WORLD TRADE ORGANIZATION

WT/DS31/AB/R
30 June 1997

(97-2653)

Appellate Body

CANADA - CERTAIN MEASURES CONCERNING PERIODICALS

AB-1997-2

Report of the Appellate Body

WORLD TRADE ORGANIZATION

APPELLATE BODY

Canada - Certain Measures Concerning Periodicals	AB-1997-2
	Present:
Canada, Appellant/Appellee	Matsushita, Presiding Member
United States, Appellant/Appellee	Ehlermann, Member
	Lacarte-Muró, Member

I. Introduction

Canada and the United States appeal from certain issues of law and legal interpretations in the Panel Report, *Canada - Certain Measures Concerning Periodicals*[1] (the "Panel Report"). The Panel was established to consider a complaint by the United States against Canada concerning three measures: Tariff Code 9958[2], which prohibits the importation into Canada of certain periodicals, including split-run editions; Part V.1 of the Excise Tax Act[3], which imposes an excise tax on split-run editions of periodicals; and the application by Canada Post Corporation ("Canada Post") of commercial "Canadian", commercial "international" and "funded" publications mail postal rates, the latter through the Publications Assistance Program (the "PAP") maintained by the Department of Canadian Heritage ("Canadian Heritage") and Canada Post.[4]

[1]WT/DS31/R, 14 March 1997.

[2]Customs Tariff, R.S.C. 1985, c. 41 (3rd Supp.), s. 114, Schedule VII, Item 9958.

[3]An Act to Amend the Excise Tax Act and the Income Tax Act, S.C. 1995, c. 46.

[4]Canada Post Corporation Act, R.S.C. 1985, c. C-10; Publications Mail Postal Rates, Canada Post Corporation, effective 4 March 1996; Canadian Publication Mail Products Sales Agreement, 1 March 1995; International Publications Mail Product (Canadian Distribution) Sales Agreement, 1 March 1994; Memorandum of Agreement concerning the Publications Assistance Program between the Department of Communications and Canada Post Corporation (the "MOA").

The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 14 March 1997. It contains the following conclusions:

> *(a)* Tariff Code 9958 is inconsistent with Article XI:1 of GATT 1994 and cannot be justified under Article XX(d) of GATT 1994; *(b)* Part V.1 of the Excise Tax Act is inconsistent with Article III:2, first sentence, of GATT 1994; *(c)* the application by Canada Post of lower "commercial Canadian" postal rates to domestically-produced periodicals than to imported periodicals, including additional discount options available only to domestic periodicals, is inconsistent with Article III:4 of GATT 1994; but *(d)* the maintenance of the "funded" rate scheme is justified under Article III:8(b) of GATT 1994.[5]

The Panel made the following recommendation:

> The Panel recommends that the Dispute Settlement Body request Canada to bring the measures that are found to be inconsistent with GATT 1994 into conformity with its obligations thereunder.[6]

On 29 April 1997, Canada notified the Dispute Settlement Body[7] (the "DSB") of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "*DSU*"), and filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 12 May 1997, Canada filed an appellant's submission.[8] On 14 May 1997, the United States filed an appellant's submission pursuant to Rule 23(1) of the *Working Procedures*. On 26 May 1997, Canada filed an appellee's submission pursuant to Rule 23(3) of the *Working Procedures* and the United States filed an appellee's submission pursuant to Rule 22 of the *Working Procedures*. The oral hearing provided for in Rule 27 of the *Working Procedures* was held on 2 June 1997, at which the participants presented their arguments and answered questions from the Division of the Appellate Body hearing the appeal.

[5]Panel Report, para. 6.1.

[6]Panel Report, para. 6.2.

[7]WT/DS31/5, 2 May 1997.

[8]Pursuant to Rule 21(1) of the *Working Procedures*.

II. Arguments of the Participants

A. *Canada*

Canada submits that the Panel erred in law by characterizing Part V.1 of the Excise Tax Act as a measure regulating trade in goods subject to the GATT 1994. In the alternative, Canada argues that, even on the assumption that the GATT 1994 applies, the Panel erred in law when it found Part V.1 of the Excise Tax Act to be inconsistent with Article III:2, first sentence, of the GATT 1994. In particular, Canada submits that the Panel erred in law in finding that imported United States' split-run periodicals[9] and Canadian non-split-run periodicals are like products; and in failing to apply the principle of non-discrimination that is embodied in Article III:2, first sentence, of the GATT 1994. Canada agrees with the Panel's conclusion that the "funded" postal rate scheme is a permissible subsidy in accordance with the terms and conditions of Article III:8(b) of the GATT 1994.

1. Applicability of the GATT 1994 to Part V.1 of the Excise Tax Act

Canada submits that the Panel erred in law when it applied Article III:2, first sentence, of the GATT 1994 to a measure affecting advertising services. Canada asserts that the GATT 1994 applies, as the GATT 1947 had always applied previously, to measures affecting trade in goods, but it has never been a regime for dealing with services in their own right. In Canada's view, if the GATT 1994 applied to all aspects of services measures on the basis of incidental, secondary or indirect effects on goods, the GATT 1994 would effectively be converted into a services agreement. More precisely, the GATT 1994 should not apply merely on the ground that a service makes use of a good as a tangible medium of communication. Assuming that the measure at issue is designed essentially to restrict access to the services market, the mere fact that a service makes use of a good as a vehicle or a medium is an insufficient ground on which to base a challenge under the GATT 1994.

Canada asserts that the Panel's decision to consider Part V.1 of the Excise Tax Act as a measure subject to Article III of the GATT 1994 was based largely upon an unwarranted generalization of the terms of Article III:4, as well as a misconstruction of the word "indirectly" in Article III:2, first sentence. Canada argues that it is evident from its text that Article III:4 of the GATT 1994 governs only services measures that affect the ability of foreign goods to compete on an equal footing with domestic goods.

[9]We use the terms "periodical" and "magazine" interchangeably in this Report.

Canada submits that advertising services are only subject to Article III:4 to the extent that they affect the "internal sale or offering for sale, purchase, transportation, distribution or use" of a product that is entitled to national treatment under Article III of the GATT 1994. The inference that advertising services in general are covered by Article III:2 of the GATT 1994 is without foundation.

Canada stresses that the concept of "indirectly" in Article III:2 of the GATT 1994 is intended to capture taxes which apply to "inputs" that contribute to the production or distribution of a good, such as raw materials, services inputs and intermediate inputs. It is important to distinguish services inputs that are directly involved in the production or marketing of a good from services that are "end-products" in their own right. In Canada's view, the advertising services of a publisher are not, like labour in the production of a car, an input into the production of a good. Canada asserts that services are often delivered by means of a good, and that the taxation of services that are associated with goods in this way does not "subject" those goods "indirectly" to the tax, because the tax does not affect the costs of the production, distribution and marketing of the goods. Canada argues that, although magazines serve as a tangible medium in which advertising is incorporated, this association, however close, does not meet the tests appropriate to the interpretation of Article III:2 of the GATT 1994. Canada maintains that advertising is not an input or a cost in the production, distribution or use of magazines as physical products. Therefore, the taxation of magazine advertising services is not indirect taxation of magazines as goods within the meaning of Article III:2.

Canada asserts that the Panel mischaracterized Part V.1 of the Excise Tax Act as a measure affecting trade in goods. It is a measure regulating access to the magazine advertising market. Most magazines represent two distinct economic outputs, that of a good and an advertising medium for providing a service, depending on the perspective of the purchaser. According to Canada, the tax is not applied to the consumer good because it is not based on, nor applied to, the price of a magazine. Instead, the tax is calculated using the value of advertising carried in a split-run edition of a magazine and is assessed against the publisher of each split-run magazine as the seller of the advertising service.

In Canada's view, since the provision of magazine advertising services falls within the scope of the General Agreement on Trade in Services (the "GATS"), and Canada has not undertaken any commitments in respect of the provision of advertising services in its Schedule of Specific Commitments, Canada is not bound to provide national treatment to Members of the WTO with respect to the provision of advertising services in the Canadian market.

2. Consistency of Part V.1 of the Excise Tax Act with Article III:2 of the GATT 1994

Should the Appellate Body conclude that Part V.1 of the Excise Tax Act is properly subject to the jurisdiction of the GATT 1994, Canada submits, as an alternative argument, that such measure is consistent with Article III:2, first sentence, of the GATT 1994. First, Canada asserts that the Panel erred in its finding that imported split-run periodicals and Canadian non-split-run periodicals are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994. The Panel disregarded the evidence before it, and based its finding on a speculative hypothesis, thus failing to make "an objective assessment of the facts of the case" as required by Article 11 of the *DSU*. In Canada's view, the "like product" test under Article III:2, first sentence, requires a comparison of an imported product with a domestic product. While the Panel acknowledged the correctness of this test, the Panel failed to apply it by using a hypothetical example for its comparison rather than actual examples of split-run and non-split-run magazines provided by Canada. Canada notes that the Panel asserted that its hypothetical example was necessary because there were no imported split-run periodicals in Canada due to the import prohibition under Tariff Code 9958. However, Canada argues that there are certain "grandfathered" split-run magazines produced in Canada, and that those magazines provide an accurate representation of the content and properties of a split-run edition based on a non-Canadian parent magazine. The Panel did not consider the evidence which had been filed by Canada[10], it did not provide any reason why that evidence was not relevant, and instead based its analysis upon an hypothetical scenario. Therefore, Canada argues, the Panel followed an approach which is inconsistent with the letter and spirit of Article 11 of the *DSU*.

Furthermore, Canada submits that the Panel made two errors in its hypothetical analysis of "like products". First, the Panel failed to compare an imported product with a domestic product, and instead it compared two imported "Canadian" editions. Second, the Panel failed to compare products which could be marketed simultaneously in the Canadian market. Canada also argues that the Panel's decision fails to reflect the narrow construction and case-by-case approach required by the Appellate Body Report in *Japan - Taxes on Alcoholic Beverages* ("*Japan - Alcoholic Beverages*").[11] The case-by-case approach requires an analysis based upon the specific properties of the magazines in a Canadian context.

[10]Comparing TIME (a United States' magazine) and TIME Canada (a split-run magazine) with Maclean's (a domestic non-split run magazine).

[11]WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

The chief and, for all practical purposes, the only distinguishing characteristic of a magazine is its content. Although Canada recognizes that the Panel did not, in principle, reject the idea that content can be relevant, Canada argues that the Panel evaded a determination of whether split-run periodicals containing foreign content are substantially identical to magazines developed specifically for a Canadian readership.

Canada submits that content developed for and aimed at the Canadian market cannot be the same as foreign content. Content for the Canadian market will include Canadian events, topics, people and perspectives. The content may not be exclusively Canadian, but the balance will be recognizably and even dramatically different than that which is found in foreign publications which merely reproduce editorial content developed for and aimed at a non-Canadian market.

Canada also submits that, even if United States' split-run periodicals and Canadian non-split-run periodicals are "like products", Part V.1 of the Excise Tax Act does not discriminate against imported products. Canada affirms that the tax is non-discriminatory, in form and in fact, and has no greater impact on imported products than on domestic products. Because the legislation does not make any distinction between domestic and imported products, the tax is free from any taint of overt discrimination. Canada asserts that there can be no violation of Article III:2, first sentence, unless imported products, as a class, are taxed in excess of like domestic products. Canada submits that the mere potential that an individual, imported item might be taxed at a higher rate than a like domestic product cannot create an automatic violation, when it results from fiscal classifications that are not themselves discriminatory in form or in fact. Article III:2 was not intended to impose fiscal harmonization in tax rates, methods or classifications. Canada states that its interpretation does not involve the subjectivity of the now-discredited "aims and effects" test. Canada suggests only that if the fiscal categories of a measure are origin-neutral and exhibit no inherent bias, then the mere existence of such categories, with differential rates of taxation, does not violate Article III:2. In the present case, Canada asserts there is no *de jure* or *de facto* discrimination, and the definitions (or fiscal categories) used in the Excise Tax Act display no inherent bias against imported products.

With respect to the second sentence of Article III:2 of the GATT 1994, Canada argues that imported split-run and domestic non-split-run periodicals are not directly competitive or substitutable products according to the criteria in *Japan - Alcoholic Beverages*. Because content is so specific in magazines and because readers are looking for something fairly specific, magazines are not

interchangeable or substitutable. Readers buy multiple magazines. These are complex questions of fact.

Canada argues that, in the case at hand, there are two separate determinations to be made under Article III:2. The first sentence relates to whether or not there is discrimination against like products. Only if there is no violation of the first sentence can the Appellate Body decide whether the measure is consistent with the second sentence of Article III:2. On this point, Canada argues, it is not the actual decision of the Panel that is in question, but the fact that the Panel made no decision at all on the second sentence of Article III:2. An examination of the second sentence would involve an examination of factual elements which have not been dealt with one way or the other by the Panel in the first instance.

Canada's position is that the second sentence of Article III:2 is not an appropriate subject for appellate review in this case. Canada argues that the jurisdiction of the Appellate Body is limited to matters that are specifically appealed as constituting errors of law or interpretation in the Panel Report within the meaning of paragraph 17.6 of the *DSU*. The United States failed to raise the Panel's findings on Article III:2, second sentence, as a point of appeal, and therefore, the Appellate Body has no jurisdiction to look into this issue. If the Appellate Body decides to reverse the Panel's findings on Article III:2, first sentence, that should be the end of the matter.

3. Consistency of the "Funded" Postal Rate Scheme with Article III:8(b) of the GATT 1994

Canada submits that, consistent with the Panel's findings, the payments made by Canadian Heritage to Canada Post to provide Canadian publishers with reduced postal rates are payments of subsidies exclusively to domestic producers within the meaning of Article III:8(b) of the GATT 1994.

Canada asserts that nothing in the expression, "payment of subsidies exclusively to domestic producers" implies any limitations on the manner in which the payment must be made. In this case, the payments made by Canadian Heritage to Canada Post are made for the sole benefit of Canadian publishers. In Canada's view, Canadian Heritage is purchasing a benefit for domestic producers.

Canada argues that the phrase "exclusively to domestic producers" does not support the United States' assertion that a payment must actually be made directly to the publishers. Rather, the word

"exclusively" is concerned with the distinction between "domestic" as opposed to "non-domestic" producers. Canada submits that the general thrust of Article III is against discrimination between imported and domestic products. In this context, Canada considers that granting a government subsidy "exclusively" to domestic producers means granting a subsidy only to the producers of domestic products, in the sense that it is paid to them alone and not to foreign producers.

Canada asserts that the United States' position is based on a difference of form, not substance, and that the specific form in which the subsidy is paid is irrelevant to the operation of Article III:8(b) of the GATT 1994. The word "including" in a legal text is illustrative, not exhaustive, and it demonstrates that the Members intended to cover a very broad range of subsidies, regardless of the particular form of the subsidy or the manner of payment. In Canada's view, the 1990 panel report in *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* ("*EEC - Oilseeds*")[12] confirms that the payment of subsidies can be indirect, provided that the condition of exclusivity is met. Canada submits that indirect payment merely creates a presumption that a payment not made directly to producers is not made exclusively to them. However, the panel report in *EEC - Oilseeds* clearly leaves open the possibility that the presumption can be rebutted in the right circumstances. In Canada's view, indirect payment creates at most a presumption, but it is a rebuttable presumption.

Canada submits that the broad meaning of "payment" in Article III:8(b) is confirmed by the fact that the word "payment" in the French text of the GATT 1994 appears as "attribution", and not as "paiement". The expression "payment of subsidies" is translated into French as "attribution de subventions", i.e. granting of subsidies. Canada argues the expression "attribution de subventions" clearly does not require that there must be an actual transfer of government funds to domestic producers.

Canada points out that its interpretation of Article III:8(b) of the GATT 1994 does not diminish the protection offered under Article III generally. Whether the cheques are written to Canada Post or to the publishers will not change the competitive conditions between magazines. Canada submits that it makes no sense to suggest that Article III:8(b) should be interpreted in a manner that can only lead to government inefficiencies in delivering subsidies to producers.

[12]Adopted 25 January 1990, BISD 37S/86.

Canada also argues that the panel reports quoted by the United States in its appellant's submission[13] do not support the conclusion that a subsidy must be paid directly to domestic producers to qualify under the provisions of Article III:8(b). Those panel reports do not apply to the facts in this dispute. The method of subsidy payment is not, in and of itself, conclusive in determining whether Article III:8(b) of the GATT 1994 applies. The essential factor is that the payment must be made by the government for the benefit of domestic producers.

B. *United States*

The United States agrees with the Panel's findings and conclusions concerning Tariff Code 9958, Part V.1 of the Excise Tax Act and the lower "commercial Canadian" postal rates, as summarized in paragraph 6.1 of the Panel Report, but the United States submits that the Panel erred in determining that Canada's "funded" postal rate scheme is justified by Article III:8(b) of the GATT 1994.

1. Applicability of the GATT 1994 to Part V.1 of the Excise Tax Act

The United States submits that Canada's excise tax is not exempt from Article III of the GATT 1994 on the ground that it is a "services measure" subject only to the GATS. Canada has failed to demonstrate any significant conflict between the GATT 1994 and the GATS arising from this case or that, in any event, the GATS should be accorded priority over the GATT 1994. The United States argues that Canada is incorrect in suggesting that the GATT 1994 cannot apply to measures whose application affects both goods and services.

The United States asserts that the question of whether the GATT 1994 and the GATS may overlap to some extent is irrelevant. The fundamental legal question, which the panel addressed, is whether the two agreements impose conflicting obligations with respect to Canada's excise tax, and whether one agreement should be given priority over the other. The United States submits that the Panel was correct in pointing out that nothing in the *Marrakesh Agreement Establishing the World*

[13]Panel Report, *Italian Discrimination Against Agricultural Machinery*, ("*Italian Agricultural Machinery*"), adopted 23 October 1958, BISD 7S/60; Panel Report, *United States - Measures Affecting Alcoholic and Malt Beverages*, ("*United States - Malt Beverages*"), adopted 19 June 1992, BISD 39S/206; Panel Report, *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, ("*United States - Tobacco*"), DS44/R, adopted 4 October 1994; Panel Report, *EEC - Oilseeds*, adopted 25 January 1990, BISD 37S/86.

Trade Organization (the "*WTO Agreement*")[14] suggests that a measure that comes within the scope of the GATS cannot be equally subject to the GATT 1994.

The United States maintains that because Canada's general argument forbidding any significant overlap between the two agreements is incorrect, so too is Canada's more specific argument that Part V.1 of the Excise Tax Act cannot be subject to the GATT 1994 because it applies to advertising services. Measures affecting imported products are not excluded from the purview of the GATT 1994 simply because they take the form of a tax or other measure applied to "services". According to the United States, Canada's view that measures affecting imported goods are exempt from scrutiny under Article III of the GATT 1994 whenever they take the form of taxation or regulation of services would give WTO Members licence to impose a wide range of discriminatory tax and regulatory measures on imported goods. Should Canada's view prevail, a Member could, consistently with the GATT 1994, impose an exclusive tax on the rental of foreign cars, place a prohibitive surcharge on telephone services carried out using imported telecommunications equipment or tax medical services using foreign diagnostic machinery.

The United States asserts that for the purposes of Article III of the GATT 1994, it is irrelevant whether Canada's excise tax could be characterized as a measure affecting trade in advertising services within the terms of the GATS. The tax measure alters the terms of competition for imported split-run periodicals *vis-à-vis* like domestic magazines for the placement of advertisements -- as indeed it is intended to do -- and thus falls squarely within the purview of Article III:2, first sentence, of the GATT 1994.

The United States also submits that Canada's excise tax applies "directly or indirectly" to split-run periodicals. The sweeping language of Article III:2, first sentence, ensures coverage of taxes (such as taxes imposed on goods or services) that have the potential to affect the competitive position of imported and domestic goods. Thus, the Panel was correct to find that the terms "directly or indirectly" specifically encompass Canada's excise tax on split-run periodicals. The United States points out that the tax is assessed on a "per issue" basis, which plainly links the tax to the physical good, a particular issue of a magazine. The United States also stresses that Part V.1 of the Excise Tax Act is entitled "Tax on Split-Run Periodicals", and the terms of the Excise Tax Act provide that the tax is imposed "in respect of" split-run editions of periodicals.

[14]Done at Marrakesh, Morocco, 15 April 1994.

The United States submits that advertisements, together with editorial content, constitute fundamental, physical components of many, if not most, magazines. It is inconsistent to argue, as Canada does, that a tax concerning inputs is a tax directly or indirectly on a product, but a tax concerning a major component of that product is not. Furthermore, the United States asserts that advertisements affect a magazine's price, cost and competitive position as much as any input used in the production of a product.

The United States also maintains that, by its terms, the first sentence of Article III:2 applies only when imported products are "subject" to internal taxes. Since the language of that sentence includes both direct and indirect taxes on products, it is plain that the first sentence applies even when the immediate object of the taxation is not an imported product. Even if Canada's assertion that the tax applies to "advertising services" is correct, that would hardly be the end of the inquiry; the question would then be whether the tax nevertheless applies at least "indirectly" to split-run periodicals. The answer to that question is plainly "yes", as the language of the Excise Tax Act makes clear. The notion that restricting a major use of a product -- in this case, the carrying of certain types of advertising -- cannot affect competitive conditions is untenable. By applying a confiscatory tax based on advertisements placed in split-run periodicals, Canada virtually ensures the elimination of such periodicals from the Canadian marketplace -- which indeed is the whole point of the tax.

2. Consistency of Part V.1 of the Excise Tax Act with Article III:2 of the GATT 1994

The United States submits that split-run periodicals are "like" domestic non-split-run periodicals. In the United States' view, none of the three separate claims of legal error raised by Canada with respect to the Panel's findings and conclusions on Article III:2, first sentence, are persuasive.

The United States asserts that Canada's argument that the Panel erred by using a hypothetical example as a basis for comparison is without merit. The Panel correctly determined that the application of the tax turned on factors other than the characteristics of the product sold in Canada and that, as a result, imported split-run periodicals and domestic non-split-run periodicals could be practically identical products. The United States points out that the Excise Tax Act does not draw any distinctions based on type of editorial content and, consequently, under the Excise Tax Act a split-run periodical could theoretically be entirely Canadian-oriented. By the same token, a non-split-run periodical need not have any articles with a particular Canadian focus. Thus, according to the United States, Canada's

attempt to demonstrate that TIME Canada and Maclean's reflect a different editorial orientation is simply irrelevant because the application of the Excise Tax Act is not based on any such difference.

The United States also submits that, even if one could credit Canada's argument that it is seeking through the excise tax to ensure "original content" in magazines sold in Canada, this result would be contrary to the object and purpose of Article III. In the United States' view, if the GATT 1994 permitted Members to require that imported goods be designed exclusively or primarily for their markets, they could easily insulate their markets from the comparative economic advantages enjoyed by producers in other countries. By requiring "originality", WTO Members could exclude products that are sold in multiple markets or that enjoy the economies of scale that result from such sales.

The United States stresses that Canada has banned importation of split-run periodicals for over 30 years. For this reason, the Panel was entirely justified to use hypothetical examples in its reasoning on the "like product" issue.

According to the United States, Canada's argument that the Excise Tax Act does not impose a higher tax on imported products than on like domestic products is difficult in the light of the fact that, (1) the Act makes only one class of magazines -- split-runs -- subject to the special 80 percent excise tax; and (2) the Panel found that, for purposes of GATT Article III:2, imported split-run periodicals are "like" non-split-run domestic Canadian magazines. The United States argues that manifestly imported split-run periodicals are subject to a higher rate of taxation than like domestic non-split-run periodicals. That is the end of the inquiry for purposes of Article III:2, first sentence. The United States also maintains that Canada's 80 percent excise tax alters the competitive environment in the Canadian magazine market against imported split-run magazines and thus favours "like" domestically-produced periodicals. Thus, Canada's proposed "discrimination" test based on "imports as a class" is inconsistent with the recent panel and Appellate Body reports in *Japan - Alcoholic Beverages*[15], where no additional "discrimination" test based on "classes" of imported products was accepted.

The United States requests the Appellate Body to affirm the Panel's conclusions that Part V.1 of the Excise Tax Act is inconsistent with Article III:2, first sentence, of the GATT 1994.

[15]Panel Report, WT/DS8/R, WT/DS10/R, WT/DS11/R, and Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

With respect to whether imported split-run periodicals and domestic non-split-run periodicals are directly competitive or substitutable products within the meaning of the second sentence of Article III:2, the United States asserts that it is clear that if there was no competition for readers, there would be no need for Part V.1 of the Excise Tax Act. In its excise tax, Canada has targeted those magazines that are likely to be the most competitive with Canadian magazines for readers.

Regarding the jurisdictional arguments presented by Canada concerning whether the Appellate Body can examine a claim under the second sentence of Article III:2, the United States responds that there were no grounds for the United States to claim that the Panel had made a legal error in not addressing the alternative argument raised by the United States under Article III:2, second sentence. The Panel had resolved the issue by finding a violation of Article III:2, first sentence, of the GATT 1994 and therefore, had correctly stopped at that point. The United States also refers to the recent Appellate Body Report in *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*[16] which upheld the judicial economy approach taken by panels.

In the United States' view, this situation is analogous to the Appellate Body's reasoning concerning Article XX of the GATT 1994 in *United States - Standards for Reformulated and Conventional Gasoline* ("*United States - Gasoline*").[17] The procedure suggested by Canada is not consistent with the goals of Article 3.3 of the *DSU*. The parties to the dispute made a number of arguments before the Panel relating to the second sentence of Article III:2 as well as to Article III:4 of the GATT 1994. The United States asserts that there is a sufficient legal basis for the Appellate Body to apply the law to the facts in the panel record in analyzing a claim under the second sentence of Article III:2 should the Appellate Body decide to reverse the Panel's findings on Article III:2, first sentence, of the GATT 1994.

3. Consistency of the "Funded" Postal Rate Scheme with Article III:8(b) of the GATT 1994

The United States submits that the Panel erred in determining that Canada's "funded" postal rate regime falls within the scope of Article III:8(b) of the GATT 1994. According to the United States, neither the intra-governmental transfers of funds between the Canadian governmental entities nor the

[16]WT/DS33/AB/R, adopted 23 May 1997, p. 18.

[17]WT/DS2/AB/R, adopted 20 May 1996.

application by Canada Post of lower postage rates to domestic periodicals amounts to "the payment of subsidies exclusively to domestic producers" within the meaning of Article III:8(b).

The United States argues that any "payment" under Canada's "funded" postal rate scheme is made from one government entity to another, not from the Canadian government to domestic producers as required by Article III:8(b). Canada Post's favourable postage rates for domestic periodicals do not, in themselves, amount to a payment "exclusively to domestic producers", because whether or not there is any "subsidy" reflected in the "funded" postal rates, they take the form of advantageous transport and delivery rates for domestic periodicals. In making its findings, the Panel ignored both the plain language of Article III:8(b) and a series of adopted panel reports under the GATT 1947 that correctly interpreted Article III:8(b) as applying only to the actual payment of subsidies to domestic producers.[18] The United States also submits that the Panel did not clarify how a postal charge could amount to a subsidy payment, nor why postal fees imposed on domestic periodicals should be viewed as payments to domestic periodical producers.

According to the United States, the text of Article III:8(b) plainly requires: (1) that there be a payment, and (2) that this payment be made exclusively to domestic producers. The United States asserts that the use of the word "payment" in the phrase "payment of subsidies" -- instead of more general terms such as "provision", "furnishing" or "granting" -- indicates that the scope of Article III:8(b) is limited to measures involving an actual transfer of government funds to domestic producers. Furthermore, the two specific examples of exempted measures set out in Article III:8(b) -- "payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products" -- confirm this interpretation. In the United States' view, both types of subsidies are typically effected through monetary payments made by a government to domestic producers.

In response to Canada's reference to the French translation of the word "payment" in Article III:8(b), the United States points out that in the Spanish version of the *WTO Agreement*, adopted at Marrakesh, the translation of "payment" was changed from "concesión" in the GATT 1947 to "pago" in the GATT 1994. The term "concesión" means "grant", whereas "pago" means "payment".

[18]Panel Report, *Italian Agricultural Machinery*, adopted 23 October 1958, BISD 7S/60; Panel Report, *United States - Malt Beverages*, adopted 19 June 1992, BISD 39S/206; Panel Report, *United States - Tobacco*, DS44/R, adopted 4 October 1994; Panel Report, *EEC - Oilseeds*, adopted 25 January 1990, BISD 37S/86.

The United States also maintains that the use of the phrase "exclusively to domestic producers" indicates that the payment must actually be made to the producers, and excludes advantages provided by governments to domestic products that may provide indirect benefits to domestic producers. Article III:8(b) reflects a willingness on the part of the framers of the GATT 1947 to allow governments some ability to subsidize domestic production. On the other hand, the United States considers that the narrow terms of the provision suggests that the drafters wished to restrict such subsidies to a particular form, i.e. direct payments, that would not undermine the basic purpose of Article III.

According to the United States, the distinction between (a) payments to domestic producers and (b) advantages conferred with respect to domestic products is significant in the context of the object and purpose of Article III. First, governmental advantages directed to domestic products, such as lower transportation or delivery rates, directly and immediately undercut Article III's fundamental prohibition of less favourable treatment of imported products. By contrast, payments made to domestic producers do not automatically distort competition between domestic and imported products. Second, measures that are reflected in intra-governmental transfers, rate-setting and the like may more easily escape public attention than direct monetary transfers to producers, and thus may be less open to public scrutiny and debate. Third, governments may find it more costly and administratively complex to establish a system of direct payments to producers than to provide advantages directly tied to the treatment of products. For the preceding reasons, the limitation of Article III:8(b) to direct payments to producers may reduce the incidence and magnitude of government advantages provided solely to domestic interests, thereby reducing the possibility of competitive distortions that could undermine Article III's objective of maintaining equal competitive conditions for domestic and imported products.

The United States asserts that the Panel failed to address the question of whether payment was actually made to domestic producers. Instead, the Panel assumed, without articulating its reasoning, that the payment to Canada Post constituted payment of a subsidy to domestic producers, and that the only issue in dispute with respect to the application of Article III:8(b) was whether that payment was made "exclusively" to domestic producers. Neither Canadian Heritage nor Canada Post makes any "payment" to Canadian producers under Canada's "funded" postal rate programme. Rather, Canadian Heritage periodically transfers funds to Canada Post, and the latter does not pay those funds to Canadian producers. Canada Post uses the funds to underwrite, in part, the cost of providing transportation and delivery services for domestic periodicals at low, "funded" postal rates. The United States argues that whether or not Canada's discriminatory "funded" rate scheme reflects a government "subsidy", any such subsidy is not granted directly in the form of payments to domestic periodical producers.

Rather, the subsidy is reflected in the preferential rate charged in connection with the transportation and delivery of Canadian-produced periodicals.

If sustained, the United States submits, the Panel's finding in this case would free WTO Members to use a wide range of reduced-price governmental services and tax measures to confer advantages exclusively on domestically-produced goods. Such a result would not only undermine the equality of competitive opportunities for imported and domestic goods that Article III is meant to ensure, but would also upset the balance of rights and obligations reflected in Articles III:2 and III:4, on the one hand, and Article III:8(b), on the other.

III. Issues Raised in this Appeal

The appellant, Canada, raises the following issues in this appeal:

(a) Whether Part V.1 of the Excise Tax Act is a measure affecting trade in goods to which Article III:2 of the GATT 1994 applies, or whether it is a measure affecting trade in services to which the GATS applies;

(b) If Article III:2 of the GATT 1994 is applicable to Part V.1 of the Excise Tax Act, whether imported split-run periodicals and domestic non-split-run periodicals are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994; and

(c) Even if imported split-run periodicals and domestic non-split-run periodicals are "like products" within the meaning of Article III:2, first sentence, of the GATT 1994, is it necessary to demonstrate that Part V.1 of the Excise Tax Act discriminates against imported products.

The appellant, the United States, raises the following issue in this appeal:

(a) Whether Canada's special "funded" postal rates programme qualifies as "a payment of subsidies exclusively to domestic producers" pursuant to Article III:8(b) of the GATT 1994.

IV. Applicability of the GATT 1994

Canada's primary argument with respect to Part V.1 of the Excise Tax Act is that it is a measure regulating trade in services "in their own right" and, therefore, is subject to the GATS. Canada argues that the Panel's conclusion that Part V.1 of the Excise Tax Act is a measure affecting trade in goods, and, therefore, is subject to Article III:2 of the GATT 1994, is an error of law.[19]

We are unable to agree with Canada's proposition that the GATT 1994 is not applicable to Part V.1 of the Excise Tax Act. First of all, the measure is an excise tax imposed on split-run editions of periodicals. We note that the title to Part V.1 of the Excise Tax Act reads, "TAX ON SPLIT-RUN PERIODICALS", not "tax on advertising". Furthermore, the "Summary" of An Act to Amend the Excise Tax Act and the Income Tax Act[20], reads: "The Excise Tax Act is amended to impose an excise tax in respect of split-run editions of periodicals". Secondly, a periodical is a good comprised of two components: editorial content and advertising content.[21] Both components can be viewed as having services attributes, but they combine to form a physical product -- the periodical itself.

The measure in this appeal, Part V.1 of the Excise Tax Act, is a companion to Tariff Code 9958, which is a prohibition on imports of special edition periodicals, including split-run or regional editions that contain advertisements primarily directed to a market in Canada and that do not appear in identical form in all editions of an issue distributed in that periodical's country of origin. Canada agrees that Tariff Code 9958 is a measure affecting trade in goods, even though it applies to split-run editions of periodicals as does Part V.1 of the Excise Tax Act. As Canada stated in the oral hearing during this appeal:

> Tariff Code 9958 is basically an import prohibition of a physical good, i.e., the magazine itself. In that sense the entire debate was as to whether or not there was a possible defence against the application of Article XI of the GATT. In that case, therefore, there were direct effects and Canada recognized that there were effects on the physical good -- the magazine as it crossed the border.[22]

---

[19]Canada's Appellant's Submission, 12 May 1997, pp. 2-3, paras. 6, 9, 13 and 15.

[20]S.C. 1995, c. 46.

[21]Panel Report, para. 3.33.

[22]Canada's Statement at the oral hearing, 2 June 1997.

The Panel found that Tariff Code 9958 is an import prohibition, although it applies to split-run editions of periodicals which are distinguished by their advertising content directed at the Canadian market. Canada did not appeal this finding of the Panel. It is clear that Part V.1 of the Excise Tax Act is intended to complement and render effective the import ban of Tariff Code 9958.[23] As a companion to the import ban, Part V.1 of the Excise Tax Act has the same objective and purpose as Tariff Code 9958 and, therefore, should be analyzed in the same manner.

An examination of Part V.1 of the Excise Tax Act demonstrates that it is an excise tax which is applied on a good, a split-run edition of a periodical, on a "per issue" basis. By its very structure and design, it is a tax on a periodical. It is the publisher, or in the absence of a publisher resident in Canada, the distributor, the printer or the wholesaler, who is liable to pay the tax, not the advertiser.[24]

Based on the above analysis of the measure, which is essentially an excise tax imposed on split-run editions of periodicals, we cannot agree with Canada's argument that this internal tax does not "indirectly" affect imported products. It is a well-established principle that the trade effects of a difference in tax treatment between imported and domestic products do not have to be demonstrated for a measure to be found to be inconsistent with Article III.[25] The fundamental purpose of Article III of the GATT 1994 is to ensure equality of competitive conditions between imported and like domestic products.[26] We do not find it necessary to look to Article III:1 or Article III:4 of the GATT 1994 to give meaning to Article III:2, first sentence, in this respect. In *Japan - Alcoholic Beverages*, the Appellate Body stated that "Article III:1 articulates a general principle" which "informs the rest of Article III".[27] However, we also said that it informs the different sentences in Article III:2 in different

---

[23]Panel Report, paras. 3.25 and 3.26.

[24]An Act to Amend the Excise Tax Act and the Income Tax Act, S.C. 1995, c. 46, s. 35(1).

[25]Appellate Body Report, *Japan - Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 16.

[26]Panel Report, *United States - Tobacco*, DS44/R, adopted 4 October 1994, para. 99; Panel Report, *United States - Malt Beverages*, adopted 19 June 1992, BISD 39S/206, para. 5.6; Panel Report, *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted 18 February 1992, BISD 39S/27, para. 5.6; Panel Report, *United States - Section 337 of the Tariff Act of 1930*, ("*United States - Section 337*"), adopted 7 November 1989, BISD 36S/345, para. 5.13; Panel Report, *United States - Taxes on Petroleum and Certain Imported Substances*, adopted 17 June 1987, BISD 34S/136, para. 5.1.9; Panel Report, *Brazilian Internal Taxes*, adopted 30 June 1949, BISD IIS/181, para. 15.

[27]WT/DS8/AB/R, WT/DS10/AB/R,WT/DS11/AB/R, adopted 1 November 1996, p. 18.

ways. With respect to Article III:2, second sentence, we held that "Article III:1 informs Article III:2, second sentence, through specific reference".[28]

Article III:2, first sentence, uses the words "directly or indirectly" in two different contexts: one in relation to the application of a tax to imported products and the other in relation to the application of a tax to like domestic products. Any measure that indirectly affects the conditions of competition between imported and like domestic products would come within the provisions of Article III:2, first sentence, or by implication, second sentence, given the broader application of the latter.

The entry into force of the GATS, as Annex 1B of the *WTO Agreement*, does not diminish the scope of application of the GATT 1994. Indeed, Canada concedes that its position "with respect to the inapplicability of the GATT would have been exactly the same under the GATT 1947, before the GATS had ever been conceived".[29]

We agree with the Panel's statement:

> The ordinary meaning of the texts of GATT 1994 and GATS as well as Article II:2 of the WTO Agreement, taken together, indicates that obligations under GATT 1994 and GATS can co-exist and that one does not override the other.[30]

We do not find it necessary to pronounce on the issue of whether there can be potential overlaps between the GATT 1994 and the GATS, as both participants agreed that it is not relevant in this appeal.[31] Canada stated that its

> … principal argument is not based … on the need to avoid overlaps and potential conflicts. On the contrary it is based on a textual interpretation of the provision, on the plain meaning of the words in Article III:2 -- more precisely the word 'indirectly' interpreted in its legal context and in light of the object and purpose of the provision.[32]

---

[28]*Ibid.*, p. 23. In this respect, we draw attention to paragraphs 4.8, 5.37 and 5.38 of the Panel Report, and we note that a Panel finding that has not been specifically appealed in a particular case should not be considered to have been endorsed by the Appellate Body. Such a finding may be examined by the Appellate Body when the issue is raised properly in a subsequent appeal.

[29]Canada's Appellant's Submission, 12 May 1997, p. 3, para. 14.

[30]Panel Report, para. 5.17.

[31]Canada's Appellant's Submission, 12 May 1997, p. 3, para. 14; United States' Appellee's Submission, 26 May 1997, p. 13, para. 29.

[32]Canada's Statement at the oral hearing, 2 June 1997.

We conclude, therefore, that it is not necessary and, indeed, would not be appropriate, in this appeal to consider Canada's rights and obligations under the GATS. The measure at issue in this appeal, Part V.1 of the Excise Tax Act, is a measure which clearly applies to goods -- it is an excise tax on split-run editions of periodicals. We will now proceed to analyze this measure in light of Canada's points of appeal under Article III:2 of the GATT 1994.

V. Article III:2, First Sentence, of the GATT 1994

With respect to the application of Article III:2, first sentence, we agree with the Panel that:

> … the following two questions need to be answered to determine whether there is a violation of Article III:2 of GATT 1994: *(a)* Are imported "split-run" periodicals and domestic non "split-run" periodicals like products?; and *(b)* Are imported "split-run" periodicals subject to an internal tax in excess of that applied to domestic non "split-run" periodicals? If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence.[138] If the answer to the first question is negative, we need to examine further whether there is a violation of Article III:2, second sentence.[33]

---

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

A. *Like Products*

We agree with the legal findings and conclusions in paragraphs 5.22 - 5.24 of the Panel Report. In particular, the Panel correctly enunciated, in theory, the legal test for determining "like products" in the context of Article III:2, first sentence, as established in the Appellate Body Report in *Japan - Alcoholic Beverages*.[34] We also agree with the second point made by the Panel. As Article III:2, first sentence, normally requires a comparison between imported products and like domestic products, and as there were no imports of split-run editions of periodicals because of the import prohibition in Tariff

---

[33]Panel Report, para. 5.21.

[34]WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 19-20.

Code 9958, which the Panel found (and Canada did not contest on appeal) to be inconsistent with the provisions of Article XI of the GATT 1994, hypothetical imports of split-run periodicals have to be considered.[35] As the Panel recognized, the proper test is that a determination of "like products" for the purposes of Article III:2, first sentence, must be construed narrowly, on a case-by-case basis, by examining relevant factors including:

(i) the product's end-uses in a given market;
(ii) consumers' tastes and habits; and
(iii) the product's properties, nature and quality.[36]

However, the Panel failed to analyze these criteria in relation to imported split-run periodicals and domestic non-split-run periodicals.[37] Firstly, we note that the Panel did not base its findings on the exhibits and evidence before it, in particular, the copies of TIME, TIME Canada and Maclean's magazines, presented by Canada, and the magazines, Pulp & Paper and Pulp & Paper Canada, presented by the United States[38], or the *Report of the Task Force on the Canadian Magazine Industry* (the "*Task Force Report*").[39]

Secondly, we observe that the Panel based its findings that imported split-run periodicals and domestic non-split-run periodicals "can" be like products, on a single hypothetical example constructed using a Canadian-owned magazine, Harrowsmith Country Life. However, this example involves a comparison between two editions of the same magazine, both imported products, which could not have been in the Canadian market at the same time. Thus, the discussion at paragraph 5.25 of the Panel Report is inapposite, because the example is incorrect.[40]

---

[35]Panel Report, para. 5.23.

[36]Appellate Body Report, *Japan - Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 20.

[37]Panel Report, para 5.26.

[38]TIME and Pulp & Paper are non-split-run United States' magazines which are imported into Canada. TIME Canada is a United States' split-run magazine produced in Canada. Maclean's and Pulp & Paper Canada are Canadian non-split-run magazines.

[39]"A Question of Balance", *Report of the Task Force on the Canadian Magazine Industry*, Canada 1994, First Submission of the United States to the Panel, 5 September 1996, Exhibit A.

[40]Both the United States and Canada agreed that the example of Harrowsmith Country Life was incorrect: Canada's Appellant's Submission, 12 May 1997, pp. 17-18, paras. 64-71; United States' Appellee's Submission, 26 May 1997, p. 32, para. 80; Canada's Statement at the oral hearing, 2 June 1997; United States' Statement at the oral hearing, 2 June 1997.

The Panel leapt from its discussion of an incorrect hypothetical example[41] to

> … conclude that imported "split-run" periodicals and domestic non "split-run" periodicals can be like products within the meaning of Article III:2 of GATT 1994. In our view, this provides sufficient grounds to answer in the affirmative the question as to whether the two products at issue are like because, … the purpose of Article III is to protect expectations of the Members as to the competitive relationship between their products and those of other Members, not to protect actual trade volumes.[42] (Emphasis added)

It is not obvious to us how the Panel came to the conclusion that it had "sufficient grounds" to find the two products at issue are like products from an examination of an incorrect example which led to a conclusion that imported split-run periodicals and domestic non-split-run periodicals can be "like".

We therefore conclude that, as a result of the lack of proper legal reasoning based on inadequate factual analysis in paragraphs 5.25 and 5.26 of the Panel Report, the Panel could not logically arrive at the conclusion that imported split-run periodicals and domestic non-split-run periodicals are like products.

We are mindful of the limitation of our mandate in Articles 17.6 and 17.13 of the *DSU*. According to Article 17.6, an appeal shall be limited to issues of law covered in the Panel Report and legal interpretations developed by the Panel. The determination of whether imported and domestic products are "like products" is a process by which legal rules have to be applied to facts. In any analysis of Article III:2, first sentence, this process is particularly delicate, since "likeness" must be construed narrowly and on a case-by-case basis. We note that, due to the absence of adequate analysis in the Panel Report in this respect, it is not possible to proceed to a determination of like products.

We feel constrained, therefore, to reverse the legal findings and conclusions of the Panel on "like products". As the Panel itself stated, there are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article

[41]Panel Report, para 5.25.

[42]Panel Report, para 5.26.

III:2, first sentence. If the answer to one question is negative, there is a need to examine further whether the measure is consistent with Article III:2, second sentence.[43]

Having reversed the Panel's findings on "like products", we cannot answer both questions in the first sentence of Article III:2 in the affirmative as is required to demonstrate a violation of that sentence. Therefore, we need to examine the consistency of the measure with the second sentence of Article III:2 of the GATT 1994.

B. *Non-Discrimination*

In light of our conclusions on the question of "like products" in Article III:2, first sentence, we do not find it necessary to address Canada's claim of "non-discrimination" in relation to that sentence.[44]

VI. Article III:2, Second Sentence, of the GATT 1994

We will proceed to examine the consistency of Part V.1 of the Excise Tax Act with the second sentence of Article III:2 of the GATT 1994.

A. *Jurisdiction*

Canada asserts that the Appellate Body does not have the jurisdiction to examine a claim under Article III:2, second sentence, as no party has appealed the findings of the Panel on this provision. In the United States' view, the procedure suggested by Canada is not consistent with the fundamental goals stated in Article 3.3 of the *DSU*, according to which the prompt settlement of disputes is essential to the effective functioning of the WTO and the maintenance of a proper balance of rights and obligations of Members. Contrary to Canada, the United States asserts that there is a sufficient basis in the panel record for the Appellate Body to apply the law to these facts.

[43]See Panel Report, para. 5.21, cited with approval at page 20 herein.

[44]See Canada's Appellant's Submission, 12 May 1997, p. 3, para. 12, where Canada makes this argument as an alternative point of appeal.

We believe the Appellate Body can, and should, complete the analysis of Article III:2 of the GATT 1994 in this case by examining the measure with reference to its consistency with the second sentence of Article III:2, provided that there is a sufficient basis in the Panel Report to allow us to do so. The first and second sentences of Article III:2 are closely related. The link between the two sentences is apparent from the wording of the second sentence, which begins with the word "moreover". It is also emphasized in *Ad* Article III, paragraph 2, which provides: "A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where …". An examination of the consistency of Part V.1 of the Excise Tax Act with Article III:2, second sentence, is therefore part of a logical continuum.

The Appellate Body found itself in a similar situation in *United States - Gasoline*. Having reversed the Panel's conclusions on the first part of Article XX(g) and having completed the Article XX(g) analysis in that case, the Appellate Body then examined the measure's consistency with the provisions of the chapeau of Article XX, based on the legal findings contained in the Panel Report.[45]

As the legal obligations in the first and second sentences are two closely-linked steps in determining the consistency of an internal tax measure with the national treatment obligations of Article III:2, the Appellate Body would be remiss in not completing the analysis of Article III:2. In the case at hand, the Panel made legal findings and conclusions concerning the first sentence of Article III:2, and because we reverse one of those findings, we need to develop our analysis based on the Panel Report in order to issue legal conclusions with respect to Article III:2, second sentence, of the GATT 1994.

B. *The Issues Under Article III:2, Second Sentence*

In our Report in *Japan - Alcoholic Beverages*, we held that:

> … three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:
>
> (1) the imported products and the domestic products *are "directly competitive or substitutable products" which are in competition with each other*;
> (2) the directly competitive or substitutable imported and domestic products *are "not similarly taxed*"; and

[45]WT/DS2/AB/R, adopted 20 May 1996, pp. 22-29.

> (3) the dissimilar taxation of the directly competitive or substitutable imported domestic products *is "applied … so as to afford protection to domestic production*".[46]

1. Directly Competitive or Substitutable Products

In *Japan - Alcoholic Beverages*, the Appellate Body stated that as with "like products" under the first sentence of Article III:2, the determination of the appropriate range of "directly competitive or substitutable products" under the second sentence must be made on a case-by-case basis.[47] The Appellate Body also found it appropriate to look at competition in the relevant markets as one among a number of means of identifying the broader category of products that might be described as "directly competitive or substitutable", as the GATT is a commercial agreement, and the WTO is concerned, after all, with markets.

According to the Panel Report, Canada considers that split-run periodicals are not "directly competitive or substitutable" for periodicals with editorial content developed for the Canadian market. Although they may be substitutable advertising vehicles, they are not competitive or substitutable information vehicles.[48] Substitution implies interchangeability. Once the content is accepted as relevant, it seems obvious that magazines created for different markets are not interchangeable. They serve different end-uses.[49] Canada draws attention to a study by the economist, Leigh Anderson, on which the *Task Force Report* was at least partially-based, which notes:

> US magazines can probably provide a reasonable substitute for Canadian magazines in their capacity as an advertising medium, although some advertisers may be better served by a Canadian vehicle. In many instances however, they would provide a very poor substitute as an entertainment and communication medium.[50]

Canada submits that the *Task Force Report* characterizes the relationship as one of "imperfect substitutability" -- far from the direct substitutability required by this provision. The market share of imported and domestic magazines in Canada has remained remarkably constant over the last 30-plus

---

[46]WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 24.

[47]*Ibid.*, p. 25.

[48]Panel Report, para. 3.113.

[49]Panel Report, para. 3.115.

[50]Panel Report, para. 3.119.

years. If competitive forces had been in play to the degree necessary to meet the standard of "directly competitive" goods, one would have expected some variations. All this casts serious doubt on whether the competition or substitutability between imported split-run periodicals and domestic non-split-run periodicals is sufficiently "direct" to meet the standard of *Ad* Article III.[51]

According to the United States, the very existence of the tax is itself proof of competition between split-run periodicals and non-split-run periodicals in the Canadian market. As Canada itself has acknowledged, split-run periodicals compete with wholly domestically-produced periodicals for advertising revenue, which demonstrates that they compete for the same readers. The only reason firms place advertisements in magazines is to reach readers. A firm would consider split-run periodicals to be an acceptable advertising alternative to non-split-run periodicals only if that firm had reason to believe that the split-run periodicals themselves would be an acceptable alternative to non-split-run periodicals in the eyes of consumers. According to the United States, Canada acknowledges that "[r]eaders attract advertisers" and that, "… Canadian publishers are ready to compete with magazines published all over the world in order to keep their readers, but the competition is fierce".[52]

According to the United States, the *Task Force Report* together with statements made by the Minister of Canadian Heritage and Canadian officials, provide further acknowledgment of the substitutability of imported split-run periodicals and domestic non-split-run periodicals in the Canadian market.[53]

We find the United States' position convincing, while Canada's assertions do not seem to us to be compatible with its own description of the Canadian market for periodicals.

According to the Panel:

> Canada explained that there is a direct correlation between circulation, advertising revenue and editorial content. The larger the circulation, the more advertising a magazine can attract. With greater advertising revenue, a publisher can afford more to spend on editorial content. The more a publisher spends, the more attractive the magazine is likely to be to its readers, resulting in circulation growth. Similarly, a loss

[51]Panel Report, para. 3.119.

[52]Panel Report, para. 3.117.

[53]Panel Report, para. 3.118.

> of advertising revenue will produce a "downward spiral". Less advertising entails less editorial, a reduction in readership and circulation and a diminished ability to attract advertising. Magazines can be sold on newsstands, or through subscriptions, or distributed at no cost to selected consumers … Canadian English-language publications face tough competition on newsstands; they account for only 18.5 per cent of English-language periodicals distributed on newsstands, where space is dominated by foreign publications …[54]
>
> … Canadian periodical publishers face a major competitive challenge in their business environment that is not common to their counterparts in countries with a larger population to serve. The pivotal fact is the penetration of the Canadian market by foreign magazines. Canadian readers have unrestricted access to imported magazines. At the same time, Canadian readers have demonstrated that they value magazines that address their distinct interests and perspectives. However, foreign magazines dominate the Canadian market. They account for 81.4 per cent of all newsstand circulation and slightly more than half (50.4 per cent) of the entire circulation of English-language magazines destined for the general public in Canada.[55]

This description of the Canadian market for periodicals corresponds to the following passages of the *Task Force Report*, as quoted in the Panel Report:

> "[Canadian publishers'] English-language consumer magazines face significant competition for sales from imported consumer magazines. In large measure, this is because the majority of the magazines are from the United States and *are a close substitute.* … It is reasonable to expect that the content of American magazines will be of interest to Canadians …".
>
> This report also observes that "there is considerable price competition" on newsstands between domestic and imported magazines", and that:
>
> "the initial effect of the entry of Canadian regional editions of foreign magazines into the Canadian advertising market would be a loss of advertising pages in Canadian publications offering advertisers a readership with similar demographics".[56]

[54]Panel Report, para. 3.28.

[55]Panel Report, para. 3.29.

[56]Panel Report, para. 3.118.

This description corresponds also to the statement made by the then Minister of Canadian Heritage, the Honourable Michel Dupuy:

> Canadians are much more interested in American daily life, be it political or sports life or any other kind, than vice versa. Therefore, the reality of the situation is that we must protect ourselves against split-runs coming from foreign countries and, in particular, from the United States.[57]

The statement by the economist, Leigh Anderson, quoted by Canada and the *Task Force Report*'s description of the relationship as one of "imperfect substitutability" does not modify our appreciation. A case of perfect substitutability would fall within Article III:2, first sentence, while we are examining the broader prohibition of the second sentence. We are not impressed either by Canada's argument that the market share of imported and domestic magazines has remained remarkably constant over the last 30-plus years, and that one would have expected some variation if competitive forces had been in play to the degree necessary to meet the standard of "directly competitive" goods. This argument would have weight only if Canada had not protected the domestic market of Canadian periodicals through, among other measures, the import prohibition of Tariff Code 9958 and the excise tax of Part V.1 of the Excise Tax Act.

Our conclusion that imported split-run periodicals and domestic non-split-run periodicals are "directly competitive or substitutable" does not mean that all periodicals belong to the same relevant market, whatever their editorial content. A periodical containing mainly current news is not directly competitive or substitutable with a periodical dedicated to gardening, chess, sports, music or cuisine. But newsmagazines, like TIME, TIME Canada and Maclean's, are directly competitive or substitutable in spite of the "Canadian" content of Maclean's. The competitive relationship is even closer in the case of more specialized magazines, like Pulp & Paper as compared with Pulp & Paper Canada, two trade magazines presented to the Panel by the United States.

The fact that, among these examples, only TIME Canada is a split-run periodical, and that it is not imported but is produced in Canada, does not affect at all our appreciation of the competitive relationship. The competitive relationship of imported split-run periodicals destined for the Canadian market is even closer to domestic non-split-run periodicals than the competitive relationship between

[57]Panel Report, para. 3.118.

imported non-split-run periodicals and domestic non-split-run periodicals. Imported split-run periodicals contain advertisements targeted specifically at the Canadian market, while imported non-split-run periodicals do not carry such advertisements.

We, therefore, conclude that imported split-run periodicals and domestic non-split-run periodicals are directly competitive or substitutable products in so far as they are part of the same segment of the Canadian market for periodicals.

2. Not Similarly Taxed

Having found that imported split-run and domestic non-split-run periodicals of the same type are directly competitive or substitutable, we must examine whether the imported products and the directly competitive or substitutable domestic products are not similarly taxed. Part V.1 of the Excise Tax Act taxes split-run editions of periodicals in an amount equivalent to 80 per cent of the value of all advertisements in a split-run edition. In contrast, domestic non-split-run periodicals are not subject to Part V.1 of the Excise Tax Act. Following the reasoning of the Appellate Body in *Japan - Alcoholic Beverages*[58], dissimilar taxation of even some imported products as compared to directly competitive or substitutable domestic products is inconsistent with the provisions of the second sentence of Article III:2. In *United States - Section 337*, the panel found:

> … that the "no less favourable" treatment requirement of Article III:4 has to be understood as applicable to each individual case of imported products. The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products.[59]

With respect to Part V.1 of the Excise Tax Act, we find that the amount of the taxation is far above the *de minimis* threshold required by the Appellate Body Report in *Japan - Alcoholic Beverages*.[60] The magnitude of this tax is sufficient to prevent the production and sale of split-run periodicals in Canada.[61]

---

[58]WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 27.

[59]Adopted 7 November 1989, BISD 36S/345, para. 5.14.

[60]WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 27.

[61]Indeed, this was the explicit objective of the Canadian policy. See Panel Report, paras. 3.118 and 5.25.

3. So as to Afford Protection

The Appellate Body established the following approach in *Japan - Alcoholic Beverages* for determining whether dissimilar taxation of directly competitive or substitutable products has been applied so as to afford protection:

> … we believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.
>
> Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, … Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the relevant circumstances in any given case.[62]

With respect to Part V.1 of the Excise Tax Act, we note that the magnitude of the dissimilar taxation between imported split-run periodicals and domestic non-split-run periodicals is beyond excessive, indeed, it is prohibitive. There is also ample evidence that the very design and structure of the measure is such as to afford protection to domestic periodicals.

The Canadian policy which led to the enactment of Part V.1 of the Excise Tax Act had its origins in the *Task Force Report*. It is clear from reading the *Task Force Report* that the design and structure of Part V.1 of the Excise Tax Act are to prevent the establishment of split-run periodicals in Canada, thereby ensuring that Canadian advertising revenues flow to Canadian magazines. Madame Monique Landry, Minister Designate of Canadian Heritage at the time the *Task Force Report* was

[62]WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 29.

released, issued the following statement summarizing the Government of Canada's policy objectives for the Canadian periodical industry:

> The Government reaffirms its commitment to protect the economic foundations of the Canadian periodical industry, which is a vital element of Canadian cultural expression. To achieve this objective, the Government will continue to use policy instruments that encourage the flow of advertising revenues to Canadian magazines and discourage the establishment of split-run or 'Canadian' regional editions with advertising aimed at the Canadian market. We are committed to ensuring that Canadians have access to Canadian ideas and information through genuinely Canadian magazines, while not restricting the sale of foreign magazines in Canada.[63]

Furthermore, the Government of Canada issued the following response to the *Task Force Report*:

> The Government reaffirms its commitment to the long-standing policy of protecting the economic foundations of the Canadian periodical industry. To achieve this objective, the Government uses policy instruments that encourage the flow of advertising revenues to Canadian periodicals, since a viable Canadian periodical industry must have a secure financial base.[64]

During the debate of Bill C-103, An Act to Amend the Excise Tax Act and the Income Tax Act, the Minister of Canadian Heritage, the Honourable Michel Dupuy, stated the following:

> … the reality of the situation is that we must protect ourselves against split-runs coming from foreign countries and, in particular, from the United States.[65]

Canada also admitted that the objective and structure of the tax is to insulate Canadian magazines from competition in the advertising sector, thus leaving significant Canadian advertising revenues for the production of editorial material created for the Canadian market. With respect to the actual application of the tax to date, it has resulted in one split-run magazine, Sports Illustrated, to move its production for the Canadian market out of Canada and back to the United States.[66] Also, Harrowsmith

---

[63]*Task Force Report*, Appendix 5, p. 92.

[64]*Ibid.*, p. 94.

[65]Panel Report, para. 3.118.

[66]Panel Report, para. 3.121.

Country Life, a Canadian-owned split-run periodical, has ceased production of its United States' edition as a consequence of the imposition of the tax.[67]

We therefore conclude on the basis of the above reasons, including the magnitude of the differential taxation, the several statements of the Government of Canada's explicit policy objectives in introducing the measure and the demonstrated actual protective effect of the measure, that the design and structure of Part V.1 of the Excise Tax Act is clearly to afford protection to the production of Canadian periodicals.

VII. Article III:8(b) of the GATT 1994

Article III:8(b) of the GATT 1994 reads as follows:

> (*b*) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

Both participants agree that Canada's "funded" postal rates involve "a payment of subsidies". The appellant, the United States, argues, however, that the "funded" postal rates programme involves a transfer of funds from one government entity to another, i.e. from Canadian Heritage to Canada Post, and not from the Canadian government to domestic producers as required by Article III:8(b).

As we understand it, through the PAP, Canadian Heritage provides Canada Post, a wholly-owned Crown corporation, with financial assistance to support special rates of postage for eligible publications, including certain designated domestic periodicals mailed and distributed in Canada. This programme has been implemented through a series of agreements, the MOA, between Canadian Heritage and Canada Post, which provide that in consideration of the payments made to it by Canadian Heritage, Canada Post will accept for distribution, at special "funded" rates, all publications designated by Canadian Heritage to be eligible under the PAP. The MOA provides that while Canadian Heritage will administer

[67]Panel Report, paras. 3.99 and 5.25.

the eligibility requirements for the PAP based on criteria specified in the MOA, Canada Post will accept for distribution all publications that are eligible under the PAP at the "funded" rates.

The appellant, the United States, cited four GATT 1947 panel reports as authorities for its interpretation of Article III:8(b).[68] However, these panel reports are not all directly on point. In *Italian Agricultural Machinery* and *EEC - Oilseeds*, the panels found that subsidies paid to purchasers of agricultural machinery and processors of oilseeds were not made "exclusively to domestic producers" of agricultural machinery and oilseeds, respectively. In *United States - Malt Beverages* and *United States - Tobacco*, the issue was whether a reduction in the federal excise tax on beer or a remission of a product tax on tobacco constituted a "payment of subsidies" within the meaning of Article III:8(b). In *United States - Malt Beverages*, the panel found that a reduction of taxes on a good did not qualify as a "payment of subsidies" for the purposes of Article III:8(b) of the GATT 1994.[69] In *United States - Tobacco*, having found that the measure at issue was not a tax remission, the panel concluded that it was a payment which qualified under Article III:8(b) of the GATT 1994.[70]

In *EEC - Oilseeds*, the panel stated that "it can reasonably be assumed that a payment not made directly to producers is not made 'exclusively' to them".[71] This statement of the panel is *obiter dicta*, as the panel found in that report that subsidies paid to oilseeds processors were not made "exclusively to domestic producers", and therefore, the EEC payments of subsidies to processors and producers of oilseeds and related animal feed proteins did not qualify under the provisions of Article III:8(b).[72]

A proper interpretation of Article III:8(b) must be made on the basis of a careful examination of the text, context and object and purpose of that provision. In examining the text of Article III:8(b), we believe that the phrase, "including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products" helps to elucidate the types of subsidies covered by Article III:8(b) of the GATT 1994. It is not an exhaustive list of the kinds of programmes that would qualify as "the payment of subsidies exclusively to domestic producers", but those words exemplify

---

[68]Panel Report, *Italian Agricultural Machinery*, adopted 23 October 1958, BISD 7S/60; Panel Report, *United States - Malt Beverages*, adopted 19 June 1992, BISD 39S/206; Panel Report, *United States - Tobacco*, DS44/R, adopted 4 October 1994; and Panel Report, *EEC - Oilseeds*, adopted 25 January 1990, BISD 37S/86.

[69]Adopted 19 June 1992, BISD 39S/206, para. 5.12.

[70]DS44/R, adopted 4 October 1994, paras. 109 and 111.

[71]Adopted 25 January 1990, BISD 37S/86, para. 137.

[72]*Ibid*.

the kinds of programmes which are exempted from the obligations of Articles III:2 and III:4 of the GATT 1994.

Our textual interpretation is supported by the context of Article III:8(b) examined in relation to Articles III:2 and III:4 of the GATT 1994. Furthermore, the object and purpose of Article III:8(b) is confirmed by the drafting history of Article III. In this context, we refer to the following discussion in the Reports of the Committees and Principal Sub-Committees of the Interim Commission for the International Trade Organization concerning the provision of the Havana Charter for an International Trade Organization that corresponds to Article III:8(b) of the GATT 1994:

> This sub-paragraph was redrafted in order to make it clear that nothing in Article 18 could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 would override the provisions of Section C of Chapter IV.[73]

We do not see a reason to distinguish a reduction of tax rates on a product from a reduction in transportation or postal rates. Indeed, an examination of the text, context, and object and purpose of Article III:8(b) suggests that it was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by a government.

We agree with the panel in *United States - Malt Beverages* that:

> Article III:8(b) limits, therefore, the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.[74]

---

[73]Interim Commission for the International Trade Organization, Reports of the Committees and Principal Sub-Committees: ICITO I/8, Geneva, September 1948, p. 66. Article 18 and Section C of Chapter IV of the Havana Charter for an International Trade Organization correspond, respectively, to Article III and Article XVI of the GATT 1947.

[74]Adopted 19 June 1992, BISD 39S/206, para. 5.10.

As a result of our analysis of the text, context, and object and purpose of Article III:8(b), we conclude that the Panel incorrectly interpreted this provision. For these reasons, we reverse the Panel's findings and conclusions that Canada's "funded" postal rates scheme for periodicals is justified under Article III:8(b) of the GATT 1994.

VIII. Findings and Conclusions

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

(a) upholds the Panel's findings and conclusions on the applicability of the GATT 1994 to Part V.1 of the Excise Tax Act;

(b) reverses the Panel's findings and conclusions on Part V.1 of the Excise Tax Act relating to "like products" within the context of Article III:2, first sentence, thereby reversing the Panel's conclusions on Article III:2, first sentence, of the GATT 1994;

(c) modifies the Panel's findings and conclusions on Article III:2 of the GATT 1994, by concluding that Part V.1 of the Excise Tax Act is inconsistent with Canada's obligations under Article III:2, second sentence, of the GATT 1994; and

(d) reverses the Panel's findings and conclusions that the maintenance by Canada Post of the "funded" postal rates scheme is justified by Article III:8(b) of the GATT 1994, and concludes that the "funded" postal rates scheme is not justified by Article III:8(b) of the GATT 1994.

The foregoing legal findings and conclusions modify the conclusions of the Panel in Part VI of the Panel Report, but leave intact the findings and conclusions of the Panel that were not the subject of this appeal.

The Appellate Body *recommends* that the Dispute Settlement Body request Canada to bring the measures found in this Report and in the Panel Report, as modified by this Report, to be inconsistent with the GATT 1994 into conformity with Canada's obligations thereunder.

Signed in the original at Geneva this 23rd day of June 1997 by:

_____

Mitsuo Matsushita
Presiding Member

_____ _____

Claus-Dieter Ehlermann
Member

Julio Lacarte-Muró
Member