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JAPAN - TAXES ON ALCOHOLIC BEVERAGES

Status Report by Japan

The following communication, dated 10 September 1997, from the Permanent Mission of Japan to the Permanent Delegation of the European Commission, the Permanent Missions of Canada and the United States and to the Dispute Settlement Body is circulated at the request of Japan.

Status Report on Implementation of the Recommendations and Rulings of
the Dispute Settlement Body Regarding "Japan - Taxes on Alcoholic Beverages"
(WT/DS8/11, WT/DS10/11, WT/DS11/8)

Pursuant to Article 21.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), the Government of Japan ("GOJ") hereby presents this first status report on the implementation of the recommendations of the Dispute Settlement Body ("DSB") regarding "Japan - Taxes on Alcoholic Beverages".

On 1 November 1996, the DSB adopted the Appellate Body report on "Japan - Taxes on Alcoholic Beverages" (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R) and the panel report on "Japan - Taxes on Alcoholic Beverages" (WT/DS8/R, WT/DS10/R, WT/DS11/R) as modified by the Appellate Body report. On 20 November 1996, the GOJ informed its intentions in respect of implementation of the recommendations of the DSB and advised the DSB that a "reasonable period of time" would be required in which to comply with the recommendations.

The adjustment of the liquor tax rate which is necessary to implement the recommendations of the DSB requires the amendment to the Liquor Tax Law. The amendment to the tax system, including the liquor tax, of each fiscal year needs to be decided in the form of legislation along with annual budget which begins in April and ends in March. The legislation needs approval in both chambers of the Diet with a majority vote and the executive branch is required to submit the draft amendment to the next fiscal year's tax system to the Diet by the end of January. It should be also noted that, in order to submit the draft amendment of tax legislation to the ordinary session of the Diet, the content of the draft amendment must be decided by the middle of December. Under these strict procedures for the amendment of the tax legislation, the Liquor Tax Law was amended as follows as a part of the FY 1997 Tax Amendments, with a view to ensuring earliest possible implementation of the recommendations of the DSB.

Since the GOJ informed the DSB of its intentions in respect of implementation of the recommendations, it held a series of consultations with all the other parties to the dispute concerning

measures to be taken in conjunction with the implementation of the recommendations and the period for implementation. After examining the result of these consultations as well as all relevant aspects of domestic situations, the GOJ drew up a reform plan for the liquor tax system, which was decided by the Research Commission on the Tax System of the ruling Liberal Democratic Party on 18 December 1996. The GOJ decided officially on the Outline of Tax Amendments including the Liquor Tax amendment on 10 January 1997, and submitted its draft amendment to the Liquor Tax Law to the Diet on 31 January 1997 to be enacted as the next fiscal year's tax legislation. On the same date, the European Communities ("EC") and Japan formally reached a mutually acceptable solution in the form of an exchange of letters regarding the modalities for the implementation by the GOJ of the recommendations of the DSB in accordance with the said draft amendment, as notified jointly to the WTO by both governments on 15 July 1997 (WT/DS8/17, WT/DS10/17, WT/DS11/15).

The draft amendment of the Liquor Tax Law to implement the reform plan accepted by the EC was considered and approved by both chambers of the Diet without modifications. The Amendment was promulgated on 31 March 1997 (Law No. 21, 1997). The following is the outline of the Amendment. (See also WT/DS8/17, WT/DS10/17, WT/DS11/15.)

- As for the tax rate on whisky/brandy, the GOJ shall reduce it by about 58 per cent to 409,000 yen per kilolitre (40 degrees of alcohol content, 10,225 yen per kilolitre per degree of alcohol), through two stages of reduction; first reduction by about 44 per cent on 1 October 1997 and the second reduction by about 26 per cent from the level of 1 October 1997 on 1 October 1998.
- As for the tax rate on Shochu A and liqueurs, the GOJ shall increase it to the level of the current tax rate on "spirits" in terms of tax rate per degree of alcohol content:
 - The tax rate on Shochu A shall be increased through the same stages as whisky/brandy to 248,100 yen per kilolitre (25 degrees of alcohol content, 9,924 yen per kilolitre per degree of alcohol).
 - The tax rate on liqueurs shall be increased on 1 October 1997 to 119,088 yen per kilolitre (12 degrees of alcohol content, 9,924 yen per kilolitre per degree of alcohol).
- As a result of the above adjustment, from 1 October 1998, an identical taxation on Shochu A, "spirits" and liqueurs in terms of tax rate per degree of alcohol content will be brought about and the tax differential between Shochu A and whisky/brandy will be reduced to the *de minimis* level of 1.03 times in terms of tax rate per degree of alcohol content.
- As for the tax rate on Shochu B, the tax rate adjustment shall be completed through three stages of increases on 1 October 1997, 1 October 1998 and 1 October 2001 to 248,100 yen per kilolitre (25 degrees of alcohol content, 9,924 yen per kilolitre per degree of alcohol). An additional three year period from 1 October 1998 to 1 October 2001 is needed in view of the effects on both consumers and producers of this tax increase by as much as 2.4 times. As a result, a taxation on Shochu B, "spirits" and liqueurs in terms of tax rate per degree of alcohol content will become identical from 1 October 2001.

In addition to the above amendment to the Liquor Tax Law, the GOJ, based upon the requests of the EC, will also carry out as compensation autonomous reduction of import duties on whisky/brandy, the value of which is equivalent to that of the tax differential which will remain with regard to Shochu B for a three-year period from 1 October 1998 to 1 October 2001. With this measure, adverse effects on imported whisky/brandy due to the tax differential during the said period will effectively be dissolved.

Meanwhile, the Government of the United States (“USG”) requested, on 24 December 1996, that the “reasonable period of time” should be determined through binding arbitration as is provided for by Article 21.3(c) of the DSU. On 14 February 1997, the arbitrator determined that “a ‘reasonable period of time’ within the meaning of Article 21.3(c) of the DSU for Japan to implement the recommendations and ruling of the DSB of 1 November 1996 in *Japan - Taxes on Alcoholic Beverages* is 15 months” (WT/DS8/15, WT/DS10/15, WT/DS11/13). Taking this determination seriously, the GOJ has been examining possible and practical responses to this issue. At the same time, the GOJ has been holding a series of discussions with the USG in order to find a mutually acceptable solution regarding the modalities of the implementation of the recommendations of the DSB.