Cases before International Courts and Tribunals Involving Questions of Public International Law 2009

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World Trade Organization — GATT Article III and the Interpretative note to Article III — the distinction between charges on importation and internal taxes — national treatment

China – Measures affecting Imports of Automobile Parts
Report of the Panel (18 July 2008), WT/DS339, 340 & 342/R, and Report of the Appellate Body (15 December 2008), WT/DS339, 340 & 342/AB/R, both adopted by the WTO Dispute Settlement Body on 12 January 2009

I. Background to the Dispute

Australia, along with six other WTO Members, was a third party in this dispute in which the United States, the European Communities, and Canada complained about Chinese measures affecting imports of automobile parts.

China's schedule to the General Agreement on Tariffs and Trade 1994 (hereinafter 'GATT') included tariff bindings on complete motor vehicles at rates averaging about 25 per cent, and on automobile parts at rates averaging about 10 per cent.[2] The Schedule did not include a binding on kit cars but under China's Accession Protocol, China had made a commitment that if China introduced a new classification for kit cars, the customs duty would not exceed 10 per cent.[3]

In 2004 and 2005, China had brought the following measures into force:[4]

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2 *Accession of the People's Republic of China*, WTO Doc WT/L/432 (23 November 2001) (Decision of 10 November 2001, with *Protocol of the Accession of the People's Republic of China* appended) annex 8 ('*Schedule CLII – People's Republic of China*').

3 See the *Accession of the People's Republic of China*, WTO Doc WT/L/432 (23 November 2001) (Decision of 10 November 2001, with *Protocol of the Accession of the People's Republic of China* appended) art 1.2, which refers to commitments listed in paragraph 342 of the *Report of the Working Party on the Accession of China*, WTO Doc WT/ACC/CHN/49 (1 October 2001), which includes a reference to paragraph 92 which contains the relevant commitment on kit cars.

4 The details of the measures are set out in the Panel Report, *China – Measures Affecting Imports of Automobile Parts*, WTO Docs WT/DS339/R, WT/DS340/R, WT/DS342/R (18 July 2008) [2.1]; Appellate Body Report, *China – Measures*

1. Policy on Development of Automotive Industry (Order of the National Development and Reform Commission (No. 8)) (hereinafter 'Policy Order 8');
2. Administrative Rules on Importation of Automobile Parts Characterized as Complete Vehicles (Decree of the People's Republic of China, No. 125) (hereinafter 'Decree 125'); and
3. Rules on Verification of Imported Automobile Parts Characterized as Complete Vehicles (Public Announcement of the Customs General Administration of the People's Republic of China, No. 4 of 2005) (hereinafter 'Announcement 4').

These measures operate together to impose a 'charge' and associated 'administrative procedure' on imported auto parts. A 25 per cent charge is imposed if the auto parts themselves are characterised as a 'complete vehicle' after being assembled into a motor vehicle, and a 10 per cent charge if the parts are not so characterised following assembly. Article 21 of Decree 125 provides that imported parts will be characterised as a complete vehicle if either:

1. it is a completely knocked down ('CKD') or semi-knocked down ('SKD') car kit;
2. the parts comprise a body and an engine;
3. the parts comprise a body or an engine, and three other assembly systems;
4. the parts comprise five or more assembly systems (not a body or an engine); or
5. total price for the parts account for at least 60 per cent of the total price of the completed vehicle.

Separate auto parts may be characterised as a complete vehicle even if they have been imported in multiple shipments into China, so long as they satisfy one of the Decree 125 categories after assembly.[5]

The administrative procedures require automobile manufacturers to *inter alia* self-evaluate the characterisation of imported parts used in a particular vehicle model, verify this characterisation, and pay either the 10 per cent or 25 per cent charge. The Panel found that the time taken to complete these processes could range from 30 days to multiple years.[6] Both the charge and the administrative procedures are imposed after the parts have been imported into China.

The complainants argued two violations in the alternative: either the measures were an internal charge that violated Article III, or the measures were charges on importation in violation of Article II. China argued that any violation was justified

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Affecting the Import of Automobile Parts, WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [109]–[110].

5 See Appellate Body Report, *China – Measures Affecting the Import of Automobile Parts,* WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [114].

6 Panel Report, *China – Measures Affecting Imports of Automobile Parts*, WTO Docs WT/DS339/R, WT/DS340/R, WT/DS342/R (18 July 2008) [7.66].

under Article XX(d). The United States and Canada also claimed that the charge and administrative procedure imposed on CKD and SKD kits were inconsistent with China's obligations under the Accession Protocol.

II. The Preliminary Question: 'Internal Charge' or 'Ordinary Customs Duty'

In response to the complainants' argument that the measures imposed an internal measure that was inconsistent with China's obligations under Article III:2, China responded that the charge and administrative measures were not an internal charge at all, but rather an 'ordinary customs duty' under Article II:1(b). China contended that the measures were an enforcement mechanism to ensure that the correct customs duty was paid and that Article II covers charges connected to importation regardless of the time of collection.

(a) Panel and Appellate Body findings

In order to determine which provision is applicable, the Panel analyses both Article III:2 and Article II:1(b) and explains the difference between internal charges covered by Article III:2 and charges on importation covered by article II:1(b). The panel explains that charges constitute internal charges covered by Article III if "the obligation to pay such charge accrues because of an *internal* factor ... occur[ring] *after the importation* of the product of one Member into the territory of another Member."[7] The panel further explains that charges constitute ordinary customs duties under Article II where the obligation to pay the charge accrues "based on the products as they enter the customs territory of another Member."[8] The Panel says that:

> if the obligation to pay a charge does not accrue based on the product at the moment of its importation, it cannot be an "ordinary customs duty" within the meaning of Article II:1(b), first sentence of the GATT 1994: it is, instead, an "internal charge" under Article III:2 of the GATT 1994, which obligation to pay accrues based on internal factors.

In applying this standard to the facts, the Panel relied on a number of factors collectively to conclude that in this case, the measures imposed by China were internal. Firstly, it was significant that the charge was determined by how the imported parts were internally assembled into a motor vehicle, not by the auto parts being imported into the territory of China. Secondly, the Panel found that identical imported parts from the same shipment could be levied with a different charge, depending on the motor vehicle they ended up being assembled into. Finally, the Panel noted that the charge was imposed on automobile manufacturers, rather than on importers of the parts.[9]

The Appellate Body upheld the Panel's resolution that the 10 or 25 per cent levied on imported auto parts was an internal charge under Article III:2, and agreed that the above three identified factors were significant in this characterisation. The

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7 Ibid [7.132].
8 Ibid [7.166].
9 Ibid [7.205]–[7.210].

Appellate Body also found it was legally significant that the charge was not imposed based on the auto parts as they entered China, but instead was dependant on how the parts were used in assembly.[10]

(b) Australia's submissions: an 'internal measure' under Article III:2

Australia's contribution, as a third party, was to support the arguments of the complainants as to the distinction between the fields of application of Article II and Article III and that the relevant charge was an internal tax subject to Article III rather than a customs duty subject to Article II. In particular, Australia agreed generally with Canada's approach that an internal measure is enforced based on events which occur within China, whilst a border measure is imposed at the time or point of importation.[11]

Australia submitted that this distinction would uphold the purpose of Article III to ensure that imported goods are treated "in the same way as the like domestic products, once they had been cleared through customs".[12] Australia cited previous cases in support of this view: *EC – Parts and Components* in which emphasis was placed on whether the obligation arose at the point of importation or after the imported goods had been assembled inside the EC;[13] *Belgian Family Allowances*[14] where it was influential that the event triggering liability to the levy was the purchase of the goods by a public body inside Belgium not the importation of the goods into Belgium; and *EEC – Animal Feed Proteins*[15] where certain measures were held to be subject to the rules on internal measures under Article III and not subject to the rules on border measures under Article III because border measure

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10 Appellate Body Report, *China – Measures Affecting the Import of Automobile Parts*, WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [129] – [178].

11 Canada, 'First Written Submission of Canada', Submission in *China – Measures Affecting the Import of Automobile Parts*, 13 March 2007, [78]–[86].

12 See Australia, 'Third Party Oral Statement of Australia', Submission in *China – Measures Affecting the Import of Automobile Parts*, 23 May 2007, [7], quoting this passage from GATT Panel Report, *Italian Discrimination Against Imported Agricultural Machinery*, GATT Doc L/833 (15 July 1958, adopted 23 October 1958) GATT BISD 7S/60, [11], which was quoted with approval in *Japan — Taxes on Alcoholic Beverages*, WTO Docs WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (4 October 1996, adopted 1 November 1996) 16.

13 See Australia, 'Third Party Oral Statement of Australia', Submission in *China-Measures Affecting the Import of Automobile Parts*, 23 May 2007, [8]–[10], referring to GATT Panel Report, *EC – Regulation on Imports of Parts and Components*, GATT Doc L/6657 (22 March 1990, adopted 16 May 1990) GATT BISD 37S/132, [5.4]–[5.8].

14 See Australia, 'Third Party Oral Statement of Australia', Submission in *China – Measures Affecting the Import of Automobile Parts*, 23 May 2007, [11], referring to GATT Panel Report, *Belgian Family Allowances*, GATT Doc G/32 (6 November 1952, adopted 7 November 1952) GATT BISD 1S/59, [2].

15 See Australia, 'Third Party Oral Statement of Australia', Submission in *China – Measures Affecting the Import of Automobile Parts*, 23 May 2007, [11], referring to GATT Panel Report, *EEC Measures on Animal Feed Proteins*, GATT Doc L/4599 (2 December 1977, adopted 14 March 1978) GATT BISD 25S/49, [4.13]–[4.18].

are measures collected at the time of goods entered the country, and as a condition of entry.

Australia supported the United States' submission that these GATT cases were decided by applying a 'substance over form' approach.[16] Applied to the present facts, it was argued that the charge is not necessarily a border measure just because China's domestic law had designed the charge so that it could be labelled as a customs duty.[17] Australia further argued that China could not evade the national treatment obligations under Art III by 'deeming' imported automobile parts to not have entered into their country's internal commerce.

China submitted to the Panel that an ordinary customs duty under Article II:1(b) may be imposed either at or after the point of importation, so long as the charge arises from an obligation which arose 'as a condition of importation'.[18] In response Australia, in its third party oral submissions, points out that the charge was not enforced until after manufacturing, and was only enforced if the final manufactured vehicle satisfied certain criterion. On this basis, Australia submitted that any liability on the charge 'attaches internally' and hence was an internal measure under Article III:2.[19]

As an issue of public policy, Australia shared the concerns of the European Communities that the processing or manufacturing of goods after importation cannot be accepted as an 'intermediate step' prior to calculating the tariff. If this approach were adopted, the concern was that the entire system of tariff classification would be worthless.[20]

(c) Relevance of the harmonized system

On appeal, China submitted that the Panel had failed to take into account the rules under the Harmonized System ('HS') and, in particular, Rule 2(a) of the General Rules for the Interpretation of the Harmonized System as context for interpreting Article II:1(b). Rule 2(a) provides that a reference in a HS customs classification to an article includes that article in incomplete or unfinished form which has the "essential character" of the complete or finished article and includes that complete or finished article if presented in unassembled or disassembled form.[21] China

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16 United States of America, 'First Written Submission of the United States of America', Submission in *China – Measures Affecting the Import of Automobile Parts*, 13 March 2007, [4].

17 Australia, 'Third Party Oral Statement of Australia', Submission in *China – Measures Affecting the Import of Automobile parts*, 23 May 2007, [12]–[13].

18 People's Republic of China, 'First Written Submission of the Peoples Republic of China', Submission in *China – Measures Affecting the Import of Automobile Parts*, 17 April 2007, [49]–[70].

19 Australia, 'Third Party Oral Statement of Australia', Submission in *China – Measures Affecting the Import of Automobile Parts*, 23 May 2007, [14].

20 European Communities, 'First Written Submission by the European Communities', Submission in *China – Measures Affecting the Import of Automobile Parts*, 13 March 2007, [140].

21 Appellate Body Report, *China – Measures Affecting the Import of Automobile Parts*, WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [156].

argued that taking the HS including rule (2)(a) into account in interpreting Article II:1(b) indicated that the Article contemplated that Members would apply ordinary customs duties after the Member had determined the relevant classification in accordance with the rules of the HS and that, under the relevant laws, China's determinations that the unassembled auto parts constituted the finished motor vehicle were determinations in accordance with the rules of the HS even though the assembly occurred after the time of importation and even if the parts subsequently assembled into the finished motor vehicle arrived in different shipments.[22]

Australia disagreed with this interpretation and application of General Rule 2(a) for two key reasons. Firstly, Australia points out in its third party oral submissions that the Harmonised System classifies goods within a particular shipment, at the point of importation. Secondly, that China disregarded the significance of imported products being 'as presented' under the essential character rule.

Rather than turning to these particular issues, the Appellate Body agreed with the Panel that Rule 2(a) of the Harmonized System did not apply in resolving this preliminary question. It would be relevant if the question was whether auto parts could be classified as complete motor vehicles at all under China's Schedule of Concession, as this would require particular entries within China's Schedule to be interpreted. On resolving this issue over the meaning and application of Articles II:1(a) and III:2,[23] the Appellate Body held that the Panel had not erred in law in failing to rely on the Harmonized System in deciding whether the charge was an internal charge or an ordinary customs duty.

III. Violation of Article III

The complainants argued that China had violated *inter alia* their 'national treatment obligations' under GATT Articles III. After finding the measures constituted an 'internal charge' under Article III:2, the Panel considered Articles III:2 and III:4 separately, and found that China's measures were in violation of both of these provisions.

China appealed the Panel's finding on Article III:2 and III:4 on the basis that the measures were not an 'internal charge' at all, so did not fall under Article III. As the Appellate Body agreed with the Panel's finding that the charge constituted an 'internal charge' rather than an 'ordinary customs duty', it upheld the panel's finding that China's charge was inconsistent with both Article III:2 and III:4.

(a) Article III:2 first sentence

The Panel applied the usual two-step analysis to Article III:2, 1st sentence. Firstly, it found the complainants had established that imported and domestic auto parts were 'like products', as "*all imported auto parts* were potentially subject to the measure".[24] Secondly, the tax on the imported auto parts was "in excess" of that

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22 Ibid [14]–[18].

23 Ibid [152]ff.

24 Panel Report, *China – Measures Affecting Imports of Automobile Parts*, WTO Docs WT/DS339/R, WT/DS340/R, WT/DS342/R (18 July 2008) [7.216–217].

their domestic counterparts, which were not subject to the charge at all.[25] The panel found it unnecessary to decide if there was a violation of Article III:2, 2nd sentence. China's appeal that the measures were a border measure was rejected by the Appellate Body.

(b) Article III:4

The Panel found that China's measures were inconsistent with Article III:4, by applying a three-step approach:[26]

(i) Were the foreign and domestic products 'like'?

As a broader scope of 'like products' applied under Article III:4 compared to III:2, the Panel found the imported parts were 'like' the domestic products. This issue was not appealed by China.

(ii) Did the disputed measures affect the internal sale, offering for sale, purchaser transportation, distribution or use?

The Panel held that the administrative procedures and the charge 'inevitably influenced' a manufacturer's choice between domestic and imported automobile parts. [27] China appealed this finding, and submitted that any 'influence' was inherent in the rates contained in China's Schedule. The Appellate Body upheld the Panel's findings that 'deeming' an imported part to constitute a complete vehicle acted as a disincentive for manufacturers. In addition, the Appellate Body noted that the costs and administrative procedures could be completely avoided if manufacturers used domestic parts. As manufacturers would limit their use of imported auto parts due to these measures, competition in the automobile parts market would be affected.[28]

(iii) Were the imported auto parts afforded 'less favourable treatment' compared to the domestic products?

The Panel considered the criteria for determining the charge imposed on imported auto parts. The Panel found that a purchaser would have to take into account whether their use of an imported part would trigger any of the five Decree 125 categories leading to imposition of an additional tax. Less favourable treatment would occur if the additional charge was required to be paid. The Panel also found that less favourable treatment arose simply out of having to comply with the administrative procedures, which were not imposed on domestic auto parts. This particular issue was not appealed by China.

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25 Ibid [7.220–222].
26 Ibid [7.278]ff.
27 Ibid [7.249].
28 Appellate Body Report, *China – Measures Affecting the Import of Automobile Parts*, WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [192]ff.

IV. Violation of Article II:1(a) and II:1(b)

The complainants argued in the alternative that there was a violation of Article II. Although the Panel had found a violation of Article III, it decided to address this alternative submission in the event that it was wrong in its interpretation that the measure was an internal measure rather than a border measure. The Panel did find a violation of Article II, and China also appealed this finding. However on appeal, the Appellate Body held that since it had found that Article III rather than Article II applied, it was not necessary for it to decide on this alternative finding by the Panel.

Australia supported the complainants' arguments[29] that if the Panel found the measures were an 'ordinary customs duty' subject to Article II, China was nonetheless in violation of its binding tariff schedules under Article II. Australia pointed to the fact that 'deeming' imported automobile parts to constitute a whole vehicle after the importation process, thus applying a 25 per cent tariff, had the effect of undermining China's obligation to apply only 10 per cent tariff on imported auto parts.[30]

V. A General Exception under Article XX(d)

China argued that a defence under Article XX(d) was available. China argued that the measures were 'necessary to secure compliance' with "a valid interpretation of China's tariff provisions for motor vehicles.[31] The Panel found that China had failed to establish that the act of importing auto parts into China and then assembling them into motor vehicles was inconsistent with China's domestic law providing for customs duties. Therefore, it had failed to demonstrate that measures against such conduct were necessary to secure compliance with China's customs law.[32]

In addition, the Panel noted that even if some measures were required in order to secure compliance with their tariff schedules, China failed to explain why GATT consistent alternatives were not available. China did not present why such options such as investigating individual claims of breach could not be implemented, instead of the GATT inconsistent measures.[33]

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29 European Communities, 'First Written Submission by the European Communities', Submission in *China – Measures Affecting the Import of Automobile Parts*, 13 March 2007, [280]; United States of America, 'First Written Submission of the United States of America', Submission in *China – Measures Affecting the Import of Automobile Parts*, 13 March 2007, [119]; Canada, 'First Written Submission of Canada', Submission in *China – Measures Affecting the Import of Automobile Parts*, 13 March 2007, [144].

30 Australia, 'Third Party Oral Statement of Australia', Submission in *China – Measures Affecting the Import of Automobile Parts*, 23 May 2007, [19]ff.

31 See Appellate Body Report, *China – Measures Affecting the Import of Automobile Parts,* WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [7.285], quoting the submission of the Chinese government.

32 Panel Report, *China – Measures Affecting Imports of Automobile Parts*, WTO Docs WT/DS339/R, WT/DS340/R, WT/DS342/R (18 July 2008) [7.337].

33 Ibid [7.360]ff.

In its oral submissions to the Panel, Australia noted that China had not addressed the chapeau requirement at all.[34] As the first element of falling under paragraph (d) was not proven by China, the Panel did not consider whether the chapeau requirement was satisfied.

China did not appeal the Panel's finding that it had failed to satisfy Article XX(d).

VI. Violation of China's Accession Working Party Report

The Panel held that the measures were inconsistent with the Working Party Report, for failing to commit to the upper bound rate of 'no more than 10 per cent to CKD and SKD kits'. China appealed this finding, and the Appellate Body reversed the Panel's decision.

The Appellate Body held the Panel had erred in finding that Decree 125 imposed an ordinary customs duty on the CKD and SKD kits. The Appellate Body disagreed with the Panel's finding that the 25 per cent charge was levied at the point of importation, and noted the charge was imposed after assembly of the kits into an automobile. The Appellate Body also found this characterisation as a border measure to be inconsistent with the Panel's preliminary findings that the measures constituted an internet charge under Article III.[35]

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34 Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc WT/DS58/AB/R (12 October 1998) [116].

35 Appellate Body Report, *China – Measures Affecting the Import of Automobile Parts*, WTO Docs WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R (15 December 2008) [240].