to the whole price in lieu of the specific tax.

2. For the high quality the special grade whisky whose manufacturers' selling price (CIF + customs duty for imported products) is higher than 1950 yen per litre in whisky, 2,930 yen per litre in brandy, 220 per cent of the ad valorem tax are applied instead of 150 per cent shown above. However, the volume subject to the 220 per cent tax rate is extremely small.

Annex V

TABLE OF LIKE AND COMPETITIVE/SUBSTITUTABLE PRODUCTS/
according to the Submission by the EEC

The Community has prepared the following summary in tabular form of the products made in Japan which it considers to be like or directly competitive with or substitutable for products exported to Japan. It believes that in view of the complexity of the facts of the dispute this summary presentation may be helpful.

Products exported to Japan	Japanese-made Like Products	Products which are Directly Competitive with or Substitutable for products exported to Japan
Gin	Japanese gin	
Vodka	Japanese vodka/shochu A	
Scotch, Irish and other whiskies	Japanese whisky (all grades) and "spirits similar to whisky"	All distilled liquors: whisky -all grades grape brandy - all grades fruit brandy - all grades shochu types A & B gin, vodka, tequila, etc.
Grape brandy (Cognac, Armagnac and others)	Japanese grape brandy (all grades)	
Fruit brandy/ eau -de-vie Calvados, Kirsch)	Japanese fruits brandy	
"Classic" liqueurs (e.g., Grand Marnier, Cointreau, Benedictine)	Japanese "classic" liqueurs; liqueurs of Japanese origin with characteristics (sweetness, aromatic flavour, alcoholic strength) similar to "classic" liqueurs	All liqueurs - "classic" and of Japanese origin
Cream liqueurs		
Still Wine	Japanese still wine	Wine and sweetened wine
Sparkling wine/ Champagne	Japanese sparkling wine	All sparkling wine