

***MEXICO – TAX MEASURES ON SOFT DRINKS AND OTHER
BEVERAGES***

(WT/DS308)

**EXECUTIVE SUMMARY OF THE
FIRST SUBMISSION OF
THE UNITED STATES OF AMERICA**

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I. INTRODUCTION

1. Since January 1, 2002, Mexico has imposed discriminatory tax measures on soft drinks and syrups that favor its domestic cane sugar industry, in violation of its obligations under Articles III:2 and III:4 of the *General Agreement on Tariffs and Trade 1994* (“GATT 1994”). Specifically, in December 2001, the Mexican Congress approved an amendment of the *Ley del Impuesto Especial sobre Producción y Servicios* (“IEPS”) adding a 20 percent tax on soft drinks and syrups that use HFCS or any sweetener other than cane sugar (“HFCS soft drink tax”), as well as a 20 percent tax on the representation, brokerage, agency, consignment and distribution of such products (“distribution tax”).

2. The HFCS soft drink and distribution tax is embodied in the following measures, which are the measures at issue in this dispute: (1) the IEPS, as amended effective January 1, 2002, and its subsequent amendments published on December 30, 2002, and December 31, 2003; and (2) related or implementing measures, contained in the *Reglamento de la Ley del Impuesto Especial sobre Producción y Servicios*, the *Resolución Miscelanea Fiscal Para 2003*, and the *Resolución Miscelanea Fiscal Para 2004*.

II. LEGAL ARGUMENT

3. For purposes of sweetening soft drinks and syrups, cane sugar is directly competitive and substitutable with HFCS. In Mexico, cane sugar is the overwhelmingly dominant sweetener, with the vast majority of soft drinks and syrups produced in Mexico being sweetened with cane sugar. Conversely, in the United States the sweetener of choice for soft drink and syrup production is HFCS. Further, cane sugar comprises over 95 percent of Mexican sweetener production; whereas HFCS before the discriminatory tax comprised nearly 100 percent of Mexican sweetener imports from the United States. Because the tax exempts cane sugar and soft drinks and syrups sweetened with cane sugar, it clearly favors domestic cane sugar production over imports.

A. The IEPS Is An Internal Tax

4. The Ad Note to GATT Article III clarifies that an internal tax that applies to imported products at the time of importation is, nonetheless, an internal tax within the meaning of GATT Article III. The HFCS soft drink tax applies to imported soft drinks and syrups at the time of importation and like domestic products upon their internal transfer. The HFCS soft drink tax also applies to subsequent transfers of imported soft drinks and syrups in Mexico. The distribution tax taxes the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS in Mexico. The HFCS soft drink tax and distribution tax are, thus, an internal taxes within the meaning of GATT Article III.

**B. The HFCS Soft Drink Tax and Distribution Tax Are Inconsistent with
GATT Article III:2, First Sentence**

5. A determination of an internal tax's inconsistency with GATT Article III:2, first sentence is a two step process: First, the imported and domestic products at issue must be "like." Second, the internal tax must be applied to imported products "in excess of" those applied to the like domestic products.

**1. Soft Drinks and Syrups Sweetened with HFCS and Soft Drinks and
Syrups Sweetened with Cane Sugar Are Like Products**

6. "Like" products need not be *identical* in all respects. For example, vodka and shochu were found in a previous dispute to be like products within the meaning of GATT Article III:2, first sentence. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products because they have virtually identical physical properties, end-uses and tariff classifications and are equally preferred by consumers.

(a) Physical Characteristics

7. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are physically identical in virtually all respects. First, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are identical in physical appearance. Second, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are virtually indistinguishable by the human body as both contain the same number of calories and are digested and absorbed by the human body in the same manner.

8. Third, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar have nearly the same chemical composition. Cane sugar and HFCS are similarly mixtures of fructose and glucose. Thus, the only difference between an HFCS-sweetened and a cane sugar-sweetened soft drink or syrup is the *exact* ratio of the fructose-glucose mixture.

9. Fourth, per Mexican regulation, a soft drink or syrup sweetened with HFCS and one sweetened with cane sugar bear the same ingredient on the label: "azúcares" ("sugars"). "Azúcares," per Mexico's regulation, is defined as all mono- or disaccharide sugars. This definition captures both the monosaccharide sugar, HFCS, and the disaccharide sugar, cane sugar.

(b) End-Uses and Channels of Distribution

10. Soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar share identical end-uses and channels of distribution. A soft drink or syrup's sweetener does not affect its end-use. There is no evidence that, when Mexican bottlers, such as

Coca-Cola Femsa, switched to a blend of HFCS and sugar (or when U.S. bottlers switched in the 1980s), these end-uses in any way changed.

11. For similar reasons, whether a soft drink or syrup is sweetened with HFCS or sugar does not affect its channels of distribution. Major bottlers do not mentioned a soft drink or syrup's sweetener as in any way affecting its channels of distribution. There is no evidence that channels of distribution for soft drinks or syrups in Mexico changed in the period from the late 1990s through 2001 when bottlers such as Coca-Cola Femsa had switched to a blend of HFCS and sugar for soft drink production, nor that they changed again when, because of the HFCS soft drink tax and distribution tax, bottlers switched back to 100 percent cane sugar.

(c) Consumer Preferences

12. Prior to switching to use of HFCS, U.S. soft drink bottlers undertook extensive consumer surveys to determine the consumer acceptability of soft drinks sweetened with HFCS. These surveys revealed that overall HFCS-sweetened and sugar-sweetened soft drinks were equally acceptable to consumers. Other surveys conducted were based on head-to-head comparisons of HFCS- and sugar-sweetened soft drinks and showed no consistent pattern of preference for sugar-sweetened soft drinks versus HFCS-sweetened soft drinks. Today, Coca-Cola reports "there is no noticeable taste difference."

13. In the course of its antidumping determination on HFCS from the United States, the Mexican Government noted that a panel of 30 tasters did not detect any significant difference in sweetness or any pattern of preference. That same determination concluded overall: "These possible differences in products manufactured with the two sweeteners in question may prove that these sweeteners are not identical, but this does not mean that they do not have an extremely similar taste." As a result of positive consumer testing, U.S. manufacturers of soft drinks and syrups switched from sugar to 100 percent HFCS by the mid-1980s. Similarly, in the late 1990s in Mexico, Mexican soft drink producers began increasingly to substitute HFCS for cane sugar.

14. In addition, with the exception of a handful of niche products, soft drinks are simply not marketed on the basis of whether they contain sugar or HFCS as a sweetener.

(d) Tariff Classification

15. The tariff classification system in Mexico does not separately break out soft drinks and syrups based on whether they are sweetened with sugar (whether cane or beet) or HFCS.

16. In sum, HFCS-sweetened and cane sugar-sweetened soft drinks are like products within the meaning of GATT Article III:2, first sentence.

2. Soft Drinks and Syrups Sweetened with HFCS Are Taxed in Excess of Soft Drinks and Syrups Sweetened with Cane Sugar

(a) HFCS Soft Drink Tax

17. The HFCS soft drink tax applies a 20 percent tax on soft drinks and syrups. Only internal transfers of soft drinks and syrups sweetened exclusively with cane sugar are exempt from the IEPS. Thus, with respect to imports, the IEPS taxes (1) all soft drinks and syrups upon their importation – regardless of the sweetener used – and then (2) taxes their subsequent internal transfer if they use any sweetener other than cane sugar.

18. Virtually all regular soft drinks and syrups produced in the United States are sweetened with HFCS, while all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar. Therefore, by exempting soft drinks and syrups sweetened with only cane sugar, the IEPS successfully exempts all regular soft drinks and syrups produced in Mexico from payment of the 20 percent tax. A 20 percent tax that applies to imported soft drinks and syrups but not to soft drinks and syrups produced domestically is a tax “in excess” of that applied to like domestic products. Therefore, as applied at the time of importation and upon internal transfers, the HFCS soft drink tax is inconsistent with GATT Article III:2, first sentence.

(b) Distribution Tax

19. The IEPS also applies a 20 percent tax on the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS. Soft drinks and syrups sweetened with cane sugar are exempt from the distribution tax. A tax applied on the representation, brokerage, agency, consignment and distribution of a good is, in effect, a tax on the good itself. Therefore, by taxing the representation, brokerage, agency, consignment and distribution of soft drinks and syrups sweetened with HFCS at 20 percent while completely exempting soft drinks and syrups sweetened only with cane sugar, the IEPS subjects HFCS-sweetened soft drinks and syrups to taxes “in excess of” of those applied on like domestic products – soft drinks and syrups made with cane sugar. Accordingly, the distribution tax is also inconsistent with GATT Article III:2, first sentence.

C. The IEPS Is Inconsistent with Article III:2, Second Sentence of GATT 1994

20. A measure is inconsistent with GATT Article III:2, second sentence if (1) the imported product and domestic product are “directly competitive or substitutable products;” (2) the directly competitive or substitutable imported and domestic products are “not similarly taxed;” and (3) the dissimilar taxation is applied “so as to afford protection to domestic production.” The IEPS as a tax on soft drinks and syrups made with HFCS, as well as a tax on the use of HFCS itself, meets each of these elements such that the IEPS is inconsistent with Mexico’s obligations under GATT Article III:2, second sentence.

1. The HFCS Soft Drink Tax as Applied to HFCS Is Inconsistent with GATT Article III:2, Second Sentence

21. By imposing a 20 percent tax on soft drinks and syrups sweetened with HFCS, Mexico has, in effect, imposed a prohibitive tax on the use of HFCS.

(a) HFCS and Cane Sugar Are Directly Competitive or Substitutable Products

22. HFCS and cane sugar are directly competitive or substitutable products. Whether two products are “directly competitive or substitutable” must be determined on a case-by-case basis and in light of all the relevant facts in the case. An assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste. This requires evidence of the direct competitive relationship between the domestic and imported products, including comparisons of their physical characteristics, end-uses, channels of distribution and prices. Moreover, the category of directly competitive or substitutable products is broader than the category of “like products”: even *imperfectly* substitutable products can fall under the second sentence of Article III:2. Products do not have to be substitutable for all purposes at all times to be considered competitive. It is sufficient that there is a pattern that they may be substituted for some purposes at some times by some consumers.

(i) Physical Characteristics

23. HFCS and cane sugar for use in soft drinks and syrups have substantially the same physical characteristics. This analysis should focus on the defining physical characteristics of HFCS and cane sugar for the purpose of competition in the marketplace. Because the HFCS soft drink tax applies on the use of HFCS in soft drinks and syrups, the relevant “marketplace” is the soft drink and syrup industry.

24. HFCS is a liquid sweetener that has substantially the same chemical characteristics as cane sugar. Both HFCS and cane sugar are composed of a combination of glucose and fructose molecules and, when in a soft drink or syrup, both exist as monosaccharides within three to four weeks of bottling. HFCS-55 contains just five percent more fructose than cane sugar; HFCS-42 contains just eight percent less. The similar chemical composition of HFCS and cane sugar is not accidental. In fact, when HFCS was developed, it was calibrated to be just as sweet as sugar as a sweetener for soft drinks. This was done by developing a fructose-glucose ratio that closely mimicked that of cane sugar.

25. Because the chemical constituents of sugar and HFCS are so similar, the taste perceptions in soft drink and syrup formulations are extremely similar. This is especially true after the sugar in a soft drink has inverted, or broken down to a monosaccharide solution of fructose and glucose

molecules just as the molecules exist in HFCS. Testing conducted by the soft drink and HFCS industries found that HFCS-sweetened soft drinks and sugar-sweetened soft drinks were comparable and of equal acceptability to the consumer. HFCS and cane sugar are also physically similar when it comes to smell and color. Both HFCS and cane sugar are odorless and, as liquids, both are colorless.

26. HFCS's form as a liquid sweetener does not distinguish it from cane sugar as a sweetener for soft drinks and syrups. First, some producers of soft drinks and syrups actually use cane sugar in its liquid form. Second, part of the bottling process when using cane sugar as a sweetener is mixing the cane sugar with water to produce a sugar syrup, which is then mixed with other ingredients to produce a soft drink.

27. In the context of the SECOFI antidumping investigation of HFCS in 1997-98, the Mexican Government has also determined that cane sugar and HFCS share the same essential physical characteristics and concluded that HFCS-55, HFCS-42 and sugar are "like products" for the purposes of Mexico's antidumping law and Article 2.6 of the Anti-Dumping Agreement.

28. When this antidumping determination was challenged in binational panel proceedings under NAFTA Chapter 19, the binational panel agreed with Mexico that sugar and HFCS are "like products."

(ii) End Uses and Consumer Preferences

29. Overlap in end-use is important in determining direct competitiveness or substitutability. The existence of mixtures, and the use of two products in varying mixtures, also testifies to their overlap in uses and to their commercial interchangeability. Commonality of end-uses in foreign markets and consumer tastes are also relevant. For HFCS itself or sugar, the relevant consumers are sweetener users of HFCS in the bottling industry and elsewhere. The end-uses of HFCS and cane sugar, and consumer tastes for these products, demonstrate their competitiveness or substitutability.

30. The evidence submitted by the United States shows that HFCS was developed with the end-use of soft drink bottling as its major objective. Mexican soft drink producers have used varying mixtures of HFCS and cane sugar, and have converted from cane sugar to mixtures of HFCS and then back again. This free variation between sweeteners testifies to the commercial interchangeability of HFCS and cane sugar in Mexican soft drink production. When a soft drink bottler uses a blend of HFCS and sugar, the bottler is using both sweeteners for the same purpose, in the same plant, for the same brand of the same soft drink.

31. In addition, because the HFCS soft drink tax does not apply to fruit or vegetable juices, major juice bottlers can, and do, use as much HFCS in their sweetened juices as they wish – up to 100 percent of sweetener in some cases. Mexican bottlers' reaction to the HFCS soft drink tax was to switch back to 100 percent sugar. The former use of HFCS and sugar in mixtures, and the

use of up to 100 percent HFCS by bottlers who are not subject to a prohibitive tax, testify to the distortion of market choices created by the HFCS tax. In the United States and Canada, soft drink and syrup producers have shifted almost entirely from sugar to HFCS over time.

32. Switching between HFCS and sugar is not expensive or difficult. Switching from HFCS to sugar is more difficult and costly, and Mexican bottlers would not have done so if they had not been forced to by the 20 percent tax. In the early 1980s in the United States when U.S. bottlers were using blends of HFCS and sugar, varying the HFCS-sugar ratio in a given batch of soft drinks could be done with relative ease.

33. Also, Mexican labeling regulations do not distinguish between “sugars” as a food or beverage ingredient. Thus, a bottler can move between different mixtures of HFCS and sugar without changing its labeling.

34. The Mexican Government has recognized the overlap in end-uses and consumer tastes between HFCS and cane sugar. As noted above, in the final antidumping determination of January 1998, SECOFI found that HFCS and sugar “fulfill the same functions and are commercially interchangeable in the marketplace.” SECOFI noted the ample proofs presented that consumers “perceive no difference at all” between sugar, invert sugar and HFCS. The determination also notes that a panel of 30 tasters did not detect any significant difference in sweetness or any pattern of preference for HFCS-55, refined sugar or invert sugar and that an examination of a range of food and beverage industries showed a practice that substitution of HFCS for sugar was not promoted as a change in brand or a “new flavor.”

35. During the review of this determination by the binational panel under Chapter 19, Mexico argued that “technical studies and testimonies of representatives of the [soft drink] industry show that HFCS and sugar are both used interchangeably in the industry without affecting the quality of soft drink products,” and that “HFCS and sugar while not perfect substitutes possess characteristics and composition sufficiently similar that they serve a great number of similar functions. This allows them to be commercially interchangeable in such a great variety of sub-sectors of the beverages and food sectors.” The Chapter 19 binational panel concluded that sugar and HFCS are commercially interchangeable.

36. Sugar and HFCS are therefore directly competitive or substitutable and in direct competition in the marketplace.

(iii) Channels of Distribution

37. The channels of distribution for HFCS and cane sugar, and for soft drinks sweetened with them, provide additional evidence that these products are directly competitive or substitutable. HFCS and sugar are sold through similar channels from producers to industrial bottlers, and in some cases the same company sells both HFCS and sugar to similar customers.

38. HFCS of U.S. origin has been sold to Mexican customers through two channels: on an FOB basis directly from the U.S. exporter and terminals built by HFCS exporters in Mexico. The latter received HFCS exports from plants in the United States and then sold the HFCS to customers in Mexico. Mexican bottlers buy Mexican cane sugar directly from the sugar mill or from a distributor. Any difference in distribution channels is, thus, attributable to the fact that HFCS is the imported sweetener and cane sugar is the domestic sweetener. Both sweeteners are sold directly from the sweetener producer to the end-user, which with respect to this dispute are soft drink and syrup bottlers.

39. In the antidumping investigation on HFCS from the United States, SECOFI examined distribution channels for HFCS and sugar and found that they were the same, and were targeted at the same customers.

(iv) Tariff Classification

40. The classification of these products in the Mexican tariff schedule also supports the conclusion that these are directly competitive or substitutable products. Although cane sugar is generally classified under heading 1701 and HFCS under heading 1702, some cane sugar products (i.e., liquid cane sugar and invert cane sugar) are classified under heading 1702.

41. With respect to soft drinks and syrups sweetened with either HFCS or cane sugar, as recounted above, the tariff classification system in Mexico does not separately break out soft drinks and syrups based on whether they are sweetened with cane sugar or HFCS.

(v) Price Relationships and Competition in the Marketplace

42. The price relationships between HFCS and cane sugar in soft drink use also demonstrate that they are directly competitive or substitutable products. The connection between the price, or availability, of HFCS and the price of sugar has been amply demonstrated by the real-world economic experiment of the HFCS soft drink tax. In the three days following the enactment of the tax, for example, 30 Mexican bottlers cancelled all orders for HFCS. By mid-January 2002, the HFCS soft drink tax had resulted in a 8 percent increase in Mexican sugar prices.

43. Because of the HFCS tax, and the collapse of demand for HFCS from bottlers, importers shuttered their terminals or otherwise virtually ceased imports of HFCS for soft drink and syrup production, and domestic HFCS producers partially or totally idled their production. Yet demand for sweeteners has remained constant or growing with annual growth in population and GDP. As sugar replaced HFCS in soft drink and syrup production, the additional demand for sugar artificially created a sugar shortage. The Secretariat of Economy explained its decision to provide an extraordinary *cupo* (market access quota) for sugar imports during the latter part of 2003: “This plan results from various complaints about shortage problems in sugar, presented to the Secretariat of Economy by producers who use sugar in their production processes. *These*

concerns are fundamentally a consequence of the entry into force of the Impuesto Especial sobre Producción y Servicios (IEPS) for soft drinks made with fructose, which has generated a substitution of sugar for fructose ...”

44. The Mexican Government Comisión Federal de Competencia (CFC, or Federal Competition Commission) has also recognized that sugar and HFCS are directly competitive with each other in the marketplace, in two separate decisions regarding competition in the sugar industry. These decisions were based on an examination of the detailed facts of competition in the Mexican sweeteners market and found that HFCS is a close substitute for refined sugar in carbonated drinks. As the panel in *Chile – Alcoholic Beverages* noted: the question of competition from an anti-trust perspective generally utilizes narrower market definitions than used when analyzing markets pursuant to Article III:2, second sentence and it seems logical that competitive conditions sufficient for defining an appropriate market with respect to anti-trust analysis would *a fortiori* suffice for an Article III analysis. The Panel in this dispute should read the findings of the CFC to confirm that cane sugar and HFCS are directly competitive or substitutable products in the Mexican market.

(vi) Summary on Direct Competition and Substitutability

45. To set the HFCS-sugar comparison in perspective, the Panel might consider the WTO disputes regarding discrimination in taxation of distilled spirits. Each of these disputes concerned a situation of long-standing tax discrimination, in which tax barriers largely foreclosed the market to the imported product. The panel and the parties in each of these cases had to place a particular focus on *potential* competition and latent demand, since actual discrimination was so severe and so long-standing.

46. In the present case, there is not just *potential* competition between imported HFCS and domestic cane sugar: the Panel has available to it data on *actual* competition between these products including product switching before and just after the HFCS soft drink tax was imposed. HFCS itself was developed to mimic and improve on cane sugar in soft drink bottling operations, and its success in the marketplace of the bottling industry testifies to how close a substitute it is for sugar. Indeed, if HFCS were not quite so successful at competing with cane sugar, the Mexican Government might not have acted to protect the Mexican sugar industry by enacting the HFCS soft drink tax to expel imported HFCS from the soft drink and syrup market in Mexico.

47. For all these reasons, the Panel should find that for purposes of sweetening soft drinks, imported HFCS and Mexican cane sugar are directly competitive or substitutable products, and compete directly in the soft drink and syrups sweeteners marketplace in Mexico.

(b) HFCS and Cane Sugar Are Not Similarly Taxed

48. There can be no question that the HFCS soft drink tax taxes HFCS and cane sugar dissimilarly. When contained in a soft drink or syrup, HFCS results in a 20 percent tax on the

value of the finished soft drink or syrup. Use of exclusively cane sugar in that same soft drink or syrup results in no tax at all. As applied to HFCS, however, the impact of the tax differential actually far exceeds a 20 percentage point difference. This is because the HFCS soft drink tax is calculated on the value of the finished soft drink or syrup such that the tax results in a tax that is four times the value of the HFCS – or in other words, a 400 percent tax on HFCS. With a tax liability of 400 percent, the HFCS producer cannot even provide HFCS to its customer for free: the producer would have to pay the customer to take it. The HFCS soft drink tax is essentially a prohibitive tax on the use of HFCS in soft drinks and syrups. Needless to say, a prohibitive tax applied to the imported product that is not applied to the directly competitive or substitutable domestic product is a dissimilar tax within the meaning of GATT Article III:2, second sentence.

(c) HFCS Soft Drink Tax Is Applied So As to Afford Protection to Domestic Production

49. The protective application of a measure is to be discerned from the structure of the measure itself, including the very magnitude of the dissimilar taxation involved. A measure's purpose, to the extent it is "objectively manifested in the design, architecture and structure of the measure" may also be "intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production."

50. Mexico's tax on the use of HFCS is applied "so as to afford protection" to Mexican cane sugar production. The HFCS soft drink tax is structured such that all soft drinks and syrups are taxed 20 percent, except those sweetened exclusively with cane sugar. Cane sugar is a domestically-produced sweetener in Mexico. Since Mexico does not import sugar – or does so in only very small amounts – this is a benefit bestowed nearly exclusively on domestic producers. Domestic producers have, thus, benefitted from being placed in an un-taxed category, while their greatest commercial rival, the imports of HFCS, remain subjected to taxation.

51. Moreover, as indicated above, HFCS remains not only subject to taxation but taxation at a prohibitive rate. As stated, a 20 percent tax on the value of the finished soft drink or syrup results in a 400 percent tax on the use of HFCS itself. The enormity of this dissimilar taxation has effectively excluded imported HFCS from the Mexican sweeteners market. Dissimilar taxation of this magnitude and nature objectively manifests the intention of the tax to protect Mexican cane sugar production.

52. Further, the structure of the HFCS soft drink tax is such that the low-taxed product is almost exclusively domestically-produced, while the high-taxed product, prior to imposition of the discriminatory tax, comprised virtually all directly competitive or substitutable imports. Indeed, in 2001 HFCS accounted for 99.7 percent of Mexican nutritive sweetener imports. By contrast, in 2001 cane sugar comprised somewhere between 90 and 95 percent of domestically produced sweeteners in Mexico. Thus, at the time of its imposition, the HFCS soft drink tax applied to nearly 100 percent of sweetener imports but less than ten percent of Mexican production. The Appellate Body addressed a similar situation in *Chile – Alcoholic Beverages*.

53. The protectionist structure of the IEPS is confirmed by a remarkable series of judicial and political pronouncements that the purpose of the tax is to “protect the sugar industry.” For example, the highest interpretative authority in Mexico, the Supreme Court, has definitively and conclusively characterized Mexico’s tax scheme as designed to protect Mexican domestic production of cane sugar.

54. In sum, the HFCS soft drink tax, as a tax on HFCS but not the directly competitive or substitutable domestic product cane sugar, is applied in a manner so as to afford protection to domestic production, and, therefore, is inconsistent with Mexico’s obligations under GATT Article III:2, second sentence.

2. The HFCS Soft Drink Tax and Distribution Tax as Applied to Soft Drinks and Syrups Is Inconsistent with GATT Article III:2, Second Sentence

(a) Soft Drinks and Syrups Sweetened with Cane Sugar Are Directly Competitive or Substitutable with Soft Drinks and Syrups Sweetened with HFCS

55. The category of “like” products is a subset of those products which are directly competitive or substitutable. Therefore, as soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are like products they are necessarily directly competitive or substitutable products.

56. Moreover, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable products for many of the same reasons they are “like”. First, with respect to physical appearance, end-uses and channels of distribution, consumer preferences and tariff classification, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are virtually the same. Second, HFCS-sweetened and sugar-sweetened soft drinks and syrups compete in the same market and for the same customers. For these reasons, as well as others examined in more detail above, soft drinks and syrups sweetened with HFCS and soft drinks sweetened with cane sugar are directly competitive or substitutable products within the meaning of GATT Article III:2, second sentence.

(b) Soft Drinks and Syrups Sweetened with HFCS and Soft Drinks and Syrups Sweetened with Cane Sugar Are Not Similarly Taxed

57. As stated above, the HFCS soft drink tax imposes a tax at a rate of 20 percent on (1) all importations of soft drinks and syrups from the United States and (2) subsequent internal transfers of such soft drinks and syrups if they are sweetened with HFCS. The IEPS exempts from the latter soft drinks and syrups sweetened with cane sugar. As also stated, all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar, such that the exemption

successfully excludes all regular soft drinks and syrups produced in Mexico from payment of the tax. Consequently, the HFCS soft drink tax results in a 20 percent tax on imported soft drinks and syrups, and their subsequent internal transfer if sweetened with HFCS, that is not similarly applied to directly competitive or substitutable products. Imposing a 20-percentage-point differential between the tax on the imported product and the tax on the directly competitive or substitutable product clearly means that the products are not “similarly taxed”. Accordingly, the HFCS soft drink tax as applied to soft drinks and syrups – both at the time of importation and on subsequent transfers – results in the type of dissimilar taxation captured under GATT Article III:2, second sentence.

58. In addition, the distribution tax also results in dissimilar taxation of imported soft drinks and syrups. Like the tax on internal transfers, the IEPS exemption for soft drinks and syrups sweetened with cane sugar, also successfully excludes all regular soft drinks and syrups produced in Mexico from payment of the distribution tax. Because virtually all regular soft drinks and syrups produced in the United States are sweetened with HFCS, imported soft drinks and syrups do not enjoy the same exemption. As a consequence, the distribution tax taxes the representation, brokerage, agency, consignment and distribution of imported soft drinks and syrups but not the representation, brokerage, agency, consignment and distribution of soft drinks and syrups produced in Mexico. A tax on the representation, brokerage, agency, consignment and distribution of a good, is in effect, a tax on the good itself. Therefore, the distribution tax constitutes a tax applied on imported soft drinks and syrups that is not similarly applied to directly competitive or substitutable products produced in Mexico.

(c) The HFCS Soft Drink and Distribution Tax Is Applied So As to Afford Protection to Domestic Production

59. As stated above, whether a measure is “applied so as to afford protection to domestic production” is “an issue of how the measure in question is applied.” The IEPS – both its HFCS soft drink tax and its distribution tax – is applied such that it affords protection to domestic production. Under the IEPS, soft drinks and syrups sweetened with HFCS are taxed at 20 percent (whether on their importation, internal transfer or in connection with their representation, brokerage, agency, consignment or distribution), whereas soft drinks and syrups sweetened with cane sugar are not. As discussed above, soft drinks and syrups sweetened with HFCS and soft drinks and syrups sweetened with cane sugar are directly competitive or substitutable products. Moreover, as also explained above, all regular soft drinks and syrups produced in Mexico are sweetened with cane sugar, whereas virtually all soft drinks and syrups produced in the United States are sweetened with HFCS. Therefore, the structure of the IEPS, is to apply a 20 percent tax on soft drinks and syrups imported from the United States and no tax on directly competitive or substitutable soft drinks and syrups produced in Mexico.

60. The structure of the IEPS is precisely the type of structure that has been found on prior occasions to constitute persuasive evidence that a measure is applied “so as to afford protection.” Furthermore, if viewed on an order of magnitude basis the 20-percentage point difference in this

dispute far exceeds the tax differential examined in the other WTO alcoholic beverages disputes. Moreover, the IEPS applies not only on the importation and internal transfer(s) of soft drinks and syrups themselves but also on their representation, brokerage, agency, consignment and distribution. Thus, the tax differential is not just 20 percent on the value of the soft drink or syrup but an additional 20 percent on the value of any representation, brokerage, agency, consignment or distribution used to effectuate that soft drink or syrup's transfer.

61. As a tax on imported soft drinks and syrups that is not similarly applied to directly competitive or substitutable soft drinks and syrups produced in Mexico, the IEPS (HFCS soft drink tax and distribution tax) is inconsistent with Mexico's obligations under GATT Article III:2, second sentence.

D. The HFCS Soft Drink Tax, Distribution Tax and Reporting Requirements Applied on the Use of HFCS Are Inconsistent with GATT Article III:4

62. In examining a claim under GATT Article III:4, the Appellate Body has identified three distinct elements required to establish a violation: (1) the imported and domestic products are "like products;" (2) the measure is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product. The IEPS meets each of these criteria as a tax on the use of HFCS by (1) taxing the transfer of soft drinks and syrups made with HFCS at 20 percent (HFCS soft drink tax); (2) taxing the representation, brokerage, agency, consignment and distribution of soft drinks and syrups made with HFCS (distribution tax); and (3) subjecting soft drinks and syrups made with HFCS to numerous bookkeeping and reporting requirements (reporting requirements). These measures are not imposed on cane sugar or soft drinks and syrups made only with cane sugar.

1. HFCS and Cane Sugar Are Like Products

63. As the details provided above reveal, HFCS and cane sugar compete head-to-head as sweeteners for soft drinks and syrups. Indeed, as a sweetener in soft drinks and syrups, HFCS and cane sugar are near perfect substitutes. This is demonstrated by the facts reviewed above and, in particular, by the fact that prior to imposition of the IEPS, soft drink and syrup producers were, in rapidly increasing amounts, actually substituting HFCS for cane sugar. These facts overwhelmingly support a finding that HFCS and cane sugar are "directly competitive or substitutable" products for purposes of sweetening soft drinks and syrups within the meaning of GATT Article III:2. They are also more than adequate to support a finding that HFCS and cane sugar are "like" products within the meaning of GATT Article III:4.

64. First, the analysis provided with respect to the GATT Article III:2, second sentence claim thoroughly establishes that, prior to the discriminatory tax, HFCS competed directly with cane sugar as a sweetener for soft drinks and syrups in Mexico. Second, HFCS and cane sugar overlap in the ways deemed relevant to the like product inquiry: (i) the physical properties of the

products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes. Each of these elements was addressed in relation to the claim under GATT Article III:2, second sentence, and support a determination that, for purposes of GATT Article III:4, HFCS and cane sugar are “like” products as sweeteners for soft drinks and syrups.

2. IEPS Is a Law Affecting the Use of HFCS

65. The term “affecting” in GATT Article III:4 is broad in scope. This broad scope, as articulated by several panels and affirmed by the Appellate Body, “cover[s] not only laws and regulations which directly govern the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products.”

66. The IEPS “affects” the use of HFCS by conditioning access to an advantage on use of the domestic sweetener, cane sugar. Specifically, under the IEPS, soft drink and syrup producers who use exclusively cane sugar to sweeten their products are wholly exempt from the HFCS soft drink tax, the distribution tax and the reporting requirements. Soft drink and syrup producers who use HFCS to sweeten their products do not enjoy the same advantage. Instead, soft drink and syrup producers who use HFCS to sweeten their products must (1) pay a 20 percent tax on the transfer of their products (HFCS soft drink tax); (2) pay a 20 percent tax on representation, brokerage, agency, consignment or distribution of their products; and (3) track and report commercially sensitive information, including their products’ top 50 customers and suppliers, to the Mexican authorities (reporting requirements). The added burdens imposed on the use of HFCS not only “influence” producers’ choice of sweeteners but, because of the prohibitive nature of the tax (four times the value of the sweetener itself), economically compel producers to use domestically-produced cane sugar over HFCS. It is difficult to imagine evidence more telling of this, than the fact after imposition of the IEPS every Mexican bottler using HFCS reverted to a 100 percent use of cane sugar. The IEPS is, thus, a law “affecting” the “internal ... use” of HFCS.

3. IEPS Accords Less Favorable Treatment to HFCS

67. The IEPS undoubtedly affords “less favourable treatment” to imports than “accorded like products of national origin.” In Mexico cane sugar is almost exclusively a domestically-produced sweetener. The IEPS bestows a real and substantive advantage on the use of cane sugar that is not accorded to HFCS – a product which prior to application of the IEPS to soft drinks and syrups accounted for nearly 100 percent of U.S. sweetener imports. While soft drinks and syrups using exclusively cane sugar as a sweetener are wholly exempt from the IEPS, those sweetened, even partially, with HFCS are subject by virtue of the IEPS to (1) a 20 percent tax on their transfer (HFCS soft drink tax); (2) a 20 percent tax on their representation, brokerage, agency,

consignment and distribution (distribution tax); and (3) bookkeeping and reporting requirements concerning commercially sensitive information (reporting requirements). The first of these alone – as a tax four times the value of the input – is sufficient to work as a prohibition on the use of HFCS. In sum, the IEPS by virtue of its HFCS soft drink tax, distribution tax and reporting requirements is inconsistent with GATT Article III:4 as a law affecting the internal use of HFCS and affording imported HFCS less favorable treatment than the like product of national origin.

III. CONCLUSION

68. For the reasons set out above, the United States respectfully requests the Panel to find that the IEPS is: (1) inconsistent with GATT Article III:2, first sentence as a tax applied on imported soft drinks and syrups “in excess of those applied to like domestic products” (HFCS soft drink tax); (2) inconsistent with GATT Article III:2, first sentence as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS “in excess of those applied to like domestic products” (distribution tax); (3) inconsistent with GATT Article III:2, second sentence as a tax applied on imported HFCS which is “directly competitive or substitutable” with Mexican cane sugar which is “not similarly taxed” (HFCS soft drink tax);¹ (4) inconsistent with GATT Article III:2, second sentence as a tax applied on imported soft drinks and syrups which are directly competitive or substitutable with domestic soft drinks and syrups which are “not similarly taxed” (HFCS soft drink tax); (5) inconsistent with GATT Article III:2, second sentence as a tax applied on the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS which are directly competitive or substitutable with domestic soft drinks and syrups which are “not similarly taxed” (distribution tax); and (6) inconsistent with GATT Article III:4 as a law that affects the internal use of imported HFCS and accords HFCS “treatment ... less favorable than that accorded to like products of national origin” by (a) taxing soft drinks and syrups that use HFCS as a sweetener (HFCS soft drink tax), (b) taxing the agency, representation, brokerage, consignment and distribution of soft drinks and syrups sweetened with HFCS (distribution tax), and (c) subjecting soft drinks and syrups sweetened with HFCS to various bookkeeping and reporting requirements (reporting requirements).²

¹ The IEPS is also inconsistent as a tax on HFCS with GATT Article III:2, first sentence. However, because the IEPS so clearly taxes a directly competitive or substitutable imported product in a manner so as to afford protection to domestic production, the United States, in the interest of brevity, has chosen to focus its submission on the second sentence.

² The IEPS is also inconsistent with GATT Article III:4 as a law that affects “the internal sale, offering for sale, purchase, transportation, [and] distribution” of imported soft drinks and syrups and accords them “treatment ... less favorable than that accorded to like products of national origin” by taxing their agency, representation, brokerage, consignment and distribution (distribution tax). However, because the IEPS also so plainly violates GATT Article III:2, the United States, in the interest of brevity, has focus this submission on analysis under GATT Article III:2 with respect to the distribution tax as applied to soft drinks and syrups.