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CHINA – MEASURES AFFECTING IMPORTS OF AUTOMOBILE PARTS

Reports of the Panel

Addendum

This addendum contains Annex A to the Reports of the Panel to be found in documents WT/DS339/R, WT/DS340/R and WT/DS342/R. Annexes B, C, D and E can be found in Add.2.

ANNEX A

RESPONSES AND COMMENTS OF PARTIES TO QUESTIONS FROM THE PANEL

ANNEX A-1

RESPONSES AND COMMENTS OF PARTIES TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST SUBSTANTIVE MEETING

A. MEASURES AT ISSUE AND PRODUCTS AT ISSUE

1. In respect of the criteria set out in Articles 21 and 22 of Decree 125:

(a) (China) Could China elaborate on the rationale behind these specific criteria.

Response of China

1. The rationale behind these specific criteria is to specify the groups of imported auto parts and components that China considers to have the essential character of a motor vehicle under General Interpretative Rule 2(a).

(b) (All parties) Are these types of criteria commonly used as standards by customs offices in determining whether parts and components of a product should be considered as a complete product?

Response of China

2. As discussed in response to question 117, there are a variety of factors that customs authorities consider in evaluating whether an incomplete or unfinished article (whether assembled or unassembled) has the essential character of the complete article. The types of criteria set forth in Articles 21 and 22 are consistent with these factors.

Response of the European Communities (WT/DS339)

3. The European Communities is not aware of any other WTO member using the same or similar criteria and such criteria are certainly not used by the EC.

4. Leaving aside that China is using the criteria internally within China, the use of the criteria in tariff classification would lead to a violation of Article II GATT as they do not respect the HS nomenclature (in particular rule 1 of the general rules for the interpretation of the Harmonized System and, to the extent rule 2(a) is relevant, the "as presented" and "essential character" criteria there under).

5. The only circumstances in which parts could be classified as the complete article could be in the context of certain knocked down kits, but that would require a case-by-case analysis. In this respect reference is made to the reply to question 47.

Response of the United States (WT/DS340)

6. The criteria set out in Articles 21 and 22 of Decree 125 are not the types of criteria commonly used as standards by customs officials in determining whether parts and components of a product should be considered as a complete product. The United States follows the long-standing principle that goods should be classified based on its condition as entered, regardless of what occurs to the goods after entry. US Customs officials apply General Interpretative Rule (GIR) 1 and classify

merchandise in accordance with the terms of the headings and the relevant section and chapter notes. When components and parts of a motor vehicle are entered, US Customs officials will determine whether they meet the terms of a particular heading. For example, a vehicle body is specifically described by the terms of heading 87.07, which provide for: "Bodies (including cabs), for the motor vehicles of headings 87.01 to 87.05". A gasoline engine is specifically described by the terms of heading 84.07, which provide for: "Spark-ignition reciprocating or rotary internal combustion piston engine".

7. In situations where a finished good is entered unassembled (e.g., a complete kit to make 1 good), the United States will classify the imported good that is unassembled as if it were complete under General Interpretative Rule 2(a). In situations where incomplete or unfinished merchandise is imported, US Customs authorities will examine the merchandise as presented at the time of importation to determine whether the incomplete or unfinished merchandise has the essential character of the complete or finished good. For example, see General Explanatory Note to Chapter 87 (JE-37).

Response of Canada (WT/DS342)

8. No. Canadian customs officials perform assessments on a case-by-case basis of those parts as presented together at the border. They do not base their classification of those parts on a formula that is linked to the number of imported assemblies, much less the percentage of imported volume or value of parts used in imported assemblies. This is particularly the case with vehicles since they consist of a great number of individual parts, including assemblies and sub-assemblies.

Comments by the United States on China's response to question 1(b)

9. In its response, China refers to its response to the Panel's question 117. However, the factors that China relies on as justification for classifying the different combinations of auto parts and components is in contradiction to the terms of the Harmonized System and the proper application of the General Interpretative Rules. As demonstrated in the US Response to question 47, customs officials cannot group some assemblies together and claim that they have the essential character of a complete motor vehicle. For example, a single component (e.g., diesel engine sub-assembly A or sub-assembly B as described in Exhibit CHI-3) entered is classified under the terms of a heading that describes that component (e.g., heading 8409). If a group of components are entered together (e.g., diesel engine sub-assembly A and sub-assembly B as described in Exhibit CHI-3) that may form an assembly (e.g., a complete diesel engine), the United States would classify it under the heading that describes that assembly (e.g., heading 8408). If a group of components do not form an assembly, they are individually classified (e.g., a crankshaft and side panel would not constitute an assembly and would be individually classified). None of the assemblies listed in Exhibit CHI-3 ever constitutes incomplete or unfinished motor vehicles within the meaning of General Interpretative Rule 2(a); instead, they would be individually classified in accordance with the terms of General Interpretative Rule 1 (e.g., spark-ignition reciprocating or rotary internal combustion piston engines of heading 84.07, transmission shafts of heading 84.83, chassis fitted with engines of heading 87.06, bodies (including cabs) of heading 87.07).

2. (*China*) What were China's *bound* and *applied* tariff rates for "CKD and SKD kits", "motor vehicles" and "auto parts" prior to China's accession to the WTO and at the time of China's accession to the WTO?

Response of China

10. Prior to China's accession to the WTO, there were no bound tariff rate for "CKD and SKD kits," "motor vehicles" and "auto parts".

11. In 2001, immediately prior to China's accession to the WTO, the average applied tariff rate for "motor vehicles" was 63.6%, and the average applied tariff rate for "auto parts" was 24.7%. There were no separate tariff lines for "CKD and SKD kits" in China's Tariff Code. CKD and SKD kits were classified as complete vehicles according to GIR 2(a) and the applied rates were identical to the tariff rates applicable to the corresponding complete vehicle model.

12. In 2002, at the time of China's accession to the WTO, the average bound tariff rate for "motor vehicles" was 49.4%, and the average bound tariff rate for "auto parts" was 20.4%. Again, there were no separate tariff lines for "CKD and SKD kits" in China's Tariff Code, and these were classified as motor vehicles in accordance with GIR 2(a). In 2002, the average applied tariff rate for "motor vehicles" was 42.2%, and the average applied tariff rate for "auto parts" was 18.1%. These details can be summarized as follows:

	Complete Vehicle	CKD/SKD Kits	Parts
2001 Bound Rate	None	None	None
2001 Applied MFN Rate	63.6%	63.6%	24.7%
2002 Bound Rate	49.4%	49.4%	20.4%
2002 Applied MFN Rate	42.2%	42.2%	18.1%

Comments by the United States on China's response to question 2

13. In its response, China explained that immediately prior to its accession to the WTO on 11 December 2001, "the average applied tariff rate for 'motor vehicles' was 63.6%, and the average applied tariff rate for 'auto parts' was 24.7%. There were no separate tariff lines for 'CKD and SKD kits' in China's Tariff Code. CKD and SKD kits were classified as complete vehicles according to GIR 2(a) and the applied rates were identical to the tariff rates applicable to the corresponding complete vehicle model." While the United States does not dispute China's statements regarding the applied tariff rates for motor vehicles, it does dispute China's explanation regarding parts and CKD and SKD kits as being both inaccurate and incomplete.

14. From 1992 to 1995, China did maintain separate tariff lines for CKDs and SKDs. As China's exhibit CHI-30 shows, these tariff lines established tariff rates that were the same as the scheduled tariff rates applicable to motor vehicles. However, China normally did not apply these rates. Instead, the applicable rate for CKDs and SKDs was negotiated between an individual auto manufacturer and the Chinese authorities. The key factors in this negotiation were the amount of the auto manufacturer's investment in China and the extent to which the auto manufacturer used local content in the assembly of its vehicles, both at the time of the negotiation and under the auto manufacturer's future plans. Normally, an auto manufacturer with a larger amount of investment and a larger percentage of local content would be able to negotiate a lower tariff rate than would an auto manufacturer with a smaller amount of investment and a smaller percentage of local content. Particularly for the auto manufacturers that the Chinese authorities viewed as committed to China based on these factors, the negotiated tariff rates for CKDs and SKDs were substantially below the

tariff rates for motor vehicles. In addition, the Chinese authorities would normally apply the same negotiated tariff rates to parts, as the negotiated tariff rates were often also below the tariff rates for parts set forth in China's tariff schedule.

15. After 1995, China eliminated the tariff lines for CKDs and SKDs, as China's response reflects. However, contrary to China's assertions, China even then did *not* apply tariff rates for CKDs and SKDs that were the same as the scheduled tariff rates applicable to motor vehicles. China continued to apply tariff rates for CKDs and SKDs (and parts) that were negotiated between an individual auto manufacturer and the Chinese authorities, just as it had in the period from 1992 to 1995.

16. These same tariff practices continued through the time of China's accession to the WTO and post-accession until China began to implement the measures at issue in this dispute.

17. From 1992 until the implementation of the measures at issue in this dispute, China pursued these tariff practices because it was focused on building up its capacity for the local assembly of motor vehicles, and it did not have sufficient domestic manufacturers of auto parts to supply domestic auto manufacturers. China therefore welcomed and encouraged imports of CKDs and SKDs (and parts) that could be assembled into motor vehicles in China, particularly by auto manufacturers that demonstrated a commitment to China.

18. China's policy of encouraging imports of CKDs and SKDs (and parts) that could be assembled into motor vehicles locally was facilitated by China's policy of maintaining import quotas on motor vehicles. In this regard, China maintained import quotas on vehicles prior to its accession to the WTO in 2001, and it negotiated the right to maintain import quotas on motor vehicles for three years after its accession, i.e., until 1 January 2005, as reflected in Part I, paragraph 7.1, and Annex 3 of China's Protocol of Accession, as explained more fully below under question 14(b).

19. China's tariff practices relating to CKDs and SKDs (and parts) during the period from 1992 until China's accession to the WTO at the end of 2001 help to explain why paragraph 93 of the Working Party Report accompanying China's Protocol of Accession reads the way it does. As the panel will recall, paragraph 93 provides:

> In response to questions about the tariff treatment for kits for motor vehicles, the representative of China confirmed that China had no tariff lines for completely knocked-down kits for motor vehicles or semi-knocked down kits for motor vehicles. If China created such tariff lines, the tariff rates would be no more than 10 per cent.

20. When negotiating this provision in the years leading up to China's WTO accession, WTO Members, including the United States, knew that China had separate tariff lines for CKDs and SKDs that scheduled tariff rates that were the same as those for motor vehicles from 1992 to 1995, and that China eliminated these tariff lines effective 1 January 1996. WTO Members also knew that the Chinese authorities had nevertheless been applying substantially lower tariff rates for CKDs and SKDs (and parts) than for motor vehicles, both when China had separate tariff lines for CKDs and SKDs and when it did not. In negotiating paragraph 93, therefore, WTO Members wanted to ensure that China would continue to treat CKDs and SKDs essentially as parts for tariff purposes after acceding to the WTO and that China would be unable to re-establish separate tariff lines for CKDs and SKDs, at higher rates, if its policy focus changed as its domestic auto industry evolved.

3. ***(All parties)*** **Do automobile manufacturers themselves also assemble or manufacture the so-called "assemblies" listed in Article 4 of Decree 125? If so, how common is this in the**

automobile industry in general or in the Chinese automobile industry? Is there a clear distinction between automobile manufacturers and parts manufacturers?

Response of China

21. It is a common practice in China for automobile manufacturers to assemble some or all of the assemblies listed in Article 4 of Decree 125. For instance, a majority of auto manufacturers in China produce the body assembly by themselves. Many auto manufacturers in China have their own assembly lines for engines and transmissions.

22. Auto manufacturers and part manufacturers, however, are distinct in some respects. First, auto parts manufacturers normally focus on one particular type or series of parts, while auto manufacturers focus on the overall assembly of the vehicle. Second, auto manufacturers are normally in a position to articulate and define the parameters of parts and their quality standards, which must be met by their auto part suppliers.

23. The complainants have stated, and China agrees, that the auto parts industry is highly fragmented in China.[1] This makes most of the part suppliers dependent, legally or financially, on one auto manufacturer. All top auto manufacturers in China have stable and long-term supply chains for auto parts, as well as complex corporate structures in which many of the necessary auto parts are produced by subsidiaries and joint ventures. This feature, as China understands it, is common in Asian auto industries.

Response of the European Communities (WT/DS339)

24. The answer as to whether automobile manufacturers themselves also assemble or manufacture the so-called "assemblies" listed in Article 4 of Decree 125 depends on the business strategy of each manufacturer. However, the European Communities understands that in the most typical situations at least some elements of the "assemblies" would be manufactured by the manufacturer of the complete vehicle. This concerns in particular the vehicle body, which is an element of a vehicle that is usually separate for each model. In contrast, for example the steering system and the brake system are typically assembled and manufactured by suppliers and sold to the vehicle manufacturer. However, there are no general rules that apply to all manufacturers and all models.

25. There is no difference between the automobile industry in general and the Chinese automobile industry with the very important exception of the way in which the contested measures affect the strategy of vehicle and parts manufacturers in China. As explained by the European Communities in its first written submission the Chinese measures force vehicle manufacturers to depart from their normal business strategies in the rest of the world (in particular paragraphs 68 to 74). The measures require in all situations that the vehicles contain a certain proportion or combination of locally made parts and components (or "assemblies"). If the necessary local content is not ensured, the manufacturer will be obliged to pay the 25 % duty on all imported parts, which due to very small profit margins will mean that the given model will not be competitive in the Chinese market.

26. With regard to the distinction between vehicle manufacturers and parts manufacturers the answer again depends on the specific context. Sometimes parts manufacturers may belong to the same industrial group as the vehicle manufacturers but more often the parts manufacturers are independent and provide parts to many different vehicle manufacturers. Indeed, there are far more

[1] Canada's first written submission, para.17; EC's first written submissions, para.18; US's first written submission, para.21.

parts manufacturers than vehicle manufacturers. Of course, due to constant changes in the industry a part manufacturer may become part of the same group as the vehicle manufacturer and vice versa. Mergers and acquisitions are an every day phenomenon in most industries. However, it is also important to underline that a vehicle manufacturer often acts as the supplier of a given part or "assembly" to another vehicle manufacturer. Even competitors in the same market may co-operate in the context of certain vehicle models. All of this depends on the strategy of the manufacturers. The Chinese measures seriously compromise the ability of the foreign industry to choose the most efficient business strategies in the Chinese market.

Response of the United States (WT/DS340)

27. Automobile manufacturers commonly assemble within their own operations and facilities at least a few of the listed assembly operations. For example, most automobile manufacturers assemble the body, whether from stampings provided by a supplier, stampings they make themselves, or a combination of both. Engine assembly is also a common operation for automobile manufacturers. The same holds true for chassis assembly, assuming that chassis means what is also referred to as the "frame". It is extremely common, if not universal, that automobile manufacturers perform one or more of the listed assembly operations, although they may not all perform the same ones or combinations thereof.

28. With respect to the listed assembly operations, a clear distinction cannot be made between automobile and parts manufacturers.

Response of Canada (WT/DS342)

29. Manufacturers sometimes prepare the "assemblies" listed in Decree 125, as do parts manufacturers. This is relatively common both in general and in China, to the extent that commonly understood commercial practices are not affected by the measures. That noted, even where vehicle manufacturers do produce particular assemblies, many of the key parts in such assemblies used in China come from so-called "Tier 1" suppliers. There is a commercial distinction between automobile manufacturers (which usually control not only the manufacturing and final assembly of a whole vehicle, but also its design, marketing and branding) and parts manufacturers (whether Tier 1, 2 or 3). Tier 1 parts manufacturers may engage in value-added activities related to the parts that they manufacture (such as research and development), which activities used to be carried out solely by vehicle manufacturers. Commercial practice may evolve in respect of which company produces parts and which company processes or assembles them. However, automobile manufactures and parts manufacturers remain distinguished by the "brand". Auto manufacturers produce vehicles under different brands with which consumers are familiar; parts manufacturers produce parts, components or modules used in the vehicles and do not have their own vehicle brands.

4. (*China*) Could China please explain the "Public Bulletin" referred to in Article 7 of Decree 125, including what purpose it serves, whether all automobile manufacturers in China have to apply for it and what is the reason for having "Characterized as Complete Vehicle" marked on the Bulletin for auto parts falling under this scope.

Response of China

30. Being listed in the Public Bulletin is required for auto manufacturers to produce and sell motor vehicles and for consumers to register and use motor vehicles in China. A vehicle model can be listed in the Public Bulletin only if it satisfies all requirements in respect of various regulations that apply to motor vehicles. Listing a vehicle model's registration status under Decree 125 is simply one

of the regulatory characteristics of the model that is disclosed in the Public Bulletin. This disclosure aids customs officials and others in the automotive industry by designating the customs status of that vehicle model, including the customs status of parts and components that are imported for its assembly.

5. (*China*) Please clarify, by referring to the relevant provisions of the measures at issue, when the decision of whether certain imported auto parts should be characterized as complete vehicles is made.

Response of China

31. This determination is made by reference to specific vehicle models, prior to the importation of the parts that the manufacturer will import to assemble that vehicle model. The overall purpose of this process is to determine whether, to assemble that vehicle model, the auto manufacturer imports multiple shipments of parts and components that have the essential character of a motor vehicle.

32. The process begins with the manufacturer's self-evaluation under Article 7 of Decree 125. If the manufacturer determines as a result of the self-evaluation that a particular vehicle model meets one or more of the thresholds for characterizing parts as having the essential character of a motor vehicle, as specified in Article 21 of Decree 125, it must register that vehicle model with the CGA prior to the importation of parts for that vehicle model (Art. 7). It must also file a registration statement with the CGA for that vehicle model (Art. 9). The manufacturer's determination, whatever the result, is subject to review and verification under Chapter IV of Decree 125 (Art. 17-18).

33. Once the manufacturer has registered a particular vehicle model in accordance with Article 9, it must provide an import duty bond to the CGA based on its projection of monthly average imports for that vehicle model (Art. 12). Thereafter, the manufacturer must import parts for that vehicle model separately from other auto parts, and must declare the imported parts as parts of a registered vehicle model (Art. 14-15). These parts enter China in bond and remain under customs control (Art. 16, Art. 27). Parts that are imported for the assembly of other vehicle models are declared as parts (Art. 35).

34. The manufacturer must pay the duty when the imported auto parts are assembled into complete vehicles (Art. 28). The automobile manufacturer is required to declare duty payment on the tenth working day of each month based on the number of registered vehicle models that it assembled in the prior month (Art. 31).

35. If the assembled vehicle is one that has been verified as meeting one or more of the thresholds of Article 21, the CGA classifies the imported auto parts in that vehicle model as a motor vehicle, just as it would have had the imported auto parts entered China in a single shipment (Art. 28). If the assembled vehicle is one that has been verified as not meeting one or more of the thresholds of Article 21, the CGA classifies the imported auto parts in that vehicle model as parts (Art. 28) – again, just as it would have had the imported auto parts entered China in a single shipment.[2]

[2] The only exceptions to these classifications are if: (1) the classification of a previously registered vehicle model changes between the entry of the parts into China and their assembly into a complete vehicle, in which event the manufacturer may declare those imported parts for which it has not yet paid duty under the relevant tariff provisions for parts (Art. 32); or (2) the imported parts are not assembled into a complete vehicle within a period of one year after entry, in which event the imported parts are assessed at the duty rate for parts (Art. 29). As China explained during the first substantive meeting, the first exception provides an element of

36. The effect of this system is that the determination of whether imported auto parts should be classified as a motor vehicle is made prior to the importation of the parts, based on the self-evaluation and verification process described above. It is this self-evaluation and verification process that gives rise to the declaration that is made at the time of importation and the obligation to provide an import bond for these entries.

6. (*China*) What is the purpose of requiring both self-evaluation by automobile manufacturers and verification by the Verification Center?

Response of China

37. The purpose of the self-evaluation is for automobile manufacturers to review each vehicle model in relation to the requirements of Decree 125 and to produce a report that details the status of each vehicle model in relation to those requirements. This self-evaluation report is then verified to confirm that the information provided by the auto manufacturer is genuine, complete, and accurate.

7. (*China*) In respect of tariff classification practice by China's customs office:

(a) Is there a system in China under which an importer can appeal the customs office's decision on the tariff classification of imported auto parts or other imported products. If so, please explain;

Response of China

38. Article 64 of the Regulation on Import/Export Tariff provides that:

> A duty payer or a security provider shall pay the duties and may apply for a review to the customs office at an immediate upper level according to relevant laws if [it] disagrees with the customs on designation as a duty payer, determination of dutiable prices, merchandise classification, origin, applicable tariff rate or exchange rate, duty reduction or duty exemption, supplement of unpaid duty, duty refund, late charges, method of duty calculation, and place of duty collection. In case [the duty payer or the security provider] disputes the review conclusion, [it] may file a case to the court according to relevant laws.

Pursuant to this provision, an importer can appeal the tariff classification of imported auto parts in Chinese courts. The courts can find that the CGA determination is not in accordance with Chinese law and can direct a remand to the agency for reconsideration.

(b) Please indicate whether there is any existing or pending court and/or administrative decisions in respect of the application of any of the provisions of the measures. If so, please explain in detail; and

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flexibility to the manufacturer in acknowledging that the sourcing of parts and assemblies for a particular vehicle model could change, while the second exception serves to bring finality to the customs process.

Response of China

39. There are no such administrative reviews or court appeals pending in relation to the application of the challenged measures.

(c) In this connection, also clarify whether the NDRC is authorized to provide its own interpretations of the provisions of Decree 125 and Announcement 4 in light of Article 78 of Policy Order 8. If so, has NDRC issued any interpretations of the provisions of the challenged measures?

Response of China

40. The NDRC is not authorized to provide its own interpretations or explanations of the provisions of Decree 125 and Announcement 4 under Article 78 of Policy Order 8, and the NDRC has not done so.

8. *(Complainants*) Please explain whether, and if so, to what extent, the procedural requirements under the measures affect the average period necessary for the assembly of a vehicle.

Response of the European Communities (WT/DS339)

41. It is important to put this question into its proper context. The considerable complexity of the measures in itself affects the launching of a new model in the Chinese market. The bottom line for most manufacturers is that they must avoid the 25 % duty since otherwise it will simply not be commercially worthwhile to even begin the administrative procedure under the measures. The conception and launching of a new model can thus be delayed by 2-3 years, as vehicle manufacturers will have to look for domestic suppliers able to provide the required proportion of domestic parts or assemblies, and test their reliability. Establishing the self-verification report required by Article 7 of Decree 125 may take an additional six months for a team of 10-15 highly skilled experts. After a manufacturer decides to begin the procedures for introducing a new model, which it believes and hopes to be subject only to the 10 % duty as regards imported parts, it can in reality take up to one year before all the procedures are finalised. The measures thus also results in having to launch in a context of legal uncertainty that may persist for months and sometimes even for years.

42. At the stage of the assembly operations, the measures impose a considerable administrative burden and, as a consequence, additional costs. It should be emphasised that 30% to 35% of parts are common to different models. For a vehicle manufacturer, the most efficient way is to ship parts together and use them depending on the production needs which may easily vary from the initial plan. There may be a need to increase the production of a specific model as a result of sales higher than anticipated; there may be a need to replace urgently deficient parts. Because China's measures impose to declare for which model the parts will be imported (Article 15 of Decree 125), vehicle manufacturers have to unnecessarily define in detail for which model each part is imported. The flexibility required for an economically sound management of parts supply is taken away.

Response of the United States (WT/DS340)

43. As the United States explained in paragraphs 46-66 and 99-104 of its first submission, China's measure impose burdensome procedural requirements on manufacturers who use imported parts, while any manufacturers who use only domestic parts are excused from these burdensome requirements. This difference accords less favorable treatment to imported parts as compared to like

domestic parts, and results in a *prima facie* violation of Article III:4. China has not even attempted to rebut this *prima facie* case.

44. Information on the average period of delay resulting from China's measures was not an element of the United States' *prima facie* case on this issue, and the United States does not have such information readily available.

Response of Canada (WT/DS342)

45. It is not possible to describe, as a general rule, the effect that the measures have on the average period necessary to assemble a vehicle. The overall effect will vary based upon, e.g., the web of suppliers and the particular sourcing (both domestic and imported) of parts. The most significant delay results from a combination of the procedural and substantive requirements: vehicle manufacturers need to ensure that the domestic content in their vehicles is well over the 40% minimum requirements in order to avoid charges under the measures, keeping in mind possible differences in valuation of imported content. For some models, this can result in significant delays in beginning production (in the order of many months). This is so as to find domestic suppliers to guarantee sufficient domestic content, thereby giving the vehicle manufacturer comfort that the number of Deemed Imported Assemblies will remain below the required threshold in the event of differences in the valuation of certain parts.

9. (*All parties*) Assuming that a country can have an anti-circumvention policy in the context of ordinary customs duties, how much flexibility should a country have in introducing measures to enforce such a policy?

Response of China

46. The issue of circumvention in this case is one of ensuring the proper tariff classification of imports and thereby preventing the evasion of higher duty rates that apply to motor vehicles. China considers that the challenged measures implement and enforce an interpretation of its tariff provisions for "motor vehicles" that is consistent with the interpretative rules of the Harmonized System. A Member's ability to adopt measures to interpret its tariff schedule in accordance with the rules of Harmonized System is co-extensive with those rules; any such measure must comport with the requirements of the Harmonized System.

47. To illustrate the point, it may be helpful to use an example that is not relevant to the present dispute. General Interpretative Rule 3 addresses the circumstance in which goods are prime facie classifiable under two or more headings, and provides a set of rules to resolve this conflict. Under GIR 3(a), "the heading which provides the most specific description shall be preferred to headings providing a more general description." Suppose that a Member adopted a measure to advise importers as to which headings it considered to be "prima facie classifiable under two or more headings," and, in those cases, to advise importers as to which headings it considered to be "the most specific".

48. This measure would affect how the Member classifies certain articles. It could result in tariff classifications and determinations of duty liability with which importers disagree on the facts of specific cases. But from the standpoint of evaluating the consistency of the measure with the Member's WTO obligations, including Article II of the GATT 1994, the relevant inquiry would be whether the measure results in classifications consistent with the HS terms employed in that Member's tariff schedule. Any assessment of such classification determinations would need to consider whether the results are consistent with the requirements of GIR 3(a), including, as may be pertinent, any interpretations of GIR 3(a) adopted by the WCO. Thus, the measure could not result in tariff

classifications, and determinations of duty liability, that were manifestly inconsistent with GIR 3(a) (e.g., by identifying articles that are not "prima facie classifiable under two or more headings," or by applying the "more general description" over "the most specific"). This is, in relevant respect, the degree of flexibility that a Member has in adopting measures to interpret its Schedule of Concessions in accordance with the rules of the Harmonized System.

Response of the European Communities (WT/DS339)

49. Since a county's tariff schedule has to be interpreted in the light of the Harmonized System, any "flexibility" must be in accordance with HS nomenclature and its rules. To the extent the question refers to Article XX(d) of the GATT, the "flexibility" must comply with the requirements of that provision and in particular be necessary to secure compliance with laws or regulations which are not inconsistent with the GATT and fulfil the criteria laid down in the *chapeau* of Article XX.

Response of the United States (WT/DS340)

50. The United States cannot accept the assumption – advocated by China in this dispute – that it amounts to "circumvention" when automobile manufacturers use normal channels of trade to source bulk shipments of parts for assembly purposes. As the United States has explained, China's attempt to analogize all auto manufacturing operations as the assembly of separately organized and shipped "knock down kits" is baseless, and ignores the reality of modern manufacturing operations.

51. Moreover, the United States does not otherwise know what China means by "circumvention" with respect to the application of customs laws. The United States follows the long-standing principle that goods should be classified based on its condition as entered, regardless of what occurs to the goods after entry.

52. The United States, however, notes that the WTO Agreement certainly does not prevent the enforcement of a Member's customs laws. Many provisions of the WTO Agreement refer to the existence of, and the enforcement of, customs laws. For example, Article X of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") imposes certain disciplines, including that customs laws be administered "in a uniform, impartial and reasonable manner." Additional disciplines are set out in other WTO Agreements, such as the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994* ("Customs Valuation Agreement") and the *Agreement on Import Licensing Procedures*.

Response of Canada (WT/DS342)

53. Canada considers that a tariff-related "anti-circumvention" policy could not operate in a manner consistent with the express legal obligations set out in the non-discrimination articles of GATT 1994. Any measures that impose internal charges only on imported products, on the theory that such a charge is necessary to prevent what China calls "circumvention" of tariffs, is *prima facie* a violation of GATT Article III, and must be defended under Article XX(d). While Canada believes that the measures cannot be justified under Article XX (see Canada's first oral submission at paragraphs 27-36), Canada does not consider it appropriate in the abstract to consider what internal charges might be justified under Article XX(d).

Comments by the United States on China's response to question 9

54. As the United States has explained, China's so-called concern with "circumvention" is that importers might make use of the lower tariff on auto parts negotiated at the time of China's accession.

55. However, the United States does agree with China's general proposition that mechanisms to enforce customs laws must be consistent with a Member's international obligations, including obligations under the WTO Agreement and under the Harmonized System Convention. To this end, China responded that the "ability to adopt measures to interpret its tariff schedule in accordance with rules of Harmonized System is co-extensive with those rules; any such measure must comport with the requirements of the Harmonized System." However, the substance of China's response to this question is intended to demonstrate a certain "degree of flexibility … in adopting measures to interpret its schedule of Concessions in accordance with the rule of the Harmonized System."

56. China's example of a national measure interpreting a General Interpretative Rule (GIR) fails to demonstrate this alleged "flexibility". The example involves GIR 3(a), which governs goods that are prima facie classifiable under two or more tariff headings. The rule provides that "the heading which provides the most specific description shall be preferred to headings providing a more general description." China's example assumes that a contracting party adopts a measure that advises importers as to which goods it considers prima facie classifiable under more than one heading and advises as to which heading is more specific.[3] Such a measure would be in compliance with the contracting party's obligations under GIR 3(a) only if the products identified were specifically described by both headings.

57. More relevant to the case at hand, there is no degree of flexibility under the Harmonized System that would legitimize the "anti-circumvention" measures that China has implemented for the classification of imported auto parts. It is China's position that "the relevant inquiry would be whether the measure results in classification consistent with the HS [Harmonized System] terms employed in that member's tariff schedule." To this end, China states that the results must be consistent with the requirements of the GIRs. However, China is implementing measures that are not in compliance with GIR 2(a). GIR 2(a) permits the classification of unfinished or unassembled goods as finished goods based upon their condition "as presented". The condition of goods presented for customs clearance is their condition at the time of importation. China's measure that mandates classification of imported auto parts under a tariff schedule heading for a completed automobile is based on the future use of those goods in the production of a completed automobile. Classification on this basis is a flagrant violation of GRI 2(a) because classification based on use after importation is not consistent with the requirement that goods be classified in their condition upon importation.

10. (*Complainants*) China submits in paragraph 15 of its first written submission that the details of the specific tariff headings and tariff rates are not relevant to the disposition of the claims before the Panel. Do the complainants agree with China? If so, is your view the same regardless of whether the charge concerned should be considered as tariff duty or internal charge?

Response of the European Communities (WT/DS339)

58. The European Communities profoundly disagrees with the statement of China in paragraph 15 of its first written submission. Rule 1 of the General Rules for the interpretation of the Harmonized System states that

[3] In its response to the Panel question, China states, "Suppose that a Member adopted a measure to advise importers as to which headings it considered to be "prima facie classifiable under two or more headings…." This statement is illogical because a heading is not classifiable under other headings. The United States, for the purposes of its rebuttal to China's response, presumes that China intended to refer to a hypothetical measure that identifies "goods" (rather than headings) that are prima facie classifiable under two or more headings.

> "The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes and, provided such headings or Notes do not otherwise require, according to the following provisions." (Emphasis added)
>
> As explained by explanatory note V to Rule 1, "…the terms of the headings and any relative Section or Chapter notes are paramount, i.e. they are the first consideration in determining classification".

59. The position of China is in direct contradiction with Rule 1.

60. The Appellate Body has also clearly recognised the importance of the terms of the specific tariff headings in the context of an analysis under Article II of the GATT. In this respect reference is made to Appellate Body Reports in *EC – Computer Equipment* and *EC – Chicken Cuts*.

61. If the measures are considered to be imposing an internal charge as the European Communities considers, the details of the tariff headings would not be relevant. The rates are relevant as the internal charge is the difference between the full vehicle rate and the part rate.

Response of the United States (WT/DS340)

62. The United States disagrees with China. In the US view, the tariff headings and rates in China's Schedule are relevant to the disposition of this dispute. The way specific tariff headings tie into the matters at issue depends on the specific claim under consideration.

63. GATT 1994 Articles III:4 and III:5 and TRIMs Agreement: For these claims, the key aspect of China's Schedule is the 15 per cent differential between the whole vehicle tariff (25%) and the parts tariff (10%). China's measure's impose a WTO-inconsistent local content requirement for vehicle manufacturers, which results in the imposition of the 15 per cent additional charge unless the local content requirements are met. Note that this local-content requirement is WTO-inconsistent, regardless of whether the additional charge is considered an internal charge or part of China's ordinary customs duties or other duties or charges.

64. GATT 1994 Article III:2: If, as the United States contends, China's measures are internal charges, then again the key aspect is the 15 per cent differential between the whole vehicle tariff (25%) and the parts tariff (10%). This additional charge is imposed only on imported parts, and never on domestic parts.

65. GATT 1994 Article II: If, as China contends, China's additional charge is a customs duty, then such a duty breaches China's tariff bindings on parts. In this instance, the difference between the whole vehicle tariff and the duty on each imported part is the amount by which China has breached its tariff bindings.

Response of Canada (WT/DS342)

66. Tariff headings would be irrelevant for purposes of assessing the nature of goods were the measures properly considered to result in internal charges on auto parts. In that case, no recourse to Article II is necessary. To the extent the Panel finds it necessary to assess the measures under Article II, it is only China's broad tariff rate commitments that are relevant to resolving this dispute.

67. China's tariff headings, under an Article II analysis, demonstrate the arbitrary nature of the measures, particularly given that China attempts to blur the distinction between parts and motor vehicles. That is inconsistent with the proper approach to tariff interpretation expressed in, *e.g.*, Rules 1 and 2(a) of the General Rules for the Interpretation of the Harmonized System.

68. Canada notes that there is agreement among the parties that at least some charges under the measures are internal. China has conceded (implicitly in footnote 20 of its first written submission, and then explicitly in response to oral questions) that charges imposed on auto parts imported by parts manufacturers located in China, and then sold to vehicle manufacturers located in China, are internal charges subject to Article III.

11. (*China*) Please clarify whether there are any other legal instrument similar to the Policy on the Development of the Auto Industry in relation to other industry sectors in China.

Response of China

69. Yes, China has adopted broad policy instruments of this nature in other industry sectors.

12. (*China*) In respect of the alleged problems relating to circumvention of ordinary customs duties for motor vehicles in China:

(a) Could China explain, based on evidence, the circumstances leading up to its decision to introduce the measures at issue to address this "alleged" problem in 2005. In particular, in light of China's statement in paragraph 22 of its first submission that "[t]he need to define a clear boundary between motor vehicles and parts of motor vehicles, coupled with evidence of tariff circumvention, prompted China to being consideration of measures..., consistent with China's Schedule of Concessions and internationally accepted principles of tariff interpretation," could China please explain in detail why the need to define such a clear boundary arose and provide copies of evidence of tariff circumvention referred to in this paragrah;

Response of China

70. For the reasons that China has explained in response to question 13 below, China does not consider that it required specific evidence of "circumvention" in order to resolve an issue of tariff classification in its Schedule of Concessions. Customs authorities routinely resolve issues of tariff classification in response to requests from importers, or as a general matter of customs administration. An example of the latter is the EC regulation provided in CHI-14, which seeks to ensure a "uniform application" of the EC tariff schedule in respect of incomplete or unassembled pick-up trucks. These types of measures provide greater certainty to importers and ensure consistent application of the tariff schedule by national customs authorities.

71. In point of fact, however, China had evidence that there was a significant issue concerning the evasion of higher duty rates that apply to motor vehicles, including parts and components that have the essential character of a motor vehicle. As China explained in its first written submission, China was aware that the value of imported parts and components had increased dramatically between 2001 and 2004, greatly outstripping the rate of total motor vehicle production in China.[4] The sharp increase in the importation of auto parts and components occurred at a time when auto manufacturers were introducing a large number of new vehicle models into the Chinese market. These figures strongly

[4] See China first written submission at para. 21.

suggested that there were issues of tariff classification concerning motor vehicles and parts of motor vehicles that warranted examination. Customs authorities routinely address specific issues in customs administration, including the issuance of tariff classification guidance, in response to these types of import trends. The legitimate nature of China's concern, and its decision to address this classification issue, is demonstrated by the fact that approximately 20 per cent of vehicle models that have gone through the evaluation process are assembled from imported parts and components that have the essential character of a motor vehicle. This point is discussed in response to question 160 below.

(b) How has China dealt with the alleged problem before the introduction of the measures at issue?; and

Response of China

72. With respect, the specific problem of tariff classification at issue in this dispute is not "alleged." As China has sought to demonstrate by reference to the practices of other WTO Members, it is a problem of tariff classification that arises whenever there is a significant difference in duty rates between complete articles and parts of those article.

73. Prior to the adoption of the measures at issue, China did not have a procedure for determining whether multiple shipments of parts and components were related to each other through their common assembly into a specific vehicle model.

Comments by the United States on China's response to question 12(b)

74. The United States disagrees with China's claim that the supposed "circumvention" of ordinary customs duties for motor vehicles in China is simply an example of "a problem of tariff classification that arises whenever there is a significant difference in duty rates between complete articles and parts of those articles." There is not a problem of classification when parts are imported separately and later assembled into a completed article. Under the Harmonized System, it is a longstanding principle that goods are classified, pursuant to General Interpretative Rule 1, under the tariff heading that most specifically describes those goods in their condition as imported.[5] The Harmonized System is made up of 96 chapters grouped into 21 sections consisting of approximately 5,000 article descriptions in the headings and subheadings. The Harmonized System is divided into categories or product headings beginning with crude and natural products and continuing in further degrees of complexity through advanced manufactured goods. As reflected in the United States' response to the Panel's question 47, there are tariff headings that specifically describe automobile parts, and, accordingly, when those parts are imported separately, they are classifiable under those provisions. It is not "circumvention" of the tariff schedule for an auto manufacturer to import parts separately and later assemble them into a completed article in the domestic market.

(c) Could China also identify other products in its Schedule for which different tariff rates are applied for an article and parts and components of such an article.

[5]General Interpretative Rule 1 states that "for legal purposes, classification shall be determined according to the terms of the heading and any relative Section or Chapter Notes and, provide such heading or Notes do not otherwise require, according to the following provisions." (Ex. CHI-15).

Response of China

75. Without having undertaken a systematic review of its Schedule of Concessions, China notes two other instances in which its Schedule of Concessions creates a significant tariff rate difference between the complete article and parts of that article:

- 8414.5110 (fans) 21.7% (at date of accession)
- 8414.9020 (parts for 8414.5110 etc.) 12.0%
- 8415.1000 (air conditioner) 21.0% (at date of accession)
- 8415.9010 (parts for 8415.1000 etc.) 11.7% (at date of accession)

13. (*All parties*) Regarding the notion of "circumvention":

(a) Please explain what "circumvention" means; and

(b) Please explain whether, and if so, how, under the WTO law, a Member is allowed to take an anti-circumvention measure. If possible, please support your response with relevant GATT/WTO jurisprudence.

Response of China

76. China's defense of the challenged measures does not depend upon a freestanding concept of "circumvention," or upon the concept of a specific type of "anti-circumvention measure" within the framework of GATT and WTO jurisprudence. What China refers to as "circumvention," as pertinent to the facts of this case, is a tariff classification issue. That tariff classification issue is whether a tariff provision for a complete article (such as motor vehicles) includes the importation and assembly of parts that, in their entirety, have the essential character of that article. This tariff classification issue is governed by General Interpretative Rule 2(a).

77. As China explained in its first written submission, auto manufacturers can evade the higher duty rate that applies to motor vehicles by structuring their imports of parts and components so that no single shipment has the essential character of a motor vehicle, even if those parts and components would have been classified as a motor vehicle had they entered China in a single shipment.[6] This is what China means by the "circumvention" of ordinary customs duties under the circumstances of this case. By structuring the importation of auto parts and components in this manner, auto manufacturers deprive China of the revenue and market access benefits that it negotiated when it obtained a higher bound duty rate for motor vehicles as compared to parts and assemblies of motor vehicles.

78. China does not consider that its right to interpret its Schedule of Concessions in accordance with the rules of the Harmonized System is dependent upon specific evidence of an intent to circumvent the higher duty rates on motor vehicles. The importation and assembly of auto parts and components through multiple shipments undermines the value of the tariff concessions that China negotiated, whether the auto manufacturer has an intention to evade the higher duty rates on motor vehicles or not. Moreover, customs authorities routinely classify imported articles contrary to the proposed classification of the importer, without regard to whether the importer's proposed classification was motivated by an intention to evade a higher duty rate. Customs authorities interpret

[6] China first written submission at para. 18.

and enforce their tariff schedules in accordance with the rules of the Harmonized System, not the intention of the importer to evade applicable duty rates.[7]

79. Nor does China consider that it requires a specific authorization within the GATT 1994, or any other WTO agreement, to adopt a measure that interprets its Schedule of Concessions in accordance with the rules of the Harmonized System. As explained in response to question 68, the Appellate Body has repeatedly affirmed the importance of the Harmonized System, including the General Interpretative Rules, in the interpretation of a Member's Schedule of Concessions. China does not need a specific basis in WTO law to have recourse to General Interpretative Rule 2(a), as interpreted by the WCO, any more than a Member would need a specific basis in WTO law to have recourse, for example, to General Interpretative Rule 4 ("Goods which cannot be classified in accordance with the above Rules shall be classified under the heading appropriate to the goods to which they are most akin."), or to relevant classification decisions of the HS Committee. These rules are part of the Harmonized System, which is the basis upon which WTO Members have negotiated their reciprocal and mutually advantageous tariff concessions.

80. For these reasons, China considers that the challenged measures fall within the scope of measures that national customs authorities routinely adopt to ensure the proper interpretation of their tariff schedules and to ensure the proper classification of imports. These measures are subject to the disciplines of Article II. However, to the extent that the Panel considers that China needed a separate basis under WTO law to enforce its tariff rate provisions for motor vehicles, that authority is provided by Article XX(d) of the GATT 1994. As China explained in its first written submission, Decree 125 secures compliance with China's customs laws by preventing the importation and assembly of auto parts as a means of circumventing China's tariff provisions for motor vehicles.[8] As discussed in response to question 160, there is ample evidence that, in the absence of these measures, auto manufacturers would evade the higher duty rates that apply to motor vehicles by importing parts and components that have the essential character of a motor vehicle, in multiple shipments.

Response of the European Communities (WT/DS339)

(a) Please explain what "circumvention" means;

81. The ordinary meaning of 'circumvention' according to the Shorter Oxford English Dictionary is "deceitful or fraudulent conduct perpetrated against a facile person" while 'circumvent' is defined as "deceive, outwit, overreach, find a way round, evade (a difficulty)". The ordinary meaning of the term appears to contemplate both situations where there is criminal or fraudulent intent behind the action and situations where such criminal or fraudulent intent is not necessarily present and where circumvention would not per se be illegal.

82. In the context of Anti-Dumping EC law defines circumvention as follows (Article 13(1) of regulation 384/96 as amended by regulation 461/2004): "Circumvention shall be defined as a change in the pattern of trade between third countries and the Community or between individual companies in

[7] To return to the example of GIR 3(a) provided in response to question 9, a Member might adopt a measure to advise importers as to which headings it considered to be "prima facie classifiable under two or more headings," and to advise importers, in those cases, as to which heading it considered to be "the most specific." The Member might adopt such a measure in response to evidence that importers were taking advantage of possible ambiguities as to which of two tariff headings might apply in order to obtain lower duty rates. But the Member would not need evidence of this intention before it could take steps to interpret and enforce its tariff schedule.

[8] China first written submission at paras. 203-214.

the country subject to measures and the Community, which stems from a practice, process or work for which there is insufficient due cause or economic justification other than the imposition of the duty, and where there is evidence of injury or that the remedial effects of the duty are being undermined in terms of the prices and/or quantities of the like product, and where there is evidence of dumping in relation to the normal values previously established for the like product, if necessary in accordance with the provisions of Article 2." To understand this provision in its context reference is made to replies to questions 132 and 141.

(b) Please explain whether, and if so, how, under the WTO law, a Member is allowed to take an anti-circumvention measure. If possible, please support your response with relevant GATT/WTO jurisprudence.

83. Anti-circumvention measures are explicitly contemplated under WTO law under Article 10 of the Agreement on Agriculture and in the context of Anti-Dumping. The Ministerial Decision on Anti-Circumvention adopted by the Trade Negotiations Committee on 15 December 1993 noted that the problem of circumvention of anti-dumping duty measures formed part of the negotiations which preceded the Agreement on Implementation of Article VI of GATT 1994 but the negotiators were unable to agree on specific text. The European Communities is of the view that anti-circumvention measures are permissible for the purposes of enforcing Anti Dumping duties within the framework of Article VI of the GATT 1994 and the Agreement implementing Article VI of the GATT. In respect of Anti-Dumping the EC is not aware of other GATT or WTO jurisprudence except for the GATT panel report *EEC – Parts and Components*.

84. To the extent the question refers to Article XX (d) of the GATT, reference is made to the reply given to question 9.

Response of the United States (WT/DS340)

85. The United States respectfully refers the Panel to the US Response to Question 9. To summarize, the United States does not know what China means by its use of the term "circumvention," other than that China believes that it is "circumvention" for automobile manufacturers to request the tariff treatment that China promised to provide to automotive parts. As also noted, the WTO Agreements contemplate that Members may enforce their Customs laws, so long as Members comply with relevant WTO obligations, such as Article X of the GATT 1994.

Response of Canada (WT/DS342)

(a) Please explain what "circumvention" means;

86. There is no recognized concept of "circumvention" in the tariff context. In the context of anti-dumping charges imposed in accordance with GATT Article VI, there are clear references to "anti-circumvention" in, for example, *EEC – Parts and Components*,[9] as well as the Ministerial Decision on Anti-Circumvention[10] adopted by the Trade Negotiations Committee on 15 December 1993.

87. However, China's use of the term "circumvention" is to justify internal charges that it considers necessary to prevent what it characterizes as "evasion" of tariffs. In the context of Article II, charges must be internal in order for this concept of "circumvention" to apply. Otherwise, the charge is properly characterized simply as either an "ordinary customs duty" or an "other duty or charge", in

[9] *EEC –Parts and Components*, Report of the GATT Panel, BISD 37S/132, adopted May 16, 1990.
[10] LT/UR/D-3/1, April 15, 1994.

which case the charge must be set out in the Member's Schedule and must be applied based on the state of the imported product on presentation at the border.

(b) Please explain whether, and if so, how, under the WTO law, a Member is allowed to take an anti-circumvention measure. If possible, please support your response with relevant GATT/WTO jurisprudence.

88. In Canada's view, any internal charge that is applied to the detriment of like imported products violates Article III:2. This violation may be justified under Article XX(d), or possibly in reference to other provisions of the *WTO Agreement* (for example, charges related to anti-dumping measures may be justifiable on the basis of Article VI). This analysis is supported by the panel in *EEC – Parts and Components*, which, at paragraphs 5.12 to 5.18, analyzed the internal charges in the light of Article XX(d).

Comments by the United States on China's response to question 13(b)

89. In describing its notion of "circumvention" in the context of this dispute, China argues that its concerns reflect a tariff classification issue. China explains: "That tariff classification issue is whether a tariff provision for a complete article (such as motor vehicles) includes the importation and assembly of parts that, in their entirety, have the essential character of that article. This tariff classification issue is governed by General Interpretative Rule 2(a)." China then acknowledges that auto manufacturers "structur[e] their imports of parts and components so that no single shipment has the essential character of a motor vehicle," but it describes this activity as circumvention because these auto manufacturers pay the lower tariff rates applicable to parts instead of the higher tariff rates applicable to motor vehicles. In China's words, this activity is circumvention because "auto manufacturers deprive China of the revenue and market access benefits that it negotiated when it obtained a higher bound duty rate for motor vehicles as compared to parts and assemblies of motor vehicles."

90. China, however, has no basis for arguing that it is being deprived of the "revenue benefits" that it negotiated in the form of higher duty rates for motor vehicles. The United States and other WTO Members negotiated lower duty rates on parts, and it is they who are being deprived (by the application of China's measures) of their negotiated benefits.

91. China also glosses over the true coverage of the measures at issue by describing them as being aimed at importing parts "in multiple shipments." China's measures cover the importation of parts (1) in multiple shipments, (2) from multiple suppliers, (3) from multiple countries,[11] (4) pursuant to multiple purchase orders, (5) placed as much as one year apart. Moreover, the number of shipments potentially grouped together by China's measures is astounding. Even the simplest motor vehicle contains about 1,500 parts, as is shown in China's discussion in response to question 69. More commonly, motor vehicles have thousands of parts.

92. According to China, the tariff classification issue is "whether a tariff provision for a complete article (such as motor vehicles) includes the importation and assembly of parts that, in their entirety, have the essential character of that article." China specifies that "[t]his tariff classification issue is governed by General Interpretative Rule 2(a)." The United States notes that the concept of parts "in their entirety" is not included in the GIR 2(a). GIR 2(a) provides for the classification of goods "as presented," which is their condition at the time of importation. Consistent with GIR 1, when an

[11] China's measures even cover parts that auto manufacturers purchase from suppliers in China if those suppliers had themselves imported those parts.

imported auto part is specifically described by a heading of the tariff schedule, it is classifiable under that heading notwithstanding that, post importation, the auto part may be used in the assembly of a complete automobile. Even a measure that compels an auto manufacturer to provide proof of the post-importation assembly of many different imported parts, in their entirety, into a complete automobile does not retroactively confer to those parts at the time of importation the "essential character" of an automobile.

14. In paragraph 21 its first written submission, China indicates that between 2001 and 2004, the value of imported parts and components increased by 300%.

(a) (*Complainants*) Please comment on this statement, including whether, and if so, how, these types of data are relevant to the measures at issue; and

Response of the European Communities (WT/DS339)

93. The European Communities does not consider that such statistics are relevant to the measures at issue. The European Communities is of the view that the Schedule of concessions of China or the Harmonised System under chapters 84 and 87 do not provide for the anti-circumvention measures argued by China. Hence, there is no need to consider trade statistics.

94. However, in general the European Communities is of the view that such statistics could at most demonstrate that after WTO accession, trade has increased in imported parts and components. This is a direct consequence of China's commitment to reduce the tariff rate for parts and components to a bound level of 10 % or less. If the expected effect of a commitment could serve as a justification for not respecting this commitment any longer, this would entirely undermine the legal value of WTO commitments. Any possible changes in trade patterns should also be examined in the light of all relevant data including the changes in imports of complete vehicles, production of complete vehicles in China, production of auto parts in China (which may require imports of parts further processed in China) and the number of vehicles in circulation in China (which affects the demand for imports of parts for repair and maintenance).

Response of the United States (WT/DS340)

95. The United States fails to see how the trade data presented by China is relevant to any matters at issue in this dispute. The United States has *prima facie* established breaches of various provisions of the WTO Agreement, including Article III of the GATT 1994 and the TRIMs Agreement. China's trade data is not relevant to these claims. The United States does note, however, that data on trade flows could be relevant for determining the level of nullification and impairment under Article 22 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU").

96. The United States understands that China relies on these data in support of its theory that automobile manufacturers began to split their CKD kits into separate shipments in order to avoid the whole vehicle rate that China claims it is allowed to apply to such kits. As an initial matter, the United States does not agree with China's views on the classification of separate shipments as a single CKD. But even leaving this aside, China's data on total imports of parts and components do not support China's factual assertions. China has presented no data showing that imports of CKD kits fell over the same period. And, more importantly, China has presented no evidence that these imported parts and components were destined for facilities that assembled "kits", as opposed to being destined for either (a) replacement parts or (b) manufacturing plants that imported bulk parts and components in the normal course of operations.

Response of Canada (WT/DS342)

97. Canada is not in a position to confirm the specific facts put forward by China, but does not disagree that parts imports grew in response to increased demand within China.

98. However, Canada strongly disagrees with China's interpretation of this statistic. China in effect asks the Panel to conclude that increased importation of auto parts is evidence that vehicle manufacturers are improperly importing parts on which they should be paying whole-vehicle duties. Canada notes simply that China has presented no evidence on which such a conclusion could be based.

99. From an economic point of view, fluctuations in imports and exports may result from any number of factors, such as domestic demand, foreign supply, trade regulations, currency rates, investment flows and tax policies. It is impossible to quantify which factors give rise to a 300% rise in imports, on the basis of a mere assertion that the size of the growth must be significant. The only evidence available demonstrates that the surge in imports of auto parts into China is related to the increased supply of vehicles in China, both for domestic consumption and export. More important, China's WTO commitments are independent of growth in a particular set of imports. China has not established, in respect of those commitments, whether or how that import growth may be a justification for the measures.

(b) (*China*) Could China please also indicate the percentage change, if any, in imports of complete vehicles during this same period.

Response of China

100. The figures are as indicated in the following table:

		2001	2002	2003	2004
Complete Vehicles	Unit	71,398	128,195	171,710	175,654
	Increase Rate (%)	-	80%	34%	2.3%
	Value (1,000USD)	1,712,394	3,209,378	5,275,917	5,416,170
	Increase Rate (%)	-	87%	64%	2.7%
Auto Parts	Auto Parts	2,155,639	2,312,355	7,384,300	8,679,599
	Engine Parts	443,765	639,715	1,400,043	1,712,467
	Total (1,000USD)	2,599,404	2,952,070	8,784,343	10,392,066
	Increase Rate (%)	-	13.6%	197.6%	18.3%

101. The table indicates that the rates of increase for complete vehicles sharply declined in 2003 and 2004. This is abnormal in light of the fact that China's quota on complete vehicles was substantially loosened over these years. In comparison, the rates of increase for auto parts were as high as 197.6% in 2003. The importation of complete vehicles accounted for 52.09% of total imports of auto products in 2002. This percentage decreased to 37.52% in 2003 and 34.26% in 2004, indicating a shift toward importing vehicle parts.

Comments by the United States on China's response to question 14(b)

102. In its response to question 14(b), China again makes the point that it found a pattern of "circumvention" during the period from 2001 to 2004 because imports of auto parts increased overall at a quicker rate than did imports of motor vehicles. China also points to a slowing rate of increase

for imported motor vehicles in 2003 and 2004 and argues that this trend was "abnormal" because China's import quotas on motor vehicles were being "substantially loosened" during this time period.

103. China's response is not convincing. China was doing everything in its power to limit imports of motor vehicles during the years 2001, 2002 and 2003. Only in 2004 did China begin to lift the barriers that it had put in place to limit vehicle imports, and these barriers were only lifted in full by the end of 2004 (with the exception of the high tariff rates that are still applicable to motor vehicles).

104. As explained above (see question 2), during the period from 2001 to 2004, China was pursuing tariff practices that encouraged the importation of parts and even CKDs and SKDs for assembly in China, while it was discouraging the importation of vehicles through an import quota regime. Under the import quota regime, China set an annual import quota for motor vehicles (and two key parts) at a value of $6 billion, with annual increases of 15 per cent. At the same time, however, China actively impeded foreign auto companies' attempts to fill this quota, which kept their imports of vehicles even further artificially low.

105. The United States described this situation in the 2002 USTR Report to Congress on China's WTO Compliance, which was issued on 11 December 2002. That report explained:

> "From the outset, China's quota system was beset with problems. The State Council did not issue necessary regulations until mid-December 2001. Not only were these regulations late, but they also appeared to be inconsistent with China's WTO commitments in certain respects. Further delay ensued as the administering authorities charged with implementing this system – [the Ministry of Foreign Trade and Economic Cooperation, known as MOFTEC] for some products and the State Economic and Trade Commission (SETC) for other products – struggled with implementation. More problems arose when MOFTEC and SETC finally began allocating quotas. In the case of autos, for example, while MOFTEC issued necessary implementing rules shortly after the issuance of the State Council's regulations, it did not open up the quota application process until February [2002], and it did not begin to allocate quotas until late April [2002]. Because of a lack of transparency, it was difficult to assess whether the quotas were allocated in accordance with the agreed rules. It became apparent, however, that MOFTEC was creating false fill rates by filling the quota for autos with auto parts (other than the key auto parts allowed by China's accession agreement). By mid-year, MOFTEC had also not yet fully allocated the auto quotas, although part of this delay was due to MOFTEC's crackdown on the illegal secondary market for auto import licenses."[12]

106. The report goes on to recount the efforts of the United States to obtain improvements in the operations of China's quota system, based on detailed commitments that China had made in its Protocol of Accession regarding applicable rules and procedures. The United States raised its concerns bilaterally with China and during meetings of the Committee on Market Access and the Committee on Import Licensing, as did other WTO Members. The report concluded that "[w]hile it is possible that some of the problems that arose during 2002, such as the missed deadlines, may have been attributable to first-time difficulties in implementing a new system, other problems seemed to reflect protectionist policies, particularly, for example, MOFTEC's filling of the quota for autos with auto parts." *Id.*, pages 12-13.

[12] 2002 USTR Report to Congress on China's WTO Compliance, page 12.

107. One year later, on 11 December 2003, the United States reported little improvement in China's import quota system for vehicles. The 2003 USTR Report to Congress on China's WTO Compliance explained:

> In 2003, the problems encountered with the auto quota system in 2002 continued, and MOFTEC was again late in issuing quota allocations, which resulted in uncertainty and significant disruption of wholesale and retail operations for imported autos. Given the persistence of these problems, it appears that China's poor implementation of its auto quota commitments is not due simply to difficulties in implementing a new quota system.[13]

108. Following sustained pressure from the United States, at the end of 2003, China began to loosen its restrictions on the importation of some motor vehicles. At that time, "China announced that certain US auto companies would be authorized to import sizeable quantities of US-produced autos in 2004 without having to use Chinese enterprises holding quotas. This development effectively ends the auto quota system for these companies as of the end of 2003, one year ahead of schedule."[14]

109. Thus, the import data that China proffers in response to question 14(b) does not reflect China's notion of circumvention. It does not demonstrate that auto manufacturers decided to change their business practices to avoid the higher duty rates on motor vehicles. Rather, the data reflects the Chinese government's own concerted efforts to discourage imports of motor vehicles by manipulating an already restrictive quota regime while promoting imports of CKDs and SKDs and parts through the tariff practices described above under question 2.

15. (*China*) Out of the total CKD and SKD kits imported since the entry into force of the measures at issue, what proportion of such imports was made under the second paragraph of Article 2 of Decree 125?

Response of China

110. Since the adoption of the challenged measures, all imports of CKD and SKD kits have been made under Article 2.2 of Decree 125.

16. (*China*) Article 30 of Decree 125 states that rules under this measure "apply to the situations in which vehicles manufactured under 'trade-for-processing' programmes are sold into the domestic market".

(a) Please clarify whether this sentence also applies to manufacturers "located in a bonded zone, in an export processing zone, or in other special zones supervised by the customs";

Response of China

111. The provision cited by the question is not applicable to the situation of bonded zones. Domestic sales of complete vehicle assembled under trade-for-processing programmes are dealt with by Article 30.2 of Decree 125, while domestic sales of complete vehicles assembled in bonded zones and other special zones are dealt with by Article 30.3.

[13] *Id.*, page 23.
[14] *Id.*, page 24.

112. Like other inward processing regimes maintained by other WTO Members, the key feature of the trade-for-processing programme is deferral of duties on imports of materials that are used to produce products for export. Eligible processors import materials for processing into final products that they will export from China. Eligible processors do not need to be located in a bonded zone or another type of special zone supervised by the customs. Eligible processors are required to post bonds rather than pay duties when they import materials for this purpose. Article 30.2 simply concerns the circumstance in which parts imported under the trade-for-processing programme are, in fact, used to assemble motor vehicles that are sold into the domestic market.

(b) Please explain automobile manufacturers located (i) "in a bonded zone", (ii) "in an export processing zone", and (iii) "in other special zones supervised by the customs";

Response of China

113. Auto manufacturers located in these special customs zones are part of the "processing trade." Because these special customs zones are geographically isolated with fence requirements, they are easier for customs authorities to supervise, and offer certain benefits to importers. Unlike out-of-zone processors, for example, in-zone processors are not required to post a cash deposit on imports of materials for use in the production of goods for export.

(c) Please explain the difference between automobile manufacturers referred to in Article 2 of Decree 125 and those operating under the "trade-for-processing" program and located in a "bonded zone", in an "export processing zone" or "other special zones supervised by the customs under Article 30 of Decree 125; and

Response of China

114. According to Article 7.1 of Decree 125, automobile manufacturers operating under the processing trade, including those located in special customs zones, are outside the scope of Decree 125 unless they sell automobile products into the domestic Chinese market, a circumstance dealt with by Article 30. This is natural because processors are not required to pay customs duties on imported parts, as long as they process and export these imports in accordance with the conditions of the programme.

(d) Please clarify the relationship between Article 49 of Order 8 and Article 30 of Decree 125.

Response of China

115. There is no relationship between the two articles cited. Article 49 of Order No. 8 concerns the application of investment policies to vehicle manufacturers in export-processing zones.

17. (*Complainants*) China submits in footnote 14 in its first written submission that "the complainants appear to have mistaken the rules applicable to bonded areas as applicable to bonded entries" and that "pursuant to Art. 12 of Decree 125 importers provide comprehensive import bonds commensurate with their stated plans for importing and assembling auto parts that have the essential character of a motor vehicle". Please comment on China's statement.

Response of the European Communities (WT/DS339)

116. The European Communities does not believe it has misunderstood the Chinese rules. It seems that the suspending regime allegedly applied by China concerning bonded goods at issue is a hybrid one, which confuses international customs practice regarding bonded areas with the "bond" imposed on vehicle manufacturers in the amount of the relevant duty on automotive parts on importation. China refers to the word "bonded" in relation to both situations (guarantee – transit procedure) and this has a misleading effect. The "bond" (i.e. the guarantee or security deposit) is made on the basis of the duty rate for parts (generally 10 %), i.e. on the basis of the characteristics of the goods as presented to customs. The European Communities also refers to the more detailed answer given by Canada.

Response of the United States (WT/DS340)

117. China – both in the above cited footnote 14 and in its answers at the first substantive meeting – has presented a clarification of its bonding requirements on imported auto parts. This clarification further supports the position of the United States that the additional charges imposed by China's measures are internal charges, not Customs duties.

118. In particular, China has clarified (1) that all automotive parts covered by China's measures enter under a bond based on the 10% rate for auto parts, and (2) that the bond is simply a financial guarantee, and does not involve any control by Chinese Customs on the importers disposition of the part. That is, if the importer sells the part as a spare part, or if for any reason the part is not used in the manufacture of a vehicle within one year, then the 10% parts rate applies. Only if the part is used in the manufacture of a vehicle not meeting local content requirements will China proceed to impose the 25 per cent "whole vehicle" rate on the part.

Response of Canada (WT/DS342)

119. China has not explained what it means by the concept of "bonded entries", which is not a concept that exists in Canadian law. In contrast, there is a recognized concept in international customs practice of bonded areas (e.g., bonded warehouse) or export-processing zones (e.g., free trade zone), which are areas of special customs supervision, control and administration. In using the term "bonded entries", China appears to be referring to the bond imposed on vehicle manufacturers in the amount of 10% of the value of parts that they import directly. This bond is simply akin to a "security deposit" to ensure payment of the duty liability based on the state of the good as presented at the border. China has not disagreed with what the complainants believe is the relevant fact related to bonding – that parts imported into China are not kept physically segregated. Imported parts are not kept in bonded areas or export-processing zones, they are not required to be kept separately in sealed containers, and they are not otherwise restricted from entering the internal market.

18. (*China*) Please explain in detail about "*comprehensive* duty bonds" that automobile manufacturers importing auto parts characterized as complete vehicles must pay under Article 12 of Decree 125.

Response of China

120. The pertinent part of Article 66 of the Customs Law of China provides that "in case the consigner or the consignee applies for release of the goods before the determination in respect of classification and valuation is made or valid customs declaration form and accompanied documents and/or certificates are provided, customs shall allow release [of the goods] where [the consigner or the

consignee] provides bonds, commensurate with the legal obligation it shall assume pursuant to relevant laws and regulations." Parties may provide comprehensive customs bonds, upon the approval of customs, for customs matters of the same nature that will reoccur multiple times within a given time period. Article 12 of Decree 125 is an application of these general customs bond rules in the particular circumstance of auto parts that are imported for registered vehicle models. These comprehensive duty bonds are required to ensure that the auto manufacturer abides by all relevant customs rules and can satisfy the customs liability.

121. The amount of the comprehensive customs bonds is based on the projected amount of duties that the importer will pay each month. In practice, customs calculates the bonds based on the applicable rates for auto parts, which minimizes the burden on auto manufacturers. Customs offices are required to recalculate the bonds every three months and may require the auto manufacturer to adjust the amount of the bond.

19. (*China*) Please explain what procedural requirements "the administration of bonded goods" under Article 16 of Decree 125 entail, including what the phrase "*remain under customs control*" in paragraph 31 of your first submission means.

Response of China

122. The "administration of bonded goods" may vary from one type of customs matter to another. The following is an outline of the procedure in a typical scenario, the importation of goods for use under the trade-in-processing programme:

- An eligible processor registers itself with the relevant customs office;
- The eligible processor obtains from the relevant customs office a Processing Trade Manual;
- Each transaction, by which raw materials are obtained from foreign sources, is recorded in the Processing Trade Manual and other applicable customs records;
- The consumption of raw materials is recorded in the Processing Trade Manual and other applicable customs records; and
- Once the finished products are exported, the processor applies for the appropriate adjustment of the import entry in its Processing Trade Manual and other applicable customs records.

123. Article 100 of the Customs Law of China defines "goods remaining under customs control" as goods that are:

- covered by Article 23 of the Customs Law of China;
- in the status of pass-through, transit, or continuous transportation;
- under special duty exemption and reduction;
- under a temporary import/export arrangement;
- in bonded status; or
- not fulfilling all necessary customs requirements.

20. (*China*) Article 27 of Decree 125 refers to "the rules for bonded goods".

(a) Please clarify whether the rules referred to in this provision are "*Procedures on Customs Control over Bonded Areas*", as provided by the complainants in Exhibit JE-31. If not, please explain how the rules referred to in Article 27 of Decree 125 are different from the rules

provided in *Procedures on Customs Control over Bonded Areas* and provide a translated copy of such rules for bonded goods; and
Response of China

124. Article 27 of Decree 125 does not refer to the Customs Control measures over Bonded Zones, which is only one of many types of "rules for bonded goods." As is the case in the customs practices of other WTO Members, China's "rules for bonded goods" vary from one customs procedure to another, depending on the nature of the procedure and the degree of customs control that is required.

125. The bonding requirements under the measures at issue include the following elements:

- the registration of vehicle models for which the imported auto parts have the essential character of a motor vehicle;
- a requirement that the auto manufacturer keep accurate records of the parts and components that it imports in bond, and account for their assembly into registered vehicle models;
- the establishment of the Q-account, which connects the auto manufacturer to the relevant customs office via the Internet;
- recording each entry of bonded auto parts for the registered vehicle models in the Q-account; and
- making adjustments to the Q-account as parts and components that entered in bond are assembled into registered vehicle models and the applicable duties are paid.

(b) Could China explain how "the rules for bonded goods" are applied to the auto parts imported by auto part *suppliers* and then subsequently sold to automobile manufacturers? In China's view, are these imported auto parts *not* in free circulation.

Response of China

126. The rules for bonded goods do not apply to auto parts imported by a third party and subsequently sold to the auto manufacturer. As described in response to question 83, these goods are in free circulation in China.

21. (*China*) Please explain the respective roles played by various Chinese authorities, such as the General Administration of Customs, the NDRC, the Ministry of Commerce, and the Ministry of Finance, with respect to the administration of the rules relating to the imposition of the charge and the procedural requirements under the measures at issue.

Response of China

127. The role of the GENERAL ADMINISTRATION OF CUSTOMS relating to the measures at issue includes:

- being a member of the Leading Panel (Article 6.2 of Decree 125);
- receiving auto manufacturers' self-evaluation conclusion and registration request (Articles 7.1 and 19.2 of Decree 125);
- receiving auto manufacturers' review application (Articles 7.2 and 19.2 of Decree 125);
- entrusting the State Verification Centre for Complete Vehicle Character ("Verification Centre") to conduct reviews (Article 7.2 of Decree 125);
- issuing review opinions (Article 7.3 of Decree 125);

- receiving auto manufacturers' registration materials and forwarding them to relevant authorities (Articles 10, 19.2, 30.2, and 30.3 of Decree 125);
- receiving auto manufacturers' verification requests and entrusting the Verification Centre to conduct verifications (Articles 17, 19.1, 19.2, and 20.2 of Decree 125);
- formulating detailed verification rules (Article 17 of Decree 125);
- designating the Verification Centre to conduct verification when the auto manufacturer does not apply for registration or verification (Article 26 of Decree 125);
- administering imported auto parts for registered vehicle models in accordance with the rules for bonded goods (Article 27 of Decree 125); and
- making classification determinations and assessing applicable customs duties in accordance with China's customs laws (Articles 28, 31 of Decree 125)

128. The role of the NATIONAL DEVELOPMENT AND REFORM COMMISSION relating to the measures at issue includes:

- being a member of the Leading Panel (Article 6.2 of Decree 125);
- marking "Complete Vehicle Character" on the Public Bulletin for On-Road Vehicle Manufacturers and Their Products (Article 7.4 of Decree 125); and
- suspending the relevant vehicle model listing in the Public Bulletin in the event that an auto manufacturer violates relevant rules (Article 37 of Decree 125).

129. The role of the MINISTRY OF COMMERCE relating to the measures at issue includes:

- being a member of the Leading Panel (Article 6.2 of Decree 125); and
- marking "complete vehicle character" on the Automatic Import License (Article 7.4 of Decree 125).

130. The role of the MINISTRY OF FINANCE relating to the measures at issue includes being a member of the Leading Panel (Article 6.2 of Decree 125).

22. (*China*) Article 10 of Decree 125 states, *inter alia*, "Having received the relevant documents, the NDRC, the Ministry of Commerce, and the district customs office ... shall administer the registration in accordance with their respective responsibilities." Article 11 of Decree 125 then sets out the responsibilities for the district customs office. In light of the terms of Article 11, what are the respective responsibilities of the NDRC and the Ministry of Commerce in this regard as referred to in Article 10?

Response of China

131. These responsibilities are detailed in response to question 21.

23. (*China*) Please elaborate, by referring to Articles 2, 3 and 4 of Announcement 4, on the respective functions of the "Leading Panel Office" and the "Verification Center" in respect of the verification of imported auto parts characterized as complete vehicles.

Response of China

132. The Leading Panel Office is an executive office of the Leading Panel. The office is responsible for daily work in the administration of Decree 125, such as coordination of the verification efforts.

133. The function of the Verification Centre in relation to the measures at issue includes:

- being entrusted by the customs office to conduct simple or on-site reviews (Article 7.2 of Decree 125 and Article 4 of Announcement No.4);
- being entrusted by the customs office to conduct verifications on registered vehicle models and to issue the Verification Report (Articles 17, 18, 19.l, 19.2, 20.1, 20.2, 30.2 and 30.3 of Decree 125 and Article 4 of Announcement No.4); and
- being instructed by the customs office to conduct verifications in case an auto manufacturer does not apply for registration or verification (Article 26 of Decree 125 and Article 4(3) of Announcement No.4).

134. The Verification Centre is to be an independent professional firm, which is now organized under the auspices of the China Automotive Technology & Research Centre.

24. (*China*) In respect of Article 29 of Decree 125, as provided by China in Exhibit CHI-3:

(a) Please elaborate on the companies that can be considered as "the *affiliated* companies of the automobile manufacturer" within the meaning of Article 29;

Response of China

135. This is a translation error. The provision should read as follows:

> Article 29 If the customs characterizes the imported automobile parts as complete vehicles for the purpose of classification and duty collection, the importation duty and the importation VAT, which have been paid by suppliers of these imported parts upon importation, shall be deducted, provided that the automobile manufacturer provides relevant proof of duty payment.

(b) If this term applies only to the companies that have a certain *relationship* with automobile manufacturers, then how is the importation of auto parts by supplier companies with *no affiliation* with automobile manufacturers treated under the measures?; and

Response of China

136. There is no difference.

(c) Article 29 also refers to "in accordance with relevant regulations." Please clarify the "relevant regulations" indicated in Article 29 and provide a translated copy of the relevant regulations.

Response of China

137. No specific regulation is referred to by this phrase. It directs the auto manufacturer to the normal customs declaration procedures.

25. (*China*) While Article 18 of Announcement 4 refers to a "change of tariff classification" as the basic criterion for "substantial processing", the complainants submit that the two additional criteria specified therein involve aggregate value-based considerations (i.e. "*ad valorem* percentage" and "manufacturing and processing procedures"). Please clarify whether

this is a correct understanding of Article 18 and explain how substantial processing is applied within the meaning of Article 19 of Announcement 4.

Response of China

138. Article 18 of Announcement No. 4 sets forth three criteria for "substantial processing," which are valid criteria for "substantial transformation" widely adopted as part of many countries' rules of origin, including China's *Regulation on Rules of Origin for Import or Export Goods*.

139. The primary criterion is a "change of tariff heading". The other two criteria apply only if a "change of tariff heading" does not, on its own, result in a finding of substantial transformation. The first supplementary criterion is the ad valorem value added by the processing. This criterion is used by many customs authorities in making substantial transformation determinations, and is explicitly recognized by Article 2(a)(ii) of the Agreement on Rules of Origin. The second supplementary criterion involves an examination of the nature of the process and whether it vests the essential character to the processed goods. Again, this is a factor that many customs authorities consider in making substantial transformation determinations.

26. (*China*) In respect of Article 22(2) of Decree 125, it is understood that the new class A/B distinction will enter into force as of 1 July 2008. If so, please explain why this should not be considered as an indication of arbitrariness of China's measures for determining when imported auto parts should be considered as a complete vehicle.

Response of China

140. China has deferred the implementation of Article 22(2) primarily because of the administrative complexity of implementing this particular provision. There is nothing arbitrary about the A/B distinction, or its deferral. The parts designated under Class A reflect China's consideration of which parts, by themselves, impart the essential character of the particular assembly at issue. The parts designated under Class B reflect China's consideration of the other parts of that assembly which, in the aggregate, also impart the essential character of the assembly at issue. Until the class A/B distinction takes effect, China is classifying assemblies on the basis of the aggregate threshold number of parts for that assembly. With or without the class A/B distinction, China considers that the designated parts at the designated thresholds impart the essential character of that assembly.

27. (*China*) If China was concerned with tariff circumvention on automobile parts at the time of its accession to the WTO, why didn't China indicate specific terms and conditions to this effect in its Schedule?

Response of China

141. As explained in response to question 54, China was not required to inscribe specific terms and conditions in its Schedule of Concessions to preserve its ability to interpret its Schedule of Concessions in accordance with the rules of the Harmonized System, as interpreted by the WCO. The Harmonized System, which includes the General Interpretative Rules, is the basis upon which WTO Members negotiate and schedule their tariff commitments; it is not a "term or condition" that Members must include in their Schedules of Concessions in order to preserve. When Members negotiate Schedules of Concessions on the basis of the Harmonized System, it must be presumed that they are aware of the rules of classification that apply to the Harmonized System.

142. For the reasons set forth in response to question 133, China considers that it is more relevant to pose this question in the reverse: If the complainants thought that China should not be allowed to apply GIR 2(a) to its tariff provisions for "motor vehicles," and that China should not be allowed to avail itself of the longstanding interpretation of GIR 2(a) that the WCO reaffirmed in 1995, then why didn't they negotiate a specific commitment to this effect? Moreover, if the complainants thought that China should not be allowed to resolve the relationship between complete articles and parts of articles in the same manner as the complainants had done in respect of duties that were of concern to them, then why didn't they obtain such a commitment? These were, after all, the relevant circumstances that prevailed at the time of China's accession to the WTO. In light of these circumstances, the burden rested on the complainants to obtain a commitment that China would not adhere to these rules and practices.

28. (*China*) Please clarify the order in which the application to the NDRC to be listed on Public Bulletin and the application to the Ministry of Commerce for an automatic importation licence take place under the measures at issue.

Response of China

143. Being listed in the Public Bulletin is required for auto manufacturers to produce and sell motor vehicles in China. If an auto manufacturer is planning to produce and sell a particular vehicle model, the manufacturer shall apply to the NDRC to be listed in the Public Bulletin. As explained in response to question 4, one of the regulatory characteristics that is listed in the Public Bulletin with respect to a specific vehicle is its customs status under Decree 125.

144. With regard to automatic import licences for motor vehicle products, the purpose of establishing the automatic import licence system is to monitor the importation of motor vehicle products. If an auto manufacturer is planning to import auto parts which are subject to an automatic import licence requirement, it must apply to MOFCOM for this purpose. This process is unrelated to the listing in the Public Bulletin.

29. (*China*) Please explain why registration with Customs is unnecessary under Article 7 of Decree 125 for imported auto parts that are determined not to be considered as complete vehicles after self-evaluation and review by the Verification Center.

Response of China

145. The purpose of registration is to keep track of how auto manufacturers import and assemble auto parts that, in their entirety, have the essential character of a motor vehicle. This determination is made on a model-by-model basis. The registration of a vehicle model confirms that imports of auto

parts for that vehicle model will be subject to the duty provisions for motor vehicles, and subject to the customs procedures that Decree 125 establishes to collect these duties.

146. According to Decree 125, if the auto manufacturer conducts a self-evaluation and determines that the imported auto parts should not be characterized as a complete vehicle, and this is confirmed by the Verification Center, registration of that vehicle model is unnecessary because imports of parts for that vehicle model will not be subject to the customs procedures that Decree 125 establishes.

30. (*China*) Please explain in detail, citing specific provisions and providing a translated version thereof, if necessary, the customs violations and criminal liabilities referred to in the first and second sentences of Article 36 of Decree 125.

Response of China

147. There are three types of acts encompassed by the laws referred to in Article 36 of Decree 125: (1) criminal smuggling violations; (2) non-criminal smuggling violations; and (3) other customs violations. Article 153 of the *Criminal Law of the People's Republic of China* defines smuggling as a criminal offence by reference to the amount of the import taxes that are evaded. The amount of any criminal penalties and the duration of any imprisonment depend upon the amount of the import taxes that are evaded. Article 82 of the *Customs Law* and Articles 7 and 9 of the *Regulation of the People's Republic of China on the Implementation of Customs Administrative Punishment* define non-criminal smuggling as acts of smuggling that do not rise to the thresholds of a criminal offence. Penalties for these violations include confiscation of the smuggled goods, the imposition of fines, and the destruction or confiscation of equipment used in the act of smuggling. Finally, Articles 12, 14, 15, 18, and 23 of the *Regulation of the People's Republic of China on the Implementation of Customs Administrative Punishment* define other types of non-smuggling customs violations, such as the submission of untruthful declarations (Article 15) or actions that violate customs control of goods (Article 18). The financial penalties for these violations vary.

148. CHI-34 contains translations of the relevant portions of these laws and regulations.

31. (*China*) An *auto part manufacturer* located in China imports "100 vehicle bodies" and "100 engines" in a single shipment with the purpose of assembling these assemblies in China and subsequently selling the 100 assembled assemblies to a *vehicle manufacturer* located in China who subsequently uses:

(a) 50 assemblies to assemble whole vehicles for sale in China;
(b) 30 assemblies to assemble whole vehicles to be exported from China; and
(c) 20 assemblies as replacement parts of vehicles for sale in China.
(d) Please explain, citing the applicable provisions, how these "100 vehicle bodies" and "100 engines" would be respectively treated under the measures at the border and after they will have been used by the automobile manufacturer as indicated above.

Response of China

149. Vehicle bodies and engines are, in most cases, unique to specific vehicle models. It is highly unlikely that an auto part manufacturer would import both the bodies and engines of a specific vehicle model, and then sell those assemblies in an arm's-length transaction to an auto manufacturer in China. These assemblies are generally not interchangeable with other vehicles, and certainly are not interchangeable with vehicle models produced by different automobile manufacturers. Bodies, engines, and other assemblies are made to the specifications of each automobile manufacturer,

ordinarily for a specific vehicle model (or a number of closely related vehicle models). Thus, if an auto part manufacturer were to import these assemblies, it would have to be by prior arrangement with the automobile manufacturer.

150. This highlights the problem of customs administration that China has in respect of enforcing Decree 125. Because of the close commercial relationships between auto part manufacturers and automobile manufacturers, and the heavy commercial dependence of the former upon the latter, it is possible for auto manufacturers to arrange with their auto parts suppliers to be the importers of record for the auto parts and components that they use to assemble specific vehicle models. This is the loophole that Article 29 of Decree 125 seeks to close by applying the motor vehicle duty rates to imported auto parts and components that have the essential character of a motor vehicle, without regard to whether the auto manufacturer or a third-party supplier was the importer of record.

151. Under the particular facts of this question, however, China considers that the body and engine of a vehicle model have the essential character of a motor vehicle. This is evidenced in Article 21 of Decree 125. Thus, China would classify the imports described in this question as a motor vehicle without regard to who the importer was (i.e., a parts manufacturer, an auto manufacturer, or any other importer).

32. (*Complainants*) In paragraphs 62-67 of its first written submission, China cites examples of customs practices from certain WTO Members, including from the complainants, to demonstrate the existence of the "widespread" and "consistent practice of WTO Members in imposing customs duties after the 'time and point of importation'". Please comment on the accuracy of these examples and their relevance to the characterization of the measures.

Response of the European Communities (WT/DS339)

152. China misinterprets the customs legislation it cites by trying to mix up ordinary tariff classification with the customs procedures related to the post clearance recovery of the customs debt. When goods are imported into the EC in order to be released for free circulation, a customs declaration is lodged with the customs administration. It contains the precise physical description of the goods that is sometimes also supported by pictures or laboratory analysis. The importer will propose a tariff code (CN code in the EC) where to classify such goods. The customs administration will then "take a snapshot" of the customs declaration related to the goods at issue and classify them according to the HS rules in force at the time of importation. These are transposed into the EC's Combined Nomenclature (or, we understand, the US' HTSUS). Only rarely are goods physically inspected at the border. If it turns out that the tariff classification at the time of importation has been done by relying upon incorrect documentation submitted by the importer (for instance misleading laboratory analysis, different characteristics of the goods imported that do not correspond to those indicated in the import declaration), the customs administration is allowed to check the goods and re-classify them accordingly because the goods that have been imported are different from those declared in the customs import declaration lodged by the importer at the time of importation. As it is apparent from the above, China's examples are based on the rules in force concerning the post clearance recovery of the customs debt that have nothing to do with the ordinary tariff classification done at the border at the time of importation. In other words, the imposition and collection of customs duties is always made on the basis of the status of goods at the time of importation or in other words as presented at the border.

153. The EC understands that the same applies for the customs systems of the US and Canada. Even if there was, in the legal system of an individual WTO member, a practice of classifying goods

based on events after importation, such practice would not be "widespread and consistent" and would certainly not fulfil the test of Article 31(3)(b) of the Vienna Convention.

Response of the United States (WT/DS340)

154. Paragraph 62 refers to "the consistent practice of WTO Members in imposing customs duties after "the time or point of importation" in order to demonstrate that, as stated in paragraph 63, Article II of the GATT "is not limited to charges that are collected 'on or at the point of importation.'" Contrary to China's characterization of US practice in paragraph 63, the imposition of customs duties occurs at the time of importation of goods that are entered into the United States. Specifically, 19 C.F.R. § 141.1(a) provides that duties and liability for their payment accrue upon imported merchandise on arrival of the importing vessel or other means of transport within the United States. Additional duty liability does not accrue based upon the usage of the goods after entering the United States.

155. The classification of the goods is based on the condition of the goods when imported and entered for consumption in the United States. The classification and corresponding amount of duties owed must be identified and deposited at the time of importation, when the importer files an Entry Summary. This is the point at which customs duties are imposed. China implies that the United States "imposes" customs duties beyond the point of importation into the United States by alleging "customs authorities are not required to make a final classification determination and assessment of duty liability until one year after the merchandise has entered the customs territory of the United States." 19 C.F.R. § 159.11.

156. The United States mandates a one-year time frame for liquidation, to which China refers in paragraph 62, for the purpose of providing an adequate amount of time to verify the accuracy of the information provided by the importer concerning the nature of the imported goods, including the correctness of their classification based upon their condition at the time of importation. Liquidation means the final computation of the duties that accrued on an entry of imported merchandise, 19 C.F.R. § 159.1, which are based solely on the condition of the merchandise at the time of importation, 19 C.F.R. § 141.1(a). The one-year time frame for liquidation is necessary due to the sheer volume of goods arriving at the ports, for which the United States is not in a position to instantaneously review entry documents and determine their accuracy at the time of importation.

157. China also notes in paragraph 64 that the United States only requires the deposit of estimated duties at the time of importation, pending the finalization of those duties within one year from the date that the goods are entered for consumption into the United States. This practice does not undermine the legal requirement that the imposition of customs duties occurs at the time of importation. Estimated duties are deposited in lieu of the final imposition of duties, per 19 C.F.R. § 141.101, because (as explained above) the United States is unable to verify the accuracy of the classification and amount of duties alleged by the importer based on the condition of the goods at the time of their importation. The one-year time frame within which the United States will verify the accuracy of the amount of the estimated duties is not a time frame within which the United States may impose additional customs duties, unless such duties are based upon the condition of the goods at the time of their importation.

158. Paragraph 65 alleges that "many countries specify more specialized circumstances in which duties can be assessed after the time or point of importation." The first example cited by China is the allegation that Canada "retains the authority to reconsider the origin, classification, and value of imported goods for a period of up to four years after liquidation." The other examples also involve like provisions under the laws of the EC, New Zealand, Australia, and India, all of which permit a

final determination of duty liability after the goods have been imported. Retaining the right to verify the accuracy of origin, classification, valuation, and other facts that may affect the dutiability of goods is fundamentally different from China's measure, which changes the level of a charge based on the local content thresholds of an internal manufacturing operation. In contrast, the imposition of customs duties must be based upon the condition of the goods at the time of importation. If an importer misrepresents that condition (by misstating the origin, classification, value, etc. of the goods), then proper enforcement of the trade laws requires the imposition of the additional duties that were properly owed based on the condition of the merchandise at the time of importation.

159. In paragraph 67, China identifies an alleged nexus between "widespread and consistent practices of WTO Members" (as described in the preceding paragraphs) that impose "charges after 'the time or point of importation'" when "the charge bears an objective relationship to the administration and enforcement of a valid customs liability." These "widespread" and "consistent" practices of WTO Members, as described by China in paragraphs 62-67, are relevant to China's position concerning the permissibility of its classification of auto parts only to the extent there is a valid customs liability. In regard to the classification of goods, this determination is a valid customs liability when it is based on the condition of the goods at the time of importation. The examples cited by China merely demonstrate that other WTO Members enforce this particular valid customs liability by verifying that the classification of the goods is correctly based upon their condition at the time of importation.

Response of Canada (WT/DS342)

160. Canada disagrees. It is common and consistent customs practice to classify a good based on an objective assessment of the essential characteristics of the good as presented at the border. Although the duty may be calculated and paid later, liability for customs duties is based on this assessment.

161. With specific reference to Canadian law cited by China, Canada's *Customs Act* establishes how a good is assessed at the point of importation.[15] In particular, Sections 32 and 33 describe the conditions under which goods may be released from customs control before duty payment has been made. However, the calculation of the duty remains based upon the essential character of the goods on presentation prior to release from customs. Sections 57 to 66 of the *Customs Act* elaborate on the process for making determinations, re-determinations or further re-determinations of tariff classification, which may occur after the good has been imported, *but remain based on the condition of the goods at the time of importation.*

162. In terms of the practice of other customs authorities cited by China,[16] China has attempted to relate its measures to the customs regimes of a number of WTO Members by drawing selectively, and out of context, from those regimes. In fact, all of the cited customs authorities follow the practice of examining goods based upon their status at presentation at the border:

- **Australia's** legislation assesses duty based upon the status of goods as they arrive at the border. Section 162A of Australia's *Customs Act 1901* deals with the special case of items temporarily brought into Australia and then removed,[17] such as commercial

[15] Customs Act, R.S.C. 1985 (2nd Supp.), c. 1 (Customs Act), excerpted sections (Exhibit CDA-1).
[16] China's first written submission, at paras. 62-67.
[17] Ibid., at fn. 43 (Exhibit CHI-12).

samples, shipping containers, and scientific equipment.[18] Section 165 simply allows Australian customs to seek payment after importation where there was an underpayment or erroneous refund of duties.[19]

- **New Zealand's** case law establishes clearly that "goods are to be identified in their condition at time of their importation" and that "identification must be objective, having regard to the characteristics which the goods present on informed inspection".[20] The provisions cited by China merely relate to common practices of customs authorities in relation to that snapshot: allowing payment to occur after importation (Section 86 of New Zealand's *Customs and Excise Act of 1996*) and allowing corrections for inaccurate assessments (Section 89 of the *Act*).[21]

- **India's** customs law also assesses duty based upon the snapshot at the border. The provision in India's Provisional Duty Assessment Regulations cited by China regarding provisional duty assessment[22] refers to the ability of customs to provisionally determine duty in instances where further examination of the snapshot is needed (*e.g.*, scientific testing, professional examination, current market pricing research).[23]

- **European Communities'** law can best be addressed by Canada's co-complainant directly, but Canada notes that the provisions cited by China simply reflect the same general practices discussed above, namely procedures relating to examining the snapshot of a good taken at the border.[24]

33. (*Complainants*) In your view, should imported CKD or SKD kits be classified differently than the auto parts included in such kits if such auto parts were to be imported separately?

Response of the European Communities (WT/DS339)

163. To the extent that a CKD or SKD kit would be subject to a separate tariff line or be classified *in casu* as the complete vehicle because all the parts of a complete vehicle are presented to customs at the same time, there could be a difference between the classification of separately imported parts and a CKD or SKD kit. However, depending on the particular case it can also be that both the kits and the parts imported separately would be classified as parts. It is therefore not possible to treat such kits in a generalised manner as imports of complete vehicles as is the case with the contested measures.

[18] See on this topic Australian Customs Service, Temporary Importations; online at: http://www.customs.gov.au/site/page.cfm?u=4355 (Exhibit CDA-2).

[19] Cited by China in its first written submission, at fn. 44 (Exhibit CHI-12).

[20] Campervan correctly classified [2005] NZCAA 2 (1 February 2005), at para. 15 (Exhibit CDA-3).

[21] China's first written submission, at fns. 41 and 42 (Exhibit CHI-11).

[22] Ibid., at fn. 45 (Exhibit CHI-13).

[23] See Batra v. Commissioner of Customs (Indian Customs, Excise and Service Tax Appellate Tribunal, Appeal No. C/615/03, decision dated March 20, 2006) for a discussion of the procedure for investigating the proper price of the good on presentation at the border following a preliminary assessement – in that case the reassessment was set aside based on a lack of evidence (Exhibit CDA-4).

[24] China's first written submission, at fns. 38, 39 and 40 (Exhibit CHI-10).

Response of the United States (WT/DS340)

164. Yes, the classification should be different. Under the Harmonized System, a good should be classified in its condition as imported. Assuming that an imported CKD or SKD kits is a complete vehicle unassembled, it would be classified differently than the auto parts included in such kits if such auto parts were to be imported separately.

Response of Canada (WT/DS342)

165. Canada notes as a preliminary matter that the Harmonized System does not use the terms CKD or SKD, nor are they in common use in customs practice. In the auto industry, the terms CKD and SKD are used without a fixed definition. The terms refer to a large collection of parts imported together for the purpose of assembling a vehicle in the internal market. While CKDs usually are completely unassembled, SKDs contain parts that are partially assembled.

166. For tariff classification, what is relevant is the application of Rule 2(a), which requires a determination of whether imported parts have the essential character of a whole product.

167. The terms CKD or SKD become relevant in this dispute only because they are used both in the Working Party Report on China's accession, and in the measures. In this context, certain collections of parts may only properly be described as CKDs or SKDs where all or nearly all of the parts necessary to construct a whole vehicle are presented to customs together in one shipment. Chinese customs officials have the discretion either to classify CKDs or SKDs as parts, or to classify them at the six-digit level as a whole vehicle (in which case there should be a further classification at the seven- or eight-digit level to show that it is a whole vehicle in unassembled form, and therefore subject to a 10% duty).

168. Separate shipments of parts must be classified separately, based upon the parts in a given shipment. Canada does not accept China's implicit claim that separate shipments of parts may be related, nor that separate shipments of parts can be considered to have the essential character of a whole vehicle. In practice, parts shipments include a variety of parts for a variety of vehicles, from multiple suppliers and possibly to multiple destinations in the internal market.

34. (*China*) In light of the example given in paragraph 97 and your statement in paragraph 98 of your first written submission, is China of the view that CKD or SKD kits under Article 21(1) of Decree 125 are of the same value or quantity as the combinations of auto parts set out in Article 21(2) and (3). Please explain in detail.

Response of China

169. Not necessarily. The example provided in paragraph 97 of China's first written submission was meant to illustrate the basic principle underlying Decree 125 by using a relatively "easy" case – a motor vehicle that the auto manufacturer assembles entirely from imported parts and components. The point of this example is that the tariff classification of imported auto parts and components should not change based solely on the manner in which the auto manufacturer structures its imports.

170. The same principle applies, however, to imported parts and components that have the essential character of a motor vehicle within the meaning of GIR 2(a), even if the imported parts and components represent less than 100 per cent of the parts and components necessary to assemble the complete vehicle. Whether the auto manufacturer imports these parts and components in one shipment or in multiple shipments, the tariff classification should be the same. The purpose of the

combinations of auto parts set out in Article 21(2) and 21(3) is to define the thresholds of imported parts and components that China considers to have the essential character of a motor vehicle. These combinations of auto parts may or may not be equivalent in quantity or value to the quantity or value of auto parts that constitute a CKD or SKD kit. The relevant inquiry under GIR 2(a) is whether they have the essential character of a motor vehicle.

35. (*China*) In respect of the criteria of Article 21(2) of Decree 125, the European Communities argues that "China applies the full vehicle duty to all imported parts if the vehicle contains certain imported assemblies that constitute only 17-29% of the value of the complete vehicle" (paragraph 67 of the European Communities' oral statement).

(a) Please comment on the specific values identified by the European Communities with respect to the imported assemblies under Article 21(2) of Decree 125; and

(b) Please clarify the value for each combination of imported auto parts under Article 21(1) and (2) of Decree 125.

Response of China

171. China has addressed this particular contention of the EC in response to questions 64 and 147. In sum, the EC is challenging where China has drawn the line for purposes of the essential character test. This is a separate question from the validity of the challenged measures per se.

36. (*China*) Please provide a copy of the customs form that importers in China are required to fill out. If there are any additional forms to be filled out specifically by auto parts importers in China, please indicate them and provide copies of such forms.

Response of China

172. CHI-35 contains a copy of this customs form.

37. (*All parties*) Please explain the relationship between the obligations respectively under Article II and Article III of the GATT 1994 in light of the Appellate Body's statement in Japan - Alcoholic Beverages II that "the broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the WTO Agreement." Further, how do you relate this statement to the instant case?

Response of China

173. The Appellate Body's statement in *Japan – Alcoholic Beverages II* highlights the importance of the threshold issue in this dispute. The Appellate Body stated that "the broad and fundamental purpose of Article III is to avoid protectionism in the application of *internal* tax and regulatory measures."[25] Quoting the GATT panel report in *Italy – Agricultural Machinery*, the Appellate Body observed that "the intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products *once they had been cleared through customs*."[26]

[25] Appellate Body Report, *Japan – Alcoholic Beverages II* at p. 16 (emphasis added).

[26] Appellate Body Report, *Japan – Alcoholic Beverages II* at p. 16, quoting Italian Discrimination Against Imported Agricultural Machinery, BISD 7S/60, para. 11 (emphasis added).

174. These statements follow from the plain language of Article III, which, by its terms, applies to "imported" products.[27] This limitation on the scope of Article III is critical to understanding its relationship to Article II. Article II countenances a particular type of discrimination against imported products – the application of ordinary customs duties to which domestic products are not subject. Members may apply such duties to products from other Members "on their importation" into the customs territory, and in accordance with the limits bound in their Schedules of Concessions. Once the products are "imported," however, they become subject to the basic principles of non-discrimination set forth in Article III.

175. Whether one examines the matter from the standpoint of Article II ("on their importation"), or from the standpoint of Article III ("imported"), it is evident that the delineation between Article II and Article III requires some understanding of what it means for products to have completed the process of importation. It is the completion of this process that marks the turning point between permissible discrimination under Article II and impermissible discrimination under Article III. The Appellate Body in *Japan – Alcoholic Beverages II* acknowledged this distinction, and highlighted a possible answer to the interpretive issue, by referring to the statement of the GATT panel in *Italy – Agricultural Machinery* that Article III applies to "imported products … once they ha[ve] been cleared through customs."

176. In China's consideration, imports have been "cleared through customs" once all customs formalities are complete and the goods are in free circulation within the customs territory. In particular, China considers that imports have been "cleared through customs" once the national customs authorities have completed the administrative processes that are necessary for the imposition and assessment of the specific border charges that the Member is *allowed* to impose in respect of the imports at issue, and the imports are no longer subject to customs control. A Member may not impose any charge in connection with the customs clearance process and thereby evade the non-discrimination disciplines of Article III. Rather, it must be a charge of a type that the Member is allowed to impose under its Schedule of Concessions or in accordance with other WTO provisions.

177. This brings China to the tariff classification issue at the heart of the present dispute. As China has explained, the challenged measures interpret the tariff provisions for "motor vehicles" in China's Schedule of Concessions to include the importation and assembly of auto parts and components that have the essential character of a motor vehicle, without regard to whether the parts and components enter China in one shipment or in multiple shipments. The critical issue in relation to China's obligations under Article II and its Schedule of Concessions is whether China is allowed to interpret the term "motor vehicles" in this way, and to establish a customs process to give effect to this interpretation. As China has explained, the application of General Interpretive Rule 2(a) to multiple shipments of auto parts and components is consistent with the decision of the World Customs Organization, and is consistent with the practice of other WTO Members in like circumstances. China's interpretation of the term "motor vehicles," and its adoption of measures to give effect to this interpretation, are therefore consistent with its WTO obligations.

178. A basic feature of the customs process that China has adopted to give effect to this interpretation of the term "motor vehicles" is to defer the completion of customs formalities in respect of parts that are declared as parts of registered vehicle models until the auto manufacturer has imported and assembled all of the imported parts and components that it will use to assemble that vehicle model. Until this process is complete, the imported parts and components are subject to a customs bond and remain under customs control in accordance with the customs laws of China.

[27] See, e.g., Art. III:2 ("imported into the territory of any other contracting party"); Art. III:4 ("imported into the territory of any other contracting party").

When the Customs General Administration of China assesses customs duties on these imported parts and components in accordance with the declaration that the manufacturer made at the time of importation, these parts and components are not yet "imported." The parts and components are not in free circulation, and the Customs General Administration has not yet completed the administrative process for the clearance of these parts and components into the customs territory of China.

179. What these considerations demonstrate is that it is not "protectionism" for a Member to interpret and enforce its Schedule of Concessions in accordance with the rules of the Harmonized System, and to establish customs processes for this purpose. The concerns of Article II and the concerns of Article III are of equal dignity and importance within the GATT system. Just as Article II does not allow Members to take actions that would be inconsistent with its obligations under Article III, Article III does not prohibit Members from taking actions that are consistent with its rights under Article II.

Response of the European Communities (WT/DS339)

180. The statement of the Appellate Body in *Japan – Alcoholic Beverages II* demonstrates that the purpose of Article III is broader than guaranteeing that internal measures of WTO members do not undermine their commitments under Article II. This demonstrates that the measures and in particular the cumbersome procedural requirements that go manifestly beyond any general customs procedures would violate the national treatment obligation under Article III even if China had no bound tariffs on the products at issue. This statement would also seem to lend support to a position that the same measures could breach both Article II and Article III of the GATT 1994 depending on the emphasis and angle of the analysis. The European Communities would also like to refer to *EC – Export Subsidies on Sugar* where the Appellate Body considered that Article II:1(b) does not permit members to qualify their obligations under other provisions of the GATT (paragraphs 217 to 219).

Response of the United States (WT/DS340)

181. As explained in *Japan-Alcohol*, Article III "obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products."[28] Article II has a different purpose and imposes different obligations – under Article II, Members bind their tariff rates on specific goods, and are obliged to charge no higher Customs duties than the level set out in their respective schedules. Since Article II is an additional obligation, nothing in Article II is intended to, or indeed could, undermine the national treatment obligations set out in Article III.

182. The following paragraph from *Japan – Alcoholic Beverages II* is directly relevant to the disposition of this dispute.

> The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the WTO Agreement. Although the protection of negotiated tariff concessions is certainly one purpose of Article III, the statement in Paragraph 6.13 of the Panel Report that "one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II" should not be overemphasized. The sheltering scope of Article III is not limited to products that are the subject of tariff concessions under Article II. The Article III national treatment obligation is a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic

[28] *Japan – Alcoholic Beverages II*, at 17.

> production. This obligation clearly extends also to products not bound under Article II. This is confirmed by the negotiating history of Article III.[29]

183. In particular, the reasoning in this paragraph highlights that China's measures – which favor the use of domestic parts over imported parts by imposing higher charges on other imported parts, as well as through the imposition of extra administrative burdens, if local content thresholds are not met – are independent breaches of Article III:4, regardless of any question under Article II with regard to whether China has breached its tariff concessions on auto parts. The independent scope of Article III, and in particular the fact that Article III applies regardless of any question of tariff bindings, is the basis for the US position during the first substantive meeting that the Panel should begin its analysis with China's breaches of Article III:4.

Response of Canada (WT/DS342)

184. The statement from the Appellate Body in *Japan – Alcoholic Beverages II* reflects the breadth of a Member's obligations respecting internal measures when compared with the narrower scope of obligations respecting border charges. The Appellate Body considered in that same paragraph the statement of the panel that "one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II".[30] Importantly, however, it reasoned that this logic applies not only to scheduled products, but also to those that are not specifically bound under Article II. In a similar vein, in *EC – Export Subsidies on Sugar*, the Appellate Body reasoned that there is no authority to allow a Member to qualify its obligations under the GATT by means of its Schedule.[31]

185. A border charge must be limited to those "ordinary customs duties" or "other duties and charges" listed in a Member's Schedule and must apply to a good as presented at the border. GATT Article II:2 and the *Ad* Note to Article III also confirm that an internal charge can be applied to a product presented at the border to the extent that it is consistent with an internal charge levied on a like product. The obligation set out in Article III to eschew protectionism not only constrains the scope of charges under Article II to the limits set out in a Member's Schedule; necessarily, it also prohibits a creative application of those charges so as to affect internal competition, whether or not such application occurs after the good passes the border. The very principle of negotiating clear tariff rates is to facilitate trade free of protectionism.

186. Applied to the instant case, the Appellate Body's statement demonstrates the inconsistency of China's measures with the specific requirements of Article III. It also demonstrates that, since the avoidance of protectionism is implicit in the relationship between Article III and other GATT provisions, the tariff bindings on auto parts are only one element of the broader obligation to avoid trade protectionism.

38. *(China)* Please comment on the systemic concerns expressed by the complainants and certain third parties that if the processing and manufacturing of the products after importation into the territory of a Member could be generally accepted as an intermediate step before tariff

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[29] *Japan – Alcoholic Beverages II*, at 17 (emphasis added).

[30] Appellate Body Report, *Japan – Alcoholic Beverages II*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, at pp. 16-17.

[31] *EC – Export Subsidies on Sugar*, Report of the Appellate Body, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005, at paras. 217-220, quoting from the *US – Sugar* GATT Panel Report.

classification, the system of tariff classification would circumvent GATT 1994's core national treatment obligations under Article III.

Response of China

187. China considers that these concerns misconstrue the nature of the interpretive issue before the Panel. It is not China's position that Members may base tariff classification determinations on the "processing and manufacturing of the products after importation." Rather, it is China's position that Members may interpret their Schedules of Concessions in a manner that is consistent with the rules of the Harmonized System, and consistent with the practices of other WTO Members in like circumstances.

188. The present dispute involves a narrow and technical issue of customs classification: The relationship between complete articles and parts of those articles. As China has explained at length, this specific issue of customs classification is addressed by General Interpretative Rule 2(a) of the Harmonized System. GIR 2(a) states that a tariff provision for a complete article includes unassembled parts and components of the complete article that have the essential character of that article. As explained in response to question 111, the World Customs Organization has interpreted GIR 2(a) to permit members of the Harmonized System to apply this principle of tariff interpretation to complete articles that are assembled from multiple shipments of parts and components. This application of GIR 2(a) is, as explained in response to question 112, constrained by the rules of GIR 2(a) itself: The parts and components must have the essential character of the complete article, and they must be capable of assembly by means of the types of assembly operations specified in Explanatory Note VII to GIR 2(a).

189. The need for customs authorities to apply GIR 2(a) in this manner arises only in circumstances in which there is a significant difference in duty rates between the complete article and the parts of that article. This could arise in the case of ordinary customs duties (as in the case of motor vehicles in China, or furniture in Canada) or in the case of other types of duties (such as complete articles that are subject to anti-dumping or countervailing duties). When this need arises, customs authorities must implement a process to determine whether specific importers are importing parts and components in multiple shipments that, in their entirety, have the essential character of the complete article that is subject to the higher rate of duty. Such a process necessarily entails an examination of the importer's practice with respect to the importation and assembly of parts and components in multiple shipments, and whether those imported parts and components, in their entirety, have the essential character of the complete article. This is not a tariff classification based on "the processing and manufacturing of the products after importation." Rather, it is a determination as to whether a particular series of import transactions are related to each other through their common assembly into a complete article. This determination ascertains the commercial reality of whether the importer is importing parts and components in multiple shipments that have the essential character of the complete article.

190. It should be evident from the foregoing that China is not advocating a general principle that "the processing and manufacturing of products after importation" can be "generally accepted as an intermediate step before tariff classification." China is not saying, for example, that customs authorities could classify a bolt of cloth as a "shirt" because of how it might be (or is actually) processed and manufactured after importation. Nor is China saying that customs authorities can defer tariff classification to see how imported articles are processed and manufactured, and then base the tariff classification on the resulting product. Instead, China's position is that customs authorities are permitted under Article II of the GATT 1994 to deal with the complex relationship between complete articles and parts of those articles in a manner that is consistent with the Harmonized System, and in a

manner that allows customs authorities to give effect to the substance of a series of import transactions over their form.

191. Contrary to the complainants' hyperbole, this is not an assault on the core national treatment disciplines of Article III of the GATT. China is not even remotely suggesting that Members can impose discriminatory measures on imported products merely by characterizing the measures as border measures under Article II. Nor is China suggesting that Members can use tariff classification determinations to impose measures that are inconsistent with the non-discrimination principles of Article III. China's position is simply that Members may interpret their Schedules of Concessions in accordance with the rules of the Harmonized System, and in a manner that is consistent with the object and purpose of securing the benefit of reciprocal and mutually advantageous tariff concessions.

192. It suits the complainants' purposes to turn a technical issue of tariff classification into an alleged assault on Article III of the GATT. By mischaracterizing the nature and scope of China's argument, the complainants' have sought to portray China's position as creating a massive loophole in Article III. It does no such thing. The position that China is advocating is limited to the specific circumstance in which there is a significant duty differential between a complete article and the parts of that article. China considers that this is not a common situation, and certainly not one whose resolution would pose a systemic risk to the GATT. In China's view, the only loophole that needs closing is the complainants' position that importers can evade higher duties that apply to complete articles merely through the manner in which they structure their imports. This arbitrary, form-over-substance position is the only argument in this proceeding that poses a systemic risk to the GATT – that is, to the security and predictability of tariff concessions under Article II.

39. (*Complainants*) Please comment on the tariff classification decisions of the complainant governments referred to by China in relation to Explanatory Note VII to Rule 2(a) of the General Interpretative Rules in paragraphs 102-103 and footnote 74 of China's first written submission.

Response of the European Communities (WT/DS339)

193. The description provided by China of judgment of the Court of Justice of the European Communities in case 165/78 *Michaelis* under paragraphs 102 and 103 of its first written submission is misleading and taken out of context.

194. First, the Schedule of concessions of the then EEC in 1978 contained a special tariff heading "for the parts of an unassembled or disassembled article" (see question 1 referred to the Court of Justice by the national court).

195. Second, all the parts were presented to the customs at the same time. China entirely ignores this fundamentally important element.

196. Third, the Court explicitly came to the conclusion that the parts as presented to the customs would allow the assembly of a complete article i.e. all the parts necessary to make the complete article were presented to the customs. Hence, the unfinished article had the essential character of the complete or finished article.

Response of the United States (WT/DS340)

197. The United States does not understand China's reliance on the US ruling (HQ 960242), as the classification decision did not address whether the imported goods should be considered parts or

incomplete, unassembled goods. The facts in the US ruling indicate that all of the slipper components (vamps and soles) were entered together and that there were no excess components.

Response of Canada (WT/DS342)

198. The Explanatory Note is meant to cover situations where *all* parts arrive at the border in *one* shipment. In such situations, all parts that are necessary to form the article are classified together if they have the "essential character" of *that* complete or finished article as presented. Any excess parts not required to form *that* article contained in the *same* shipment can be classified as parts.

199. The *IMCO – J. Michaelis GmbH & Co. v. Oberfinanzdirektion de Berlin* case cited by China is correct in its interpretation of Explanatory Note VII, but taken out of context and misapplied by China to its measures. The European Court of Justice was considering a single shipment, containing all the parts necessary to manufacture pens, and a certain number of excess parts. That is, multiple shipments were *not* in issue, a fact that China conveniently neglects to mention.

40. (*China*) Please clarify whether various combinations of auto parts listed in Article 21(2) of Decree 125, for example, a body and an engine as provided in Article 21(2)(a), refer only to the situation where those specific auto parts are imported together at the same time, either assembled or without being fitted together, as the European Communities submits in paragraphs 261 and 265 of its first written submission.

Response of China

200. China does not believe that this was the EC's characterization of Article 21(2)(a) of Decree 125. As stated in paragraph 261 of the EC's first written submission, Article 21(2)(a) "foresees a situation where the vehicle body and the engine are imported together *or separately* but without being fitted together." (Emphasis added.) This is essentially correct. Consistent with the overall purpose of Decree 125, the structure of the import transactions is not relevant; what matters is whether the imported part and components in a particular vehicle model, in their entirety, have the essential character of a motor vehicle.

41. (*China*) In respect of Article 24 of Decree 125 (and Article 16 of Announcement 4), Could China please confirm:

(a) Whether "assemblies and sub-assemblies" are *not* excluded from "imported unfinished automobile parts"; and

Response of China

201. Assemblies and sub-assemblies are excluded from "imported unfinished automobile parts." Assemblies and sub-assemblies of parts are not susceptible to substantial transformation; they already constitute a finished portion of the motor vehicle and will not undergo further transformation prior to their assembly into the vehicle. An example of an "imported unfinished automobile part" would be a semi-manufactured steel bar or disc that is not recognizable as a finished part, and that must undergo further processing (e.g., into a spring or washer) before it is assembled with other parts and components.

(b) If not excluded, whether it is possible to consider "imported unfinished assemblies" that have been "substantially processed" in China as "domestic automobile parts".

Response of China

202. As explained above, assemblies and sub-assemblies are not subject to further transformation.

42. (*China*) Could China please confirm whether *Regulation on Rules of Origin for Imported and Exported Goods of the People's Republic of China* is applicable to "substantial processing" as indicated in Article 17 of Announcement 4.

Response of China

203. The *Regulation on Rules of Origin for Imported and Exported Goods of the People's Republic of China* does not directly apply to "substantial processing" as indicated in Article 17 of Announcement 4. This is because neither Decree 125 nor Announcement No. 4 relates to the application of Rules of Origin. However, the substantial transformation criteria for "substantial processing" in Article 17 are specified by reference to the Regulation.

43. (*China*) When automobile manufacturers or auto part manufacturers in China import key component or sub-assemblies, as indicated in Annexes 1 and 2 to Decree 125, to incorporate into one of the assemblies referred to in Article 4 of Decree 125, what is the tariff rate applicable to those parts?

Response of China

204. If the key components or sub-assemblies are parts of a registered vehicle model, the tariff rate applicable to those parts is the relevant tariff rate for motor vehicles.

44. (*China*) Please clarify what "inter-customs-transhipment" (or "Customs-to-Customs transfer" according to the translation provided by the complainants) provided in Article 13 of Decree 125 means.

Response of China

205. According to the *Customs Supervision Rules of the People's Republic of China on Inter-customs-transshipment of Goods*, the reference to "inter-customs-transshipment" refers to the movement of goods under the supervision of the customs from the port of entry to another designated port that will be responsible for the handling of customs clearance procedures. Under Article 13 of Decree 125, the auto manufacturer declares imports of parts for registered vehicle models and pays the applicable duties through the customs office where the auto manufacturer is located. It is for this purpose of centralized administration that an inter-customs movement would occur.

45. (*China*) Please elaborate on the registration requirements indicated in Articles 7, 26 and 37 respectively of Decree 125.

Response of China

206. All three articles refer to the same registration process, under different circumstances. Article 7 states the general obligation to register a vehicle model that meets one or more the thresholds of Decree 125 prior to the importation of parts for that vehicle model. Article 26 concerns the ability of the CGA to direct a verification of a vehicle model in the event that the auto manufacturer has failed to register or apply for verification of that vehicle model. Article 37 concerns

the situation in which an auto manufacturer, in violation of Decree 125, imports auto parts that have the essential character of a motor vehicle in multiple shipments without having registered that vehicle model.

46. (*China*) Could China clarify the exact point in time and place that automobile manufacturers must pay tariff duties for imported auto parts in relation to the terms of Articles 13 and 28 of Decree 125.

Response of China

207. While Articles 13 and 28 are relevant to this question, the most relevant provision is Article 31 of Decree 125. Article 13 establishes where the automobile manufacturer is to declare the importation of parts and pay duties for registered vehicle models – to the district customs office where the manufacturer is located. Article 28 establishes when the auto manufacturer is to declare duty payments – when the imported auto parts are assembled into registered vehicle models. But the "exact point in time and place" at which the automobile manufacturer pays the duty is governed by Article 31. As described in response to question 5, Article 31 requires the automobile manufacturer to declare duty payments on the tenth working day of each month based on the number of registered vehicle models that it assembled in the prior month.

47. *(Complainants*) Please explain how CKD and SKD kit imports are classified in your country.

Response of the European Communities (WT/DS339)

208. The European Communities does not have a tariff line for CKD and SKD kits. There is no established legal definition for such kits but as indicated under paragraph 267 of its first written submission, the European Communities understands these concepts under the measures as referring to kits that consist of all parts necessary to make a complete automotive product, in most cases a complete vehicle. In view of the Chapter note to Chapter 87 of the Harmonized System, which provides for a specific application of Rule 2 (a) of the Harmonized System in this context, the classification of CKD and SKD kits in an individual case is a difficult question as the Chapter note uses concepts such as "fitting" and "equipping" putting therefore emphasis on the state of assembly and manufacture of the relevant product. An SKD kit that by definition denotes 'semi-knocked down' kits would from a general point of view appear more likely to fulfil the conditions to be classifiable as a complete vehicle (or other relevant product) as the parts would be presented to the customs with a certain degree of "fitting and equipping". A CKD kit that denotes a 'completely knocked down' kit is in principle further away from the examples provided for by the Chapter note to chapter 87 as the parts presented to the customs are in a completely unassembled state. However, a CKD kit that consists of all the parts necessary to assemble a complete vehicle may in some circumstances be classified as the complete vehicle provided that no working operation beyond assembly for completion into a complete vehicle is necessary in accordance with explanatory note VII to rule 2 (a). In this respect it should be emphasised that different kits intended to become complete vehicles may need different further working operations depending e.g. of the level of high technology electronics in the final vehicle. Therefore, the classification of a kit must always be made on a case by case basis and not generally as China does unless the member's schedules provide for tariff lines for different kind of kits.

Response of the United States (WT/DS340)

209. The terms "CKD" and "SKD" are not terms that are defined or used in the Harmonized System, nor are they defined or used by the United States in its administration of the Harmonized Tariff Schedule of the United States. To the extent that the United States understands these terms as defined by China in Decree 125, Annex I of Exhibit 3-CHI, we classify merchandise in its condition as imported. For example, a single component entered is classified under the terms of a heading that describes that component. If a group of components are entered together that may form an assembly, we would classify it under the heading that describes that assembly. If a group of components do not form an assembly, they are individually classified (e.g., a crankshaft and side panel would not constitute an assembly and would be individually classified). Given the limited description in Annex 1, the following chart explains how the United States would classify these assemblies and sub-assemblies:

Assembly Name	Description	Sub-assembly Letter	U.S. Classification
Vehicle Bodies	Class M1	A	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class M1	B	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class M1	2 A's & 1 B	If entered together, then we would classify under heading 87.07, as bodies by application of GIR 2(a)
	Class M2	A	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class M2	B	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class M2	A&B	Given the descriptions of the sub-assemblies, we do not see how 2 A sub-assemblies can be combined as Sub-assembly A covers roof box.
	Class M3	A	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class M3	B	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class M3	A&B	Given the descriptions of the sub-assemblies, we do not see how 2 A sub-assemblies can be combined as Sub-assembly A covers roof box.
	Class N	A	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class N	B	If sub-assembly is entered separately, we would classify under subheading 8708.29 (if for the vehicles of headings 87.01 to 87.05) or under subheading 8709.90 (if for the vehicles of heading 87.09)
	Class N	A&B	Given the descriptions of the sub-assemblies, we do not see how 2 A sub-assemblies can be combined as Sub-assembly A covers roof box.
Engine Assemblies	Diesel Engine	A	If sub-assembly entered separately, we would classify under subheading 8409.99
	Diesel Engine	B	If sub-assembly entered separately, we would classify under subheading 8409.99
	Diesel Engine	A&B	If sub-assemblies A and B are entered together, then we would classify under subheading 8408.20, by application of GIR 2(a)

Assembly Name	Description	Sub-assembly Letter	U.S. Classification
	Gasoline Engine	A	If sub-assembly entered separately, we would classify under subheading 8409.91
	Gasoline Engine	B	If sub-assembly entered separately, we would classify under subheading 8409.91
	Gasoline Engine	A&B	If sub-assemblies A and B are entered together, then we would classify under subheading 8407.31 to 8407.34 (depending upon cylinder capacity), by application of GIR 2(a).
Transmission Assemblies	MT	A	If sub-assembly entered separately, we would classify under subheading 8708.93 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
	AT	A	If sub-assembly entered separately, we would classify under subheading 8708.93 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
	AT	B	If sub-assembly entered separately, we would classify under subheading 8708.40 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
	AT	A&B	If sub-assemblies A and B are entered together, then we would classify under subheading 8708.40 by application of GIR 2(a)
Vehicle axle of Class M1, M2, M3 and N vehicles	Driving axle		We would classify under subheading 8708.50 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
	Driven axle		We would classify under subheading 8708.50 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
Frames			We would classify under subheading 8708.99 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
Braking Systems			Assuming that all components are entered together as an assembly, we would classify under subheading 8708.30. If components entered separately, then classification may be under provisions of chapters 84, 85, 87, or 90.
Steering Systems	Power steering		We would classify under subheading 8708.94 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)
	Non-power steering		We would classify under subheading 8708.94 (if for the vehicles of headings 87.01-87.05) or subheading 8709.90 (if for the vehicles of heading 87.09)

Response of Canada (WT/DS342)

210. As discussed in more detail in response to Question 33, Canada does not use these terms in customs classification. Rather, classification on importation is determined on the basis of the essential character of the good.

48. (*China*) Please clarify whether there is a legal hierarchy among Policy Order 8, Decree 125 and Announcement 4. If so, please explain, and if not, which legal instrument should prevail in case of conflict between these measures?

Response of China

211. There is no "legal hierarchy" between Policy Order No. 8 and Decree 125 in the sense suggested by the question. As explained in response to questions 49 and 50, Order No. 8 is a broad policy instrument that sets forth general goals across a wide array of issues relating to motor vehicles and the automobile industry. Chapter XI of Order No. 8 addresses the administration and enforcement of China's tariff rates for motor vehicles and motor vehicle parts. Article 60 of Order No. 8 directed the CGA, together with other relevant agencies, to promulgate the specific administrative rules to give effect to the general principles set forth in Chapter XI. The CGA did so through the promulgation of Decree 125. Afterwards, in order to detail the procedures for the verification of evaluations by automobile manufacturers, the CGA formulated Announcement No. 4 to provide further details concerning the verification process.

212. The legal obligation of auto manufacturers to pay the applicable customs duties on imports of auto parts that have the essential character of a motor vehicle, and the customs procedures that the CGA has adopted to ensure the proper classification of these imports and the collection of the relevant duties, are set forth in Decree 125.

49. (*China*) Should Decree 125 and Announcement 4 be read in light of the preamble of Policy Order 8?

Response of China

213. As China has explained, Order No. 8 encompasses a vast array of topics relating to the development and use of motor vehicles in China, including, inter alia, emissions standards, environmental control technologies, the development of hybrid vehicles, consumer protection, consumer financing for motor vehicle purchases, automotive insurance, vehicle safety, auto trademarks and brands, foreign direct investment, domestic and international cooperation in automotive research and development, the establishment of auto dealerships, road planning and construction, and vehicle registration and inspection, among many other topics.

214. The preamble to Order No. 8 encompasses all of these topics in broad and sweeping terms. China does not consider that the language in the preamble to Order No. 8 is meaningful or relevant to an evaluation of the one chapter of Order No. 8 that is relevant to the present dispute – the chapter concerning the administration and enforcement of China's tariff provisions for motor vehicles and motor vehicle parts. It is that chapter, and that chapter only, that gave rise to the customs enforcement procedures embodied in Decree 125 and Announcement No. 4 that are the subject matter of this dispute.

50. (*China*) Does China agree with the interpretation advanced by the complainants regarding the objectives of Policy Order 8, for example the statements in paragraphs 28-29 of Canada's first written submission? If not, could China please indicate what are the main objectives of Policy Order 8?

Response of China

215. China does not agree with this interpretation. As explained in response to question 49, Order No. 8 encompasses a vast array of topics related to motor vehicles and the motor vehicle industry in China. To the extent that there is a "main objective," or even "main objectives," of Order No. 8, they are broadly reflected in the titles of the different chapter headings. As noted,

Chapter XI of Order No. 8 concerns the administration and enforcement of China's tariff provisions for motor vehicles.

216. China considers that the complainants' effort to mix and match different aspects of the policies set forth in Order No. 8 is an attempt to shift attention away from a critical fact in this dispute – the fact that China negotiated a Schedule of Concessions that *allows* it to maintain higher duty rates on motor vehicles than the duty rates that apply to parts and components of motor vehicles. This difference in tariff rates *has an impact on market access and a concomitant impact on the development of domestic producers*. This is in the very nature of customs duties. As China explains in response to question 133 below, the issue presented in this dispute is whether China is allowed to enforce these market access arrangements, or whether, as the complainants contend, those market access arrangements are essentially unenforceable.

51. *(Complainants)* Do the complainants agree with the translations provided by China of the challenged measures in Exhibits CHI-2, CHI-3, CHI-4? If not, please indicate specific provisions of the measures to which the complainants do not agree.

Response of the European Communities (WT/DS339)

217. During the consultations the co-complainants requested several times the translation of the measures from China. China committed to provide us with a translation during the consultations. This commitment was not kept. Therefore we have been obliged to do the translations ourselves. There has been a considerable investment of time and effort to make the translation as accurate as possible. With this background the European Communities considers that it is not in accordance with the principle of due process to require the complainants to now rely on translations that China provided only in its first written submission *i.e.* 5 weeks after submitting our own first written submission. It would therefore be for China to argue why the translations submitted by the complainants may not be accurate.

218. In the alternative and to reply to the specific question of the Panel, we have listed the points on which we disagree with the translations provided by China in a separate document attached to the replies to the questions (Exhibit JE – 38).

Response of the United States (WT/DS340)

219. In furtherance of the Complainants' decision to submit an initial set of joint exhibits, including translations of China's measures in Exhibits CHI-2, CHI-3, CHI-4, the United States respectfully refers the Panel to the EC's response to this question.

Response of Canada (WT/DS342)

220. The complainants worked carefully with translators in an attempt to provide translations of the measures that are complete, clear and grammatically correct in English. Those translations were provided by the complainants as JE-18, JE-27 and JE-28, and are the translations on which the complainants rely.

221. CHI-2, CHI-3 and CHI-4 generally conform in substance with the translations provided by the complainants. However, as set out in the answers to questions provided by the European Communities, China's translations differ from the translations of the complainants in various material ways. Canada associates itself with the EC response to this question in respect of the detail and significance of those differences.

52. (*China*) Does China agree with the complainants' translation of China's 1994 Automotive Policy Order as provided in Exhibit JE-24? If not, please indicate specific provisions of the measures to which China does not agree.

Response of China

222. China has submitted as CHI-36 a redlined version of the complainants' translation, noting specific corrections to the translation.

53. (*China*) China has submitted a translated version of Policy Order 8 for Articles 52 through 62 in Exhibit CHI-2. Does China agree with the translations provided by the complainants in Exhibit JE-18 for the remaining parts of Policy Order. 8? If not, please indicate the specific provisions translated by the complainants with which China does not agree and provide explanations for such position and translations by China of such provisions.

Response of China

223. China has submitted as CHI-37 a redlined version of the complainants' translation, noting specific corrections to the translation.

54. (*China*) China submits that the criteria in Article 21 of Decree 125 allows for a an *ex-ante* verification of whether the importer intends to import auto parts and components which, in their entirety, constitute the essential character of a complete vehicle, and that this is a *condition declared at the time of importation*. Could China explain why it did not include such "condition" in its Schedule of Concessions?

Response of China

224. The term "condition" in Article II:1(b) of the GATT 1994 refers to conditions that the Member intends to have "some qualifying or limiting effect on the substantive content or scope of the concession or commitment."[32] The paradigmatic "condition" on a tariff rate concession is a tariff rate quota, such as the one at issue in *Canada – Dairy*. That is not the type of "condition" at issue in this dispute. China has not restricted, in any way, the substantive content or scope of its tariff rate concessions on motor vehicles. Importers are free to import as many motor vehicles as they wish, without qualification or restriction. The measures challenged in this dispute simply ensure that imported parts and components that have the essential character of a motor vehicle receive the same tariff classification whether they enter China in one shipment or in multiple shipments. The declaration to which China has referred, and that the importer makes at the time of importation, is part of the customs process that China has adopted to ensure this result.

225. As the parties discussed at length during the first substantive meeting, the GATT panel in *EEC – Parts and Components* considered that a measure is within the scope of Article II if it imposes charges "*conditional upon* the importation of a product *or* at the time or point of importation."[33] China has demonstrated that WTO Members routinely assess border charges after the time or point of importation, and no party appears to question this proposition. In evaluating whether the charges that Members assess after the time or point of importation are border charges within the scope of Article II, the relevant inquiry is, in China's view, whether the importer's obligation to pay the charge arose by reason of the importation of the product, i.e., as a "condition" of the importation of the product.

[32] *Canada – Dairy* at para. 134.
[33] *EEC – Parts and Components* at para. 5.5 (emphasis added).

The importer's obligation to pay the applicable customs duty is a condition of the importation of the product – that is, it is the importation of the product that triggers the obligation to satisfy the liability. As China has explained, Members may assess and confirm these charges after the time or point of importation, provided that they relate back to a charge that the Member was allowed to impose by reason of the importation of the product.

226. In this light, the "condition declared at the time of importation" is that a particular shipment of auto parts is one of a series of shipments of auto parts that, in their entirety, have the essential character of a motor vehicle. This "condition" is a characteristic of the import, not a limitation or restriction on the importer's ability to import motor vehicles at the bound duty rate. Having made this declaration, the auto manufacturer imports these parts and components subject to the obligation to pay the applicable duty rate for motor vehicles when, as declared, it assembles these parts and components into a motor vehicle that it has previously registered as meeting one or more of the thresholds in Article 21 of Decree 125. The imposition of this duty is a valid border charge under Article II because it objectively relates to an ordinary customs duty that China is allowed to impose, and that arose by reason of the importation of the product.

227. As China has explained in response to several other questions, the customs process that China has adopted to apply GIR 2(a) to multiple shipments of auto parts and components is consistent with the rules of the Harmonized System, as interpreted by the WCO, and consistent with the practice of other WTO Members in addressing the relationship between complete articles and parts of articles. The Harmonized System is not a "term, condition or qualification" that China was required to inscribe in its Schedule of Concessions before it could take steps to interpret its Schedule of Concessions in accordance with the rules of the Harmonized System.

55. (*All parties*) Please explain in detail what customs "clearance" means.

Response of China

228. The definition of "customs clearance," as well as other related terms, is addressed by the *Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures* (the "*Kyoto Convention*").[34] As the notion of "clearance" is built upon several other international customs concepts, China will approach this topic in a cumulative fashion.

229. The *Kyoto Convention* defines "clearance" as "the accomplishment of the Customs formalities necessary to allow goods to enter home use, to be exported or to be placed under another Customs procedure." There are two key concepts embedded in this definition: "Customs formalities" and "Customs procedures." The *Kyoto Convention* defines "Customs formalities" as "all the operations which must be carried out by the persons concerned and by the Customs in order to comply with the Customs law." While the *Kyoto Convention* does not directly define the term "Customs procedure," the WCO has elsewhere defined the term "customs procedure" as a "treatment applied by the Customs to goods which are subject to Customs control."[35] This is reflected in the *Kyoto Convention* itself, which defines the term "Customs control" as "measures applied by the Customs to ensure compliance with Customs law." Thus, a "Customs procedure" is a measure applied by customs to ensure compliance with customs law.

[34] The *Kyoto Convention* entered into force on 3 February 2006. All three complainants, as well as China, have ratified the convention. Relevant portions of the Kyoto Convention appear at CHI-38.

[35] World Customs Organization, *Glossary of International Customs Terms* (CHI-39)

230. As reflected in the definition of "clearance," one such "Customs procedure" is "clearance for home use." The Kyoto Convention defines this as "the Customs procedure which provides that imported goods enter into free circulation in the Customs territory upon the payment of any import duties and taxes chargeable and the accomplishment of all the necessary Customs formalities." The term "goods in free circulation," in turn, is defined as "goods which may be disposed of without Customs restriction."

231. These layered definitions support China's contention that goods have been "cleared through customs" once all of the customs formalities required in connection with the importation of those goods are complete, and the goods are no longer subject to customs control. It is important to note that, under the *Kyoto Convention*, the release of the goods does not necessarily mean that the goods have "cleared" customs. Under the *Kyoto Convention*, the term "release of goods" means "the action by the Customs to permit goods *undergoing clearance* to be placed at the disposal of the persons concerned." Thus, goods can be "released" to the importer (i.e., placed at its disposal), even though the goods have not been "cleared" (for example, because the goods remain under customs control).

232. These considerations further support China's contention that the time or place at which a charge is imposed is not determinative of whether the charge is within the scope of Article II of the GATT. The entire structure of the *Kyoto Convention* supports the conclusion that customs formalities are routinely concluded *after* the goods have been released into the customs territory. The relevant consideration is whether the customs procedure to which the goods are subject after they have been released is one that pertains to the satisfaction of a liability that arose by reason of the importation of the goods (i.e., whether it is a "Customs formality" that is carried out "in order to comply with the Customs law.").

Response of the European Communities (WT/DS339)

233. The concept relates to the fact that goods, once the customs clearance has taken place, are in free circulation within the customs territory of the importing country. In order to be released for free circulation all the import formalities will have to be completed: goods will have to be classified according to HS rules and the corresponding customs duty (customs debt) will have to be paid by the importer or at least be secured by a guarantee.

Response of the United States (WT/DS340)

234. In the United States, "clearance" is a legal term that may apply to passengers, vessels, and goods entering (and, in some cases, exiting) the customs territory of the United States. With respect to the importation of goods, "clearance" is not formally defined under the customs laws of the United States. The United States defines "entry" into the United States not merely as the arrival of goods at a port, but as the process of presenting documentation for clearing goods through Customs. Imported goods are considered cleared for entry into the United States when the proper entry documentation has been filed and the goods are released from customs custody (into the custody of the importer) on the basis of that documentation.

Response of Canada (WT/DS342)

235. The term "clearance" in the Canadian context is limited to persons, conveyances, and certain products that are imported by private persons (i.e., non-commercial importations).

236. In the case of commercial importations, products must be reported at the nearest customs office[36] and accounted for and duty paid at the time of importation.[37] When products arrive at the border, the importer, carrier or broker reports their arrival at the first customs office upon entry into Canada. If it is convenient for the importer to account for the products and pay any duties or taxes at that time, the importer may submit any documents and payment required, after which the products leave the control of customs officials and enter internal Canadian commerce. Should the importer opt to have the goods accounted for and duty-paid at an inland customs office, the products travel "in bond" to the inland office under customs control. Upon arrival at the inland customs office, either the importer or broker submits the required documents and payment to customs officials, after which the products leave customs control and enter internal Canadian commerce.

Comments by the United States on China's response to question 55

237. According to China, "[t]he relevant consideration is whether the customs procedure to which the goods are subject after they have been released is one that pertains to the satisfaction of a liability that arose by reason of the importation of the goods." For tariff classification purposes, the liability that arises in connection with the importation of the goods is the collection of "Customs duties," which are defined by the revised (1999) Kyoto Convention on the Simplification and Harmonization of Customs Procedures as "the duties laid down in the Customs tariff to which goods are liable on entering or leaving the Customs territory." Therefore, the relevant consideration in this case is whether China's measures enforce the collection of a Customs duty under China's tariff schedule for which an auto part was liable when it entered the customs territory of China by virtue of its importation. While the time or place of the assessment of the charge may vary, that charge cannot be based upon a change in the condition of the auto part that occurred after its entry into the Customs territory of China.

56. (*China*) Let us assume for a moment that an automobile manufacturer in China is planning to import certain automobile parts for one of their vehicle models for sale on the Chinese market. Could China please explain in chronological order, referring to relevant provisions of the measures concerned and taking into your response to previous question, "all" the procedural requirements that such an automobile manufacturers must follow to import auto parts:

Response of China

238. In response to question 5, China has detailed, in chronological order, the relevant provisions of the measures as they pertain to the importation of auto parts and components that, in their entirety, have the essential character of a motor vehicle. This is the customs procedure that applies to the importation of auto parts and components in multiple shipments, where those parts and components have been verified as having the essential character of a motor vehicle.

239. In response to the previous question, China has detailed the relevant provisions of the *Kyoto Convention* as they pertain to the customs clearance process, the completion of customs formalities, and the maintenance of imported goods under customs control subject to a customs procedure. The chronological steps detailed in response to question 5 define a process whereby imported auto parts and components remain subject to customs control in order to ensure compliance with China's tariff provisions for motor vehicles. This process ensures the correct application of GIR 2(a) to multiple shipments of parts and components that are related to each through their common assembly into a

[36] Customs Act, sections 12-16 (Exhibit CDA-1).
[37] Ibid., sections 32-35.

specific vehicle model, consistent with the rules of the Harmonized System and consistent with the practices of other WTO Members under like circumstances.

(a) Would any aspect of the procedures China just explained be different if the same manufacturer were to purchase all or some imported auto parts from domestic suppliers? If so, how?;

240. The only procedural difference in respect of imported auto parts purchased from suppliers within China arises under Article 29 of Decree 125. Under that provision, the auto manufacturer is entitled to deduct from the applicable duty any amount of duty that has already been paid in respect of those imported parts.

(b) What procedures would the same automobile manufacturer have to satisfy if it were to use only imported auto parts "*not* characterized as complete vehicles" for its vehicle model?; and

241. The auto manufacturer must conduct the evaluation process of that vehicle model and have the evaluation verified by the CGA. If the verification confirms that the imported auto parts and components in that vehicle model do not have the essential character of a motor vehicle, auto parts that the auto manufacturer imports for this vehicle model are not subject to the customs procedure established by Decree 125. As detailed in response to question 5, Article 35 of Decree 125 provides that auto parts imported for the assembly of these vehicle models are to be declared as parts. These parts do not enter in bond, are not subject to customs control, and are subject to the ordinary customs procedures for the payment of customs duties.

(c) Are there any procedural requirements that automobile manufacturers using only domestic auto parts must satisfy for the manufacturing and sale of automobiles in the Chinese market?

242. Under Article 7 of Decree 125, an automobile manufacturer is only required to undergo the evaluation and verification process if it assembles vehicle models with imported parts for sale in the Chinese market. If the automobile manufacturer uses only domestic auto parts, then it is not subject to Decree 125.

57. (*China*) Does China have laws or regulations similar to Decree 125 and Announcement 4 that would apply more generally to all products having separate tariff rates for parts and components and complete products, in particular under China's general customs law? If not, please explain why.

Response of China

243. As detailed in response to question 12(c), there are only limited circumstances in China's tariff schedule in which there is a significant tariff rate difference between a complete article and parts of that article. China does not have a law or regulation that deals with each such circumstance. It is important to recall, in this context, that China's Schedule of Concessions establishes the upper limit of the duties that it may apply to imported products. The fact that China has established a customs process to resolve the tariff classification relationship between parts and wholes in one context does not mean that it needs to establish a similar customs process in other such contexts. Like customs authorities all over the world, China allocates its customs administration resources based on a variety of considerations, including the commercial significance of the products at issue, the volume of imports, and the potential revenue loss from misclassification of the imports.

58. (*China*) Please elaborate on how Article 2 of Decree 125 applies to CKD and SKD kits, including specific importation procedures applicable to automobile manufacturers under the second paragraph of Article 2.

Response of China

244. Importers import CKD/SKD kits into China in accordance with the ordinary provisions of the *Customs Law of the People's Republic of China*. First, the importer must apply to the Ministry of Commerce for an automatic import license. When the importer imports the CKD/SKD kits, it declares the imports to the Customs and provides the relevant import documentation, including the declaration form, the automatic import license, and the certificate of origin. The Customs then makes a tariff classification of the CKD/SKD kits in accordance with GIR 2(a), and would classify them as motor vehicles. The importer would then pay the applicable motor vehicle duty rate for the CKD/SKD kits in accordance with the regular procedures for the payment of customs duties.

59. (*China*) Why is the application of Article 21(3) of Decree 125 postponed until July 2008? Please explain in relation to the rationale behind the criteria set out in Article 21 of Decree 125.

Response of China

245. China has deferred the application of Article 21(3) of Decree 125 primarily because of the administrative complexity of implementing this particular criterion. China believes that once auto manufacturers and customs officials have gained more experience with the implementation of Decree 125, and have laid a solid foundation of record-keeping and reporting for the administration of the measure, it will be easier for manufacturers and customs authorities to determine and account for the value of imported parts and components.

246. As China explains in response to question 117, the value of imported parts and components in relation to the value of the complete article is one criterion that customs authorities consider in the application of the essential character test. The other criteria specified under Article 21 are also relevant criteria in the application of the essential character test.

60. *(Complainants*) China submits in footnote 65 of its first written submission that the complainants' customs authorities routinely classify CKD kits as "complete vehicles". Please comment on this statement

Response of the European Communities (WT/DS339)

247. The European Communities is not aware of any such "routine" by its customs officials. China does not present any evidence in respect of the practice of the EC. Reference is also made to the reply given to question 47.

Response of the United States (WT/DS340)

248. The United States does not agree with the characterization in footnote 65 that US customs authorities routinely classify CKD kits as "complete articles". The US issues over 10,000 classification rulings each year, but China cites only to a single ruling, and that ruling involves an unassembled pistol, not an automotive vehicle. As explained in the United States answer to Question 47, the terms "CKD" and "SKD" are not defined or used by the United States in its administration of the Harmonized Tariff Schedule of the United States. As further explained in the answer to Question 47, any classification decision by US Customs would depend on the specific

details concerning the items (whether the importer labels them as a "CKD" or "SKD" or something else) as actually entered.

Response of Canada (WT/DS342)

249. As set out above in response to Questions 33 and 47, Canadian customs practice does not use the term "CKD", but on a case-by-case basis officials may determine that a collection of all or virtually all of the parts necessary to build a vehicle has the "essential character" of a complete vehicle.

250. Canada notes that the Canadian memorandum that China cites refers to a very specific category of "kit car" which, as defined in the memorandum, refers to specialized automotive kits that become fully operational replicas of specialty or antique motor cars following their assembly. They are not CKDs or SKDs of the sort that are at issue in this dispute.

61. (*Complainants*) Paragraph 93 of the Working Party Report states that if China were to have created a separate tariff line for CKD and SKD kits, the duty rate would be 10 per cent.

(a) (*All parties*) Has China created separate tariff lines for CKD and SKD kits?; and

Response of China

251. No. China has not created separate tariff lines for CKD and SKD kits.

Response of the European Communities (WT/DS339)

252. No, the European Communities is not aware of any formal tariff line created by China for CKD and SKD kits. However, as stated in its first written submission, the European Communities is of the view that for all practical purposes China has introduced a disguised tariff line on such kits.

Response of the United States (WT/DS340)

253. The United States is not aware of any tariff lines in China's tariff schedule for CKD or SKD kits. However, China's measures – by treating CKD and SKD kits as "deemed whole vehicles" subject to a 25% whole vehicle rate – have accomplished the same result as a new tariff line that specifically mentions CKDs and SKDs. Thus, the de facto result of China's measure is as if China created a new tariff line for CKDs and SKDs.

Response of Canada (WT/DS342)

254. China does not have a formal tariff line for either CKDs or SKDs. However, in its customs tariff for 1995, China did have separate tariff lines differentiating between certain whole vehicles and CKDs at the eight-digit level, while other descriptions of a particular tariff line included the term "CKD" in their description. For the most part, where there was a separate tariff line at the eight-digit level, the duty rates for CKDs were the same. In some cases, the CKD rate was lower.[38]

255. Starting in 1996, references to CKDs were removed from China's customs tariff. China's evidence on how CKDs were treated after this point is contradictory; it asserts without evidence either

[38] See Chinese Tariff Schedules Showing CKD Lines, 1991-1995 (Exhibit CHI-30), entries for 8704.1010 and 8704.1020.

that CKDs were prohibited from importation or that they were classified as whole vehicles.[39] The available evidence is limited, but suggests that China treated CKDs as equivalent to parts.[40] That evidence is supported by discussions during and after China's accession relating to quotas on imports of whole vehicles and auto parts. The evidence arising out of those discussions suggests a common understanding of WTO Members that China treated CKDs as parts for classification purposes:

In the July 21, 2000 draft of the Working Party Report, the text indicated that China was not treating CKD kits as whole vehicles: "In response to questions from some Members [China] confirmed that the quota for autos and certain parts did not include CKD kits".[41]

Following accession, China confirmed in the Committee on Import Licensing that it was classifying CKDs as parts for purposes of "customs statistics":

> [I]n Japan's statistics, auto knock-down kits, or CKD and SKD, which were imported for assembly in China, were not included, because in the past two years in the initial period of production of new car models by Chinese domestic manufacturers, they had to import a considerable amount of knock-down kits for assembly production; for the import of these parts they had to be granted certain quotas; however, *as regarded customs statistics, because these parts arrived at the customs in the form of component parts, they had not been incorporated in the statistics for complete automobiles.*[42] (emphasis added)

256. Canada does not understand China, following its accession, to have created a separate tariff line at the seven- or eight-digit level for CKDs or SKDs. However, Canada understands that, prior to the enactment of the measures, CKDs were often classified as parts. The effect of the measures was to move the classification of CKDs from parts (under heading 87.08) to whole vehicles (under heading 87.03 or 87.04), and thus in effect create a new tariff line for CKDs at the eight-digit level, just as China had in 1995. Canada submits that paragraph 93 of the Working Party Report applies, and the new tariff line that China has effectively created must have a rate of 10%. Any other result would render paragraph 93 meaningless.

(b) (*Complainants*) If a separate tariff line for CKD and SKD kits has not been created, what is the relevance of paragraph 93 of the Working Party Report to this dispute?

Response of the European Communities (WT/DS339)

257. The European Communities considers that without prejudice to a potential direct violation of the commitment made by China under paragraph 93 of the Working Party Report, or nullification or impairment of benefits in the meaning of Article XXIII:1 (b) of the GATT 1994, this commitment provides crucial context for interpreting China's Schedule of commitments upon accession to the WTO. The commitment to apply 10 % duty if it were to create a tariff line on such kits lends strong support to an argument that China has considered such kits as akin to automotive parts upon accession to the WTO.

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[39] See China's first written submission, at paras. 40 and 184.

[40] See complainants' joint Background section, Canada's first written submission, at fn. 36.

[41] Draft Report of the Working Party on the Accession of China to the WTO, WT/ACC/SPEC/CHN/1/Rev.2, July 21, 2000, at p. 34 (paragraph numbered "xx").

[42] Report to the Council for Trade in Goods on China's Transitional Review, G/LIC/11, 29 October 2003, at para. 3.31.

Response of the United States (WT/DS340)

258. The United States submits that the final sentence of paragraph 93, in the context of the rest of the paragraph, imposes an obligation on China to provide a tariff treatment of no greater than 10 per cent on CKDs and SKDs. The paragraph starts out by noting that certain members of the Working Party expressed particular concerns about the "tariff treatment" of kits. In fact, the paragraph twice uses the term "tariff treatment." The use of the term "tariff treatment" highlights that the working party's concern was the rate of duty applied by China (that is, 25 per cent for whole vehicles versus 10 per cent for parts), and that the concern was not the classification of CKDs or SKDs. In this context, the only reasonable interpretation of the clause "If China created such tariff lines" is that the clause simply reflects an understanding on the part of the negotiators that CKDs and SKDs were at that time being entered as parts (not whole vehicles), and that the working party was concerned that China would change the tariff treatment by creating a new CKD/SKD line with a whole-vehicle rate. Conversely, it would not be reasonable to read the sentence as allowing China to provide any tariff treatment it wished, so long as China creates no new tariff heading for CKDs and SKDs. Such a reading would amount to no commitment at all – as illustrated by the current measures of China – since China could change tariff treatment by classifying the CKDs/SKDs as whole vehicles, and thus this reading would not meet the negotiators stated intention of addressing concerns with the tariff treatment (as opposed to classification) of CKDs and SKDs.

Response of Canada (WT/DS342)

259. A tariff commitment can be created when a Member, which committed itself to provide certain tariff treatment if it creates a tariff line for a specific good, *in effect* does so by enacting a measure that pronounces how that good is to be treated, or otherwise institutes a practice in respect of that good's classification. Article 21(1) of Decree 125 *in effect* does this by treating CKDs and SKDs as "deemed whole vehicles" charged at a tariff rate of 25%. This would be inconsistent with China's commitment to apply treatment of 10%, whether or not CKDs are classified as "motor vehicles" or "parts". The principle of effective treaty interpretation, *ut res magis valeat quam pereat*, requires an interpreter to give effect to all the terms of a provision and not render them meaningless (unless it is clear the parties intended to do so).[43] China's commitment would be meaningless if the phrase "if a separate tariff line is created" was not read in the context of the whole of paragraph 93, and in the light of the common intentions of the parties when paragraph 93 was negotiated.

260. Read in the context of the whole provision, the ordinary meaning of "if a separate tariff line is created" illustrates that preferential tariff treatment is specifically to address WTO Members' "*particular concerns* about tariff treatment in the auto sector" (emphasis added). That is, CKDs would continue to receive the 10% tariff treatment received pre-accession.

261. Consistent with Article 32 of the *Vienna Convention*, this textual interpretation is supported by "the circumstances surrounding the conclusion" of the *Accession Protocol*. In particular, the following facts are significant in considering the context in which that language was concluded:

(a) all other parts and intermediate products (bodies and chassis with engines) were bound at a 10% rate;

(b) China previously had separate tariff lines for some CKDs at a lower tariff rate;

[43] Sir Robert Jenning & Sir Arthur Watts, eds., Oppenheim's International Law, 9th ed., Volume I, Peace, Parts 2 to 4 (Harlow, Essex: Longman Group UK, 1992), at pp. 1280-1281 (Exhibit CDA-5).

(c) Members understood that China was at the time of accession classifying CKDs as parts, and charging them the parts rate (though without discounts for meeting domestic content thresholds); and

(d) most Members who have separate tariff lines for CKDs charge lower rates than for fully assembled vehicles.

62. (*China*) With respect to CKD and SKD kits, is there any difference between "manufacturing" and "assembling". If so, what is the difference and how is such difference relevant to understanding Rule 2(a) of the General Interpretative Rules?

Response of China

262. The scope of GIR 2(a), second sentence, is defined by reference to the types of assembly operations specified in Explanatory Note VII to GIR 2(a). The Explanatory Note states, in relevant part:

> For the purposes of this Rule, "articles presented unassembled or disassembled" means articles the components of which are to be assembled either by means of fixing devices (screws, nuts, bolts, etc.) or by riveting or welding, for example, **provided** only assembly operations are involved.
>
> No account is to be taken in that regard of the complexity of the assembly method. However, the components shall not be subjected to any further working operation for completion into the finished state.

263. Neither GIR 2(a) nor the Explanatory Note contains any reference to "manufacturing". The relevant consideration, in respect of the scope of GIR 2(a), is whether the unassembled parts and components can be assembled into the complete article by means of the specified assembly operations, without regard to the complexity of the assembly method. No party has disputed that CKD and SKD kits can be assembled into a complete motor vehicle by means of the assembly methods detailed in Explanatory Note VII. Among other considerations, this conclusion follows from the fact that national customs authorities routinely classify CKD and SKD kits for motor vehicles as "motor vehicles" in accordance with GIR 2(a).

264. The notion of "manufacturing" is only relevant, if at all, in what is implied by the statement that "the components shall not be subjected to any further working operation for completion into the finished state." By "working operation," the drafters of GIR 2(a) presumably meant to use the word "working" in the sense of "making, manufacture, construction; the manner or style in which something is made."[44] Thus, if the components must be subjected to an additional "working operation" (i.e., a manufacturing operation) before they can be assembled into the complete article, then the components cannot be classified as the complete article in accordance with GIR 2(a). In the context, it is reasonable to interpret the term "working operation" to mean some process beyond the types of assembly operations detailed in the Explanatory Note.

265. In sum, the notion of "manufacturing" is not relevant to the application of GIR 2(a) to CKD and SKD kits, as it is beyond dispute that CKD and SKD kits are assembled into finished vehicles by means of the assembly operations specified in the Explanatory Note.

[44] The New Shorter Oxford English Dictionary at 3720 (CHI-40).

Comments by the United States on China's response to question 62

266. In its response to this question, China stated: "In sum, the notion of 'manufacturing' is not relevant to the application of GIR 2(a) to CKD and SKD kits, as it is beyond dispute that CKD and SKD kits are assembled into finished vehicles by means of the assembly operations specified in the Explanatory Note." The factual question as to whether CKD and SKD kits can be assembled into finished vehicles is indeed disputed by the United States, as spelled out in our response to the Panel's question 47. Further, "manufacturing" operations are not covered by GIR 2(a). See Explanatory Note VII to GIR 2(a), which states in relevant part "[h]owever the components shall not be subjected to any further working operation for completion into the finished state."[45]

63. (*China*) What is the relationship between "CKD and SKD kits" and the "assemblies" referred to in Article 21(2) of Decree 125?

Response of China

267. There is no particular relationship, other than that they all consist of auto parts in various states of assembly. A complete motor vehicle is, of course, an assemblage of various parts. It is a convention in the automobile industry to group these parts into "assemblies," such as all of the constituent parts that make up the "transmission assembly." In its most literal sense, a CKD kit consists of the parts necessary to assemble a particular motor vehicle, completely unassembled. In practice, there is a continuum between a CKD kit and a kit in which at least some of the parts and components are in a more advanced stage of assembly – that is, an SKD kit.

64. (*China*) Could China please comment on paragraphs 67-68 of the European Communities' oral statement.

Response of China

268. In China's view, the point that the EC is trying to make in paragraphs 67 and 68 of its oral statement is not entirely clear. The EC's argument appears to be that the data presented in paragraph 19 of China's first written submission demonstrate that certain combinations of assemblies specified under Article 21 of Decree 125 do not, in the EC's view, have the essential character of a motor vehicle under GIR 2(a).

269. The first response to this contention is that the fact that certain assemblies only constitute a certain portion of the value of the assembled motor vehicle does not necessarily mean that those assemblies do not, in their entirety, have the essential character of a motor vehicle. The ratio of a particular assembly to the value of the assembled motor vehicle will change from one vehicle model to another. While a ratio of imported parts beyond a certain value level may indicate that those parts have the essential character of the complete article, the fact that the ratio of imported parts is below a certain value is not necessarily determinative under the essential character test. As discussed in response to question 117, the value of parts and components in relation to the value of the finished article is one factor that customs authorities rely upon in applying the essential character test under GIR 2(a).

270. The second response to the EC's contention is that if it wants to challenge the application of Decree 125 to the facts of specific cases, and argue that certain combinations under Article 21 of Decree 125 do not have the essential character of a motor vehicle, then it should being that case either

[45] Exhibit CHI-15.

to a WTO dispute settlement panel or to the Harmonized System Committee of the World Customs Organization. But the claim that it has brought before this Panel is that there is no set of facts to which China could apply the challenged measures and obtain a correct classification result. China rebuts this contention in response to question 147 below.

65. (*China*) Please clarify whether the final duty liability always lies with automobile manufacturers regardless of the recorded importer.

Response of China

271. The auto manufacturer is, in most cases, the importer of record for most of the imported parts and components that it assembles into a registered motor vehicle model. In those cases, the duty liability lies with the auto manufacturer as the importer of record.

272. Article 29 of Decree 125 concerns the circumstance in which the auto manufacturer purchases imported auto parts and components from a third-party supplier in China. In that case, the auto manufacturer is liable for the difference between any duty that has already been paid on the imported parts and components, and the duty that is applicable by reason of their incorporation into a registered vehicle model for the manufacturer has declared that the imported parts have the essential character of a motor vehicle.

66. (*China*) Please explain how tariff duties are imposed on imported auto parts when auto part manufacturers import auto parts.

Response of China

273. China assumes that this question pertains to imports of auto parts by auto part manufacturers that are not also manufacturers of complete motor vehicles. In that event, the importer would declare the imported auto parts under the applicable tariff rate provisions for auto parts, and would pay the applicable duty rates for these parts in accordance with the ordinary customs procedures for the payment of duties.

67. (*Complainants*) If China was imposing an anti-dumping duty on complete vehicles, would China in your view have the right to impose such duty upon imports of CKD and SKD kits?

Response of the European Communities (WT/DS339)

274. Such measures should be applied in accordance with the relevant WTO rules most notably Article VI of the GATT 1994 and the Agreement on Implementation of Article VI of the GATT 1994. In any event, any such duties should not affect the normal application of the provisions in force concerning ordinary customs duties.

Response of the United States (WT/DS340)

275. A Member's ability to impose antidumping duties is governed by Article VI of GATT 1994 and the AD Agreement. The investigating Member has the right to impose anti-dumping duties on imports of those products for which it has made a determination that there was dumping of the products under investigation, injury to domestic producers of the like products, and a causal link. The investigating Member is not required to impose these duties on the basis of tariff lines and, in fact, investigating Members rarely do. Typically, the duties are applied to the products covered by the

investigating Member's determination, which can be defined in numerous ways. The product coverage can be defined to apply to some but not all products that fall under a particular tariff line or to products falling under or within a variety of tariff lines. In addition, the product coverage can apply to finished products or to parts or both. That is what the rules of GATT Article VI and the Anti-Dumping Agreement allow. The only requirements are the findings of dumping, injury and causal link.

276. Thus, with regard to the hypothesized anti-dumping order imposing duties on complete vehicles, it would depend on precisely how the product coverage of the anti-dumping order was defined as to whether duties could be applied to CKD kits and SKD kits. If the product coverage expressly included the kits, and the requisite findings of dumping, injury and causal link had been made, it would be appropriate to impose duties on the kits. If it was unclear whether the product coverage included the kits and the investigating authority made an appropriate circumvention finding, it would again be appropriate to impose duties on the kits. If, however, the product coverage of the anti-dumping order expressly excluded the kits, it would not be appropriate to impose duties on them.

Response of Canada (WT/DS342)

277. If China was imposing an anti-dumping duty on complete vehicles, the ability to impose that duty on CKDs and SKDs would depend entirely on the constraints imposed by GATT Article VI and the *Agreement on Implementation of Article VI* (the "*AD Agreement*"). As set out in Article 1 of the *AD Agreement*, anti-dumping duties can only be applied under the circumstances provided for in Article VI of the GATT 1994 and pursuant to investigations initiated and conducted in accordance with the provisions of the *AD Agreement*. Anti-dumping duties can only be imposed on imports falling within the description of those goods covered by an anti-dumping duty order or finding.

278. Typically, the scope of anti-dumping duty investigations, any resulting order and, consequently, any anti-dumping duties imposed, will extend to goods in their assembled and disassembled states whenever such goods are commonly presented for entry at the border in a knocked-down state. GIR 2(a) is not directly applicable in making a determination about the proper scope of coverage of products to be assessed an anti-dumping duty.

68. (*All parties*) Please comment on the view that if WTO Members are allowed to resort to the notions contained in Rule 2(a) of the General Interpretative Rules, such as "as presented" and "essential character", in relation to tariff classification, it could have serious implications on the world trading system in light of today's commercial reality that manufacturers import parts and components from different sources and assemble them together.

Response of China

279. The Appellate Body has repeatedly affirmed the importance of the Harmonized System in interpreting a Member's Schedule of Concessions. As the Appellate Body observed in *EC – Computer Equipment*, it was "undisputed" in that case that "the Uruguay Round tariff negotiations were held on the basis of the Harmonized System's nomenclature and that requests for, and offers of, concessions were normally made in terms of this nomenclature."[46] In *EC – Chicken Cuts*, the AB observed that "prior to, during, as well as after the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties to *use* the Harmonized System as the basis for their

[46] *EC – Computer Equipment*, at para. 89.

WTO Schedules …"[47] On this basis, the Appellate Body considered that "the Harmonized System is relevant for purposes of interpreting tariff commitments in the WTO Members' Schedules."[48]

280. The General Rules are, as their name indicates, "rules for the *interpretation* of the Harmonized System."[49] As the chapeau to the General Rules indicates, the purpose of the General Rules is to provide "principles" according to which "the classification of goods … *shall* be governed." Under Article 1(a) of the *International Convention on the Harmonized Commodity Description and Coding System* (the "Harmonized System Convention"), the General Rules are a part of the Harmonized System.[50] In addition, under Article 3.1(a)(ii) of the Harmonized System Convention, contracting parties are required to apply the General Rules. General Interpretive Rule 2 is one of six General Interpretive rules. As China has explained to the Panel, the purpose of GIR 2(a) is to deal with the relationship between complete articles and parts of articles.[51]

281. In light of this history and context, China does not consider that the relevant issue is whether WTO Members should be "allowed" to apply GIR 2(a). To the extent that they are also WCO members, WTO Members are *required* to apply GIR 2(a). As it pertains to the interpretation of Members' Schedules of Concessions, GIR 2(a) is just as important in providing context as any other element of the Harmonized System. Members have negotiated tariff commitments on the basis of the Harmonized System, including the principles set forth in GIR 2(a) for distinguishing between tariff provisions for complete articles and tariff provisions for parts of articles. There is no basis to conclude that this context is any less relevant under Article 31(2)(a) of the *Vienna Convention* than any other aspect of the Harmonized System.[52]

282. As for the concern that terms such as "essential character" and "as presented" would have on the world trading system, it is important to stress that GIR 2(a) does not provide a license for national customs authorities to classify imports however they wish. With respect to GIR 2(a), first sentence, the article must be "incomplete or unfinished," and while there is some scope for disagreement concerning the application of the "essential character" test to a specific set of facts, these types of disagreements tend to fall within a narrow range of relevant characteristics. In the case of any such disagreements, domestic customs procedures and international procedures in the WCO and WTO are available to challenge the application of the rules to specific products.

283. With respect to GIR 2(a), second sentence, the unassembled or disassembled parts must be capable of assembly into the complete article within a carefully circumscribed range of assembly operations. Thus, customs authorities could not invoke GIR 2(a) to classify any collection of parts or materials as a complete article that those parts or materials could conceivably form. Under GIR 2(a), customs authorities cannot combine iron and carbon to make steel, or combine flour and yeast to make bread. By the terms of Explanatory Note VII to GIR 2(a), the second sentence applies only to "articles the components of which are to be assembled either by means of fixing devices … or by riveting or welding, for example, provided only assembly operations are involved." In actual practice, there is a fairly narrow range of products under the Harmonized System to which this circumstance applies.

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[47] *EC – Chicken Cuts*, at para. 199.
[48] *EC – Chicken Cuts*, at para. 199.
[49] *EC – Chicken Cuts*, at para. 233.
[50] JE-35.
[51] This is underscored by General Interpretive Rule 2(b), which deals with the closely related issue of the relationship between a material and a mixture or combination that includes that material.
[52] See *EC – Chicken Cuts* at para. 199 (concluding that, under Article 31(2)(a) of the Vienna Convention, the Harmonized System is "an agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty.")

284. Thus, the principles of GIR 2(a) do not pose a threat to the international trading system. Customs authorities have been applying the principles of GIR 2(a) for many years, even before the adoption of General Interpretive Rule 2(a) in 1963. These principles are a standard feature of international customs practice.

Response of the European Communities (WT/DS339)

285. These notions cannot be taken out of their proper context. Rule 2 (a) very clearly demonstrates that all of its elements must be fulfilled at the same time. Taking any of these notions out of their context entirely undermines the whole system of tariff classification and results in tariff classification at will. Members may of course use Rule 2(a) in its proper context to assist in individual cases that fulfil all the conditions of the Rule. However, China ignores the very basic rule that is Rule 1 of the HS system by jumping directly into rule 2 (a) and then picks and chooses what in that rule fits to its anti-circumvention theory. This would seriously compromise "the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade" (Appellate Body e.g. in *EC – Chicken cuts*, at para. 243).

Response of the United States (WT/DS340)

286. If China's view were adopted, then no producer would ever be able to rely on the tariff bindings set out in a Member's schedule. In every case, producers would face the possibility that an importing Member (as China has done) would adopt thresholds that arbitrarily defined some collection of imported parts as having the character of a whole product, and would thus begin assessing duties on the parts as if they were the whole product. Moreover, if China's view were adopted, every Member (regardless of the specific details of their tariff bindings on parts and whole products) would be entitled (as China has done) to impose higher charges on imported parts (as long as the rate of duty was equal or lower to the binding on the finished product) used in domestically manufactured products if those products failed to meet domestic content thresholds . In other words, every Member would be entitled to adopt local-content based TRIMs, despite the prohibition on such measures in the TRIMs Agreement.

Response of Canada (WT/DS342)

287. Canada does not take issue with WTO Members making use of GIR 2(a) in classification of individual shipments of products on the basis of the "snapshot" of goods as they arrive at the border. The "essential characteristics" must be assessed based on the objective characteristics of *the* product *as presented* at the border in a single shipment.

288. In marked contrast, accepting China's arguments that GIR 2(a) could apply to multiple shipments arriving at different times (whether or not from multiple destinations, and after the product has been imported based on criteria such as end-use) would undermine significantly the security and predictability afforded by tariff concessions. In *EC – Chicken Cuts*, the Appellate Body considered the understanding of Members in respect of tariff concessions. It noted that the object and purpose of the GATT 1994 is "the security and predictability of 'the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade'".[53] A Member that could ignore one lower tariff concession for another, higher one would thwart the understanding

[53] *EC –Chicken Cuts*, Report of the Appellate Body, WT/DS269/AB/R, WT/DS286/AB/R, adopted 27 September 2005, at para. 241, fn. 455, citing the Appellate Body in *EC – Computer Equipment*.

of Members negotiating the concession and thereby undermine the object and purpose of the GATT 1994.

Comments by the United States on China's response to question 68

289. On page 54 of its first submission, China asserts that: "As China has explained to the Panel, the purpose of GIR 2(a) is to deal with the relationship between complete articles and parts of articles." This is a misstatement of General Interpretative Rule 2(a), which deals with the relationship of articles either incomplete or unfinished as well as articles complete or finished that are presented unassembled or disassembled. The notion that this is the only relevant rule ignores the application of General Interpretative Rule 1, which states that: "for legal purposes, classification shall be determined according to the terms of the heading and any relative Section or Chapter Notes and, provide such heading or Notes do not otherwise require, according to the following provisions."

290. For example, the gasoline engine assemblies described in Exhibit CHI-3, are precluded from classification in chapter 87 as "parts" of motor vehicles by the application of General Interpretative Rule 1 and Legal Note 2(e) to Section XVII (which includes chapter 87), and directs classification of this assembly to Heading 84.07 which provides for: "Spark-ignition reciprocating or rotary internal combustion piston engines." This interpretation is supported by EN VIII to GIR 2(a), which provide that "Cases covered by this Rule are cited in the General Explanatory Notes to Sections or Chapters (e.g., Section XVI, and Chapters 44, 86, 87 and 89)." The General EN to Chapter 87 states that this "Chapter also covers parts and accessories which are identifiable as being suitable for use solely or principally with the vehicles included therein, subject to the provisions of the Notes to Section XVII (see the General Explanatory Note to the Section)."

291. Further, China's Footnote 20 also misstates GIR 2(b). That footnote argues: "This is underscored by General Interpretive Rule 2(b), which deals with the closely related issue of the relationship between a material and a mixture or combination that includes that material." To the contrary, GIR 2(b) provides guidance on how to interpret headings that reference a "material or substance." GIR 2(b) simply has no relevance to how customs officials should classify articles and parts.

292. On page 56, China asserts the following: "Thus, the principles of GIR 2(a) do not pose a threat to the international trading system. Customs authorities have been applying the principles of GIR 2(a) for many years, even before the adoption of General Interpretive Rule 2(a) in 1963. These principles are a standard feature of international customs practice." China's selective use of GIR 2(a) does pose a threat to the international trading system, because it ignores the structure of the Harmonized System and General Interpretative Rule 1. The Harmonized System is made up of 96 chapters grouped into 21 sections consisting of approximately 5,000 article descriptions in the headings and subheadings. The Harmonized System is divided into categories or product headings beginning with crude and natural products and continuing in further degrees of complexity through advanced manufactured goods.

293. General Interpretative Rule 2(a) requires that customs officials make a determination as to whether components entered together impart the essential character of a complete or finished article. If not, then the components are to be individually classified. This view is supported by the structure of the Harmonized System itself, which specifically names certain parts in their own headings (e.g., spark-ignition reciprocating or rotary internal combustion piston engines of heading 84.07, transmission shafts of heading 84.83, chassis fitted with engines of heading 87.06, bodies (including cabs) of heading 87.07) and contains headings for parts suitable for use solely or principally with motor vehicles (e.g., heading 87.08 which provides for parts and accessories of the motor vehicles of

headings 87.01 to 87.05). To classify all parts eventually incorporated into complete motor vehicles, as motor vehicles would empty many headings and subheadings of the goods specified therein.

69. (*All parties*) When you refer to CKD and SKD kits in relation to the assembly of automobiles, are they always composed of the same combination of auto parts or is there a range of combinations of auto parts that could comprise such CKD and SKD kit? Please also provide definitions of CKD and SKD kits respectively.

Response of China

294. There is no standard definition in the automotive industry of what constitutes a CKD or SKD kit. As China explained in its first written submission, the ordinary understanding of a CKD kit is that it includes all, or nearly all, of the parts and components necessary to assemble a complete vehicle. In *Indonesia – Autos*, the EC informed the panel that CKD kits for export to Indonesia included "almost all the parts and components necessary for assembling the cars."[54] The United States informed the panel that the CKD kits for the Ford Escort "would have contained all of the individual parts necessary to build a complete Escort, except for locally procured parts and components, such as oil and gasoline."[55] However, industry sources sometimes use the term "CKD kit" to include a certain proportion of locally-supplied parts and components. BMW, for example, states on its web site that "[i]n the CKD process, certain parts and components are packaged as kits in precisely defined assembly steps and exported for assembly in the respective countries. *These kits are then supplemented with locally manufactured parts in the partner countries*."[56] As China has explained previously, an "SKD kit" differs from a CKD in the extent of its prior assembly; it can be thought of as a CKD kit that has been partially assembled before it is exported to the destination market.

295. Because there is an inherent amount of ambiguity in these terms, one often needs to examine the context in which the terms are used to discern the intended meaning. A recent article concerning a new "CKD logistics centre" opened by the Czech auto manufacturer Skoda Auto provides some sense of how these terms are used, and also provides context for answering the question below concerning the CKD assembly process. The article explains:

> The new CKD logistics centre has been designed for end-to-end preparation, packaging and shipping of Skoda vehicles in three different assembly set versions – SKD (semi-knocked-down), MKD (medium-knocked-down) and CKD (completely-knocked-down). Complete unassembled vehicles are shipped by the centre to foreign-based assembly plants in special containers or by train.
>
> An SKD assembly set is made up of a completely geared body, drive unit (engine, transmission and front axle), rear axle and other chassis parts (such as wheels, fuel tank, exhaust system, etc.). …
>
> One level down in terms of assembly-readiness, the MKD system comprises a painted body plus a further 1,300 – 1,700 parts. The vehicle assembly is performed on a standard assembly line, using a technological process comparable with that applied in the "parent" assembly plant….

[54] *Indonesia – Autos*, at para. 8.239.
[55] *Indonesia – Autos*, at para. 8.242.
[56] http://www.bmwgroup.com/e/0_0_www_bmwgroup_com/produktion/produktionsnetzwerk/produktionsstandorte/montagewerke.html (visited 4 June 2007).

> The lowest level of assembly-readiness is CKD. The manufacturing plant delivers body parts and other components broken down to a large number of items. The assembly plant welds and paints the body, installs the drive unit and other components and completes the final vehicle build on a standard assembly line.[57]

296. Note that the distinguishing feature among these three different types of kits is the degree of "assembly-readiness". The SKD has substantially assembled parts and components (such as the entire drive unit), the MKD kit has an assembled body that has already been painted plus "1,300 – 1.700 parts," while the CKD kit is "broken down to a large number of items," including an unassembled body.

Response of the European Communities (WT/DS339)

297. There are no established legal definitions of CKD and SKD kits. In the language of the industry CKD or SKD kits may denote a combination of parts that make up a certain more general part of a vehicle ("assembly" using the language of Decree 125) or a combination of parts that make up a complete vehicle. Therefore, in the industry the concepts are used in a variety of ways. However, the European Communities understands that CKD and SKD kits under the measures comprise all the parts necessary to make a complete vehicle.

Response of the United States (WT/DS340)

298. This response is based on the understanding of the United States regarding general industry usage of the terms "CKD" and "SKD". As noted in response to Question 47 above, these terms are not used by the US Customs Service for the purpose of tariff classification. In addition, the United States is not aware of any formal, published definition of these terms.

299. CKD stands for "complete knocked-down" and SKD stands for "semi knocked-down". Completely knocked-down kits" ("CKDs") are parts imported together in unassembled condition that provide the necessary parts in order to manufacture a whole vehicle. The kit may include not only parts, but also sub-assemblies and assemblies such as engine, transmission, axle assemblies, chassis and body assemblies. Semi knocked-down kits" ("SKDs") refers to partially assembled combinations of parts that can be used to manufacture a whole vehicle..

Response of Canada (WT/DS342)

300. See Canada's response to Question 33.

70. (*All parties*) In light of your response to the previous question, please clarify whether you agree with the European Communities' explanation on CKD and SKD kits in paragraph 267 of its first written submission, including its reference to "all the parts necessary to manufacture not only a vehicle, but also an 'assembly'"?

Response of China

301. For the reasons set forth in response to question 69, China does not consider that a CKD or SKD kit must include *all* of the parts necessary to assemble a motor vehicle. As noted above, there is some ambiguity in how the automotive industry uses these terms. While it is generally agreed that a CKD kit includes nearly all of the parts and components necessary to assemble a motor vehicle, the

[57] "Skoda Auto steps up global production with new distribution facility" (5 May 2006) (CHI-41).

industry sometimes uses the term "CKD kit" in a way that encompasses a certain proportion of locally-supplied content.

302. With respect to the EC's use of the term "assembly" in relation to a CKD kit, China believes that the EC was referring to the possibility that a particular assembly might itself be imported in the form of a CKD kit. This is contemplated by Article 22(1) of Decree 125, which provides that an assembly shall be considered imported if it is assembled from "imports of a complete set of parts …" Thus, for example, if a transmission assembly is assembled from a complete set of imported parts, Decree 125 classifies the imported parts as a transmission assembly, not as parts of a transmission assembly. This is consistent with General Interpretative Rule 2(a).

Response of the European Communities (WT/DS339)

303. The European Communities understands that this question is addressed to the other parties.

Response of the United States (WT/DS340)

304. The United States notes that the EC statement in paragraph 267 is describing the EC view of how "CKD" and "SKD" are used in Decree 125. The EC notes that China's measure does not exhaustively define these terms, and the EC "assumed" that such kits "consist of "all the parts necessary manufacture a vehicle or an 'assembly'." The United States believes these assumptions are reasonable, given the lack of clarity in China's measures.

Response of Canada (WT/DS342)

305. As set out above, Canada agrees that CKDs or SKDs contain all or virtually all of the parts necessary to manufacture a whole vehicle.

Comment by the United States on China's response to question 70

306. In its response to this question, China states that it does not consider that a CKD or SKD kit must include all of the parts necessary to assemble a motor vehicle. China explains that "there is some ambiguity in how the automotive industry uses these terms," and that "[w]hile it is generally agreed that a CKD kit includes nearly all of the parts and components necessary to assemble a motor vehicle, the industry sometimes uses the term 'CKD kit' in a way that encompasses a certain proportion of locally-supplied content." The United States agrees that industry uses the term "kit" to describe a wide range of combinations of parts, many of which do not include all of the parts necessary to assemble a motor vehicle. However, the Panel's question is addressed to the measures at issue (not industry usage of the terms). And China's measures, particularly Articles 2 and 21(1) of Decree 125, appear to define CKD and SKD kits as kits that include all of the parts necessary to assemble a motor vehicle.

71. (*All parties*) Please explain in detail what kind of manufacturing processes are usually involved to make a complete vehicle using CKD or SKD kits?

Response of China

307. The automobile assembly process (including the assembly of CKD or SKD kits) is commonly divided into three parts: welding, painting, and the final assembly (or "fitting") of the vehicle. Motor vehicles are assembled from metal components that have been stamped, or pressed, into the required shapes. While there is some variation from one vehicle model to another, the basic structural

elements of a passenger motor vehicle are the side panels, the floor panels (including the front wall and the back wall), the roof, and the opening panels (i.e., the doors, bonnet, and rear hatch). These components must be welded together to form the body of the vehicle (often referred to as the "body in white"). Once welded together, the assembled body is painted and cured through various processes of spraying, heating, sanding, and lacquering. The painted body then goes through an assembly line process in which the various interior and exterior components of the vehicle (such as the windscreen, dashboard, seats, and steering wheel) are fitted to the vehicle by means of screws, fasteners, or bonding agents. Usually toward the end of this process, the vehicle is attached to the powertrain assembly (consisting of the engine, transmission, and axles), which has already been assembled on a different assembly line. The car is fitted with wheels and bumpers, and the doors are attached to the vehicle body. At the end of this process, the assembled vehicle undergoes inspection and testing.

308. The nature and extent of the assembly operations required for any given CKD or SKD kit will, of course, depend upon the extent to which the parts and components of the vehicle were assembled prior to their arrival at the assembly facility. For example, an SKD kit may consist of a vehicle body that was welded and painted prior to export. In that event, the vehicle would only need to undergo the final assembly process in the destination market. Likewise, the various assemblies of the motor vehicle (such as the engine and transmission) may already be assembled in an SKD kit; this is alluded to in the excepts from the article concerning Skoda Auto quoted above.

309. Whatever its state of prior assembly, however, both CKD and SKD kits are assembled by means of the types of assembly operations specified in Explanatory Note VII to General Interpretative Rule 2(a).

Response of the European Communities (WT/DS339)

310. It is not possible to give a general answer as the level of fitting and equipping will by definition vary. The example of a SKD kit provided in Exhibit CHI-5 would not require complex manufacturing processes provided all the electronic equipping and calibration is already done and only the fitting of the tyres would be necessary. In contrast, the difference between manufacturing a CKD kit into a complete vehicle may not differ considerably from the manufacturing of a complete vehicle generally. However, this will depend on the manufacturing facilities of the manufacturer and the complexity of the relevant model. Modern vehicles that typically contain elements of computer technology require various types of calibration during the manufacturing process. Most body and chassis components will also need further working operations in the form of rust treatment, painting and polishing.

Response of the United States (WT/DS340)

311. It is not possible to give a general answer as the level of fitting and equipping will vary depending on the circumstances and the content of the kit. An SKD with a high level of assembly (or, put another way, very little disassembly) may require relatively simple assembly operations. In contrast, assembling a complete knock down kit (CKD) will be more complex.

Response of Canada (WT/DS342)

312. It is not until the final stage of assembly that the chassis with engine (tariff heading 87.07) combines with the body (tariff heading 87.08) to form a complete vehicle. In order to explain how CKDs or SKDs are assembled, Canada considers it necessary to set out briefly the normal manufacturing process for a complete vehicle.

Chassis: the frame is placed on the assembly line. The complete front and rear suspensions, gas tanks, rear axles and drive shafts, gear boxes, steering box components, wheel drums and braking systems are installed sequentially. The engine with its transmission is then attached.

Body: the floor pan is the largest body component, containing many panels and braces. The front and rear door pillars, roof and body side panels are first assembled onto the floor pan. Additional body components, including fully assembled doors, deck lids, hood panel, fenders, trunk lid and bumper reinforcements, are then installed. Next the vehicle body is spray-painted. After the shell leaves the paint area, it undergoes interior assembly. This include parts such as instrumentation, dash panels, interior lights, seats, door and trim panels, audio system, steering column, and windshield.

Final Assembly: the chassis assembly conveyor and the body shell conveyor meet at this stage of production. As the chassis passes the body conveyor, the body is placed onto the chassis and bolted to the frame. The automobile proceeds down the line to receive final trim components, battery, tires, anti-freeze and gasoline. The vehicle is inspected and is given a price label and is prepared for delivery to retailers if it passes.

313. If CKDs or SKDs are used, while final assembly may be similar, the assembly operations for the body and chassis will be much less complicated than assembly solely from parts. However, it is not possible to provide a more detailed answer in the abstract, given the number of parts and assembly combinations.

72. (*All parties*) Do the complainants agree with the description of SKD kits as illustrated in Exhibit CHI-5. If not, explain why.

Response of China

314. China notes that this question was directed to all parties, although it appears to ask a question of the complainants. As China noted in its first written submission at para. 36, the auto industry sometimes uses the term "SKD kit" to refer to a complete vehicle that has been partially *dis*assembled prior to shipping. (More commonly, the term refers to a partially assembled motor vehicle that has never been fully assembled.) That appears to be the intended meaning of the logistics company in this particular case. As stated in the text that accompanied the photo at CHI-5, the logistics company notes that "SKD (semi knocked down kits) have already been *dismantled*, packed and shipped for DaimlerChrysler …"[58] The company also notes that the shipping process for these SKD kits involves the "partial dismantling" of these vehicles. From the photograph, it is evident that the "dismantling" entailed removing the tyres and strapping them to the shipping skid.

Response of the European Communities (WT/DS339)

315. The European Communities agrees that the description in Exhibit CHI-5 illustrates a particular type of an SKD kit provided all of the parts are presented to the customs at the same time.

Response of the United States (WT/DS340)

316. Exhibit CHI-5 appears to illustrate a complete vehicle rather than an SKD kit. It appears to show a fully finished vehicle with its tires strapped to the shipping skid and not yet mounted.

[58] See http://www.blg.de/news-content2006/februar06_en.php.

Response of Canada (WT/DS342)

317. Canada agrees that Exhibit CHI-5 could be a particular type of SKD, provided that all of the parts necessary to manufacture the SKD in question are included in a given shipment at a given time. However, the example would be an unusual SKD, since Canada understands that SKDs usually are in a less advanced state of assembly than shown in the exhibit.

73. (*All parties*) Canada submits in footnote 1 of its first written submission that "in this submission, except where the measures specifically provide for other categories of goods, "parts" includes all auto parts and components associated with the production of whole vehicles or individual assemblies." In light of this statement, please clarify the exact scope of the products at issue in this case. Please explain in detail by referring to, inter alia, HS headings.

Response of China

318. The motor vehicles at issue fall under headings 87.02 (motor vehicles for the transport of ten or more persons, including the driver), 87.03 (motor cars and other motor vehicles principally designed for the transport of persons), and 87.04 (motor vehicles for the transport of goods). Different tariff headings under Chapters 84, 85 and 87 set forth China's commitments with respect to parts and assemblies of motor vehicles. These include, at the four-digit level:

84.07 Spark-ignition reciprocating or rotary internal combustion piston engines
84.08 Compression-ignition internal combustion piston engines (diesel or semi-diesel engines)
84.09 Parts suitable for use solely or principally with engines of heading No. 84.07 or 84.08
85.39 Electric filament or discharge lamps, including sealed beam lamp units …
87.06 Chassis fitted with engines, for the motor vehicles of headings Nos. 8701 to 8705
87.07 Bodies (including cabs), for the motor vehicles of headings Nos. 8701 to 8705
87.08 Parts and accessories of the motor vehicles of headings Nos. 8701 to 8705

319. Not all subheadings under these headings relate to the motor vehicles of headings 87.02, 87.03, or 87.04.

Response of the European Communities (WT/DS339)

320. At the four digit level the products at issue fall generally into the following HS headings:

(a) complete vehicles (under headings 87.01 to 87.05 of which headings 87.02 to 87.04 are most relevant in view of the scope of the measures)

(b) intermediate products such as the body and the chassis fitted with engine (under headings 87.06 and 87.07)

(c) parts and accessories of the motor vehicles of headings 87.01 to 87.05 (under heading 87.08)

(d) parts and accessories of motor vehicles classified elsewhere than chapter 87 (in particular Chapters 84 and 85; in this respect most relevant are headings 84.07, 84.08, 84.09, 84.83 and 85.11 but also other headings may be relevant depending on the vehicle type).

Response of the United States (WT/DS340)

321. This footnote in Canada's first submission sets out a working definition of "parts," and the United States agrees with this definition. The United States notes, however, that the scope of this dispute is not established by any disputing party's working definition of "parts" as set out in a submission. Rather, the scope of this dispute is set out in the terms of reference, which in turn refers to matters (including the measures) set out in the request for an establishment of a panel. Thus, the products at issue in this dispute are the products subject to China's measures (Order No. 8, Decree 125, and Announcement No. 4). The product coverage of China's measures appears to be very broad, and to include any piece (part, assembly, or anything else) used in the production of complete vehicles.

322. The United States understands that at the four digit level, the products at issue fall generally into the following HS headings: (1) complete vehicles (under headings 87.01 to 87.05 of which headings 87.02 to 87.04 are most relevant in view of the scope of the measures); (2) intermediate products such as the body and the chassis fitted with engine (under headings 87.06 and 87.07); (3) parts and accessories of the motor vehicles of headings 87.01 to 87.05 (under heading 87.08); and (4) parts and accessories of motor vehicles classified elsewhere than chapter 87 (in particular Chapters 84 and 85; in this respect most relevant are headings 84.07, 84.08, 84.09, 84.83 and 85.11 but also other headings may be relevant depending on the vehicle type).

323. Nonetheless, the tariff classification (either asserted by complainants or asserted by China) does not determine the scope of the products covered within the scope of this dispute. As noted, the United States is challenging the consistency of the measures with covered agreements, and the scope of the products encompassed in this dispute are any products that China subjects to its measures identified in the request for establishment of a panel.

Response of Canada (WT/DS342)

324. The products at issue in this case are all products which are, or could be, subject to charges or reporting requirements under the measures.

325. Article 2 of Decree 125 specifies that charges may be imposed on all imported auto parts "which are needed for production and assembly of vehicles by automobile manufacturers". Article 3 specifies that "automobiles" include vehicles having at least four wheels used for carrying passengers or freight. Article 20 specifies that optional parts attached to a vehicle are covered by the measures. As a consequence, Canada believes that the majority of parts at issue in this dispute fall under Chapter 87 (especially headings 87.06, 87.07, and 87.08), with other parts falling notably under Chapter 40 (especially headings 40,11, 40.12, and 40.16), 84 (especially headings 84.07, 84.08, and 84.09) and 85 (especially headings 85.01, 85.03, 85.06, 85.07, 85.11 and 85.12).

74. (*Complainants*) Please comment on China's statement in footnote 129 to its first written submission, which was made in response to the complainants' reference to Exhibit JE 25 (p. 189).

Response of the European Communities (WT/DS339)

326. This statement would appear to confirm that China considers CKD and SKD kits as consisting of all the parts necessary to manufacture a vehicle. Furthermore, China appears to admit that a significant combination of parts necessary to manufacture a vehicle presented at the same time to customs at the border was classified as parts prior to China joining the WTO.

Response of the United States (WT/DS340)

327. Footnote 129 of China's first written submission addresses statements about CKD and SKD kits made in a book cited by the complainants. The statements at issue appear to be correct.

328. Prior to its WTO accession on 11 December 2001, the Chinese government generally did not allow the importation of CKD or SKD kits with essentially all of the parts required to assemble a complete vehicle. However, if an automobile manufacturer committed to the establishment of significant manufacturing facilities in China, China sometimes would allow the importation of these kits as needed to get the operations started.

329. With regard to kits that did not contain essentially all of the parts required to assemble a complete vehicle (meaning kits that lack major assemblies such as engines or other parts required to meet the criteria for having the "essential character" of a complete vehicle within the meaning of the General Interpretive Rules and their explanatory notes), China applied import duties at rates that varied depending on whether the automobile manufacturer was sourcing 40, 60 or 80 per cent of its parts locally - the higher percentage of parts sourced locally, the lower the duties on the imported parts.

330. In footnote 129 of its first submission, China notably does not dispute the accuracy of these facts. Rather, China disputes whether or not the groups of components mentioned in the source should be called "kits". But whether China calls them "kits" or not is beside the point. The source supports the Complainants' assertion that the groups of components being imported into China prior to accession were being assessed duties at rates far below the whole-vehicle rate, and again illustrates that the purpose of paragraph 93 of the Working Party report was to ensure that groups of parts and components imported into China after accession would be assessed as parts, and not at the higher whole-vehicle rate.

Response of Canada (WT/DS342)

331. Since there is no established general definition of the terms CKD and SKD, Canada does not agree with China that this is a "misuse" of these terms. Canada does agree, as set out in answer to Question 61(a), that evidence of China's treatment of CKDs and SKDs prior to accession is limited. As noted in response to that question, China's own claims regarding treatment of CKDs are contradictory.

332. Canada also agrees that these terms as used in Exhibit JE-25 are broader in scope than the term used by the complainants, as they apparently included collections of parts that were not sufficient to assemble a whole vehicle. As discussed in answer to Question 33, this is consistent with the broader definition of CKDs or SKDs in the auto industry. Further, Canada understands that the basic information provided by that author to the effect that CKDs and SKDs were charged lower tariff rates than assembled vehicles does hold true for the term as used in this dispute. This is so because even if virtually all parts necessary to assemble a vehicle were imported in one shipment that arrived together at the border (i.e., a CKD or SKD as the term is used in this dispute), those parts were charged a tariff rate for CKDs or SKDs with less than 40% domestic content. While that rate was higher than the rate for parts used in manufactured vehicles with greater domestic content, the rate was nevertheless lower than the tariff rate for imported fully assembled vehicles.

75. (*All parties*) Are there any differences between CKD kits and SKD kits? If so, please explain.

Response of China

333. As China has explained in response to question 69, and as illustrated in response to that question, CKD and SKD kits differ in their extent of prior assembly. An SKD kit is a CKD kit with various parts and components at a more advanced stage of assembly.

Response of the European Communities (WT/DS339)

334. The difference between the concepts is the different level of assembly and manufacture or "fitting and equipping" to use the specific language used under chapter 87 of the HS system. A CKD is a 'completely knocked-down" kit in which nothing or very little is fitted or equipped while an SKD or a 'semi knocked-down kit' consists of partially assembled, fitted, equipped and/or processed combinations of parts that together would make up a complete vehicle. Reference is also made to the reply provided to question 47.

Response of the United States (WT/DS340)

335. Please see the response to question 69 above.

Response of Canada (WT/DS342)

336. See Canada's response to Question 33. However, Canada does not believe that this difference is material for purposes of this dispute.

76. (*China*) Article 21(1) of Decree 125 refers to "imports of CKD or SKD kits *for the purpose of assembling vehicles*." Are CKD or SKD kits imported for purposes other than assembly of vehicles? If so, what are those other purposes?

Response of China

337. CKD and SKD kits are not imported for any purpose other than assembly into motor vehicles.

77. (*China*) In support of the argument of circumvention, China submits in paragraph 21 of its first written submission that "since the adoption of the challenged measures, auto manufacturers have confirmed that approximately 120 of the 500 or so vehicle models that have completed the evaluation process ... are assembled from imported parts and components having the essential character of a motor vehicle."

How many of these evaluation processes were related to importations done by the manufacturer itself and how many by the supplier? How many of these evaluation processes were related to importations of CKD or SKD kits? How many of these evaluation processes were disputed by the manufacturer under the proceedings of Article 12 of Announcement 4? How many of these evaluation processes were disputed by the manufacturer before the courts in China?

Response of China

338. As of 1 May 2007, the CGA has verified 713 vehicle models, of which 130 have been verified as assembled from imported parts and components that have the essential character of a motor vehicle. China is uncertain what the question means when it asks "how many of these evaluation processes were related to importations done by the manufacturer itself and how many by the supplier." Evaluations are performed by automobile manufacturers with respect to the vehicle models that they assemble. They are not performed by parts suppliers. If the question is intended to ask how many registered vehicle models have imported parts that are imported *exclusively* by third-party suppliers (and none by the manufacturer itself), the answer is that there are 15 such models, all of which are buses.

339. None of the evaluation processes have related to CKD or SKD kits. As China has noted, auto manufacturers import CKD/SKD kits as motor vehicles, in accordance with GIR 2(a).

340. None of the evaluation processes have been disputed by the manufacturer under Article 12 of Announcement 4, and none have been disputed in court.

B. NATURE OF THE MEASURES

78. (*All parties*) Please comment on the following argument contained in paragraph 14 of Australia third party oral statement, made in relation to China's claim that a charge imposed after the time or point or importation can still be a border charge if it relates to a condition of *liability that attached at the time of importation*:

> **"Presumably, in an attempt to establish a nexus with importation, the measures at issue include a declaration made at the time of importation. However, this declaration appears to be entirely focused on the way in which the imported parts will be used internally within China, rather than on the contents of a consignment upon importation. ... Therefore ... the *liability attaches internally*, after the vehicle has been manufactured." (emphasis added)**

Response of China

341. China has responded to essentially the same argument in response to question 54. China's responses to questions 79 and 134 below are also pertinent to this question. In sum, the customs process that China has established under the challenged measures serves to determine whether multiple shipments of parts and components are related to each other through their common assembly into a finished motor vehicle. The liability to pay the customs duty does not "attach internally"; it attaches by reason of the importation of multiple shipments of parts and components that, in their entirety, have the essential character of a motor vehicle. The auto manufacturer's obligation to pay this customs duty arises by reason of the importation of a group of auto parts that have the essential character of a motor vehicle, whether it imports those parts in a single shipment or multiple shipments.

Response of the European Communities (WT/DS339)

342. The European Communities entirely agrees with the argument contained in paragraph 14 of Australia's third party oral statement. In this respect, the European Communities refers to the examples provided in paragraph 66 of its first written submission, which clearly illustrate that the 15 % additional charge on auto parts is not dependent on the importation of the part, but on the use to

which this part was put in China. If a WTO Member could transform a measure triggered by the internal use of imported products into a border measure just by imposing a declaration at the border, Article III of the GATT would be reduced to nullity.

Response of the United States (WT/DS340)

343. The United States agrees with this statement, and believes that this position is consistent with the reasoning of the United States showing that China's charges are internal ones, and not customs duties.

Response of Canada (WT/DS342)

344. Canada agrees with Australia's statement, and in that regard refers the Panel to paragraphs 65 and 66 of Canada's first written submission, as an illustration of how liability attaches internally under the measures.

79. (*China*) If a country were to require retailers importing certain goods to declare at the time and point of importation whether they would subsequently sell such goods internally, would a sales tax eventually levied internally after the selling of these goods be considered as a border charge, rather than an internal tax, simply because it is related to a "condition of liability attached at the time of importation"? Would your response be different if, in addition to the declaration at the border, the retailer were also required to place a bond?

Response of China

345. The short answers to these two questions are "no" and "no". In fact, these questions perfectly illustrate the fallacy of the complainants' contention that China is seeking to create a loophole in Article III.

346. China has repeatedly emphasized that it does not take the position that a WTO Member can impose any charge as a liability of importation, and thereby evade the disciplines of Article III. This is a fictitious argument that the complainants have sought to attribute to China. Within the scope of Article II, the relevant question is whether the charge is one that the Member is allowed to impose by reason of the importation of the product, in accordance with its Schedule of Concessions and other WTO obligations. As China has explained in response to other questions, it is consistent with Article II to impose these charges after the time or place of importation, provided that the charge relates to a liability that arose by reason of the importation of the product.

347. This brings China, once again, to what it considers to be the central issue in this dispute: Is it allowed under the rules of the Harmonized System, and in accordance with the practice of other WTO Members, to classify as a "motor vehicle" multiple shipments of parts and components that, in their entirety, have the essential character of a motor vehicle? China has explained at length its position that this is a valid interpretation of the term "motor vehicle" under international customs rules and practice. Thus, the challenged measures result in the imposition of ordinary customs duties that China is allowed to impose by reason of the importation of the product.

348. The declaration that importers make at the time of importation, and the bond that they are required to provide, are simply elements of the customs procedure that China has adopted to give effect to this valid interpretation of the term "motor vehicles" as it appears in China's Schedule of Concessions. It is neither the declaration nor the bond that renders the duty valid under Article II. What makes the duty valid is that it reflects a proper interpretation of the term "motor vehicles."

80. *(Complainants*) Would the complainants consider that the payment by the vehicle manufacturer of the 25% charge on CKD and SKD kits at the border, as contemplated in Article 2 of Decree 125, be characterised as a "border measure" or "ordinary customs duty"? If so, would it be appropriate for the Panel to consider this specific case under Article II GATT?

Response of the European Communities (WT/DS339)

349. Provided the regular customs procedures are used in that context, the European Communities agrees that it would be appropriate for the Panel to consider this specific case under Article II GATT. The issue would therefore be whether it is in accordance with Article II of the GATT to classify CKD and SKD kits always and automatically as complete vehicles. As stated under paragraph 275 of the EC's first written submission, such a general and automatic classification would not be consistent with China's obligations under Article II.

Response of the United States (WT/DS340)

350. If the enterprise agrees to pay a 25% charge on an CKD or SKD at the border, the other aspects of China's measures (such as verification of local content) would not apply. In this limited case, the charge would appear to be a customs duty. The issue would therefore be whether it is in accordance with Article II of the GATT 1994 to classify CKD and SKD kits always and automatically as complete vehicles, without regard to whether, for example, only assembly operations were involved in completing the whole vehicle. In addition, the United States contends that such tariff treatment of CKDs/SKDs is inconsistent with China's obligations under paragraph 93 of the Working Party Report.

Response of Canada (WT/DS342)

351. Where such a CKD or SKD is charged 25% based upon its condition as it arrives at the border, i.e., commonly understood customs procedures are followed, Canada agrees that this is an appropriate case to be considered under GATT Article II. That consideration would include, e.g., an evaluation of whether the particular CKD or SKD could properly be said to have "the essential character" of a whole vehicle, and whether the appropriate tariff rate was charged.

81. (*Canada*) In paragraph 11 of its oral statement, Canada states that "there are *clear rules* in international trade for assessing goods on importation. These rules recognize that there must be flexibility on importation at the border..." (emphasis added) Please explain what these *clear rules* are.

Response of Canada (WT/DS342)

352. These rules are those which govern the Harmonized System, including the *International Convention on the Harmonized Commodity Description and Coding System* and the General Rules for the Interpretation of the Harmonized System. This includes Notes and Explanatory Notes to the Harmonized System. Decisions of the WCO's Harmonized System Committee may also be relevant.

82. In paragraph 4 of its oral statement, China referred to an example of an auto manufacturer whose imports of parts and components come "from its own *affiliates* and from a *single* country" (emphasis added).

(a) (*China*) Could China clarify whether the measures concerned are applied only to auto part imports coming from companies *affiliated* with the importing automobile manufacturer and from a *single* country? If so, please specify the relevant provisions of the measures concerned; and

Response of China

353. The measures do not apply only to auto part imports coming from companies affiliated with the importing automobile manufacturer and from a single country. China referred to this specific example in its opening statement simply to illustrate the complainants' positions in this dispute.

(b) (*All parties*) Canada refers to factors such as "origin" of imported parts, "who" purchases those parts, and whether there was an earlier investigation (paragraph 24 of Canada's oral statement) and "the timing of shipments or their frequency" (paragraph 34 of Canada's oral statement). Please explain whether, and if so, to what extent, these factors are relevant to the consideration of the nature of the challenged measures.

Response of China

354. These statements by Canada are highly pertinent to what China believes to be the central issue in this dispute. Canada has effectively conceded that WTO Members *can* apply the principles of GIR 2(a) to multiple shipments of parts and components, consistent with the rules of the Harmonized System. In Canada's view, the issue is one of *how* customs authorities go about doing this. That is, Canada appears to believe that it is not a question of *whether*, but *how*.

355. This is a critical concession by Canada. Once it is conceded that the WCO has interpreted GIR 2(a) to permit its application to multiple shipments of related parts and components, and once it is conceded that other WTO Members have taken a similar approach to resolving the relationship between complete articles and parts of those articles, then the complainants *must acknowledge* that customs authorities can design and implement customs procedures to accomplish this result. Moreover, the complainants must acknowledge that these customs procedures relate to the implementation and enforcement of customs duties that Members are allowed to impose by reason of the importation of parts and components that have the essential character of the complete article. These procedures are therefore within the scope of Article II of the GATT 1994.

356. Once these important points are established, this dispute becomes one that is fundamentally about the specific customs procedures that China has adopted to resolve the classification relationship between motor vehicles and parts of motor vehicles. China considers that Decree 125 establishes an open, transparent, and predictable customs procedure for determining what Canada has referred to as the "commercial reality" underlying multiple shipments of auto parts and components.[59] As China has explained, this procedure determines whether multiple shipments of parts and components are related to each other through their common assembly into a specific vehicle model. In this way, the procedure determines whether multiple shipments of parts and components are equivalent to a single shipment of parts and components that China would have classified as a motor vehicle under GIR 2(a).

357. As for the specific factors cited by Canada, the critical point is that China *does* conduct what Canada refers to as an "investigation." That is the purpose of the evaluation and verification process – to "investigate" whether an auto manufacturer imports parts and components for a specific vehicle

[59] See CHI-22.

model that, in their entirety, have the essential character of a motor vehicle. With respect to the "origin" of imported parts, China does not understand why this would be pertinent to the question of whether an auto manufacturer has imported parts and components in multiple shipments that have the essential character of a motor vehicle.[60] With respect to "who" purchases the imported parts and components, China is not certain as to what Canada means. To the extent that Canada is referring to the application of Decree 125 to parts and components that were imported by third-party suppliers, China addresses this question in response to question 83. Finally, with respect to the "timing of shipments or their frequency," China again does not understand why this would be relevant to determining whether an auto manufacturer has imported parts and components in multiple shipments that have the essential character of a motor vehicle.

Response of the European Communities (WT/DS339)

358. These factors demonstrate that the Chinese measures are much broader than the "circumvention" charges that were examined in *EEC - Parts and Com*ponents. Therefore they must *a fortiori* fall under Article III of the GATT.

Response of the United States (WT/DS340)

359. Canada in its opening statement was responding to China's premise that its measure was intended to stop importers, who were in the practice of importing CKDs, from evading the whole-vehicle tariff applied to CKDs by splitting the CKD into two separate boxes. As the United States has noted, the premise of China's argument is false: modern, full-scale manufacturing operations are not in the business of importing CKDs; instead, as a matter of course, manufacturers purchase bulk shipments of parts from various sources. And, nothing in China's measures is limited to, or targeted at, some hypothetical manufacturer who is splitting a CKD shipment into two or more separate boxes.

360. Presumably, if a Customs authority were involved in an investigation as to whether an importer was engaged in such a practice, it might examine factors such as those set out in the above question. However, China's measures are not in fact aimed at such practices, and – as Canada rightly pointed out -- the fact that China's measures do not take account of these factors further shows that China's measures were not in fact intended to stop the alleged practice of splitting a CKD into separate boxes.

Response of Canada (WT/DS342)

361. The principal reason for citing those specific factors in paragraph 24 of Canada's Oral Statement is to demonstrate that Chinese measures are broader than the "circumvention" charges at issue in *EEC – Parts and Components*. In that case, the charges were intended to prevent "circumvention" of anti-dumping duties. Both the original anti-dumping duties and the anti-circumvention charges were established following an investigation, and applied only to certain companies which imported products from a particular country.[61]

362. These factors are relevant to a consideration of the present measures in two ways. First, it is relevant because even the more targeted charges considered in *EEC – Parts and Components*, which were directly linked to particular anti-dumping duties, were still found to be internal charges subject to Article III:2.

[60] Indeed, as China points out in response to question 112, the decision of the HS Committee notes that the application of GIR 2(a) to multiple shipments is not a Rule of Origin issue.

[61] See *EEC – Parts and Components*, GATT Panel Report, at para. 2.8 and Annex I.

363. Second, these factors go to the analysis of China's defence under Article XX(d). Canada accepts that Article XX(d), in principle, could be used to justify internal charges necessary to enforce customs measures. However, as discussed in paragraph 36 of Canada's Oral Statement, the measures do not even attempt to target particular conduct. As such, even if the measures could be justified under Article XX(d), they would still be arbitrary and act as a disguised restriction on international trade in auto parts.

83. (*China*) In paragraph 27 of its oral statement, the United States submits that China appears to *concede* that the imposition of a charge on a part imported by a *third party* is an internal charge, not a customs duty based on footnote 20 of China's first written submission. Does China agree with this statement?

Response of China

364. No. China considers that any charges imposed on an auto manufacturer pursuant to Article 29 of Decree 125 objectively relate to the administration and enforcement of China's tariff provisions for motor vehicles, as they relate to the proper classification of the imported parts and components as part of a collection of imported parts and components that, in their entirety, have the essential character of a motor vehicle. China notes, in this connection, that the EC has measures to ensure that importers cannot evade the duties that apply to the complete article by using third-party importers.[62] Article 29 serves the same purpose.

365. China acknowledges, however, that this specific aspect of Decree 125 presents a different set of issues in relation to the characterization of the measure under Article II. In most cases, imported parts that the auto manufacturer purchases from a third-party supplier in China will have completed the necessary customs formalities and are no longer subject to customs control. In those cases, the imported parts and components are in free circulation in China. Because China believes that these are important considerations in the characterization of this aspect of the Decree 125, China has specifically invoked the general exception in Article XX(d) of the GATT 1994 to justify this provision. China believes that, even if the Panel were to find that this provision of Decree 125 is an internal measure subject to the disciplines of Article III, it is necessary to secure compliance with China's customs laws and regulations, including its valid interpretation of the term "motor vehicles."

84. (*Complainants*) The Panel in *EEC – Parts and Components* used the expression "conditioned upon the importation of a product" (paragraph 5.5). In this connection, please comment on China's position that the term "on their importation" can be interpreted to encompass charges that Members impose as a condition of the importation of products from other countries (China's oral statement, paragraph 25).

Response of the European Communities (WT/DS339)

366. The European Communities does not believe that the panel used the expression "conditional upon the importation of a product" as a legal test in *EEC- Parts and Components*. In paragraph 5.5 of the panel report the panel appears to cite or at most rephrase the arguments made by the EEC at the time. The actual test the panel used seems to be contained in paragraphs 5.6, 5.7 and 5.8 of the panel report.

367. However, the European Communities understands that China aims at extending the time and place at which the determination of a customs liability is normally made to a time well beyond the

[62] See China's first written submission at para. 125.

time of the product being presented to customs on importation and even beyond the time of the product being used internally in the manufacture of other products. The European Communities fundamentally disagrees with this position of China. As China considers that the charges in question are "ordinary customs duties" they should be due "on importation" not "in connection with importation" or be "conditional upon importation" of a product. In reality the charges and administrative requirements are internal measures imposed on the basis of the use of the parts in China. There is no "connection" or "condition" that relates to importation despite the ostensible formal link made with customs authorities and customs procedures.

Response of the United States (WT/DS340)

368. The United States does not agree that the term "on their importation" in Article II, first sentence, includes measures that Members impose "conditional upon the importation of a product." There is no textual or contextual basis presented by China (or otherwise) for such an interpretation. To the extent that these two phrases have different meanings, the one chosen by China (and the one not actually used in the GATT) is much broader, and seems to be chosen by China in an attempt to argue that its internal charge is a customs duty. In fact, China's phrase ("conditional upon") is so broad that it would seem to allow an internal sales tax to be different for domestic products and imported products (because the higher tax on imported products would be "conditional" upon the fact that the product had been imported). Such an interpretation would, of course, be impermissible because it would conflict with (and make inutile) Article III:2.

369. China's suggested interpretation is also inconsistent with the context of Article II:1(b) as a whole. The first sentence of Article II:1(b) associates the phrase "on their importation" with "ordinary customs duties". The second sentence of Article II:1(b) uses a broader term – "imposed on or in connection with the importation" – with the catch-all concept of "all other duties or charges of any kind." But China's interpretation would destroy this structure – it would (without reason) associate the arguably even broader phrase "conditional upon importation" with ordinary customs duties, thus rendering ineffective the decision by the drafters to use the broad concept "on or in connection with" in association with "other duties and charges."

Response of Canada (WT/DS342)

370. Canada does not agree with China's position that the phrase "conditioned upon the importation of a product" is of any assistance in considering the measures. The phrase does not appear in the text of Article II, nor does the panel in *EEC – Parts and Components* adopt the language as relevant for interpreting that Article. In Canada's view, the term was not used by the panel in any legal sense. Instead, the panel was referring merely to an argument put forward by the EEC, in the context of the second sentence of Article II:1(b).

371. Even if the panel had accepted the EEC's argument, and allowed conditions to be imposed on the importation of a product, China could not rely on a similar argument. The second sentence of Article II:1(b) refers to "other duties or charges". But China has clearly stated that it takes the position that the charges under the measures are "ordinary customs duties", *not* "other duties or charges". See also Canada's response to Questions 97, 99 and 100.

372. As a further hypothetical, even if China had explicitly included in its Schedule a note allowing it to impose conditions on the importation of auto parts as an "ordinary customs duty", it could not rely on that condition to impose internal charges contrary to GATT Article III (which China concedes that it imposes with respect to imports by anyone other than vehicle manufacturers). Panels

have consistently ruled that Members cannot use conditions reflected in a Schedule so as to justify measures otherwise inconsistent with their WTO obligations. [63]

85. (*All parties*) The complainants have presented their claims in such way that that the Panel would be required to examine their claims under Articles III and the TRIMS Agreement *only* if the measures at issue were to be considered as internal measures. In your view, if the measures were to be considered as border measures, would the Panel still be required to address the complainants' claims under Article III and Article 2 of the TRIMs Agreement?

In this connection, would the fact that the Appellate Body (para. 211) upheld the Panel's finding in *EC - Bananas III* that, *inter alia*, "border measures may be within the purview of the national treatment clause" (Panel Report, para. 7.176) be of any relevance to this question? Please explain.

Response of China

373. For the reasons that China has explained, the challenged measures are within the scope of Article II because they interpret and enforce China's tariff rate provisions for motor vehicles, as set forth in its Schedule of Concessions. If the Panel were to agree with China that the challenged measures are subject to the disciplines of Article II, this would mean, in China's view, that the Panel would not be required to consider the complainants' claims under Article III and Article 2 of the TRIMs Agreement.

374. China considers that, *within their respective spheres of application*, Article II and Article III of the GATT are mutually exclusive of each other. The critical issue is determining their respective spheres of application. The basic purpose of Article III is to prohibit Members from discriminating against imported products in comparison to the treatment that they provide to domestic products. One of the purposes of Article II, however, is to countenance a specific type of discrimination against imported products – the imposition of ordinary customs duties within the limits of the importing Member's Schedule of Concessions. The discrimination inherent in a customs duty that a Member validly imposes is not a form of discrimination that is prohibited under Article III. If that were the case, Article II would be *inutile*; the right to impose ordinary customs duties would be given in Article II only to be taken away in Article III. This interpretation is not consistent with the object and purpose of the GATT and is not consistent with principles of effective treaty interpretation.

375. The panel and Appellate Body reports in *EC – Bananas III* highlight the critical importance of defining the respective applications of Article II and Article III in relation to a challenged measure. In relevant part, *EC – Bananas III* concerned the procedures that the European Communities had adopted for the allocation of import licenses under its tariff rate quota for third-party and non-traditional ACP bananas. Under these procedures, "operators" who had marketed bananas from EC and traditional ACP sources during the preceding three-year period – so-called "Category B" operators – were allocated 30 per cent of the import licenses necessary to import third-party and non-traditional ACP bananas under the TRQ. This system created an incentive for operators to purchase *EC* and *traditional ACP* bananas in order to increase their share of *third-party* and *non-traditional ACP* imports under the TRQ.

376. Critically, the EC's procedures for distributing import licenses for third-party and non-traditional ACP bananas *bore no relationship to the tariff rate quota that it was allowed to maintain*.

[63] *EEC – Imports of Beef*, GATT Panel Report, L/5099 - 28S/92, adopted 10 March 1981, at paras. 2.2, 4.5-4.6; *United States –Sugar*, GATT Panel Report, L/6514 - 36S/331, 22 adopted June, 1989, at para. 5.5.

The EC was allowed to maintain the TRQ within the scope of its GATT commitments, and was allowed to maintain a system of import licenses to give effect to this TRQ. The issue in dispute was whether the EC's procedures for *distributing* these import licenses, and the eligibility criteria that it adopted for this purpose, were within the scope of its rights and obligations under Article II. The Appellate Body recognized this important distinction: "At issue in this appeal is not whether *any* import licensing requirement, as such, is within the scope of Article III:4, but whether the EC procedures and requirements for the *distribution* of import licenses for imported bananas among eligible operators *within* the European Communities are within the scope of this provision."[64] The Appellate Body found that the EC's distribution procedures for import licenses went "far beyond the mere import license requirements needed to administer the tariff rate quota for third-country and non-traditional ACP bananas or Lomé Convention requirements for the importation of bananas."[65]

377. As it relates to the present dispute, *EC – Bananas III* stands for the proposition that a law or regulation that a Member adopts to implement and enforce a measure that it is *allowed* to maintain by reason of the importation of a product (such as the imposition of a customs duty or the administration of a TRQ), including any portion of such law or regulation, must be *germane* to that purpose. This is what the panel meant when it stated that "border measures may be within the purview of the national treatment clause."[66] As the panel stated, the "mere fact" that the distribution criteria favouring the purchase of EC and traditional ACP bananas were included within a measure that ostensibly pertained to the administration of the TRQ did not determine whether the distribution criteria were subject to the disciplines of Article II or Article III.[67] What mattered, as the Appellate Body confirmed in its report, was whether this aspect of the measure was an element of administering the valid border measure (the TRQ), and therefore within the scope of Article II, or whether this aspect of the measure served instead to affect the internal sale, distribution, or use of the product.[68]

378. As China has demonstrated, the challenged measures implement and enforce a valid interpretation of China's tariff provisions for motor vehicles, in a manner that is consistent with the rules of the Harmonized System and the practices of other WTO Members under similar circumstances. Unlike the measures at issue in *EC – Bananas III*, the measures are germane to the enforcement of China's rights and obligations under Article II, in that they define the conditions under which China will consider the importation of multiple shipments of auto parts and components to be

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[64] *EC – Bananas III* (AB), at para. 211.

[65] *EC – Bananas III* (AB), at para. 211. This distinction had been recognized by the panel. The panel stated that "we have to distinguish the mere requirement to present a licence upon importation of a product as such from the procedures applied by the EC in the context of the licence allocation which are internal laws, regulations and requirements affecting the internal sale of imported products." *EC – Bananas III* (Panel), at para. 7.177. The panel stated that "although licences are a condition for the importation of bananas into the EC at in-quote tariff rates, we find that the *administration* of licence distribution procedures and the *eligibility* criteria for the allocation of licences to operators form part of the EC's *internal* legislation. … Therefore, the [EC's] argument that licensing procedures are beyond the purview of the GATT national treatment clause cannot, in our view, be sustained …" Id. at para. 7.178 (emphases added).

[66] *EC – Bananas III* (Panel), at para. 7.176.

[67] *EC – Bananas III* (Panel), at para. 7.177.

[68] It is therefore not the case, as the United States appeared to suggest at the first substantive meeting, that every aspect of a measure can be analyzed for its conformity with both Article II and Article III. To the extent that a measure, or some aspect thereof, gives effect to a form of discrimination that a Member is allowed to undertake pursuant to Article II, that same element of discrimination cannot be challenged under Article III. For example, when a Member requires an importer to maintain certain records with respect to imported products for the purposes of customs administration, this "discrimination" against imported products is not subject to the disciplines of Article III. It is simply an aspect of administering and enforcing the "discrimination" that the Member is entitled to undertake within the scope of its Article II commitments.

equivalent to the importation of a motor vehicle, in accordance with the principles of GIR 2(a). The measures are therefore within the sphere of application of Article II, and not subject to the disciplines of Article III.

379. The same conclusion pertains in respect of Article 2 of the *TRIMs Agreement*. Under Article 2 of the *TRIMs Agreement*, a Member may not apply "any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994." Because the challenged measures are not within the scope of either Article III or Article XI of the GATT, they are not subject to the disciplines of the *TRIMs Agreement*.

Response of the European Communities (WT/DS339)

380. The European Communities does not believe that it has presented its claims under the *TRIMs Agreement* and Article III of the GATT in a way that would require the Panel first to decide whether the measures at issue are to be considered as internal measures or not. Indeed, the European Communities explicitly stated in its oral statement under paragraphs 13 and 21 that an analysis under the *TRIMs Agreement* does not require such an *ex ante* preliminary consideration. It is China that has decided to base its defence on a premise that the Panel must first decide whether the measures at issue are internal or border measures.

381. The European Communities considers that the Appellate Body's finding in *EC – Bananas III* is relevant in this context. China appears to consider that the general description of a Measure as a "border measure" or "border charge" automatically excludes an analysis of that measure under Article III of the GATT and/or under the *TRIMs Agreement*. In other words, China appears to argue that a "border measure" in the case at hand equals "subject to Article II of the GATT". The European Communities considers that a measure that attempts to operate ostensibly at the border but which in reality applies internally is subject to an analysis under Article III of the GATT and the *TRIMs Agreement*.

Response of the United States (WT/DS340)

382. As the United States stressed in its oral statement, the United States did not intend for its first submission to indicate that Article III and the TRIMs Agreement only apply if China's charge is an internal one, instead of a customs duty. To the contrary, the United States submits that regardless of whether the charge is considered an internal one or a customs duty, the measures are a straightforward breach of Article III:4, Article III:5, and the TRIMs Agreement. The thresholds established by China's measures must be met in order to avoid the increase in the amount of 15 percentage points of the charge on imported auto parts. As such, manufacturers have a strong incentive to purchase local parts, which results in less favorable treatment under Article III:4, a mixing requirement under Article III:5, and a prohibited local content requirement under the TRIMs Agreement.

383. Paragraph 211 of *EC - Bananas III* is directly supportive of this point. In that dispute, the Appellate Body explained as follows:

> "211. At issue in this appeal is not whether any import licensing requirement, as such, is within the scope of Article III:4, but whether the EC procedures and requirements for the distribution of import licences for imported bananas among eligible operators within the European Communities are within the scope of this provision. The EC licensing procedures and requirements include the operator category rules, under which 30 per cent of the import licences for third-country and non-traditional ACP bananas are allocated to operators that market EC or traditional

> ACP bananas, and the activity function rules, under which Category A and B licences are distributed among operators on the basis of their economic activities as importers, customs clearers or ripeners. These rules go far beyond the mere import licence requirements needed to administer the tariff quota for third-country and non-traditional ACP bananas or Lomé Convention requirements for the importation of bananas. These rules are intended, among other things, to cross-subsidize distributors of EC (and ACP) bananas and to ensure that EC banana ripeners obtain a share of the quota rents. As such, these rules affect "the internal sale, offering for sale, purchase, ..." within the meaning of Article III:4, and therefore fall within the scope of this provision. Therefore, we agree with the conclusion of the Panel on this point."

384. As the Appellate Body described, the EC measures (licensing requirements) were border measures, but the criteria for allocating the licenses affected the internal sale, offering for sale, and purchase within the meaning of Article III:4. The analysis in the current dispute is the same: even if China's charges are considered customs duties, the fact that the level of these charges are conditioned upon the amount of local content used by the manufacturer affects the internal sale, offering for sale, and purchase of imported and domestic parts. As such, they are subject to analysis under Article III:4. And, because the measures favor manufacturers who use an amount of domestic parts that meets China's thresholds, the measures accord less favorable treatment to imported parts and thus breach China's obligations under Article III:4.

Response of Canada (WT/DS342)

385. Canada does not consider that any aspect of the measures could be interpreted so as to preclude an Article III or TRIMs analysis. Canada has already referred to China's concession that charges imposed on parts imported by any party in China other than vehicle manufacturers are internal. There is no question that such charges would be examined under GATT Article III and TRIMS Article 2. That noted, a border measure that imposes a charge at the time of importation, in accordance with China's Schedule, would fall within the ambit of Article II. No analysis under Article III:2 would be required.

386. The *administrative* burdens imposed by the measures on imported auto parts must be assessed under Article III:4. It is irrelevant where that burden applies. Canada suggests that in analysing the measures' administrative requirements, it is not necessary to make a preliminary determination of whether those requirements are "border measures" or "internal measures" before considering whether they violate GATT Articles III:4 and III:5.

387. Yes. The Appellate Body recognized that GATT Article III may apply to measures otherwise described as "border measures", where those measures "go far beyond" the requirements to administer standard border procedures, and affect the "internal sale, offering for sale, purchase,…" within the meaning of Article III:4.[69] Canada considers that the measures go far beyond anything typical of a scheduled border charge or typical customs procedure and deny national treatment to imported products, as set out at paragraphs 44 to 64 and 102 of Canada's first written submission.

86. (*European Communities*) China contends that the challenged measures, which it has adopted to prevent circumvention of its tariff rates for motor vehicles, operate on the *same basis* as the EC's anti-circumvention measure that was revised as a result of the panel's findings in

[69]Appellate Body Report, *EC – Bananas III*, WT/DS27/AB/R, adopted September 25, 1997 at para. 211.

EEC – Parts and Components. **(first written submission of China, paras.57-61) Please comment in detail on this statement, including the differences and similarities between the challenged measures and the old and revised EEC measures related to *EEC – Parts and Components*.**

Response of the European Communities (WT/DS339)

388. The Anti-Dumping rules of the European Communities are not before the Panel. In any event, the European Communities considers that the premise of China's argument is fundamentally flawed. Even if it were to be considered (*quod non*) that the Chinese measures enforce Customs duties, trying to extract from EC AD anti-circumvention rules or any other such rules general principles legitimising anti-circumvention rules of Customs duties would be totally inappropriate. Anti Dumping measures are subject to entirely separate obligations within the covered agreements which are defined in Article VI of the GATT and the Agreement on the Implementation of Article VI of the GATT 1994. Furthermore, the Ministerial Decision on Anti-Circumvention adopted by the Trade Negotiations Committee on 15 December 1993 explicitly recognises that uniform rules on anti-circumvention of anti-dumping measures have not been defined. Any comparison is therefore bound to be compromised by this fundamental problem with the premise of the comparison.

389. If one ignores this very basic problem for the comparison, there is perhaps a very general similarity between the old EEC measures that were subject to the panel report in *EEC – Parts and Components* and the Chinese measures in the sense that the final determination on the applicable duties was made after the assembly operations.

390. Under the new AD anti-circumvention rules, the possible AD duties on the parts will be imposed at the border, and not anymore once they are assembled in the finished product.

391. Reference is also made to the reply given to question 132.

87. (*All parties*) In light of the language of GATT Articles I, II, III as well as the Interpretative Note *Ad* Article III, how relevant, in your view, is the *precise time and place* of the collection of a charge, or the enforcement of a law or regulation, to the characterization of such charge or law/regulation?

Response of China

392. With the possible exception of the Note *Ad* Article III, China does not consider that the rights and obligations of WTO Members set forth in GATT Article I, II, and III are defined by reference to the precise time and place at which a charge is collected, or a law or regulation is enforced. None of these articles contains terminology that is directly or necessarily linked to the *time* or *place* at which the action is taken. On the contrary, these articles use a variety of different formulations to describe the types of measures to which the relevant provisions pertain, all of which seem to focus on the *event* or *condition* that triggers the right or obligation. For example:

- Article I:1 refers to "customs duties and charges *of any kind* imposed *on or in connection with importation*," and likewise refers to "all rules and formalities *in connection with importation* …"

- Article II:1(b) refers to ordinary customs duties imposed on products "*on their importation* into the territory," and refers also to "other duties or charges *of any kind* imposed *on or in connection with the importation* …"

- Article II:2 refers to charges that Members may apply "*at any time on the importation* of any product …" This is a particularly interesting formulation, as it appears to disassociate the notion of time from the *process* of "importation," a term that is used throughout Articles I and II.

- Article III:2 and Article III:4 both refer to "the products of the territory of any contracting party *imported* into the territory of any other contracting party …"

393. In China's view, the common theme among these various provisions, to the extent one can be discerned, are the notions of *importation* and *imported* as the events or conditions that trigger the substantive right or obligation. On one side are rights and obligations that the Member has in respect of products of other Members by reason of, or as a condition of, the "importation" of those products. On the other side are rights and obligations that the Member has in respect of products of other Members by reason of, or as a condition of, the fact that they have been "imported" into that Member's territory. The time or place at which the event occurs (e.g., the collection of the charge, or the enforcement of the law or regulation) is not central to this distinction; what matter is the event or condition that gave rise to the relevant right or obligation.[70]

394. This distinction requires an understanding of what the process of "importation" entails, as well as an understanding of what it means for products to be "imported." China has already sought to provide its views on this distinction, principally in connection with its responses to questions 37 and 55. In sum, China considers that the process of "importation" is complete, and that goods have been "imported," once all of the customs formalities required in connection with the importation of those goods have been satisfied, and the goods are no longer subject to customs control. As China has stressed in response to other questions, including question 79, WTO Members are not allowed to impose *any* charge on imported products, or enforce *any* type of measure against imported products, simply because it is collected or enforced as part of the "importation" process. Again, China considers that what matters is whether the measure is one that the Member is allowed to impose by reason of, or as a condition of, the importation of the product.

Response of the European Communities (WT/DS339)

395. The precise time and place of the collection of a charge, or the enforcement of a law or regulation may be relevant for the characterization of such charge or law/regulation under Articles I, II and III of the GATT. It is not possible to give a "quantitative" answer that applies across the board. However, for instance the actual payment of a charge i.e. the transfer of the monies due to importation of a good may occur after importation but the determination of the amount due must be made on importation.

[70] As noted, the one possible exception to this observation is the Note Ad Article III, which refers to an internal tax or regulatory measure that applies to both the imported product and the like domestic product, and which is "collected or enforced in the case of the imported product at the time or point of importation …" But even this one reference to "the time or point of importation" is itself ambiguous, as it still requires an understanding of what importation entails, when it occurs, and where it occurs. As China has sought to demonstrate (e.g., in response to question 55), the process of "importation" (or "customs clearance") does not necessarily conclude when the goods physically cross the border. The process of importation, including the completion of all necessary customs formalities, is often concluded long after the time at which the goods physically crossed the border, and when the goods are at a place other than the frontier.

Response of the United States (WT/DS340)

396. The United States considers that the precise time and place of the collection of a charge is relevant to the characterization of such charge as an internal one or as a border charge. However, as the question notes by its reference to Ad Article III, an internal tax applied to imported products at the border is still considered an internal tax, despite that the time and place of its collection are at the border and upon importation. The United States submits that this question must be examined based on the particular facts and circumstances of each case. In this dispute, as the United States has explained, the key factors in favor of finding China's charge to be an internal charge include (1) that the level of the charge depends on details of the manufacturing operations that take place within China, after importation; (2) that the level of that charge cannot be determined until the manufacturing process is complete; (3) that the charge is imposed on manufacturers, not importers; (4) that the charge is imposed even on imported parts that have been imported and processed in China by unrelated manufacturers; (5) that the parts deemed to be a single "whole vehicle" may have been sourced from different exporters and imported at separate times; and (6) that such parts may indeed even have been sourced from different countries. Moreover, identical imported parts in the same shipment can be subject to different charges (that are allegedly "customs duties") depending on their internal use – for example, if one part is used within China as a replacement part and the other part is used within China to manufacture a vehicle that fails to meet China's local content requirement.

Response of Canada (WT/DS342)

397. In assessing the characterization of a charge, one must consider why, as well as how or when, the charge is imposed. As set out in more detail in response to Question 32, in respect of border charges, Canada's view is that the precise time and place of collection of a charge is not determinative in characterizing a charge or law/regulation as subject to Article III or II. Border charges may be collected well after a product has been imported into a Member, so long as the calculation of that charge is based upon the condition of the product as it arrived at the border. Conversely, a clearly internal charge (for example, a value-added tax) may be collected at the exact moment that a product enters the country, in accordance with Article II:2(a) and *Ad* Article III. For a charge, what is significant is whether the charge relates to the product as presented at a Member's border. Any border charge, whether collected at the border or at some later time, may only relate to the product at that point in time. If it does not (i.e., a charge based on end-use), then it must be an internal charge.

88. (*All parties*) Please explain whether a charge, law or regulation *must* apply to *both* domestic and imported products to be considered internal in light of the language of Note *Ad* Article III as well as the Panel's findings in *EC – Asbestos* (paras. 8.93-8.95), *EEC – Animal Feed* (para. 4.16-4.18) and *Dominican Republic – Import and Sale of Cigarettes* (paras. 7.25).

Response of China

398. China considers that this is an extraordinarily difficult question of interpretation. In China's view, the heart of the interpretive problem is Article II:1(b), second sentence, which refers to "other duties or charges *of any kind* imposed *on or in connection with the importation*" of a product. Under one interpretation, any charge that applies exclusively to imported products, and that is not an ordinary customs duty covered by Article II:1(b), first sentence, is an "other duty or charge" within the scope of Article II:1(b), second sentence. This view finds limited support in the panel report in *Dominican Republic – Import and Sale of Cigarettes*, although it is important to note that Honduras, the complainant in that case, did "not contest the fact that the transitional surcharge is an ODC within

the meaning of Article II:1(b)."[71] It also finds support in the panel report in *EC – Asbestos*, which implied that an internal measure under Article III is one that applies to both the imported product and the domestic product, even if the measures in respect of the imported and domestic product are not *identical*.[72]

399. This interpretation is complicated by the Note Ad Article III, which refers to "[a]ny internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 *which applies to an imported product and to the like domestic product* and is collected or enforced in the case of the imported product at the time or point of importation …" The italicized language *which applies to an imported product and to the like domestic product* could be read as *describing* what an "internal tax or charge" is – it as a tax or charge applied to imported products *and* the like domestic products. This would support the apparent reading of the Note Ad Article III in EC-Asbestos. On the other hand, the italicized language could be read as qualifying the type of "internal tax or charge" to which the Note *Ad* Article III applies – it applies only to "internal taxes or charges" that are imposed on both the imported product and the domestic like product. This second reading would support the view that an "internal tax or charge" is not *necessarily* one that applies to both the imported product and the domestic like product. This second reading is supported by the fact that, under the first reading, the italicized language is essentially redundant – if the language "which applies to an imported product and to the like domestic product" describes what an "internal tax or charge" is, then the language is not essential to the intended meaning of that sentence. That is, under the first reading, the sentence would have the same meaning if it were written without the italicized language, as follows: "[a]ny internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which is collected or enforced in the case of the imported product at the time or point of importation …".

400. China does not consider that a resolution of this complex interpretive issue is necessary to the resolution of the present dispute. For the reasons that China has explained, the challenged measures implement China's tariff provisions for "motor vehicles," and result in the imposition of the *ordinary* customs duties on motor vehicles that China is allowed to collect under its Schedule of Concessions. These are not "other duties or charges" within the meaning of Article II:1(b), second sentence. Thus, this dispute does not implicate the relationship between "other duties or charges" under Article II:1(b), second sentence, and "internal taxes or charges" that are applied exclusively to "imported" products within the scope of Article III.

Response of the European Communities (WT/DS339)

401. The language of Article III does not require that a charge, law or regulation must apply to both domestic and imported products to be considered internal under Article III of the GATT 1994. In fact, under Article III:1 and III:2 reference is made explicitly to "imported or domestic products" (emphasis added). Therefore, a charge, law or regulation does not need to apply to both domestic and imported products to be considered internal and subject to Article III of the GATT. The Ad Note to Article III concerns specific situations where both the domestic and the imported like good are subject to charges, laws, regulations or requirements but are collected or enforced in respect of the imported good at the time or point of importation. If the scope of Article III was limited to situations where internal charges, laws, regulations or requirements are applied to both domestic and imported goods, it would render the most blatant discriminations (i.e. situations such as is the case with the Chinese measures where the internal charges, laws, regulations or requirements apply internally only to imported goods) outside the scope of Article III.

[71] *Dominican Republic – Import and Sale of Cigarettes*, at para. 7.23.
[72] *EC – Asbestos* (Panel), at para. 8.93.

Response of the United States (WT/DS340)

402. The language of Article III does not require that a charge, law or regulation must apply to both domestic and imported products to be considered internal under Article III of the GATT 1994. In fact, under Article III:1 and III:2, reference is made explicitly to "imported *or* domestic products." Moreover, if the charge had to be applied to both imported and domestic products to be within the scope of Article III, Members freely could favor domestic products – contrary to the intent of Article III – through the simple expedient of imposing a high internal charge (a sales tax for example) that applied only to imported products, while completely exempting domestic products from the sales tax. In fact, the charge in *Belgium - Family Allowances* exempted domestic products, and the GATT 1947 Panel nonetheless found that it was an internal charge that was inconsistent with obligations under Article III:2.

Response of Canada (WT/DS342)

403. Canada does not believe that a charge, law or regulation must apply to both domestic and imported products to be considered internal. The language of Article III itself imposes no such requirement, and *Ad* Article III simply clarifies that certain types of internal measures (which apply equally to imported products and to like domestic products but are applied at the border) are subject to Article III. In effect, *Ad* Article III allows internal measures to be applied at the border on imported products rather than wait until those internal products have entered the internal market, but only if those internal measures also apply equally (and separately) to domestic products. The reverse does not apply, and there is nothing permitting measures relating to the importation of goods to be applied to internal trade. Such an interpretation would effectively eliminate the value of Article III's requirement to provide national treatment, since it would allow blatant measures violating national treatment (*e.g.*, "all imported goods must pay an extra 100% charge") as long as the measures do not apply to domestic products.

404. A charge need not apply directly to both imported and domestic goods. Instead, it is correct to consider whether that charge adversely affects the conditions of competition for imported goods. This principle is well-established in cases where a charge, law or regulation only applies to imported goods, but, as a consequence, confers an advantage for those producers that use or purchase domestic goods (see Canada's first written submission, at paragraphs 97-99). This is consistent with *EC – Asbestos* (concluding that what might appear to be a measure restricting importation contrary to Article XI could also be an internal measure) and *EEC – Animal Feed Proteins*.

405. The panel in *Dominican Republic – Import and Sale of Cigarettes* did suggest in passing that the charge in question there was "not an internal tax … since it does not apply to domestic products", but as set out in paragraphs 7.22 and 7.23, there was no dispute that the charges in question were "other duties and charges" subject to Article II. The only question was whether those charges were recorded in the Schedule of the Dominican Republic.

89. (*All parties*) What is the meaning of "*at any* time on the importation" in the *chapeau* of GATT Article II:2 and "*at the* time or point of importation" in the GATT Interpretative Note *Ad* Article III? Do they convey the same or different notion of time and space? Can these provisions be of any guidance for the Panel in its characterization of the nature of the challenged measures?

Response of China

406. For the reasons set forth in response to question 87, China does not consider that any of the various formulations surrounding the word "importation" in Article I, Article II, or Article III (including the Note *Ad* Article III) are clearly tied to a notion of time or space. In fact, as China noted in that response, the formulation in the *chapeau* to Article II:2 ("*at any time* on the importation") appears to disassociate the notion of "importation" from a specific time or place. As China also noted, while the Note *Ad* Article III refers to the "time or point of importation," even this formulation requires some understanding of what "importation" means, when it occurs, and where it occurs. Thus, China does not believe that these references to time and space provide guidance for the Panel in its characterization of the nature of the challenged measures. For the reasons that China has explained, China believes that the *event* or *condition* giving rise to the measure is the most relevant consideration.

Response of the European Communities (WT/DS339)

407. The words "at any time" in the chapeau of Article II:2 GATT would seem to refer to the general right of members to impose the relevant charges, duties and fees at any time. In other words, "at any time" refers back to the words before them and not to the words "on importation" that come after. The words "*at the* time or point of importation" in Ad Article III in turn seem to refer to the time or point of importation. The words "at any time" and "at the time" in these provisions convey therefore a completely different notion of time and space. Comparing these formulations would not seem to provide any guidance for the Panel.

Response of the United States (WT/DS340)

408. The United States is not aware of how these provisions could be helpful in a characterization of the challenged measures. Neither the complainants nor China contends that the measures fall within the scope of Article II:2 or Note Ad Article III. Instead, the provisions at issue are Article II:1 and Article III:2. To be sure, the language of other GATT provisions (such as Article II:2 or Note Ad Article III) might be referred to for context, but it is unclear how those provisions provide context for any interpretative issues in this dispute.

Response of Canada (WT/DS342)

409. Both phrases refer to the same concept: that there is a process of importation during which products physically enter the territory of a WTO Member and are cleared through customs. "At any time" during that process internal taxes may be imposed in accordance with Article II:2(a), but, despite the charge being imposed at the "time or point" of importation, *Ad* Article III clarifies that it is still an internal measure and subject to Article III.

410. In Canada's view, "at any time" should be read in relation to the remainder of the phrase "on the importation". The latter phrase indicates that the point of "importation", and not after the goods are imported, is the relevant time to apply the various types of charges that are permissible under Article II:2, namely anti-dumping duties, border charges equivalent to internal charges, or fees for the costs associated with importation. For example, a customs assessment of a good taken on presentation may occur independent of the assessment of administrative costs rendered in respect of that particular importation. However, "at any time" read together with "on the importation" constrains the flexibility of customs officials to apply any charge not otherwise contemplated in Article II:2. The phrase "at the time" in *Ad* Article III appears to establish that the actual point of importation is discrete from the

passage of the good into the internal market for purposes of Article III. Neither of these provisions would seem to provide insight into timing issues in respect of Article II:1(b).

90. (*Complainants*) Do you consider that the factors mentioned by China in paragraph 67 of its first written submission are relevant to the characterization of a measure as a border measure. If so, please explain whether the challenged measures:

Response of the European Communities (WT/DS339)

411. The factors mentioned by China in paragraph 67 of its first written submission clearly aim at extending the scope of Article II GATT into measures that should be examined under Article III GATT. Article II:1(b), first sentence does not contain any language that would allow the unprecedented extension of its scope in the way China suggests in paragraph 67. As considered by the Appellate Body in *EC – Bananas III*, rules that are attached to a border measure should be considered under Article III if they affect internal sale.

Response of the United States (WT/DS340)

412. The United States does not agree with China's contentions in paragraph 67 of its first written submission. In fact, China's assertions are entirely circular – China starts with an assumption that its charges are "valid customs liabilities" and a "liability that attached at the time of importation." Neither of these assumptions is true. As the United States has explained, the charges are internal ones, and the liability actually attaches not at the time of importation, but only after manufacturing. In fact, China requires a bond at the proper 10 per cent parts rate, and the manufacturer is only liable for the 25 per cent "whole-vehicle rate" if the imported part is used to produce a vehicle that does not meet China's local content thresholds.

413. In the response to Question 32, the United States explains in detail why the customs enforcement mechanisms that China refers to in paragraph 67 have no relation to the Chinese measures at issue in this dispute.

Response of Canada (WT/DS342)

414. Canada does not agree with China's statement in paragraph 67 of its first written submission. As Canada has stated previously, while payment of duties may be calculated or paid after importation, the duties must be calculated based upon the state of goods as they are presented at the border – that is to say "at the time or point of importation".

(a) bear an objective relationship to the administration and enforcement of a valid customs liability; and

Response of the European Communities (WT/DS339)

415. Even if the criterion suggested by China would be accepted, the measures do not bear an objective relationship to the administration and enforcement of a valid customs liability since the liability is established only after the manufacture of the final product.

Response of Canada (WT/DS342)

416. An internal charge may have a relationship with a customs duty, but that does not mean that it is justifiable under Article II if the charge is imposed based on anything other than the state of a good

as presented at the border. Liability applied to imported products under the measures occurs only after the final related product, the complete automobile, rolls off the assembly line. As a result, Canada sees nothing in the measures to suggest a relationship with the administration and enforcement of valid customs liabilities.

(b) relate to a condition of liability that attached at the time of importation.

Response of the European Communities (WT/DS339)

417. The measures do not relate to a condition of liability that attached at the time of importation since the liability is triggered only after the manufacture of the final product and depending on the internal use of the imported product in China. Reference is also made to the reply given to question 84.

Response of Canada (WT/DS342)

418. Canada agrees that a border charge need not be paid at the time of importation, but it must relate to the "snapshot" of the good as it arrives at that time. As discussed in greater detail in response to Question 84, any "conditions" must be set out in a Member's Schedule, and cannot violate other provisions of the GATT. The conditions created by the measures are not set out in China's Schedule, and apply in any event in respect of the internal use of imported products, thereby violating Article III (as discussed in response to Question 37).

91. (*European Communities*) In paragraph 27 of its written oral statement, China considers that a charge is "conditional upon" the importation of a product if the charge bears an "objectively ascertainable relationship to the fulfilment of a customs liability". Footnote 4 to that paragraph suggests that China's statement has been inspired by an EEC comment on the findings of the Panel Report in *EEC – Parts and Components*. Please comment on the relevance of that comment to the instant case, in particular to the characterization of the measures as internal or border measures.

Response of the European Communities (WT/DS339)

419. As is often the case the EEC as the losing party was not pleased with the panel report and made comments accordingly. These comments were made exclusively in the context of Anti-Dumping anti-circumvention measures. Subsequently the EEC accepted to adopt the report. The comments made by the EEC at the time are therefore entirely irrelevant for the present case.

92. (*China*) China considers that the measures are border measures because *inter alia* they "do not impose duties upon parts and components after they have *unconditionally* entered China's customs territory." (paragraph 60 of China's first written submission, emphasis added). Are the charges imposed upon auto parts imported by suppliers under Article 29 of Decree 125 also *not* imposed after they have *unconditionally* entered China's customs territory? More broadly, and taking into account your own understanding of a border measure, can a measure related to a product that has *unconditionally* entered the territory of a country still be a border measure? If so, how?

Response of China

420. China has answered this question, in substance, in response to question 83.

93. (*China*) Could China clarify whether the "charge" at issue is calculated in accordance with the declaration made by the importer at the time of importation, or on the basis of the "Verification Report" issued by the Verification Center after the imported parts have been incorporated into the relevant vehicle model, in light of China's statement in paragraph 32 of its first written submission and Article 28 of Decree 125.

Response of China

421. The charge is assessed in accordance with the declaration made at the time of importation. The verification report is the conclusion of the determination that is made *prior* to the importation of auto parts for a particular vehicle model. Once it has been verified that a particular vehicle model is assembled from imported parts and components that, in their entirety, have the essential character of a motor vehicle, the auto manufacturer must thereafter declare those parts as parts of a complete motor vehicle, and pay the applicable duty rate for motor vehicles. This obligation will not change until the auto manufacturer applies for, and obtains, a new verification of the vehicle model based on a change in the composition of the imported auto parts, as provided for under Article 20 of Decree 125.

94. (*United States*) In paragraph 143 of its first written submission, China refers to an argument made by the United States in *EEC – Parts and Components* that "[i]t was a general principle of international customs practice that substance should prevail over the form of a transaction. In certain situations assembly operations could constitute a sham to evade the payment of anti-dumping duties. This was no different from the routine problems faced every day by all contracting parties of preventing efforts to evade the collection of legitimate customs tariffs on merchandise." Based on this statement, China argues that the United States has directly analogized the circumvention of AD/CV duties to the circumvention of ordinary customs duties.
Please comment on China's position in this regard.

Response of the United States (WT/DS340)

422. The above summary of a statement made by the United States in a submission in a GATT 1947 dispute does not in fact compare AD/CVD circumvention to "circumvention" of customs duties. To the contrary, it refers to the routine issue of customs enforcement – there is no reference to any action by US Customs authorities to condition the level of a charge – as China has done – based on the detailed conduct of internal manufacturing operations.

95. (*China*) China claims in paragraph 111 of its first written submission that it is common practice by WTO Members, including China, to maintain measures that prohibit the use of domestic assembly operations as a means of circumventing ordinary customs duties.

Please provide examples of imported products other than imported auto parts to which China applies this anti-circumvention principle in the context of their ordinary customs duties. Also, provide the legal basis under China's laws and regulations for such practice.

Response of China

423. As China has explained in response to question 13, China does not believe that there is a freestanding "anti-circumvention principle" at issue in this dispute. What is at issue is how China and other WTO Members deal with the relationship between complete articles and parts of those articles in assessing duties, in the specific circumstance in which the complete article is subject to a higher rate of duty than its constituent parts.

424. China has explained in response to question 57 that there are only a limited number of circumstances in which this issue arises in China's tariff schedule. For the reasons stated in that response, China has not chosen to adopt comparable measures to deal with these other circumstances.

96. (*All parties*) In respect of Article II:1(b) of the GATT 1994:

(a) What is the definition of "ordinary customs duties" within the meaning of Article II:1(b), first sentence?; and

(b) What is the definition of "other duties or charges" within the meaning of Article II:1(b), second sentence?

Response of China

425. China considers that "ordinary customs duties" are the *ad valorem* or specific duties that a Member has bound in its Schedule of Commitments under the column heading of "bound rate," and that the Member is allowed to impose on the products of other Members by reason of the importation of that product into its customs territory.

426. China considers that "other duties or charges" include, at a minimum, those duties and charges that a Member has bound in its Schedule of Commitments under the column heading of "ODCs." As noted in response to question 88, there is a complex interpretive question as to whether the term "other duties or charges" includes *any* charge that a Member applies exclusively to imported products and that is not an ordinary customs duty.

Response of the European Communities (WT/DS339)

(a) What is the definition of "ordinary customs duties" within the meaning of Article II:1(b), first sentence?; and

427. The GATT 1994 does not define the concept of "ordinary customs duty". However, it generally denotes financial charges in the form of a tax imposed on products "on importation" and the liability to which is created by the importation. Ordinary customs duties can be specific, *ad valorem* or mixed. A specific customs duty on a product is an amount based on the weight, volume or quantity of that product while an *ad valorem* customs duty on a good is an amount based on the value of that good. A mixed duty is a customs duty comprising of an *ad valorem* duty to which a specific duty is added or subtracted. The ordinary customs duties, which are due on importation are set out in a country's tariff schedules. Most national tariffs such as China's follow the structure set out by the Harmonised System.

(b) What is the definition of "other duties or charges" within the meaning of Article II:1(b), second sentence?

428. The reference to "other duties or charges" in Article II:1(b), second sentence aims generally at preventing undermining the prohibition of Article II:1(b), first sentence, of the GATT 1994, to impose ordinary customs duties in excess of the bindings. According to paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994 "in order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of concessions annexed to GATT 1994 against the tariff item to which they apply. It is understood that such recording does not change the legal character of 'other duties or charges' ".

Response of the United States (WT/DS340)

429. The GATT 1994 does not define the term "ordinary customs duty". The United States understands an ordinary customs duty means a tax imposed on a good upon its importation, and calculated based on the quantity or value of the good at the time of importation. Ordinary customs duties can be specific, ad valorem or mixed. A specific customs duty on a good is an amount based on the weight, volume or quantity of that product upon importation. An ad valorem customs duty on a good is an amount based on the value of that good upon importation. A mixed duty is a combination of an ad valorem duty and a specific duty.

430. "Other duties or charges" in Article II:1(b), second sentence is intended as a catch-all phrase to prevent the avoidance of a Member's bindings on ordinary customs duties. According to paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994 "in order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of concessions annexed to GATT 1994 against the tariff item to which they apply. It is understood that such recording does not change the legal character of 'other duties or charges' ".

Response of Canada (WT/DS342)

(a) What is the definition of "ordinary customs duties" within the meaning of Article II:1(b), first sentence?; and

431. As reported in the Guide to GATT Law and Practice:

> The word 'ordinary' was used to distinguish between the rates on regular tariffs shown in the columns of the schedules (in French "*droits de douane proprement dit*") and the various supplementary duties and charges [imposed on imports] such as primage duty.[73]

432. In practical terms, "ordinary customs duties" within the meaning of Article II are duties which are charged on imported products during the process of importation, and which are no greater than the bound rates set out in a Member's Schedule. They do not include supplementary charges of any kind that are direct or in connection with importation, and can be specific (based on, *e.g.*, quantity or weight), *ad valorem* (based on value), or a mix of the two.

(b) What is the definition of "other duties or charges" within the meaning of Article II:1(b), second sentence?

433. The *Guide to GATT Law and Practice* notes that "other duties and charges" were defined by the GATT Council to include only charges that discriminate against imports, and do not include the charges set forth in Article II:2 (charges equivalent to internal taxes, anti-dumping charges, *etc.*). "Other duties and charges" are charged during the process of importation, and are set out in a Member's Schedule in the column for "other duties or charges", as required by the *Understanding on the Interpretation of Article II:1(b) of the GATT 1994*.

434. China's Schedule does not contain any "other duties or charges" relevant to this dispute.

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[73] *Guide to GATT Law and Practice*, Volume I, at p. 78 (Exhibit CDA-6).

97. (*All parties*) What is the difference between a *charge* imposed "on ... the importation" and a charge imposed "in connection with the importation" within the meaning of Article II:1(b), second sentence of the GATT?

Response of China

435. While there is considerable ambiguity in this terminology, China considers that the most likely explanation for the use of the different formulation in Article II:1(b), second sentence, is that the *types* of charges at issue ("other duties or charges") are more varied in nature than "ordinary customs duties," the subject matter of Article II:1(b), first sentence. As explained in response to question 96, an "ordinary customs duty" is an *ad valorem* or specific duty that a Member is allowed to impose by reason of the importation of the product. There is a single event that triggers the Member's right to impose the ordinary customs duty, and the importer's obligation to pay it – the importation of the product into the customs territory. (As China has explained at length in response to other questions, this does not mean that the ordinary customs duty must be collected at the *time or place* of importation.) An "other duty or charge," by contrast, may have other, more specific events or conditions that trigger the right to impose the charge and the obligation to pay it. These events or conditions would be spelled out in the Member's Schedule of Concessions. Because these events or conditions are more varied, the drafters may have used the "in connection with" language in Article II:1(b), second sentence, to reflect this fact.

Response of the European Communities (WT/DS339)

436. In view of the obligation to record the nature and level of any "other duties or charges" in the Schedules of concessions in accordance with paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the GATT, the difference does not seem to have any practical meaning beyond the difference of scope between Article II:1(b), first and second sentence. In any event, there is no difference from the point of view of making the relevant customs classification of the product, which is to be made in accordance with the objective characteristics of the product as presented at the border and on the basis of the declaration to the customs.

Response of the United States (WT/DS340)

437. Please see the US response to Question 84.

Response of Canada (WT/DS342)

438. The phrase "in connection with importation" originally may have been intended to reflect the fact that such duties or charges were not set out in a Schedule and could have been applied in ways other than those for ordinary customs duties. However, given paragraph 1 of the *Understanding on the Interpretation of Article II:1(b) of the GATT 1994*, there is no practical difference in meaning.

439. *Only* Article II:1(b), first sentence, is relevant to resolving this dispute, because China alleges it is enforcing "ordinary custom duties" and does not consider its measures to apply "other duties or charges".

98. (*European Communities*) Responding to the above question the European Communities stated during the first substantive meeting, *inter alia*, that there was no GATT/WTO jurisprudence on the meaning of the term "in connection with the importation". Please elaborate more on this in light of the fact that the decision in the GATT Panel Report in *EEC – Parts and Components* examined an EEC argument that its measure was a border measure

precisely because it was levied "in connection with the importation" (see, *inter alia,* paras. 5.5 and 5.7 of that Panel Report).

Response of the European Communities (WT/DS339)

440. The European Communities is not aware of jurisprudence that would define the words "in connection with importation" generally. In para 5.5 of *EEC – Parts and Components* the panel appears to simply quote or at most rephrase the arguments made by EEC at the time. Under paragraphs 5.6 and 5.7 the panel considered that the policy purpose of a charge, the mere description or categorization of a charge under the domestic law of a contracting party or the treatment of the goods "as not being in free circulation" are not relevant to provide the required 'connection with importation'. To apply this reasoning to the present case, the description or categorization of the charges made under Chinese law is not relevant for determining whether the charges are levied "in connection with importation". In particular, the fact that Chinese customs authorities are involved in the procedures and that the charge to be paid by the manufacturer on the imported parts is called a duty is irrelevant for determining whether there is a connection with importation within the meaning of Article II:1(b) of the GATT. If one were to accept China's arguments that the imported auto parts are subject to bonding requirements or that the measures are addressing circumvention of customs duties, both arguments would be equally irrelevant.

99. (*All parties*) What is the difference between a *law or regulation* enforced "on the importation" and a law or regulation enforced "in connection with the importation"?

Response of China

441. China is uncertain of the textual basis for this question, as neither Article II nor Article III (nor Article I) uses this terminology in relation to the enforcement of laws of regulations. For the reasons that China has set forth in response to other questions, China believes that what is relevant for the purpose of evaluating whether the measure is subject to the disciplines of Article II or Article III is the event or condition that gives rise to the enforcement of the law or regulation.

Response of the European Communities (WT/DS339)

442. It would seem that outside the concept of *duties* and/or *charges*, this language is only used under provisions indirectly related to this case i.e. Articles I and XI GATT. Article II:1(b), second sentence refers to "in connection with the importation" but only in respect of "other duties or charges". If this is the context of the question i.e. the Panel seeks to know the view of the Parties on a law or regulation that enforces the payment of other duties or charges in connection with the importation of a product as opposed to a law or regulation that is enforced "on the importation", the European Communities refers to the difference between the first and second sentence of Article II:1(b). A law or regulation that is enforced "in connection with the importation" can only enforce "other duties or charges" not "ordinary customs duties".

443. Reference is also made to the reply given to question 87 and the examples provided there under.

Response of the United States (WT/DS340)

444. The first phrase – "on their importation" – is narrower in scope than "in connection with importation." Aside from this view, however, the United States is not aware of any issue in this dispute with regard to laws and regulation which relates to this distinction.

Response of Canada (WT/DS342)

445. As Article II applies only to charges, the words "on the importation" in that Article are only relevant to laws or regulations to the extent that they impose charges. In that context, the difference between a law and a regulation is as set out in answer to Question 97. A law or regulation connected to the language of Article II:1(b) must relate, by definition, to an "ordinary customs duty" or "other duty or charge" or it would not be covered under this Article. Simply put, if not related to an "ordinary customs duty" or "other duty or charge", a law or regulation would not fall within the scope of Article II:1(b). Accordingly, there should be no tangible difference to interpreting "on importation" or "in connection with importation" when speaking of border charges imposed on importation solely with respect to this provision.

100. (*All parties*) Please explain whether, and if so, how, the phrases "on importation" *or* "in connection with importation" as indicated in the second sentence of Article II:1(b), second sentence are respectively relevant in defining the scope of "ordinary customs duties" under Article II:1(b), first sentence.

Response of China

446. For the reasons that China has explained in response to questions 96 and 97, China does not believe that the "in connection with" language in Article II:1(b), second sentence, is relevant in defining the scope of "ordinary customs duties" under Article II:1(b), first sentence. Ordinary customs duties are the *ad valorem* or specific duties that a Member has bound in its Schedule of Commitments under the column heading of "bound rate," and that the Member is allowed to impose on the products of other Members by reason of the importation of that product into its customs territory. The event or condition that gives rise to the Member's right to impose the ordinary customs duty, and the importer's obligation to pay it, is the importation of the product into the Member's customs territory.

Response of the European Communities (WT/DS339)

447. The first sentence of Article II:1(b) only refers to "on importation" whereas the second sentence of Article II:1(b) refers to both "on importation" and "in connection with importation". The prohibition to impose ordinary customs duties in excess of those set forth in the Schedule applies "on importation" whereas the prohibition to impose "other duties and charges" applies also to situations "in connection with importation". A position such as China's that the 25 % duty imposed on imported automotive parts is an "ordinary customs duty" but imposed "in connection with importation" would seem contradictory on the face of the text of Article II:1(b) of the GATT 1994. In other words, "ordinary customs duties" cannot be imposed "in connection with importation".

Response of the United States (WT/DS340)

448. As the United States explained in its response to Question 84, the United States submits that it is significant that the drafters of the GATT matched "upon importation" to "ordinary customs duties", while the broader phrase "in connection with importation" is matched to "other duties and charges". This matching indicates that there is a tighter nexus between "ordinary customs duties" and importation than between "other duties and charges" and importation.

Response of Canada (WT/DS342)

449. Both phrases relate to "other duties and charges" in the second sentence of Article II:1(b), not "ordinary customs duties" referred to in the first sentence. Accordingly, "ordinary customs duties" are not applied "in connection with importation" as understood in Article II:1(b), second sentence. This interpretation has been confirmed in the *Understanding on the Interpretation of Article II:1(b) of the GATT 1994*, and by the Appellate Body and panel in *Chile – Price Band*.[74]

450. The phrase "on their importation", read in context, is the one that qualifies how products described in Part I of a Member's Schedule are exempt from "ordinary customs duties" in excess of those set out in the Schedule itself. The second sentence of Article II:1(b) specifically precludes the application of "other duties or charges" either *on* (at the time of) or *in connection with* (linked to, although perhaps not contemporaneous with, the physical act of importation) the goods being imported, in excess of a limited class of permissible charges into which the measures clearly do not fall.

101. (*All parties*) In the parties' view, could different aspects of the measures be respectively considered as either internal measures or border measures? In other words, could one part of the measure be a border measure while the other part be an internal measure?

Also, would the fact that CKD and SKD kits can be exempted from the measures at issue under Article 2 of Decree 125 be relevant to this consideration in any manner? Likewise, would charges levied under Article 29 of Decree 125 be relevant to this consideration in any manner?

Response of China

451. There is no question that different aspects of the same measure can be respectively considered as either internal measures or border measures. The Appellate Body has considered that a "measure" is an act or instrument of a Member "containing rules or norms."[75] It is self-evident that, in any measure, some of the rules and norms may pertain to the implementation of a Member's rights and obligations under Article II, while other rules and norms in the same measure may pertain to internal matters that are subject to the disciplines of Article III. As China suggested in response to question 85, what is relevant, in China's view, is whether the particular rule or norm at issue is germane to the administration and enforcement of an action that the Member is allowed to take (such as the imposition of a customs duty) by reason of the importation of a product from another Member. Such rules or norms within a measure are subject to the disciplines of Article II of the GATT.

452. With respect to CKD/SKD kits, China does not consider that the possibility of "dividing" a measure into border elements and internal elements is relevant to this dispute, as it is beyond doubt that CKD/SKD kits are properly classified as motor vehicles under GIR 2(a). With respect to charges levied under Article 29 of Decree 125, China has stated in response to question 92 that the application of duties to imported auto parts that are already in free circulation within the customs territory of China is conceptually different, for the purpose of analysis under Article II, from the application of duties to auto parts that the auto manufacturer imports directly.

[74] While not resolving the issue of what exactly would constitute an "other duty or charge", both the panel and Appellate Body in *Chile – Price Band* recognized there is a difference between the two. See paras. 273-287 of the Appellate Body Report and paras. 7.103-7.108 of the Panel Report.

[75] *US – Corrosion-Resistant Steel Sunset Review*, at para. 82.

Response of the European Communities (WT/DS339)

453. In principle this would be possible. However, the measures would seem to be written as a whole and splitting their provisions into separate parts is difficult. Nevertheless, the option given under Article 2 of Decree 125 to manufacturers that import CKD or SKD kits to conduct the clearance procedure and pay duties at the Customs office where the manufacturer is located and thus avoiding the further application of the measures could be singled out as a matter to be examined under Article II of the GATT while the rest of the measures would be subject to the *TRIMs Agreement* and Article III of the GATT. In contrast, Article 29 of Decree 125 is not a provision that can be separated from the other provisions of the measures. This is a general provision that applies to automobile manufacturers that purchase automotive parts from suppliers and/or do not use the imported parts within a year from importation. Article 29 uses the general language of the measures on "deemed whole vehicles" and is directly connected with the overall logic of the measures according to which the classification of the imported parts depends on their internal use in China. This is an intrinsic part of the mechanism set up by the measures to discriminate against the use of imported auto parts in the manufacture of complete vehicles, and ensures in this way the development of the Chinese vehicle and auto parts industry.

Response of the United States (WT/DS340)

454. In principle, it is possible that the same measure would impose both internal taxes and customs duties.

455. As the United States has noted, where an importer declared a CKD at the border and paid a 25 per cent tax, this aspect of the measure would appear to be a customs duty, to be examined under Article II.

456. As noted in the US oral statement, China appears to concede that Article 29 (in so far as it applies to parts sourced from manufacturers in China) imposes an internal charge that is inconsistent with Article III:2.

457. It bears repeating that, in the view of the United States, <u>any</u> charge imposed by China's measures above the 10 per cent duty owed (and for which a bond is posted) on imported parts is an internal charge, not just the additional charge imposed on parts sourced from manufacturers pursuant to Article 29.

Response of Canada (WT/DS342)

458. A measure may be applied at a Member's border, but that is not determinative of whether that measure affects internal trade in a manner understood in Article III. Canada considers that charges under the measures (as they apply to Deemed Whole Vehicles) are properly characterized as internal charges – a position that China concedes except with respect to imports directly by vehicle manufacturers. The only exception to this could be with regard to CKDs and SKDs that, as presented at the border in a single shipment, contain all or nearly all of the parts necessary to assemble the vehicle. Nonetheless, as discussed in response to Question 61, China has committed in its Working Party Report to apply a tariff rate of no more than 10% for CKDs and SKDs. Any charge over this rate results in less favourable treatment than China is obliged to provide Canada for CKDs and SKDs, and is therefore inconsistent with Article II of the GATT.

Also, would the fact that CKD and SKD kits can be exempted from the measures at issue under Article 2 of Decree 125 be relevant to this consideration in any manner? Likewise,

would charges levied under Article 29 of Decree 125 be relevant to this consideration in any manner?

459. No, as CKDs and SKDs are not actually exempt from the application of the measures. They are only "exempted" to the extent an importer is willing to accept their classification under Article 21(1) as a Deemed Whole Vehicle, which effectively means the measures apply to them. As noted in the answer to the first part of Question 101 above, the measures could be seen as applying a "border charge" only to the extent that CKDs and SKDs are classified when, as presented at the border in a single shipment, they contain all or nearly all of the parts necessary to constitute a motor vehicle. In all other instances, and for all auto parts, the application of the measures results in internal charges that are inconsistent with Article III.

460. In respect of Article 29, the charge applied to imported auto parts can only be considered a border charge to the extent it represents the applicable tariff rate for auto parts listed in China's Schedule. The charges of 15%, if a vehicle manufacturer provides evidence that the parts supplier already paid the parts duty owed, and of 25%, if such documentation cannot be produced, are internal. In the latter case, the charge is not only internal, but both punitive and completely unrelated to the actual importation of the original auto parts.

102. (*China*) Please explain why the 60% threshold criterion under Article 21(3) of Decree 125 would not constitute a local content requirement.

Response of China

461. As China explains in response to question 117 below, the value of imported parts and components in relation to the value of the finished article is one factor that customs authorities consider in applying the essential character test under GIR 2(a). China provides specific examples of this practice in response to question 117. The 60 per cent threshold criterion under Article 21(3) of Decree 125 reflects this aspect of the essential character test. China considers that a collection of imported parts and components that meets this threshold will necessarily be recognizable as a motor vehicle, and therefore have the essential character of a motor vehicle. It is not a local content requirement.

Comments by the United States on China's response to question 102

462. In its response, China claims: "As China explains in response to question 117 below, the value of imported parts and components in relation to the value of the finished article is one factor that customs authorities consider in applying the essential character test under GIR 2(a). China provides specific examples of this practice in response to question 117. The 60 per cent threshold criterion under Article 21(3) of Decree 125 reflects this aspect of the essential character test."

463. This statement by China mischaracterizes the application of Article 21(3) of Decree 125 to importers because it treats value of imported parts as 1 of 3 methods that automatically triggers the conclusion that the parts constitute complete vehicles. This is not an essential character test, but a strict value threshold. Article 21(3) of Decree 125 is not a factor in determining "essential character" but is the sole factor used by China that results in a local content requirement.

464. Further, the examples provided by China in Exhibits CHI-16, CHI-42, and CHI-45, do not support the use of value as a sole criterion for establishing essential character. Exhibit CHI-16 (NY M83114) clearly states that: "[t]he nature of the item, its bulk, quantity, or value may be looked to in a determination of essential character. It is our belief that the 34-piece Glock 17 model parts kit

proposed to be imported, absent the receiver component, constitutes the aggregate of distinctive component parts that establish its identity as what it is, a complete or finished pistol." The United States did not rely on value to determine "essential character" under GIR 2(a), but instead it relied on the fact that the kit was "imported without the frame but with all other necessary parts" as an unfinished, unassembled pistol.

465. In Exhibit CHI-42 (HQ 086555), the United States recognizes, in the context of GIR 2(a), that: "The nature of the item, its bulk, quantity, or value may be looked to [to determine an article's essential character. However, such a determination varies between different types of merchandise. [citing to Explanatory Note (VIII) to GIR 3(b) and not to ENs for GIR 2(a)]." In that ruling, the United States stated that an incomplete or unfinished backhoe excavator would be classified as an excavator, if it has the essential character of an excavator. The incomplete or unfinished excavator must be easily recognizable as an excavator. In that case, the United States concluded that the propelling base of an excavator imparted the essential character because it was substantial enough within the meaning of GIR 2(a). The US did not rely on value to determine "essential character" under GIR 2(a), but examined the nature of the item.

466. In Exhibit CHI-45, a US customs ruling describes an intermodal railway car missing certain components that would make it a stand-alone railway freight car designed to carry certain size truck trailers. As part of its facts, the ruling noted that the percentage value of the imported product compared to the completed article. In its "Law and Analysis" section, the ruling cites to GIR 2(a) and concludes that the article as imported constituted an unfinished railway or tramway freight car. The ruling simply does not provide any reasoning or set forth a basis for its conclusion, and thus does not support China's allegations that US Customs uses value-added tests as a basis for classification decisions.

103. (*Complainants*) Do you agree with the statement made by China in paragraph 41 of its first written submission that the Panel must at the outset decide on whether the measures concerned are border or internal measures. If not, why?

Response of the European Communities (WT/DS339)

467. As the European Communities stated already in paragraphs 13 and 21 of its oral statement, the *TRIMs Agreement* does not require a preliminary assessment as to whether a measure is a "border measure" or an "internal measure". Furthermore, the fact that a given measure might be generally described as a "border measure" in the sense of being enforced "on or in connection with importation" does not necessarily preclude an analysis under Article III of the GATT. In any event, the European Communities is of the view that the measures at issue in this case are subject to the *TRIMs Agreement* and Article III. This suggests that the measures are generally rather "internal measures" than "border measures" even if they are contained in customs language.

Response of the United States (WT/DS340)

468. As the United States emphasized in its oral statement, the United States does not agree. China's measures are plain breaches of Article III:4, Article III:5, and the TRIMs Agreement, regardless of whether the charges are internal ones subject to Article III:2 or customs duties subject to Article II.

Response of Canada (WT/DS342)

469. As discussed in response to Question 85, Canada agrees that charges under the measures are either internal or border charges (and China has conceded that all charges except those paid by vehicle manufacturers for parts they import directly are internal) but that the measures' administrative requirements do not need to be characterized as "border" or "internal" at the outset.

104. (*China*) Please comment on the complainants' position that one of the ways in which the measures modify the "conditions of competition" is by subjecting a manufacturer using *any* imported auto parts to a burdensome administrative regime. (e.g. Canada's first written submission, paragraph 102)

Response of China

470. As China explained at the first meeting of the Panel, what the complainants have characterized as a "burdensome administrative regime" is the customs process that China has established to determine whether an auto manufacturer imports and assembles a collection of auto parts that, in its entirety, has the essential character of a motor vehicle. China has explained in response to several questions, principally question 134, that the purpose of the customs process that China has put in place is to establish the relationship among multiple shipments of parts and components for the purpose of assessing duties that apply to the complete article.

471. China does not consider that the process it has established for this purpose is any more "burdensome" than the customs processes that Members have adopted to deal with other complex issues of customs administration, such as inward processing and duty drawback regimes. Article VIII:1(c) of the GATT 1994 explicitly recognizes that customs processes can be complex. The mere fact that these processes can be complex does not mean that they are subject to the disciplines of Article III.

105. (*Complainants*) Are the charges levied in relation to imports of CKD and SKD kits under the second paragraph of Article 20 of Decree 125 "border charges"? If so, do such charges come within the disciplines of Article II of the GATT? If so, are they "ordinary customs duties" within the meaning of GATT Article II:1(b), first sentence, or "other duties or charges" under GATT Article II:1(b), second sentence?

Response of the European Communities (WT/DS339)

472. The European Communities understands that reference is made to the second subparagraph of Article 2 of Decree 125 and not Article 20. If this is the case, the European Communities is of the view that if the importer uses the option under Article 2 of Decree 125 to declare CKD and SKD kits to customs under standard customs procedures and the classification is made on the basis of standard customs rules i.e. according to the objective characteristics of the products as presented, the charges imposed are "border charges" under Article II of the GATT. China has indicated that the charges would be "ordinary customs duties". In view of the fact that the charges imposed on such kits have not been recorded in China's Schedules of concessions in accordance with paragraph 1 of the Understanding on the Interpretation of Article II:1(b) of the GATT 1994, the charges cannot be "other duties of charges". Therefore, the European Communities can agree with China that in this specific instance the charges would be "ordinary customs duties".

Response of the United States (WT/DS340)

473. The United States understands this question to refer to Article 2 (not 20) of Decree 125. As the United States explained in response to Question 80, this would appear to be an ordinary customs duty.

Response of Canada (WT/DS342)

474. As discussed in response to Question 33, the charges may only be considered border charges to the extent that they are applied to parts which arrive at the border in one shipment and, as presented at the border, have the essential character of a whole vehicle. In such instances, the charges may be considered as border charges. As discussed in response to Question 61, those parts should then be charged ordinary customs duties at a rate of 10%. Of course, the assessment of the parts would have to be consistent with applicable tariff lines and interpretative rules, such that a mere collection of parts itself would not be sufficient to constitute a CKD or SKD if further processing is required.

106. (*Complainants*) If the charges levied in relation to imports of CKD and SKD kits under the second paragraph of Article 2 of Decree 125 are "border charges" under Article II of the GATT, would the Panel have to still decide on the claims under Article III:4 and III:5 of the GATT and Article 2 of the TRIMs Agreement?

Response of the European Communities (WT/DS339)

475. Provided that China confirms that

- only the normal general customs procedures are applied in the context of the second paragraph of Article 2 of Decree 125 and
- a CKD or SKD kit consists of all the parts necessary to manufacture a vehicle presented to customs at the same time and in a single consignment

it would be sufficient for the Panel to decide whether it is in accordance with China's Schedule of commitments to apply to such kits generally and in all cases the duty on complete motor vehicles in the case of the second subparagraph of Article 2. This reply is to be understood in the light of the fact that the European Communities has not made a separate claim under paragraph 93 of China's Accession Protocol.

Response of the United States (WT/DS340)

476. Yes, these claims would still apply, because – as the United States has explained – an ordinary customs duty can be applied inconsistently with Article III:4, III:5 and the TRIMs Agreement if the level of the duty depends on local content or local mixing requirements.

Response of Canada (WT/DS342)

477. As discussed in response to Questions 85 and 101, other than charges on CKDs and SKDs as defined by the complainants, the measures apply "internal charges", and impose additional administrative burdens which must be considered under GATT Article III:2, III:4, III:5 and Article 2 of the *TRIMs Agreement*.

107. (*Complainants*) In paragraph 20 of its written oral statement, China interprets the word "commerce" in GATT Article II:1(a) "to be synonymous with 'imports.'" Do you agree? Please explain you answer.

Response of the European Communities (WT/DS339)

478. It is not clear to the European Communities why China wishes to interpret the word 'commerce' to be synonymous with "imports". The ordinary meaning of "commerce" is "buying and selling; the exchange of merchandise or services, especially on a large scale" (Shorter Oxford English Dictionary).

Response of the United States (WT/DS340)

479. The United States does not agree – "commerce" is a broader term than "imports". In fact, the United States understands that Members may bind in their schedules export duties as well as import duties.

Response of Canada (WT/DS342)

480. While the two are related, Canada notes that "commerce" is the more general concept, which includes "imports" as a sub-component. The *Shorter Oxford English Dictionary* defines "commerce" as "buying and selling; the exchange of merchandise or services, esp. on a large scale".[76] Thus, while related, it would not be appropriate to limit "commerce" simply to "imports", which is but one part of overall "commerce".

108. China has stated that "the charges that China imposes under the challenged measures relate back to *a condition* that attached at the time of importation. That condition is that when the auto manufacturer fulfils its stated *intention* to import and assemble parts and components that have the essential character of a motor vehicle, it will be obligated to pay the applicable duty rate for motor vehicles, just as if it had imported those parts and components in a single shipment" (paragraph 31 of its first oral statement).

(a) (*China*) Could China clarify whether the products at issue cannot cross the border unless the condition as described by China is fulfilled;
Response of China

481. As China has explained in response to question 55, there is an important distinction in international customs practice, as reflected in the Revised Kyoto Convention, between the completion of customs formalities in relation to an import and the release of that import. Imported products are frequently released – i.e., placed at the disposition of the importer at the border – before they have completed "clearance." Goods released on this basis may be subject to additional customs procedures to ensure compliance with the relevant customs laws and regulations.

482. Consistent with these international customs practices, auto parts and components that an auto manufacturer imports for a registered vehicle model are "released" to the auto manufacturer at the border, but remain subject to a customs procedure, secured by a bond, to ensure compliance with China's tariff rates for motor vehicles. This procedure ensures that the importation and assembly of multiple shipments of parts and components receives the same tariff treatment under GIR 2(a) without regard to whether the parts and components enter China in one shipment or in multiple shipments. The obligation to pay the applicable duty rate for motor vehicles arises as a "condition" of – that is, by

[76] *Shorter Oxford English Dictionary*, 5th ed. (Oxford: Oxford University Press, 2002), at p. 459 (Exhibit CDA-7).

reason of – the importation of auto parts and components that China would have classified as a motor vehicle had they entered China in a single shipment.

Comments by the United States on China's response to question 108(a)

483. China's response to this question from the Panel suggests that because auto parts may be released into the control of an importer prior to the completion of all customs procedures that the "condition" of the auto parts upon importation may also be determined based on their use in the domestic market after release into the custody of the auto manufacturer. Under the Harmonized System, the condition of the good when the shipment is entered into China is the condition of the good upon importation regardless of when all customs procedures may be completed. Accordingly, the United States disagrees with China's implication that it has a right to classify imported auto parts "without regard to whether the parts and components enter China in one shipment or multiple shipments."

(b) (*China*) Please explain how the charges can be considered as "a condition attached at the time of importation" when there are no qualifications in its tariff Schedule;

Response of China

484. China has answered this question in response to previous questions, principally questions 27 and 54. In brief, China does not consider that it was required to inscribe a "term, condition or qualification" in its Schedule of Concessions in order to interpret and enforce its Schedule of Concessions in accordance with the rules of the Harmonized System. The "condition" of the auto parts and components at the time of importation is that they form part of a collection of imported auto parts and components that, in their entirety, have the essential character of a motor vehicle. This condition is established by the prior evaluation of the vehicle model to which those parts and components relate, and by the declaration of the importer at the time of importation. The auto manufacturer is obligated to pay the applicable duty rate for motor vehicles when it joins that shipment of auto parts and components with other shipments of imported auto parts and components to assemble a vehicle model that it has previously registered as meeting one or more of the thresholds set forth in Decree 125.

(c) (*China*) China stated during the first substantive meeting that the determination of whether certain auto parts should be characterized as complete vehicles is made prior to importation. In light of this statement, please explain how the condition as described by China above can be considered as "a condition attached at the time of importation"; and

Response of China

485. As described in response to the previous question, and in responses to question 134, the purpose of the prior evaluation and verification is to establish the relationship among multiple shipments of parts and components for the purpose of assessing duties that apply to the complete article. This evaluation and verification establishes whether multiple shipments of auto parts and components are related to each other through their common assembly into a vehicle model that China would have classified as a motor vehicle had the parts and components entered China in a single shipment.

486. As China explained in response to question 5, once a manufacturer has registered a vehicle model as meeting one or more of the thresholds in Article 21 of Decree 125, the manufacturer must thereafter import parts for that vehicle model separately from other auto parts, and must declare the

imported parts as parts of a registered vehicle model. Because the auto manufacturer has imported parts and components that, in their entirety, have the essential character of a motor vehicle, it is required to pay the applicable duty rate for motor vehicles as a condition of – that is, by reason of – the importation of these related parts and components.

(d) (*China*) China has also stated during the first substantive meeting that the "intention" of importers is irrelevant to the interpretation of General Interpretative Rule 2(a) and what is relevant for the purpose of tariff classification is the determination of whether the parts concerned have the essential character of a complete article (i.e. complete vehicle in this case). How does China reconcile this position with its statement cited above that the condition attached at the time of importation is related to the determination of whether the auto manufacturer fulfils its stated intention to import and assemble parts and components that have the essential character of a motor vehicle.

Response of China

487. There are two different notions of "intention" at issue here. China's point in relation to GIR 2(a) is that there is no consideration under GIR 2(a) of whether the importer *intends* to assemble parts and components into the finished article – that intention is presumed. Thus, if an importer imports a completely unassembled motor vehicle in a single container with the intention of selling the various parts and components as replacement parts, this intention is irrelevant to the classification determination – the customs authorities should classify the entry as a complete motor vehicle in accordance with GIR 2(a).

488. As China has explained in response to previous questions, the purpose of the prior evaluation and verification of specific vehicle models is to establish whether the auto manufacturer has the practice or intention of importing *multiple shipments* of parts and components that, in their entirety, have the essential character of a motor vehicle. As explained, the auto manufacturer is obligated to pay the applicable duty rate for motor vehicles for these imports. Under the customs procedure that China has established for this purpose, the auto manufacturer pays the applicable customs duties after it has assembled the multiple shipments of parts and components into the registered vehicle model.

Comments by the United States on China's response to question 108(d)

489. In its response, China states: "China has explained in response to previous questions, the purpose of the prior evaluation and verification of specific vehicle models is to establish whether the auto manufacturer has the practice or intention of importing multiple shipments of parts and components that, in their entirety, have the essential character of a motor vehicle. As explained, the auto manufacturer is obligated to pay the applicable duty rate for motor vehicles for these imports. Under the customs procedures that China has established for this purpose, the auto manufacturer pays the applicable customs duties after it has assembled the multiple shipments of parts and components into the registered vehicle model."

490. This practice by China ignores the proper application of the Harmonized System, which provides that merchandise should be classified in its condition as presented without regard to what occurs to the merchandise after importation.

109. (*All parties*) Do you agree, and why, with the following argument contained in paragraph 14 of Australia's third party oral statement, which was made in relation to China's claim that a charge imposed after the time or point of importation can still be a border charge if it relates to a condition of *liability that attached at the time of importation*:

> **"Presumably, in an attempt to establish a nexus with importation, the measures at issue include a declaration made at the time of importation. However, this declaration appears to be entirely focused on the way in which the imported parts will be used internally within China, rather than on the contents of a consignment upon importation. ... Therefore ... the *liability attaches internally*, after the vehicle has been manufactured." (emphasis added)**

Response of China

491. China has answered this question in response to question 78.

Response of the European Communities (WT/DS339)

492. The European Communities entirely agrees with the argument made by Australia in paragraph 14 of its oral statement. See also reply to question 78.

Response of the United States (WT/DS340)

493. Please see the United States response to Question 78.

Response of Canada (WT/DS342)

494. Canada agrees with Australia's statement, and in that regard refers the Panel to paragraphs 65 and 66 of Canada's first written submission as an illustration of how liability attaches internally under the measures.

C. ARTICLE II OF THE GATT 1994

110. (*All parties*) Rule 2(a) of the General Interpretative Rules states, *inter alia*, that " Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article." Please explain what "*as presented*" means as referred to in Rule 2(a)?

Response of China

495. China considers that the term "as presented" in GIR 2(a) is, on its own, susceptible to different interpretations when applied to unassembled or disassembled articles that are imported in multiple shipments. However, in light of the interpretation adopted by the WCO, discussed below, China considers that the term should be read to include "as presented in a customs declaration," or "as presented in light of the facts and circumstances surrounding the import transaction."

496. Under the *Harmonized System Convention*, the General Interpretative Rules are a part of the Harmonized System. Accordingly, China considers that it is appropriate to interpret GIR 2(a), including the term "as presented", in accordance with Article 31 of the *Vienna Convention*. China believes that there are two relevant points, in this respect.

497. First, GIR 2(a) uses the term "as presented" in the context of resolving the tariff classification relationship between complete articles and parts of articles. With respect to unassembled and disassembled articles, GIR 2(a) resolves this classification relationship by establishing that parts and

components are classified as the complete article if, "as presented," they have the essential character of that article. In this context, it would be arbitrary to conclude that the same collection of parts and components, used to assemble the same finished article, should obtain a different classification result based solely on whether the parts and components are contained in one shipment or in multiple shipments. This interpretation would vitiate the rule's resolution of the relationship between parts and wholes, because it would leave the resolution of that question entirely at the discretion of the importer. It would, moreover, violate the general principle that substance should prevail over form in the administration of customs laws.

498. The second relevant element of analysis under the *Vienna Convention* is Article 31(3)(a), "any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions." As the Panel is aware, and as explained in response to question 112, the Harmonized System Committee has interpreted GIR 2(a) specifically as it pertains to "the classification of goods assembled from elements originating in or arriving from different countries." The interpretation of the HS Committee, as adopted by the WCO, is that the application of GIR 2(a) in this circumstance is a matter "to be settled by each country in accordance with its own national regulations." This interpretation necessarily bears upon the understanding of the term "as presented." If the term "as presented" were limited to the contents of a single shipment, there would be no scope for members of the Harmonized System to apply the principles of GIR 2(a) to goods assembled from multiple shipments. The fact that the WCO has found that members of the Harmonized System may apply the principles of GIR 2(a) to goods assembled from multiple shipments can only mean that the term "as presented" is not limited to single shipments.

499. These considerations support the conclusion that the term "as presented" must be interpreted to allow national customs authorities to apply the principles of GIR 2(a) to goods that are assembled domestically from multiple shipments of imported parts and components. As discussed in response to question 112, any such application of GIR 2(a) remains constrained by the principles of GIR 2(a) itself.

Response of the European Communities (WT/DS339)

500. When goods are classified in the Harmonised System it is always done on the basis of the objective characteristics of the product at the time of importation, that is, as imported and presented to Customs on a shipment-by-shipment basis. The intentions of the importer and differing duty rates are irrelevant. This is the essence of the words "as presented" in Rule 2(a).

Response of the United States (WT/DS340)

501. For purposes of Rule 2(a), "as presented" refers to the condition of the article at the time of its importation. Under US Customs law, it is well settled that classification is based upon the condition of goods at the time of importation.

Response of Canada (WT/DS342)

502. The assessment of whether an incomplete or unfinished article has the "essential character" of the complete or finished article must be made based on the objective characteristics of that article, and solely that article, in the state it is presented to customs officials at the border (i.e., the "snapshot"). That is the meaning of "as presented" in Rule 2(a). In *EC – Chicken Cuts*, the Appellate Body confirmed that classification must be based on the objective characteristics of an article as presented when it quoted the WCO statement that "[w]hen goods are classified in the Harmonized System, it is

always done on the basis of the objective characteristics of *the* product at the time of importation".[77] No consideration is to be given to separate consignments arriving at different times, end-use or value of the article, but simply to objective characteristics of *the* product as presented at the border.

Comments by the United States on China's response to question 110

503. China defines the term "as presented" under GIR 2(a) as meaning, "in light of the facts or circumstances surrounding the import transaction." For the purposes of China's "anti-circumvention" measures, these facts and circumstances include the post importation assembly of imported auto parts into finished motor vehicles. This proposed interpretation of the term "as presented" undermines the very uniformity that the Harmonized System was designed to protect because China disregards the actual form of the shipment of the goods in favor of a future condition of the goods as integrated into a whole motor vehicle. This future condition does not exist at the time of importation of the auto part.

504. The United States disagrees with China's claim that the term "as presented" is not limited to single shipments because of the language of the Harmonized System "decision" described in paragraph 10 of Annex IJ/7 to Doc. 39.600.[78] This "decision" is not entitled to any additional weight based on Article 31(3)(a) of the Vienna Convention, which provides that in the interpretation of a treaty, there shall be taken into account "any subsequent agreement between the parties regarding the interpretation of the treaty or application of its provisions." The original comment was by the Nomenclature Committee, which was responsible for the interpretation of the Customs Cooperation Council Nomenclature (the predecessor to the Harmonized System). As the "decision" was only reflected in the report of the Committee and no amendments were made to the Explanatory Notes nor was a Classification Opinion adopted, paragraph 10 has little weight, as it is not an enforceable decision of the Harmonized System Committee.

505. Furthermore, the "decision" was not adopted by the WCO. The "decision" also does not not mean that a member customs administration can abrogate the requirements of the General Interpretative Rules by regulation at the domestic level. Nor is the "decision" an interpretation of the meaning of "as presented." In fact, the "decision" does not in any way address the phrase "as presented."

506. Indeed, China's theory of the meaning of "as presented" is contrary to a decision of the Nomenclature Committee during its 42nd session in 1979. This decision adopted the proposal of the Danish Delegation that "the word "imported" in the English version of the nomenclature of the Harmonized System be replaced by "presented" in order to align the French and English versions and so that the English version would also be applicable to exported goods when necessary.[79] This substitution was also made in the context of GIR 2(a) for purposes of consistency. "As presented" means the condition of the good when it is imported, and the reason why "as presented" replaced "imported" in the context of GIR 2(a) is editorial, not substantive.

507. This interpretation is, in fact, supported by a letter issued by the Nomenclature and Classification Directorate in October of 1989, wherein it explained that "the replacement of 'imported' by 'presented' was in fact an editorial amendment, adopted to make it quite clear that the provisions of

[77] *EC – Chicken Cuts*, Appellate Body Report, at para. 230 (emphasis added).
[78] Exhibit CHI-29
[79] See Annex F/2 to Doc. 25.300E (Exhibit US-1).

the Rules concerned apply for a given article in the state in which it is presented for Customs clearance."[80]

508. Goods are presented for customs clearance at the time of importation. Even if customs clearance is not completed until some time thereafter, assembly that occurs after the presentation is not a condition that existed when the goods were presented for customs clearance (at the time of their importation). Accordingly, China's interpretation of "as presented" (which includes post-importation assembly in the domestic market) is incorrect. For the aforementioned reasons, "as presented" is the condition of the good upon importation..

111. (*Complainants*) Please comment on China's statement in paragraph 160 of its first written submission and in paragraph 13 of its oral statement in relation to the WCO affirmed decision concerning Rule 2(a) of the General Interpretative Rules. In particular, please clarify the legal status of this WCO decision, including whether it is binding on the parties to the WCO or the WTO Members.

Response of China

509. The Decision of the Harmonized System Committee is, by its terms, an interpretation of General Interpretative Rule 2(a). Under Article 7 of the Harmonized System Convention, one of the functions of the Harmonized System Committee is "to prepare recommendations to secure uniformity in the interpretation and application of the Harmonized System." As described by the WCO, the HS Committee "is the single international body which can provide authoritative advice with regard to tariff classification."[81] Under Article 8 of the Harmonized System Convention, any "advice on the interpretation of the Harmonized System and recommendations to secure uniformity in the interpretation and application of the Harmonized System" that the HS Committee adopts are "deemed to be approved" by the WCO if no member objects to its adoption within a specified period.

510. As a consequence of these provisions, the decision of the HS Committee is an authoritative interpretation of GIR 2(a) adopted by the members of the WCO. It reflects the WCO's official interpretation of GIR 2(a) as applied to the classification of articles that are assembled from multiple shipments of parts and components. The decision of the WCO is that this particular application of GIR 2(a) is a matter "to be settled by each country in accordance with its own national regulations." This interpretation of GIR 2(a) dates back to a decision taken by the Nomenclature Committee when GIR 2(a) was first drafted in the early 1960s.[82] The 1995 decision of the HS Committee merely reaffirmed this longstanding interpretation of GIR 2(a) in the context of the Harmonized System.

511. The General Interpretative Rules are part of the Harmonized System and are binding on the members of the WCO. Logically, this should include authoritative interpretations of the General Interpretative Rules adopted by the WCO. But the question of whether the decision of the HS Committee is formally "binding" on the WCO members is not relevant to the present dispute. In finding that the application of GIR 2(a) to multiple shipments is a matter to be resolved under national laws and regulations, the WCO has necessarily interpreted GIR 2(a) as containing no prohibition on this particular application of the rule, and has found that this application of the rule is not otherwise

[80] Letter from Nomenclature and Classification Directorate dated 2 October 1989, with annexes (Exhibit US-1).

[81] WCO, *The Harmonized System: The language of international trade*, JE-36

[82] See WCO, Harmonized System Committee, Doc. 39.235 (8 February 1995) at para. 28 ("The Secretariat has set out below a decision taken by the Nomenclature Committee when General Interpretative Rule 2(a) and its accompanying Explanatory Note were drafted …").

inconsistent with the Harmonized System. By its nature, this is not an interpretation that would "bind" the WCO members; it is an interpretation that leaves this matter within the authority of each WCO member.[83]

512. As discussed in more detail in response to other questions, the Appellate Body has repeatedly affirmed the importance of the Harmonized System to the interpretation of WTO Members' Schedules of Concessions. This includes the General Interpretive Rules. As it pertains to the present dispute, the importance of the interpretation adopted by the WCO is that WTO Members have been aware, since at least 1995, that the Harmonized System allows Members to classify multiple imports of parts and components in accordance with the principles of GIR 2(a). This is part of the context in which WTO Members have negotiated and entered into tariff concessions, and it is part of the context in which China negotiated its Schedule of Concessions with other WTO Members in connection with its accession to the WTO. Under Article 31 of the *Vienna Convention*, the decision of the WCO concerning the interpretation of GIR 2(a) is therefore relevant context to the interpretation of China's tariff provisions for motor vehicles.

Response of the European Communities (WT/DS339)

513. In general, the WCO's decisions do not bind the contracting parties of the WCO.[84]

514. Exhibit CHI-29 to which reference is made in paragraph 160 of China's first written submission must also be put in its proper context. Paragraphs 1 to 8 of the decision have nothing to do with the issue of "split consignments". Paragraphs 1 to 8 relate to the judgment of the European Court of Justice in case C-35/93 *Dr Eisbein* (ECR 1994, p. I-02655) where the issue was the relevance of the complexity of the assembly operation in the context of rule 2 (a) of the Harmonised System.

515. As a completely separate issue the committee decided to include the Nomenclature Committee's decision relating to split consignments into its report. However, Rule 2 (a) has not been amended in any way pursuant to the discussion in the committee. Therefore China's submission that the decision of the committee would somehow affect the "as presented" criterion under Rule 2 (a) in the context of split consignments is entirely without merit.

Response of the United States (WT/DS340)

516. In the context of the Harmonized System, a decision taken by the Harmonized System Committee is not legally binding on its members. Decisions of this committee are considered advice and guides to the interpretation of the Harmonized System. US Customs considers that these decisions often provide valuable insight into how the Harmonized System Committee views certain provisions. In rendering its decisions, the Harmonized System Committee "also usually decides whether the decision merits an amendment to the [Explanatory Notes], the issuance of a classification opinion to be added to the Compendium, or to merely report the decision in the report of the session. If the decision results in amendments of the [Explanatory Note] or goes into the Compendium, it, then should receive considerable weight. . . . . Decisions of the [Harmonized System Committee] that are

[83] To put the matter differently, the decision adopted by the WCO precludes a WCO member from arguing that another WCO member is not allowed to apply GIR 2(a) to multiple shipments, even if the complaining WCO member does not itself apply GIR 2(a) in this manner. In this sense, the decision of the HS Committee is "binding."

[84] Even the most authoritative WCO's acts i.e. classification opinions are not binding in the EC legal order and this has been confirmed by the European Court of Justice in case C-206/03, Commissioners of Customs & Excise v SmithKline Beecham plc (European Court reports 2005 Page I-00415).

merely given in the report should be given little weight." See Treasury Decision (T.D.) 89-80, which sets forth the US position as to the proper guidance on the use of certain documents for interpretation of the Harmonized System. Since its implementation of the Harmonized System in 1989, the US Customs administration has cited this T.D. in almost every administrative ruling on tariff classification matters.

517. There were two "decisions" taken by the WCO as reflected in Annex IJ/7 to Doc. 39.600 (HSC/16- Report). The first decision taken was to remove the reference to "simple assembly" in the Explanatory Note to General Interpretative Rule 2(a). In regards to the first "decision", US Customs gives this decision considerable weight and has classified goods in accordance with the WCO's decision to remove the reference to "simple assembly".

518. The second "decision" described in paragraph 10 of Annex IJ/7 to Doc. 39.600 is merely a discussion of the contracting parties as to how the Harmonized System Committee views "split shipments". The original comment was by the Nomenclature Committee. The Nomenclature Committee was responsible for the interpretation of the Customs Cooperation Council Nomenclature (CCCN), which was predecessor to the Harmonized System. As the "decision" was only reflected in the report of the Committee and no amendments were made to the Explanatory Notes nor was a Classification Opinion adopted, US Customs finds that paragraph 10 has little weight. Also, paragraph 10 *does not mean* that a member administration can abrogate the requirements of the General Interpretative Rules by regulation at the domestic level.

Response of Canada (WT/DS342)

519. A WCO decision is not binding on WCO or WTO Members. The General Interpretative Rules, Section and Chapter Notes, including Subheading Notes, are binding on signatories to the Harmonized System. The Explanatory Notes, while not binding, constitute the official interpretation of the Harmonized System at the international level and are an indispensable complement to the System. No similar guidance is provided for other non-binding instruments such as WCO decisions. Such decisions, particularly those that do not reflect a consensus of the WCO membership, must be accorded less weight in the interpretative hierarchy of the Harmonized System, after the General Interpretative Rules, Section and Chapter Notes and Explanatory Notes.

Comments by the United States on China's response to question 111

520. In its first sentence of its response, China claims that: "The Decision [Exhibit CHI-29] of the Harmonized System Committee is, by its terms, an interpretation of General Interpretative Rule 2(a)." This is not an accurate interpretation of what Exhibit CHI-29 actually represents. As the United States noted in its initial response to this question, there were two "decisions" taken by the WCO as reflected in Annex IJ/7 to Doc. 39.600 (HSC/16- Report). The first "decision" taken was an agreement by the Harmonized System Committee (HSC) to remove the reference of "simple assembly" to the Explanatory Note to General Interpretative Rule 2(a). In regards to the first "decision", the United States Customs Service gives this decision considerable weight and has classified in accordance with the WCO's decision to remove the reference of "simple assembly".

521. In its response to this question, China states that: "As a consequence of these provisions, the decision of the HS Committee is an authoritative interpretation of GIR 2(a) adopted by the members of the WCO. It reflects the WCO's official interpretation of GIR 2(a) as applied to the classification of articles that are assembled from multiple shipments of parts and components. The decision of the WCO is that this particular application of GIR 2(a) is a matter 'to be settled by each country in accordance with its own national regulations.' This interpretation of GIR 2(a) dates back to a decision

taken by the Nomenclature Committee when GIR 2(a) was first drafted in the early 1960s." This statement is not accurate. At its 16th Session, the Nomenclature Committee specifically decided that the Explanatory Notes for the new GIR that: "No provision would be made for application of the Rule to parts and split consignments of unassembled or disassembled articles."[85]

522. China further states: "[S]ince at least 1995, that the Harmonized System allows Members to classify multiple imports of parts and components in accordance with the principles of GIR 2(a)." In short, the portion of the document that China builds its case around is nonbinding on HS contracting parties and deserves little or no weight in the WTO proceeding. The basic "decision" is a comment by the Nomenclature Committee interpreting the Customs Cooperation Council Nomenclature, to which the US was never a party. The incorporation of that comment in the HSC/16 report merely indicates that neither the status of split consignments nor the classification of goods assembled from imported goods of various origins are within the jurisdiction of the HS Convention nor the HS Committee. The "decision" taken in the HSC does not interpret GIR 2(a). In fact, it is taken in the midst of a discussion on how simple assembly and further manufacturing relate to the application of GIR 2(a).[86] In subsequent sessions, the HS Committee stated that industrial production with the use of machine tools was beyond the scope of allowable assembly contemplated by GIR 2 (a).[87]

523. Thus, the "decision" that China relies on has no direct impact on the interpretation of GIR 2(a). It in no way diminishes China's obligations under the HS Convention. China must still classify goods as presented, using the entire nomenclature, rather than classify goods by effectively eliminating from use many headings of chapters 84 and 85. China cannot abrogate its responsibilities to an international agreement through domestic regulation.

112. (*All parties*) How should General Interpretative Rule 2(a) be interpreted in light of this decision?

Response of China

524. The decision of the HS Committee acknowledges the arbitrary classification results that can occur when a set of related parts and components is broken into multiple shipments. This can occur when a single import transaction is broken into "split consignments," usually for reasons of shipping and often without the prior knowledge of the importer, or when a manufacturer imports parts and components in multiple shipments and assembles them domestically. In these circumstances, the same collection of imported parts and components can obtain a different classification based solely on the form in which the parts and components are imported. This is inconsistent with the general principle that substance should prevail over form in international customs practice.

525. As explained in response to question 111, the Nomenclature Committee of the Customs Cooperation Council (the precursor to the WCO) recognized the existence of this issue when it first drafted GIR 2(a) in the early 1960s. It was at that time that the Nomenclature Committee agreed that the application of GIR 2(a) to split consignments and multiple shipments was a matter "to be settled

[85] See Annex E to Doc. 13.450 E (NC/16/Apr. 1966) (Ex. US-2).

[86] The United States notified the public regarding its position on the various Harmonized System documentation that is available through the WCO. See T.D. 89-80, 54 FR 35127 (1989) (Exhibit US-4). Within that notice, the United States indicated that a decision by the HSC that is memorialized merely by a reference in an HSC report is accorded little weight. That T.D. is routinely cited in Headquarters rulings issued by the United States.

[87] See Annex H/25 to Doc. 40.600E (HSC/18- Report), citing to paragraph 15 of Doc. 40.447 (HSC/18) (Exhibit US-3).

by each country in accordance with its own national regulations," an interpretation that the HS Committee reaffirmed in the context of the Harmonized System in 1995.

526. In light of these decisions, GIR 2(a) must be interpreted to allow national customs authorities to apply the principles of GIR 2(a) to goods that are assembled domestically from multiple shipments of imported parts and components.[88] Any such application of GIR 2(a) must still conform to the principles of GIR 2(a), in that any collection of parts and components that customs authorities classify as a complete article must have the essential character of that article. In addition, this application of GIR 2(a) remains constrained by the limits of GIR 2(a) itself, which pertains only to the classification of unassembled or disassembled parts and components that can be assembled by means of the assembly methods specified in Explanatory Note VII to GIR 2(a).

527. The fact that the WCO has specifically interpreted GIR 2(a) to allow members of the Harmonized System to apply the principles of that rule to multiple shipments of parts and components is highly relevant to the interpretive issue before the Panel. In *EC – Chicken Cuts*, the Appellate Body considered the application of GIR 3(a) to the interpretation of the relevant portions of the EC's Schedule of Concessions. GIR 3(a) concerns the circumstance in which "goods are *prima facie* classifiable under two or more headings." In considering whether the panel erred in finding that GIR 3(a) was not applicable to the facts of that case, the Appellate Body noted that "nothing on the Panel record indicates how the term '*prima facie*' has been interpreted by the WCO's Harmonized System Committee, or the WCO itself."[89] It is implicit in this statement that, if the WCO had interpreted the term "*prima facie*" in GIR 3(a), this interpretation *would* have been relevant to the panel's consideration of whether GIR 3(a) was applicable to the facts of that case.

528. In the present dispute, unlike in *EC – Chicken Cuts*, the WCO has interpreted the relevant General Interpretative Rule in a respect that is directly relevant to the interpretation of the term "motor vehicles" in China's Schedule of Concessions. As the Appellate Body's statement in *EC – Chicken Cuts* makes clear, the interpretation of GIR 2(a) adopted by the HS Committee and approved by the WCO is relevant to the application of GIR 2(a) to the facts of this dispute. What this interpretation demonstrates is that the measures challenged in this dispute are consistent with GIR 2(a) and the Harmonized System. Under GIR 2(a), as interpreted by the WCO, China can apply the classification principles of GIR 2(a) to multiple imports of parts and components that are assembled into a complete article. That is what the challenged measures do.

Response of the European Communities (WT/DS339)

529. That decision has no influence on the interpretation of GIR 2(a).

Response of the United States (WT/DS340)

530. The WCO decision removed the reference to "simple assembly" from the Explanatory Notes from General Interpretative Rule 2(a). As an explanatory note can neither expand nor restrict the terms of the Harmonized System, US Customs believes that the interpretation of General

[88] The decision of the HS Committee refers to "goods assembled from elements originating in or arriving from different countries." There is no reason to believe that the decision of the HS Committee is not equally relevant to goods assembled from elements originating in or arriving from a single country. The number and identity of the countries from which the parts originated would only be relevant, if at all, for purposes of applying rules of origin. As pointed out in paragraph 6 of the HS Committee decision, the General Interpretative Rules pertain solely to classification under the Harmonized System, and have no bearing on rules of origin.

[89] *EC – Chicken Cuts* at para. 234 n. 443.

Interpretative Rule 2(a) has been unaffected. In applying General Interpretative Rule 2(a), it suggests that customs officials can see the entire article at the time of entry. If an article is not classifiable by General Interpretative Rule 2(a), then General Interpretative Rule 1 requires the separate classification of the components.

Response of Canada (WT/DS342)

531. A WCO decision that is not adopted in the form of a modification or addition to the General Interpretative Rules or included in, or as an Explanatory Note to, the General Interpretative Rules may provide guidance but cannot be determinative of how to apply the General Interpretative Rules. Any discretion that might be afforded to Members on how to classify split shipments must naturally be limited so as not to violate tariff commitments. As a result, this decision should have no bearing on the interpretation of Rule 2(a).

Comments by the United States on China's response to question 112

532. Please see the above comments on China's response to question 111. Contrary to China's claim in its response that "[i]n light of these decisions, GIR 2(a) must be interpreted to allow national customs authorities to apply the principles of GIR 2(a) to goods that are assembled domestically from multiple shipments of imported parts and components," the only impact of the HSC/16 report is that the reference to "simple" for assembly should be removed. Any other interpretation would be contrary to the proper application of the Harmonized System.

113. (*Complainants*) Please comment on China's position that *Note VII of the Explanatory Notes* to Rule 2(a) of the General Interpretative Rules is relevant in delineating the boundary between complete articles and parts of those articles (paragraph 100 of China's first written submission).

Response of the European Communities (WT/DS339)

533. Note VII of the Explanatory Notes to Rule 2 (a) is generally relevant in delineating the boundary between complete articles and parts of those articles provided that the basic conditions of Rule 2 (a) are respected. However, as China fundamentally disregards the basic elements of Rule 2 (a) and in particular the "as presented" condition, the way in which China uses Note VII is necessarily fundamentally erroneous.

534. China also struggles to apply Note VII even under the erroneous terms China wishes to give it. Under paragraph 101 of its first written submission China states that the separate tariff heading for parts therefore encompasses the importation of parts "other than for the purposes of assembling a complete article from imported parts" This statement is difficult to square with the fact that under the measures parts that are imported for the purposes of assembling a complete car are classified as parts if the necessary local content is ensured.

535. Furthermore, as explained already under question 39 the description provided by China of judgment of the Court of Justice of the European Communities in case 165/78 *Michaelis* under paragraphs 102 and 103 of its first written submission is misleading and taken out of context.

Response of the United States (WT/DS340)

536. General Interpretative Rule 2(a) provides for the classification, at the time of entry, of complete unassembled motor vehicles as if they were assembled under the same heading.

Explanatory Note (VII) to General Interpretative Rule 2(a) gives guidance for situations where if the component parts are in excess of the number required for that article when complete, that the component part should be classified separately. General Interpretative Rule 2(a) does not refer to "split shipments" nor does it purport to create the authority for allowing split shipments. The Explanatory Notes for General Interpretative Rule 2(a) infer that the goods are presented as a single shipment.

Response of Canada (WT/DS342)

537. As set out in response to Question 111, Canada agrees that Explanatory Notes in the Harmonized System are to be followed when applicable. However, China has misapplied this Explanatory Note and has ignored its proper use in the Harmonized System.

538. First, China has ignored the hierarchy of application of the General Interpretative Rules. As stated in the WCO Handbook, the six General Interpretative Rules[90] "are applied in a hierarchical fashion, i.e. Rule 1 takes precedence over Rule 2, Rule 2 over Rule 3, etc." This means that, following General Interpretative Rule 1, products must be properly classified *first* in their appropriate heading. As noted in Canada's Oral Statement at paragraph 19, this includes intermediate products, notably "chassis with engines". While China seeks to rely on Explanatory Note VII to Rule 2(a), it suggests that it can ignore the equally authoritative Explanatory Notes for heading 87.06, which sets out what constitutes a "chassis with engine", and makes clear that many combinations of Assemblies that the measures Deem Whole Vehicles at most should be classified under heading 87.06 (and consequently charged a duty rate of 10%).

539. Further, China has misapplied this Explanatory Note. As discussed in answer to Question 39, it covers situations where *all* parts arrive at the border in *one* shipment. In such situations, all parts that are necessary to form the article are classified together if they have the "essential character" of *that* complete or finished article as presented, while any excess parts not required to form *that* article contained in the *same* shipment can be classified as parts.

540. China also fails to address the fact that Explanatory Note VII states "no further working operations" can be considered when determining whether an article, as presented, has the essential character of a complete or unfinished article. Indeed, the measures specifically provide in Article 24 that Assemblies and key parts that are substantially transformed (and which, therefore, must have undergone further working operations) are still deemed to be imported under the measures.

114. (*Complainants*) In the complainants' view, do the General Rules for the Interpretation of the HS constitute context for the interpretation of a term in a Member's Schedule within the meaning of the *Vienna Convention on the Law of Treaties*?

[90] The Rules (without interpretative notes) are attached for ease of reference as Exhibit CDA-8.

Response of the European Communities (WT/DS339)

541. Yes. This has been confirmed by the Appellate Body e.g. in *EC – Chicken Cuts* (paragraph 199) where it stated that "the above circumstances confirm that, prior to, during, as well as after the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties to *use* the Harmonized System as the basis for their WTO Schedules, notably with respect to agricultural products. In our view, this consensus constitutes an "agreement" between WTO Members "relating to" the *WTO Agreement* that was "made in connection with the conclusion of" that Agreement, within the meaning of Article 31(2)(a) of the *Vienna Convention*. As such, this agreement is "context" under Article 31(2)(a) for the purpose of interpreting the WTO agreements, of which the EC Schedule is an integral part. In this light, we consider that the Harmonized System is relevant for purposes of interpreting tariff commitments in the WTO Members' Schedules."

542. The European Communities considers that the Harmonised System could also fulfil the criteria in Article 31(3)(c) of the Vienna Convention as a "relevant rule[] of international law applicable in the relations between the parties".

Response of the United States (WT/DS340)

543. This indeed was the finding of the Appellate Body in *EC – Chicken Cuts* (Appellate Body Report, at para.199). As an initial point, the United States notes that the United States is not a party to the Vienna Convention, but that the United States does accept that the Vienna Convention reflects customary rules of interpretation of public international law. More importantly, the United States notes that although the Appellate Body found that the HS provides context for interpretation of a Member's schedule, the Appellate Body did not fully explain its reasoning and the United States does not agree with this Appellate Body finding.

544. In fact, during the *EC – Chicken Cuts* proceeding, the United States disagreed with the proposition that the HS qualifies as "context" under Article 31(2). The HS is neither an agreement relating to the WTO Agreement that all the Members made in connection with the conclusion of the WTO Agreement, nor an instrument made by one or more Members in connection with the conclusion of the WTO Agreement and accepted by the other Members as an instrument related to the WTO Agreement. The United States does consider that the HS and its Explanatory Notes could be deemed as part of the "circumstances of the conclusion" of China's accession negotiations within the meaning of Article 32 of the Vienna Convention and, therefore, could be used as a "supplementary means of interpretation" of China's Schedule.

Response of Canada (WT/DS342)

545. Yes. See *EC – Chicken Cuts*.[91]

115. (*Complainants*) If the charges at issue were considered as tariff duties, do the complaining parties agree that Rule 2(a) of the General Interpretative Rules is relevant context for the interpretation of the term "motor vehicles" in China's Schedule?

Response of the European Communities (WT/DS339)

546. Rule 2(a) is not relevant in interpreting a Member's Schedule from a general point of view unless one singles out a very specific product that is assumed to have been presented to the customs. It

[91] *EC – Chicken Cuts*, Appellate Body Report, at para.199.

is a rule that assists the Customs in specific instances where a given incomplete or unfinished article as presented to customs appears to have the essential characteristics of the complete or finished article. It should also be kept in mind that Chapter 87 of the Harmonized System contains a specific chapter note, which according to Explanatory notes IV and VIII is a specific application of Rule 2 (a) in the context of the chapter. In accordance with Rule 1, the Chapter Notes take precedence over the more general formulation of Rule 2 (a).

Response of the United States (WT/DS340)

547. Please see the response to Question 114.

Response of Canada (WT/DS342)

548. As set out in response to Questions 111, 113 and 114, Rule 2(a) is broadly relevant to the extent that it may apply, in certain limited instances, within the Harmonized System to interpreting China's Schedule. Rule 2(a) is not context on its own. It can only be taken into consideration after applying Rule 1, which requires a determination of whether a particular automotive product "as presented" at the border is an auto part, an intermediate product or a complete vehicle.

549. China attempts to argue the interpretative issue is "motor vehicles" to confuse the issue when, instead, Rule 2(a) applies to *that* article "as presented". An "auto part", not a "motor vehicle", is the "article" presented at the border. Accordingly, since the objective assessment of "essential character" is based on a single shipment of an auto part or parts, not a collection of separate shipments, the correct term to interpret is "auto part".

116. (*Complainants*) Please comment on China's statement in paragraph 147 of its first written submission in relation to Rule 2(a) of the General Interpretative Rules. In particular, with respect to your own policies, do the complainants agree with the statements made by China on the policy practices of other Members in the last three bullet points in paragraph 147?

Response of the European Communities (WT/DS339)

550. No, because China's statement mixes correct and incorrect information on customs classification together with its position on the relevance of anti-dumping rules. For instance China refers erroneously to multiple shipments in connection with anti-circumvention. In the EC GIR 2(a) applies only to goods presented at the same time and place. As stated on numerous occasions, the EC is of the view that anti-dumping measures have nothing to do with tariff classification.

Response of the United States (WT/DS340)

551. The United States has not applied the interpretive rules of General Interpretative Rule 2(a) to classify multiple shipments of parts and components as having the essential character of the complete article. Instead, US Customs has found that bulk shipments for inventory purposes are not covered by General Interpretative Rule 2(a), as bulk shipments for inventory are not for the convenience of packing, handling or transport.

552. Duty liability arises at the time of importation. The assessment of duties is not based on the actual use of the merchandise after importation. The Harmonized Tariff Schedule of the United States does contain a very limited number of provisions known as "actual use provisions," but these provisions classify the good as entered based on the stated intention of the importer. Under these provisions, the importer may claim a reduced rate of duty if the importer claims that the good will be

used only for a specific purpose. For goods classified under actual use provisions and entered for consumption, any use contrary to that which is specified in the HTSUS provision is contrary to law.

553. With respect to its own policies, the United States has not "adopted measures that track the final use of imported parts and components as a means of evaluating whether the parts and components were imported for the purpose of circumventing duty liability on the complete article." The United States has not adopted any such measures because duty liability is based upon the classification of the article in its condition as imported. Once an article has been entered for consumption into the United States, its subsequent use is not relevant for purposes of duty liability. For example, it is not considered a circumvention of duty liability when parts of a machine, subject to a lower rate of duty than the final machine, are separately imported in different shipments into the United States (and entered at their respective lower rates of duty) for subsequent assembly or manufacture into the final machine.

554. China also alleges in paragraph 147 that "Member [sic] have imposed bonding or other security requirements to ensure collection of any duty liability on the completed article" into which "parts and components were imported for the purpose of circumventing duty liability on the complete article." As explained above, given that the United States does not specifically track the post-importation usage of goods classifiable as parts or components, there are no bonding or other security requirements based on the classification and corresponding rate of duty of a completed article into which a part or component could be integrated.

Response of Canada (WT/DS342)

555. No. China's statement attempts to collapse different legal ideas and practices into one unrelated whole to which it would apply Rule 2(a) out of context.

556. The Appellate Body has found that to establish a "subsequent practice" within Article 31(3)(b) of the *Vienna Convention*, the following two elements must be shown: 1) there must be a common, consistent, discernible pattern of acts or pronouncements; and 2) those acts or pronouncements must imply agreement among WTO Members.[92] China cannot point to "acts or pronouncements" of WTO Members, with respect to the three points it attempts to argue constitute "subsequent practice". A single act of one WTO Member cannot constitute subsequent practice.

557. With respect to the third last bullet in paragraph 147 of China's first written submission, suggesting that Members have applied Rule 2(a) to classify multiple shipments to avoid payment of duties, China has in fact only presented one example to support this alleged subsequent practice. That example is Canada's furniture memorandum (Exhibit CHI-22), discussed in response to Question 124.

558. With respect to the second last bullet, China has presented no evidence of any WTO Member charging ordinary customs duties above the rates set out in a Member's Schedule based on "conditions" applied at the border. As discussed extensively in response to Question 32, the examples China gives of customs laws of other countries merely reinforce the evidence that WTO Members impose ordinary customs duties based upon the state of the goods as they arrive at the border. Similarly, China's attempt to rely upon programs that result in the imposition of charges *lower* than those set out in a Member's Schedule based upon subsequent activity within a Member is clearly misplaced.

[92] Appellate Body Report, *US – Gambling*, WT/DS285/AB/R, adopted April 20, 2005, at para. 192.

559. With respect to the final bullet, Canada cannot see any evidence that China has presented relating to the measures requiring tracking the final use of imported parts. However, other than the examples discussed above, the only practices to which Canada believes China has referred are those of the EC and the United States relating to true "anti-circumvention in the anti-dumping context, which is legally irrelevant.

117. (*All parties*) The European Communities explains in paragraph 262 of its first written submission that a situation foreseen under Article 21(2)(a) of Decree 125, namely importation of both an engine assembly and a body assembly together, is far away from the categories foreseen by the Chinese tariff schedule examined in the light of the general Explanatory Notes for Chapter 87 whereby an incomplete or unfinished vehicle may be classified as the corresponding complete or finished vehicle provided it has the essential character of the latter.

(a) Do you consider that the two examples of incomplete or unfinished vehicles in the General Notes for Chapter 87 correspond to any of the criteria set out in Article 21 of Decree 125?; and

Response of China

560. As China discusses in response to question 131, the two examples provided in the Chapter Notes for Chapter 87 are simply examples of the application of GIR 2(a) to motor vehicles. As the EC's own classification practice demonstrates, these two examples do not define the boundaries of the application of the essential character test to motor vehicles.

561. With respect to the first example, "a motor vehicle, not yet fitted with the wheels or tyres and battery," China considers that this is at least an "SKD kit," and could be classified simply as a motor vehicle. Wheels, tyres, and batteries are all consumable items, and are commonly added to the vehicle in the domestic market.

562. With respect to the second example, "a motor vehicle not equipped with its engine or with its interior fittings," this would likely correspond to Article 21(2)(b) of Decree 125, as it constitutes a "body … plus at least three other assemblies."

Response of the European Communities (WT/DS339)

563. The criteria set out in Article 21 of Decree 125 are, in essence, totally different from the examples of incomplete or unfinished vehicles in the general notes for chapter 87. For each of the different criteria under Article 21 of Decree 125, the EC has established that the measures require that parts are classified as complete vehicles and impose on them the 25% duty on complete vehicles in breach of China's schedule of concessions and Article II of the GATT (see first written submission of the European Communities, paragraphs 237 to 281).

564. First, parts which were imported at different times, from different origins and by different importers will be combined for classification as complete vehicles, which is in direct contradiction with the "as presented" rule. In that respect, if CKD and SKD kits may in some circumstances be assimilated to the examples in the notes, this may only be if 100 % of the parts are presented to customs at the same time. A pre-determination as under Article 21(1) of the Decree 125 that CKD and SKD kits will in all circumstances be classified as a complete vehicle breaches this rule.

565. Second, the measures also require classifying as complete vehicles a combination of parts which is far from having the essential character of a complete vehicle. In each of the combinations

provided for under Article 21(2) of Decree 125, imported parts will be classified as complete vehicles even though parts, or "assemblies" essential for the functioning of a vehicle will be missing in the combination of imported parts. This is further aggravated by the fact that an "assembly" need not be imported in its entirety, or even manufactured in China from exclusively imported parts to be "Deemed Imported" and thus to count against the thresholds set out in the measures. Under Article 22 of Decree 125, it is sufficient that a certain number of key parts, or value of key parts are imported and incorporated in one "assembly" to treat that "assembly" as imported and count it against the thresholds of Article 21(2) of Decree 125. This means that the import of a relatively limited quantity or value of parts is sufficient to impose the classification of those parts as complete Vehicles. Thus, for a class M1 vehicle, the import of five key parts of the vehicle body and six key parts of the engine will be sufficient to make both Deemed Imported Assemblies and all imported parts Deemed Whole Vehicles (see Exhibit EC - 1). Further, from July 1, 2008 and the entry into force of the class A/B distinction, the imports of, e.g., one door, one engine hood, one engine block and one cylinder head will be sufficient to make the vehicle body and the engine Deemed Imported Assemblies (see Exhibit EC - 2). To put these figures in context, the average number of parts in a complete vehicle is in the thousands.

566. In respect of Article 21(3) it is clear that the examples of incomplete or unfinished vehicles in the General Notes for Chapter 87 do not operate on the basis of the aggregate price of the parts, which is an entirely alien concept to customs classification. It is therefore impossible even to begin any reasonable comparison between the examples of chapter 87 of the HS system and Article 21(3) of decree 125 because they are based on completely different criteria the latter having nothing to do with customs rules.

Response of the United States (WT/DS340)

567. The criteria set out in Article 21 of Decree 125 for determining when parts are Deemed Whole Vehicles in most cases go far beyond what can appropriately considered to be parts with the "essential character" of a motor vehicle, under the Harmonized System (including application of the Chapter note to Chapter 87). There might be a few combinations of parts Deemed Whole Vehicles by Article 21 that could conceivably properly be classified under the Harmonized System as whole vehicles if presented together in one shipment at the border. For example the body, chassis-frame, transmission, steering system and both axles (which would be one "Main Assembly" and four other "Assemblies" within the meaning of Article 21) might appropriately under the Harmonized System be classified as a whole vehicle, based upon the General Chapter Note example ("a motor vehicle not equipped with its engine"). However, that would require an individual assessment that the additional Assemblies and other parts were enough to constitute the "essential character" of a motor vehicle. But in the vast majority of cases, parts Deemed Whole Vehicles under Article 21, even if they were presented together at the border, could only be classified as intermediate products or parts.

568. With respect to Decree 125, three options to determine if an article constitutes an incomplete vehicle were established. These are:

Option 1:	body and engine
Option 2:	body or engine plus three more other assemblies (chassis-frame, steering system, transmission, brake system, drive axle, and non-driving axle).
Option 3:	five or more other assemblies.

569. Taking into account Examples A and B of an incomplete vehicle in the General Explanatory Notes to Chapter 87, neither Option 1 nor Option 3 would meet the requirements of either example.

570. In the case of Option 2, if the article comprised the body, chassis-frame, transmission, steering system and both axles it would satisfy Example B which reads: "A motor vehicle not equipped with its engine or with its interior fittings."

Response of Canada (WT/DS342)

571. The criteria set out in Article 21 of Decree 125 go far beyond what can appropriately be considered to be parts with the "essential character" of a motor vehicle. As set out in more detail in answer to Question 128, CKDs/SKDs described in Article 21 could conceivably be classified under the Harmonized System as whole vehicles. Of course, that would only be relevant were those parts presented together in one shipment at the border. At that point, an individual assessment of the parts should be made, without consideration of end use.

572. With respect to Decree 125, three options to determine if an article constitutes an incomplete vehicle were established. These are:

Option 1:	Body and engine;
Option 2:	Body or engine plus three more other assemblies (chassis-frame, steering system, transmission, brake system, drive axle, and non-driving axle); and
Option 3:	Five or more other assemblies.

573. Using examples A and B of an incomplete vehicle in the General Explanatory Notes to Chapter 87, neither Option 1 nor Option 3 would meet the requirements of either example. Example B describes the case of a "motor vehicle not equipped with its engine or with its interior fittings". It may be possible that most assemblies (but not all), together with the body or engine, could take on the essential character of a motor vehicle. That determination is, however, in the abstract. Article 21 is not exhaustive, is broad enough to capture any number of imported parts combinations, and has nothing to do with presentation of those parts at the border. In the vast majority of cases, parts that are Deemed Whole Vehicles under Article 21, even if they were presented together at the border, could only be classified as intermediate products or parts. It is not for the complainants to determine where that threshold, in the light of the broad scope of Decree 125, should be set.

Comments by the United States on China's response to question 117(a)

574. In examining the examples in the General Explanatory Notes to Chapter 87, China asserts that: "With respect to the second example, 'a motor vehicle not equipped with its engine or with its interior fittings,' this would likely correspond to Article 21(2)(b) of Decree 125, as it constitutes a 'body … plus at least three other assemblies.' " The United States submits that this conclusion is unsupported because China has not established which types of assemblies would constitute an incomplete or unfinished motor vehicle.

(b) In your view, what auto part products, other than those referred to in the general Explanatory Notes for Chapter 87, would qualify as an "incomplete or unfinished vehicle having the essential character of a complete or finished vehicle"? Please explain by referring to specific examples.

Response of China

575. There are a variety of factors that customs authorities consider in evaluating whether an incomplete or unfinished article has the essential character of a complete or finished article. With respect to machines, such as motor vehicles, a principal consideration is whether the incomplete or

unfinished article *is recognizable* as that type of machine in its assembled condition. Three examples, drawn from US customs practice, illustrate this consideration:

– In HQ 086555 (16 April 1990) (CHI-42), the US Customs considered whether incomplete backhoe excavators from Japan had the essential character of a backhoe excavator. The missing components included the bucket, the arm, the boom, and the cab assembly. In essence, the imported article was the propelling base to which the cab and the operating extensions of the excavator would be attached. The US Customs found that this incomplete backhoe was recognizable as a backhoe, and therefore had the essential character of a backhoe.

– In HQ 084896 (18 October 1989) (CHI-43), the US Customs considered the classification of a luxury four-wheel drive motor vehicle that was missing its engine and transmission. Notwithstanding the fact that this vehicle was clearly not operational as a motor vehicle, the US Customs found that it had the essential character of a motor vehicle.

– In NY H80093 (4 May 2001) (CHI-44), the US Customs considered the classification of a centrifuge imported with the bowl, gearing, and base of the centrifuge, but without the motor, valves, and the various electronic elements and controls. Because this item was recognizable as a centrifuge, the US Customs found that it had the essential character of a centrifuge.

576. As these classification rulings demonstrate, the essential character test does not require the presence of every component that is "essential" to the use or operation of the machine in its finished form. This important aspect of the essential character test is further illustrated by the EC classification determination of incomplete pick-up trucks that China has already submitted (CHI-14). Thus, for example, while a method of propulsion is clearly an essential element of a finished motor vehicle, neither the engine nor the transmission must be present for an incomplete motor vehicle to have its essential character.

577. Another factor that customs authorities apply in evaluating the essential character of an incomplete or unfinished article is the value of the incomplete article in relation to the value of the finished article. This consideration has already been seen in CHI-16, the US tariff classification of incomplete, unassembled pistol kits from Austria. As the US Customs observed in that decision, "the nature of the item, its bulk, quantity, *or value* may be looked to in a determination of essential character." Among the relevant facts in that determination was that the unassembled, incomplete SKD pistol kit constituted 94.5 per cent of the import cost of the finished pistol. Value was also a relevant fact in the backhoe excavator determination described above; the various combinations of backhoe components that the US Customs classified as a complete backhoe represented as little as 87 per cent of the total value of the excavator. In yet another classification determination, concerning an incomplete railway car, the US Customs classified the incomplete article under the applicable heading for railway cars, and not the corresponding provisions for parts, even though the imported components represented only 57 per cent of the finished railway car.[93]

578. These factors and examples demonstrate that, contrary to the EC's position at the first substantive meeting, the two examples set forth in the general Explanatory Notes to Chapter 87 do not define the range of possible applications of the essential character test to parts and components of motor vehicles. China considers that the different combinations of auto parts and components set forth in Articles 21 of Decree 125 all result in an incomplete article that is plainly recognizable as a

[93] HG 081691 (18 January 1989) (CHI-45).

motor vehicle. These combinations therefore have the essential character of a motor vehicle under GIR 2(a).

Response of the European Communities (WT/DS339)

579. It is possible that an SKD kit and even a CKD kit under Article 21(1) of Decree 125 could in some instances be considered as "an incomplete or unfinished vehicle having the essential character of a complete of finished vehicle" if the kits consist of all the parts necessary to assemble a vehicle and provided only assembly operations are involved. However, such a determination must be made on a case by case basis and not be required in all cases as is the case with the Chinese measures.

Response of the United States (WT/DS340)

580. US authorities have found the following goods constitute "incomplete or unfinished vehicles having the essential character of a complete or finished vehicle":

> Four-wheel drive luxury motor vehicle imported without the engine, transmission, as well as other minor components described as "minor elements of design" was classified under heading 87.03 as having the essential character of a complete vehicle by application of General Interpretative Rule 2(a).
>
> A dump hauler cab with instruments, front frame portion, front axle and suspension, diesel engine, transmission, differential gear, plus electrical and hydraulic system was classified under heading 87.04 as having the essential character of a complete vehicle by application of General Interpretative Rule 2(a) because it contained both the motive power source and the cab from which the vehicle is operated, as well as the transmission which reduces the speed between the crankshaft and the rear drive axle and the hydraulic braking system for the entire vehicle.
>
> Cab assemblies consisting of the basic shell (including doors), certain glass (e.g., windshield and windows), windshield wipers, headlights, and parts of the dashboard (steering column, signal indicator, possibly the steering mechanism) was classified as having the essential character of a cab under heading 87.07 by application of General Interpretative Rule 2(a), because they possess the aggregate of distinctive component parts which establish their identity as driving cabs. The parts or components added after importation are in the nature of accoutrements which furnish or otherwise outfit the cab assemblies whose identity is already clearly established.
>
> Motor chassis with enclosed cabs for dump trucks or dumper cab chassis and dumper bodies that were disassembled prior to shipment, was classified under heading 87.04 by application of General Interpretative Rule 2(a) as the cab chassis are complete subassemblies clearly dedicated to receiving dumper bodies.

581. US authorities have found that the following types of goods do <u>not</u> constitute incomplete or unfinished motor vehicles of chapter 87 by application of General Interpretative Rule 2(a):

> Bulk parts consisting of panel parts, frame, engine assembly, transmission assembly, trim parts, chassis parts (other than the frame), and other miscellaneous parts (nuts, bolts, washers, bushings and similar miscellaneous fasteners and pins), shipped in unequal numbers and shipped either together or at different times to be put into inventory for eventual assembly

with US components and components produced in a foreign trade zone. The United States determined that parts imported in bulk and principally used for inventory purposes do not impart the essential character of a motor vehicle as the imported components were not advanced to the point that they were recognizable as a motor vehicle. Further there was no evidence that any of these components were intended to be assembled into a specific motor vehicle, nor was there any evidence that they constitute something other than discrete components intended for inventory for a manufacturing operation.

The United States determined that parts imported in bulk and principally used for inventory purposes do not impart the essential character of finished cab assemblies and that the components needed to be individually classified, regardless of whether the shipment of cabs, frames assemblies, and miscellaneous parts were entered on the same day or entered on different dates.

Response of Canada (WT/DS342)

582. There are thousands of parts incorporated into various assemblies and sub-assemblies. As a result, there are numerous potential combinations that would have the essential character of a complete vehicle and would have to be assessed on a case-by-case basis. Canada notes that in most cases combinations of parts could be classified as either a chassis with engine (87.06) or body (87.07). Therefore, to have the essential character of a complete vehicle a shipment of parts presented together at the border would have to include at a minimum the body, the chassis and most other parts of the vehicle (though not necessarily the engine).

Comments by the United States on China's response to question 117(b)

583. China cites to three examples of US customs practices in Exhibits CHI-42, 43, and 44. Of the three examples, only one (Exhibit CHI-43) is directly on point to the panel's question, which asks for examples of auto parts products that would qualify as an "incomplete or unfinished vehicle having the essential character of a complete or finished vehicle." Exhibit CHI-43 was also identified by the United States along with several other rulings in its original response to this question.

584. China also asserts in its response that "Value" should be taken into consideration. In regards to whether "value" criterion constitutes the essential character of these assemblies, the United States respectfully refers the Panel to the above US comment on China's response to Panel question 102.

118. (*European Communities*) The European Communities has stated in paragraph 270 of its first written submission that CKD and SKD kits cannot be classified as complete vehicles because nothing or very little is fitted or equipped in he case of CKD kits and because SKD kits will not attain the necessary degree of fitting and equipping to be classified as complete vehicles.

(a) In light of this statement, what degree of fitting or equipping of auto parts do you consider as necessary for such parts to be classified as complete vehicles within the meaning of the General Notes for Chapter 87?; and

Response of the European Communities (WT/DS339)

585. The European Communities has not stated in paragraph 270 of its first written submission what question 118 states. Paragraph 270 concerns only CKDs whereas SKDs are considered under paragraphs 272 and 273 of the first written submission. However, it is true that in respect of CKDs

the European Communities has in its first written submission taken the view that the lack of "fitting and equipping" is an obstacle for classifying a CKD as a complete vehicle. This is a borderline question where the presence of all the parts necessary to assemble a vehicle must be weighed against a product that is more advanced from the point of view of "fitting and equipping" but may lack some minor parts when presented to customs. The question therefore is whether the quantitative element of having all the parts necessary presented at the same time can outweigh the lack of the qualitative element i.e. the "fitting and equipping". The European Communities is prepared to accept that in some instances this can be the case and a CKD could be classified as a complete vehicle provided only assembly operations are involved. However, such a determination must be made on a case by case basis and taking into account *inter alia* the technical complexity of the vehicle type.

586. With regard to SKDs the position of the European Communities is more refined than what the question suggests. This position is explained in paragraph 272 and 273 of the first written submission. The determination whether an SKD can be classified as the complete vehicle must also be made on a case by case basis. In this respect the European Communities would like to correct the first sentence of paragraph 273 of its first written submission, which should read "SKDs will <u>often</u> not attain the necessary degree of fitting and equipping to be classified as complete vehicles". The word "often" was accidentally omitted from the sentence, which seems relatively evident on the basis of paragraph 272 that discusses the various possible scenarios.

587. A measure that requires to systematically classify CKDs and SKDs as complete vehicles would therefore be in breach of Article II of the GATT.

(b) Please elaborate on your response in light of Rule 2(a) of the General Interpretative Rules and the Panel's statement in *Indonesia – Autos* that "It appears that, in order to avoid paying 200 per cent duties on CBU passenger cars, EC and US car producers ship to Indonesia virtually complete CKD kits that are effectively "*cars in a box*". Accordingly, we believe that they can properly be considered to have characteristics closely resembling those of a complete car." (Panel Report, para. 14.197,emphasis added).

588. See reply to point (a).

119. (*European Communities*) In paragraph 277 of its first written submission, the European Communities states that a criterion of 60 per cent of the aggregate price of the parts not only means that the parts are not necessarily fitted and/or equipped together but also means that fundamentally important parts may be missing. Please explain, in the European Communities' view, what auto parts could be considered as "important parts"?

Response of the European Communities (WT/DS339)

589. This statement in paragraph 277 of the first written submission is made from a general point of view. Missing parts that consist of 40 % of the aggregate price of all the parts must mean in any possible configuration that the combination of parts would not have the essential character of a complete or finished vehicle. In a complete vehicle, all parts are important for its functioning.

590. As an illustration, the Panel can refer to the example provided by China in paragraph 19 of its first written submission, in which the body (14,25 %), the engine (15,32 %), the transmission (10,02 %), and the non-driving axle (1,17 %) consist of 40,76 % of the aggregate price of all the parts.

120. (*European Communities*) China states in paragraph 89 of its first written submission that the European Communities contradicts the application of Rule 2(a) of the General

Interpretative Rules to the term "motor vehicles" by stating that there is a clear separation between complete vehicles and the parts and components thereof. Please comment on this statement.

Response of the European Communities (WT/DS339)

591. China's tariff schedules and chapter 87 of the Harmonised System contains a clear separation between complete motor vehicles (headings 87.01 to 87.05) and the parts and accessories of the motor vehicles of headings 87.01 to 87.05 (heading 87.08). The headings or their interpretative notes do not contain any language that would provide a basis for blurring this clear distinction in the way China does. This clear general categorisation must be separated from an application of the schedules and the HS system in the context of an individual shipment as presented to the Customs. Of course, there are exceptional situations such as CKDs and SKDs where the borderline between complete vehicles and parts thereof may be difficult to draw and must be made on a case by case basis. However, this is a different matter from the general question as to whether the schedules provide for a clear separation between complete motor vehicles and parts thereof.

121. (*Complainants*) Do you agree with China's illustration of the relationship between substance and form of importing activities in paragraph 97 of its first written submission? If not, why?

Response of the European Communities (WT/DS339)

592. This illustration is given by China in a context where China tries to apply GIR 2 (a) of the Harmonised System without respecting the "as presented" condition there under. This amounts to disregarding the very basic rule of tariff classification, i.e. that when goods are classified in the Harmonised System it is always done on the basis of the objective characteristics of the product at the time of importation, that is, as imported and presented to Customs on a shipment-by-shipment basis.

593. The example is also alien to reality. The industry does not function in the way the "illustration" in paragraph 97 suggests. Different automotive parts are manufactured in different parts of the world and are genuinely shipped to the customers in separate shipments. Completely different parts such as windscreens, navigation systems, batteries, tyres or screws are manufactured by completely different companies located in different countries. To suggest that the manufacturer orders all of the parts from one company, then separates the parts into different containers in order to benefit from the lower duty rates in China for parts is completely alien to reality. However, even if such practices would exist, they would not circumvent the rules on customs classification. Furthermore, even in a simple vehicle type there are thousands of parts. An example of a motor vehicle that consists of 10 components has nothing to do with reality.

594. The example is also totally alien to the measures. Except under Article 21(1) of Decree 125 (to the extent that CKDs and SKDs are defined as kits including all parts necessary to build a complete vehicle), there is no need under the measures to import all parts to have them classified as complete vehicles and attract the 25% duty. Under Article 21(2) of Decree 125, the combination of some assemblies will be sufficient. In fact, the import of some parts will suffice as Article 22 deems assemblies imported if a certain number of key parts, or value of parts were imported and incorporated in the assembly (see EC FWS, paras. 40 et seq). Under Article 21(3), it will be sufficient to import parts for 60% of the complete vehicle price.

Response of the United States (WT/DS340)

595. As an initial matter, the United States again notes that China's example – premised on separating CKDs into split shipments – has nothing to do with the measure that China actually adopted. China's measure applies to all automotive manufacturing operations – including operations that import bulk components from all over the world to produce vehicles in China.

596. The United States does not agree with the illustration stated in paragraph 97 as it overly simplifies the number of components and sub-assemblies that comprise a complete motor vehicle. The illustration as presented also appears to breach the obligations of contracting parties to the Harmonized System to apply the General Interpretative Rules 1 and 2(a), because it ignores the specific tariff headings set out in China's schedule, and applies GIR 2(a) to separate shipments at the whim of China's authorities, without any regard to how the goods were presented to Customs authorities.

Response of Canada (WT/DS342)

597. No. China's measures instead result in form *prevailing* over substance, since they apply completely arbitrary thresholds contrary to proper classification under the Harmonized System. China's example is a gross oversimplification of the commercial reality of auto parts trade and automobile production. In normal manufacturing, parts are shipped at different times from different suppliers and undergo complex manufacturing processes at different plants in China or abroad before they are ready to be incorporated into a motor vehicle.

598. With respect to China's illustration in paragraph 97 of its first written submission, as set out in answer to Questions 32 and 33, separate shipments of parts do not have the "essential character" of a "motor vehicle" as presented at the border. Furthermore, as set out in more detail in answer to Question 128, even if, *arguendo*, it were permissible to assess multiple shipments, the thresholds under the measures would still be meaningless since they have no relationship to the proper classification of auto parts. Except perhaps in respect of Article 21(1) of Decree 125, to the extent that imported CKDs or SKDs may have all or nearly all of the parts needed to manufacture a motor vehicle, an auto manufacturer may import far fewer than 100% of the parts for a vehicle and *still* suffer from China's form over substance distinction.

122. (*China*) In relation to your statement in paragraph 97, does China consider that the processes required for the assembly of vehicles using CKD or SKD kits are different from those required for the assembly of vehicles using auto parts other than CKD or SKD kits? Please explain your position in terms of specific factors, including cost and time.

Response of China

599. The short answer to this question is "no". The process to assemble a puzzle is the same whether the pieces of the puzzle are in one box or in several boxes. The same is true of motor vehicles: Once the necessary parts and components have arrived at the point of assembly, the process for assembling them into a complete vehicle is the same, regardless of when and how the parts and components arrived. (These assembly processes are detailed in response to question 71.) The same answer applies to SKD kits. An SKD kit is a CKD kit at a more advanced stage of assembly. In effect, it reflects a decision to undertake part of the assembly operations at one location, and the remainder of the assembly operations at another location. Other than the fact that the vehicle is at a more advanced stage of assembly when it arrives at its final point of assembly, structuring the import transaction in this manner does not affect the nature of the assembly process.

123. (*China*) Regarding the EC decision provided in Exhibit CHI-18, please comment on the fact that in that decision, "all parts were present including engine and gearbox".

Response of China

600. China submitted the Binding Tariff Information (BTI) in CHI-18 to demonstrate that the European Communities, like customs authorities all over the world, classifies completely unassembled or disassembled motor vehicles as "motor vehicles," and not as "parts" of motor vehicles. This practice by the EC is contrary to its position in its first written submission that a "complete set of parts … remain[s] parts until they are fitted and processed together as a complete vehicle."[94] The EC appears to have abandoned this position during the first substantive meeting of the Panel, and now acknowledges that the correct classification of a completely unassembled or disassembled motor vehicle under GIR 2(a) is as a "motor vehicle." The fact that "all parts were present including engine and gearbox" simply establishes that, in this particular instance, the vehicle in question was a completely disassembled motor vehicle (and not, for example, an incomplete set of disassembled parts and components that nonetheless had the essential character of a motor vehicle).

124. In respect of the tariff classification decision by the Canada Border Services Agency,

(a) (*China*) Referring to the CBSA's determination in paragraph 119 of its first written submission, China submits that this determination by the CBSA is indistinguishable from China's interpretation of its own Schedule of Concessions relevant to the present case. Please elaborate on this statement in relation to the criteria under Article 21 of Decree 125.

Response of China

601. As China noted in paragraph 119 of its first written submission, one of the principal differences between the CBSA determination and Decree 125 is that Decree 125 specifies, in detail, the precise thresholds at which China will consider a collection of imported auto parts and components to have the essential character of a motor vehicle. This is the purpose of Article 21 of Decree 125. The CBSA determination, by contrast, refers only to determining the "commercial reality" of a series of import transactions. The CBSA determination, for example, refers to "what was actually purchased by the importer: complete furniture or unrelated parts," without elaborating upon the meaning of "unrelated parts". Presumably, this refers to imported parts that are not, in fact, assembled with other imported parts and components into complete furniture. This is suggested by the next paragraph of the determination, which states that "[a]rticles that are imported specifically either as replacement parts *or to be incorporated with domestic components in the manufacture of domestic furniture* will be classified in their own right under the appropriate Harmonized System heading." This statement implies that, at a certain threshold, Canada would no longer consider a collection of imported furniture parts to have the essential character of complete furniture, without specifying where that threshold is.

602. The fact that China has provided detailed thresholds in Article 21 of Decree 125 makes these measures more transparent and predictable to importers. As China noted throughout the first meeting of the Panel, if importers believe that the application of these thresholds to a particular set of facts results in an incorrect tariff classification, there are both domestic and international procedures to challenge these determinations. However, as the CBSA determination illustrates, the application of GIR 2(a) to multiple shipments of parts that are assembled domestically is not inconsistent with the Harmonized System.

[94] EC first written submission at para. 270.

(b) (*Canada*) Please explain in detail how the CBSA furniture decision can be distinguished from the measures at issue, including with respect to when the decision of whether a good has the essential characteristic has been made by the Canadian customs office in that case; and

Response of Canada (WT/DS342)

603. In the case of disassembled furniture imported on the basis of a split shipment, the furniture has been completely manufactured and only disassembled for ease of transport. The furniture is purchased as a complete unit by a retailer. The Canadian rule does not apply to furniture manufacturers. It imposes no reporting requirements for importers of furniture parts relating to their sale within Canada.

604. To determine if the importing retailer is in fact importing complete furniture in disassembled form, Canadian customs officials examine the purchase orders and import documentation in order to ascertain that the imported goods are covered under the same purchase order. There is no assumption of a violation: if an importer declares that it is importing furniture parts, in the absence of contrary evidence obtained by Canadian customs officials, they are charged at the parts rate. If there is evidence that finished furniture has been purchased by a retailer but shipped disassembled, Canadian customs officials are not required to charge furniture parts at the finished furniture tariff rate but, instead, are afforded discretion whether such a determination is warranted.

605. In contrast, the measures apply to multiple shipments between different exporters and importers throughout the supply chain. Auto parts imported by parts manufacturers that process the imported articles before they are sold on the Chinese market to other parts manufacturers or to vehicle manufacturers are covered. A vehicle manufacturer is deemed to be circumventing Chinese law unless it can supply a very detailed parts audit trail to establish the domestic content of the completed vehicle. Further, customs officials must assess parts that are Deemed Whole Vehicles at the complete vehicle rate, with no discretion to do otherwise. In sum, the measures are in most material aspects completely different from Canada's rules on classification of furniture parts.

(c) (*Canada*) With respect to the part of the CBSA decision that "articles imported to be incorporated with domestic components in the manufacture of domestic furniture will be classified in their own right under the appropriate Harmonized System heading", could Canada explain whether there is any threshold level of domestic components that need to be incorporated into domestic furniture to satisfy this standard.

606. No, there is no threshold level of domestic content. Paragraph 7 of the Memorandum does not apply to imported furniture that is manufactured abroad and re-assembled in Canada, but rather it applies to domestic furniture manufactured in Canada. Canadian-manufactured furniture is not covered by this Memorandum since it is only meant to cover imported furniture that is dissassembled and subject to re-assembly in Canada.

125. (*Canada*) In respect of Canada's reference to "snapshot" during the substantive meeting regarding the determination of whether a good has the essential characteristic has to be made on importation:

(a) Could Canada explain its reference to "snapshot" in the context of Rule 2(a) of the General Interpretative Rules;

Response of Canada (WT/DS342)

607. The "snapshot" refers to the product as presented at the border. That is, the "essential character" of the product is established with the physical act of importation, in a single shipment. The "essential character" is determined on the basis of the objective characteristics of that good, in the light of any information provided by the importer and with reference to the importing Member's Schedule. Tariff liability attaches on the basis of that snapshot at the border. No consideration is to be given to other shipments with which the product may later be incorporated, the end use of the product, or the value of the good. Assessment is only based on *that* product as presented. See also Canada's response to Question 110.

(b) When does the customs' appreciation start and end?; and

608. Customs appreciation starts when the article arrives at the border and ends once customs officials have objectively classified that article based on its state as presented at the border. Thus, appreciation must occur during the physical act of importing a good, and cannot happen once goods are "imported" (clear customs). In cases where a good is transported to a bonded zone upon its arrival, appreciation must occur before that good clears customs and is released from that zone to the importer.

609. The WCO has confirmed, which fact has been noted by the Appellate Body,[95] that the appreciation is based on the assessment of the essential character of a good at the time of importation, and cannot be done so as to reflect the handling of the goods after importation. Such assessment may be on the basis of a visual inspection of the product, including indications on the packing, accompanying documentation or laboratory analysis. Regardless, it is always done on the basis of the objective characteristics of the product at the time of importation and on the basis of the terms of the Harmonized System headings and any related Section or Chapter Notes.

(c) In Canada's view, can subsequent processing beyond the border be taken into consideration for the tariff classification purpose? Could Canada relate its answer to this question to the example of the CBSA's tariff classification decision on furniture imports as referred to by China in paragraph 113-119 of China's first written submission. In particular, to what extent does the information required by Canada from the importer at the point of importation differ from that required by China under the measures at issue.

610. Subsequent processing that occurs after importation cannot be taken into consideration for purposes of product classification related to a Member's Schedule. As set out in response to Question 124, Canada's tariff classification practice for furniture does not relate to subsequent processing, nor to manufacturers of either finished furniture or furniture parts. It applies only to finished furniture that has been *disassembled* before shipping. No information is required from the retailer regarding subsequent use of the furniture. No tracking is required of imported furniture parts purchased as parts. Classification based on accompanying documentation (e.g., invoice) is an accepted form of objective classification, as stated by the WCO in its answers to panel questions in *EC – Chicken Cuts*.[96]

[95] *EC – Chicken Cuts*, Appellate Body Report, at para. 230, ref. Questions 1 and 7 of the WCO's response to questions posed by the panel.

[96] Ibid., Panel Report, Annex C-12, WCO response to Question 1, "The determination of the essential character of a product can be done in several ways. The most obvious is through a visual inspection of the

126. (*United States*) The final determination on imported "Large Newspaper Printing Presses and Components" as provided in Exhibit CHI-25 states, *inter alia*, that "to facilitate the Department's performance of the value test, all foreign producers/exporters and US importers in the LNPP industry shall be required to provide various information as indicated in the notice "on the documentation accompanying each entry" from Germany and Japan of elements pursuant to a LNPP contract." Please explain the exact point in time "each entry" in this notice is referring to. In other words, when do exporters and importers have to provide information to the DOC?

Response of the United States (WT/DS340)

611. There are several reasons why the US anti-dumping duty orders on large newspaper printing presses (LNPPs) from Germany and Japan, which were revoked effective 1999 and 2001, respectively, are irrelevant to this dispute. As an initial matter, in its response to Question 67 above, and in response to Question 140 below, the United States explains at length why "circumvention" in the antidumping context is not relevant to this dispute. The United States also has the following comments that are specific to the antidumping duties imposed on LNPPs.

612. First, unlike automobiles, which are routinely imported fully assembled, it is not feasible to import fully assembled LNPPs, which must be housed in significantly sized buildings. Given the unique nature of this product, and to ensure the effective administration of the anti-dumping order, the US Department of Commerce developed the product coverage of the LNPPs investigations to include LNPP systems, additions and the five major press system components, whether assembled or unassembled, that are capable of printing or otherwise manipulating a roll of paper more than two pages across. Because even the five major components were typically imported unassembled, the Department of Commerce provided for the "value test" cited by China in its first written submission. Specifically, if the sum of the value of elements imported to fulfill a LNPP contract was at least 50 per cent of the value, measured in terms of the cost of manufacture, of any of the five named components covered by the scope into which they are incorporated, then the imported elements were covered products.

613. Second, while the potential of circumvention of an anti-dumping duty order always exists and was referred to by the Department of Commerce in the LNPPs determination, the value test was actually part of a process the Department of Commerce provided so that importers could demonstrate that their merchandise was not subject to the anti-dumping duty order. In other words, the requested entry documentation was required if producers or importers intended to demonstrate that the relevant entries should not be subject to the anti-dumping duty order. If such documentation was provided no later than 75 days prior to the intended date of entry, the Department of Commerce could preliminarily determine that such merchandise was outside the product coverage of the order and instruct the US Customs Service to suspend liquidation at a zero deposit rate. Under the Department of Commerce's procedures, this ruling would become final unless subjected to administrative review.

127. (*China*) China submits in paragraph 133 of its first written submission that the value-based test adopted by the US Commerce required the US Commerce to wait until after all of the elements comprising the LNPP component are imported and the LNPP component is produced before making a determination as to whether the imported parts were within the scope of the order.

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product, including indications on the packing. Reference can also be made to accompanying documents. In some cases, however, laboratory analysis may be required".

To the extent that such value-based-test adopted by the US were to be considered as serving the same purpose as China's measures, could China explain what is the rationale behind certain procedural requirements under Decree 125 that are imposed on auto manufacturers *prior to* the importation of auto parts, including self-evaluation and the Verification Center's review?

Response of China

614. As China has explained in response to several questions, principally questions 38 and 78, the purpose of the evaluation and verification process is to determine whether multiple shipments and parts and components are related to each other through their common assembly into a motor vehicle model that China would have classified as a "motor vehicle" had those parts and components entered China in a single shipment. This determination is made in advance of importation principally so that China can impose an appropriate customs procedure on these related shipments of auto parts and components to ensure compliance with China's customs laws.

128. (*Complainants*) Please explain under which specific tariff headings of China's Schedule should the categories of auto parts under paragraphs (1), (2) and (3) of Articles 21 of Decree 125 fall?

Response of the European Communities (WT/DS339)

615. Even a simple motor vehicle that does not contain modern electronics would consist of thousands of parts, which in addition are separated into different specific tariff headings depending on the vehicle type. It is therefore not possible to provide an exhaustive answer. Furthermore, automotive parts are rarely imported in the form of the 'assemblies' foreseen under Article 21 of Decree 125. The "assemblies" often consist of many parts imported separately and the "assemblies" normally become such only after manufacture. Furthermore, an "assembly" can be deemed imported when actually only a certain number of key parts, or value of parts were imported and incorporated in the "assembly" (Article 22 of Decree 125). The notion of "assemblies" is a creation of the contested measures, and is not foreseen by the Chinese schedules and the HS system. This demonstrates very concretely how the Chinese measures operate internally in China and depending on the use of the parts after importation.

616. However, some general indications at the four digit level can be given:

Article 21(1):

SKDs and CKDs may in some circumstances be classified as the complete vehicle if all the parts necessary to assemble a vehicle are presented to Customs at the same time and provided only assembly operations are involved. In such a case the kits would be classified under headings 87.01 to 87.05 depending on the specific vehicle type in question. If the conditions for classification as a complete vehicle are not fulfilled *in casu*, the parts that were presented to customs would be classified separately under the specific headings for automotive parts. The most relevant four digit headings are 87.08, 84.07, 84.08, 84.09, 84.83 and 85.11 but also other headings may be relevant depending on the vehicle type. In the case of an SKD, also headings 87.06 and 87.07 may be relevant depending on the level of "fitting and equipping".

Article 21(2):

Complete engines (the "engine assembly") are classified under headings 84.07 and 84.08 and parts thereof under heading 84.09 at the four digit level.

Complete bodies (the "body assembly") are classified under heading 87.07 and parts thereof under heading 87.08 at the four digit level.

The other "assemblies" under Decree 125 do not have a specific heading under the Chinese Schedules and the HS system because the "assemblies" are a creation of the measures not foreseen by the schedules and the HS system. In most cases the parts that make up the "assemblies" after manufacture would upon importation be classified under the relevant headings for parts (most relevant four digit headings are 87.08, 84.07, 84.08, 84.09, 84.83 and 85.11). However, heading 87.06 "chassis fitted with engines" is relevant in many combinations foreseen by Article 21(2) because a "chassis fitted with engines" is according to the explicit terms of the heading "a motor vehicle without bodies". In other words, a motor vehicle without its body but containing other parts already fitted and equipped is for the purposes of the Chinese Schedules and the HS system a "chassis fitted with engines", not a complete motor vehicle. A more detailed analysis has been provided under paragraph 255 to 260 of the first written submission of the EC.

Article 21(3):

This paragraph foresees that any configuration of parts in a random order as long as the aggregate price of the imported parts attains 60 % of the complete vehicle parts is classified as the complete vehicle. The applicable headings are therefore the headings of all the parts that make up a given vehicle type. The most relevant are headings 87.08, 84.07, 84.08, 84.09, 84.83 and 85.11 at the four digit level.

Response of the United States (WT/DS340)

617. Paragraph (1) of Article 21 of Decree 125 provides that "imported automotive components fulfill the characteristics of a whole vehicle . . . [w]hen completely knocked-downs (CKD) or semi-knocked-downs (SKD) are imported to assemble vehicles." In this category, if the imported articles were truly vehicle CKD or SKD kits, meaning that all of the essential parts and components of the vehicle were included in the import shipment and the only difference between the CKD and SKD designation was the state of disassembly, with CKD being completely disassembled and SKD being only somewhat disassembled, and if only assembly operations were involved in producing a complete vehicle, then the shipments could fall under the headings for motor vehicles, i.e., HS 8703 or HS 8704.

618. Subparagraph (2)(a) of Article 21 of Decree 125 provides that "imported automotive components fulfill the characteristics of a whole vehicle . . . [w]hen the two main assemblies, i.e., vehicle body (including driver's cabin) and engine, are imported to assemble the vehicle." Under longstanding classifications by Customs authorities around the world as well as the tariff classification experts at the World Customs Organization, a vehicle body and an engine for a motor vehicle, even if shipped together, would have to be separately classified. The vehicle body would be classified under HTS 8707 and the engine would be classified under either HS 8407 (petrol) or HS 8408 (diesel). A vehicle body and an engine inherently could never be classified together as a single article. Neither a vehicle body nor an engine would ever be properly considered to have the "essential character" of a motor vehicle, nor would the theoretical combined article of a vehicle body and an engine.

619. Subparagraph (2)(b) of Article 21 of Decree 125 provides that "imported automotive components fulfill the characteristics of a whole vehicle . . . [w]hen either one of the two main assemblies, i.e., vehicle body (including driver's cabin) and engine, as well as 3 or more than 3 other assemblies (systems) are imported to assemble the vehicle." This subparagraph presents the same situation as subparagraph (2)(a). Decree 125 defies the longstanding conventions and principles of

classifying imported articles in their condition at the time of importation, as set forth in the General Interpretive Rules and their explanatory notes. A vehicle body or an engine combined with any 3 of the other specified assemblies could never be properly classified as an article with the essential character of a complete motor vehicle. For example, a vehicle body with brakes, a steering system and drive axle, but no engine simply is not a motor vehicle. It is an odd assortment of automotive parts. The same holds true for any other combinations envisioned by subparagraph (2)(b). Proper classification of any combination of the imported assemblies would be according to the individual assembly in its condition at the time of importation, with each assembly separately classified, even if all assemblies were shipped together.

620. Subparagraph (2)(c) of Article 21 of Decree 125 provides that "imported automotive components fulfill the characteristics of a whole vehicle . . . [w]hen the two main assemblies, i.e., vehicle body (including driver's cabin) and engine not being imported, 5 or more than 5 other assemblies (systems) are imported to assemble the vehicle." Classifying the specified assemblies without a body or an engine as a complete motor vehicle or more specifically as having the "essential character" of a complete motor vehicle takes the well-established principles and conventions of tariff classification even further afield. None of these assemblies, even if impossibly classified together as a single article, would ever be considered to have the "essential character" of a complete motor vehicle and, therefore, could never be classified as such.

621. Paragraph (3) of Article 21 of Decree 125 provides that "imported automotive components fulfill the characteristics of a whole vehicle . . . [w]hen the aggregate price of imported components attains 60% or more of the complete vehicle price for the vehicle model in question." No imported articles are ever properly classified according to their value. The General Interpretive Rules do not provide for this way of classification. Classification addresses the physical qualities and sometimes the function of the article without any regard to its value or its relative value with respect to the nature or purpose of the finished good.

Response of Canada (WT/DS342)

622. **Article 21(1)** of Decree 125 considers that parts imported as CKDs and SKDs are Deemed Whole Vehicles. As set out in answer to Question 33, if imported parts are imported in one shipment and have the essential character of a whole vehicle they could appropriately be classified as complete vehicles under the appropriate vehicle heading (87.01 to 87.05 inclusive). If the parts do not have the essential character of a complete vehicle, each article of the importation would be classified separately under the appropriate heading (e.g., 87.08, 87.06, 87.07, 84.07).

623. **Article 21(2)** of Decree 125 considers that parts in a vehicle are Deemed Whole Vehicles if a certain number of Assemblies are Deemed Imported (an assessment made separately under Article 22, based on three separate thresholds:

(a) **Two Main Assemblies.** These should be classified separately (i.e., the body under heading 87.07 and the engine under heading 84.07);

(b) **One Main Assembly and three other Assemblies**. If the Main Assembly is the engine, these combinations could at best constitute a chassis with engine of heading 87.06, and then only if the chassis was one of the other Assemblies. In all other combinations, each article of the importation should be classified separately (i.e., the body under heading 87.07, the engine under heading 84.07, and the other assemblies under heading 87.08); and

(c) **Five or more of the other Assemblies**. Regardless of the combinations, each article should be classified separately under the appropriate subheading of heading 87.08.

624. **Article 21(3)** of Decree 125 considers that parts used in a vehicle are Deemed Whole Vehicles if they constitute more than 60% of the value of all parts used in manufacturing the vehicle. The value of imported content is properly used only for determining origin of imported products; not for determining their tariff classification. As a result, the 60% by value threshold category is erroneously applied to classification of parts, which in most cases should be classified under heading 87.08.

129. (*All parties*) In light of the fact that imports from other WTO Members can only be subject to ordinary customs duties and terms, conditions or qualifications as set forth in a Member's Schedule under Article II:1(b), to what extent is Rule 2(a) of the General Rules for the Interpretation of the HS relevant in interpreting a Member's Schedule?

Response of China

625. As China has explained in detail in response to other questions, the Appellate Body has repeatedly affirmed the importance of the Harmonized System to the interpretation of WTO Members' Schedules of Concessions. The Harmonized System, by its terms, includes the General Interpretative Rules, including General Interpretative Rule 2(a). Moreover, as China has explained in response to question 112, the Appellate Body has specifically recognized the relevance of interpretive decisions adopted by the HS Committee and the WCO in evaluating the scope and application of the General Interpretative Rules.

626. The Harmonized System is not a "term, condition, or qualification" to a Member's Schedule of Concessions. Rather, as the Appellate Body recognized in *EC – Computer Equipment* and *EC – Chicken Cuts*, the Harmonized System is the basis upon which Members have negotiated and scheduled their tariff commitments. The Harmonized System therefore provides context under Article 31(2)(a) of the *Vienna Convention* for the purpose of interpreting a Member's Schedule of Concessions.[97] It would not be consistent with these findings by the Appellate Body to conclude that Members may interpret their Schedules of Concessions in accordance with the rules of the Harmonized System, including the General Interpretative Rules, only if they have scheduled a specific "term, condition, or qualification" for this purpose.

Response of the European Communities (WT/DS339)

627. Rule 2(a) assists the Customs in instances where a given incomplete or unfinished article as presented to customs appears to have the essential characteristics of the complete or finished article. This is different from examining the Members' schedules from a general point of view.

628. The European Communities also notes that China's Schedules do not contain any restriction on the use of parts in China.

Response of the United States (WT/DS340)

629. GIR 2(a) could be of some use in clarifying the treatment set out in China's schedule with respect to a collection of unassembled parts as presented to China's customs officials at the border.

[97] *EC – Chicken Cuts*, at para. 199.

630. GIR 2(a), however, cannot be used to interpret the provisions of the GATT itself. Thus, GIR 2(a) cannot be instructive on what is, or is not, an "ordinary customs duty" for the purpose of GATT Article II. Thus, if, as China contends, GIR 2(a) allowed for customs duties to be assessed on the use of a part in manufacturing operations, and with the rate of duty based on the local content of the complete vehicle, the resulting charge could not be an ordinary customs duty under GATT Article II, regardless of the content of GIR 2(a).

631. Likewise, GIR 2(a) cannot be used to impose a "term, condition, or qualification" on China's tariff bindings set out in its schedule that would be inconsistent with GATT obligations. For example, even if GIR 2(a) contained explicit local content requirements (such as contained in China's measures), this would not provide a defense to the breach of Article III and the TRIMs Agreement resulting from the local content requirement.

Response of Canada (WT/DS342)

632. See Canada's response to Question 112. A Member is strictly bound by those ordinary customs duties and terms, conditions or qualifications listed in its Schedule. Since there are no "terms, conditions or qualifications" specifically set out in China's Schedule allowing the principle of Rule 2(a) to be applied more broadly to products in separate shipments and based upon their internal use in China, China cannot supersede the clear tariff concessions applicable to, *e.g.*, auto parts in its Schedule.

130. (*All parties*) If the measures at issue did not exist, how would the combinations of auto parts under Article 21(2) of Decree 125 be classified under China's Schedule of Concessions upon their importation into China? Please provide your answer based on specific tariff headings under China's Schedule of Concessions.

Response of China

633. China interprets this question to ask how China would classify the combinations of auto parts under Article 21(2) of Decree 125 if they were to enter China in a single shipment. The answer is that China would classify these combinations as having the essential character of a motor vehicle under GIR 2(a). The purpose of the challenged measures is to ensure that this classification result does not change based solely on the manner in which the auto manufacturer structures its imports of parts and components.

Response of the European Communities (WT/DS339)

634. Reference is generally made to the answer given to question 128.

635. Complete engines (the "engine assembly") are classified under headings 84.07 and 84.08 and parts thereof under heading 84.09 at the four digit level.

636. Complete bodies (the "body assembly") are classified under heading 87.07 and parts thereof under heading 87.08 at the four digit level.

637. The other "assemblies" under Decree 125 do not have a specific heading under the Chinese Schedules and the HS system because the "assemblies" are a creation of the measures not foreseen by the schedules and the HS system. In most cases the parts that make up the "assemblies" after manufacture would upon importation be classified under the relevant headings for parts (most relevant four digit headings are 87.08, 84.07, 84.08, 84.09, 84.83 and 85.11). However, heading 87.06 "chassis

fitted with engines" is relevant in many combinations foreseen by Article 21(2) because a "chassis fitted with engines" is according to the explicit terms of the heading "a motor vehicle without bodies". In other words, a motor vehicle without its body but containing other parts already fitted and equipped is for the purposes of the Chinese Schedules and the HS system a "chassis fitted with engines", not a complete motor vehicle. A more detailed analysis has been provided under paragraphs 255 to 260 of the first written submission of the EC.

Response of the United States (WT/DS340)

638. Please see the following table:

Description (per Decree 125)	**Tariff Heading (per China's Schedule of Concessions)**	**Duty Rate (per China's Schedule of Concessions)**
Engine Petrol Diesel	8407.31 - .338408.20.10	10%9%
Vehicle Body	8707.10 or .90	10%
Gear Box Assemblies	8708.40	10%
Drive Axle Assemblies	8708.50	10%
Drive Axle Assemblies (non-drive axle)	8708.60.30 - .90	10%
Frame Assembly	Not clear	Not more than 10%
Steering System	8708.94	10%
Braking System	8708.31 or .39	10%
Passenger Vehicles	8703	25%

Response of Canada (WT/DS342)

639. See Canada's response to Question 128.

131. (*China*) The European Communities states in paragraph 258 of its first written submission that ""a chassis fitted with engines", which is classified under the tariff heading 87.06, falls within the scope of Article 21(2)(b) and (c) of Decree 125..." Please comment on this statement.

Response of China

640. The EC's "chassis fitted with engine" argument is premised on the assumption that the Explanatory Note to heading 87.06 is binding as to what constitutes the essential character of a motor vehicle. But as the Appellate Body has noted, the Explanatory Notes do not form part of the Harmonized System and are not binding at all, let alone as to what constitutes the essential character of a motor vehicle.[98]

641. It is interesting to note, in this regard, that the EC itself has classified as a complete motor vehicle an incomplete and unassembled vehicle that was missing substantially more than the "tyres and battery" referred to in the example provided in the Chapter Notes to Chapter 87.[99] In its first written submission, the EC invoked the Chapter Notes to Chapter 87 – which form part of the Harmonized System – to support its contention that there are only "very exceptional situations" in

[98] *EC – Chicken Cuts*, at para. 214, n. 416.
[99] CHI-14.

which incomplete vehicles are classified as motor vehicles, and yet its own classification practice is not in accordance with this example.[100]

132. (*European Communities*) Please comment in detail on China's argument in paragraph 126 of China's first written submission that the European Communities' anti-circumvention measures as embodied in EC Regulations No. 384/96 are indistinguishable from the challenged measures.

Response of the European Communities (WT/DS339)

642. The European Communities' or any other WTO Member's rules on AD circumvention are not subject to the present Panel.

643. Without prejudice to its position that China's measures fall within the scope of Article III of the GATT and the *TRIMs Agreement*, the European Communities considers that the AD circumvention rules cannot be relied upon to establish a subsequent practice relevant to the interpretation of China's obligations under Article II of the GATT and its schedule of concessions. This would totally ignore that AD duties and customs duties follow a completely different logic and are rooted in 2 different sets of WTO obligations.

644. AD duties are not Customs duties, or other duties or charges falling within the scope of Article II of the GATT. This is explicitly provided for in Article II:2 of the GATT and was confirmed by the AB in *Chile – Price Band System*, which distinguished between Customs duties, other duties or charges and AD duties (para. 276). As an exception to Article II of the GATT and to the MFN principle, AD duties may be imposed after an investigation establishing that dumped imports are causing injury. AD duties aim at re-establishing fair trade conditions between the dumped imports and the domestic like products and protecting the domestic industry from the injury caused by the dumping. They are subject to detailed obligations defined in Article VI of the GATT and the *Agreement on implementation of Article VI of the GATT 1994* ("Anti-Dumping Agreement").

645. Anti-Circumvention rules on AD measures find their legitimacy in Article VI of the GATT, the Anti-Dumping Agreement and the Ministerial Declaration on this issue. They enforce and relate to a different set of rights and obligations, and are not relevant to the interpretation of the rights and obligations of WTO Members under Article II GATT.

646. In contrast, customs duties are defined in the country's schedule of concessions. They are levied on the basis of the classification of the product in that schedule and the various interpretative notes thereof. A country may also introduce reservations or qualifications in its schedule, but in the absence of such reservations or qualifications, the purpose for which the merchandise is imported is not relevant for the tariff classification.

647. The purpose of the rules set out in Art. 13(2) of the EC anti-dumping regulation 384/96 (as amended by regulation 461/2004) is to act against shipments of parts which are either assembled in the Community or in a 3rd country if these shipments of parts replace the shipment of products which had previously been found dumped and shipped in an assembled form. All this is linked and must take place in the context of an AD measure on the assembled product with a view to undermining the remedial effect of these duties.

[100] EC first written submission at para. 251.

648. The Chinese measures are totally different. The level of customs duty depends on whether the parts end up in an assembled car with sufficient local content and/or whether they are used as a spare part. China is not acting against imports of parts which have previously been imported in the form of assembled cars. The measures act against parts as such with a view to increasing local content and developing a domestic industry for auto parts and complete vehicles.

649. EC's anti-circumvention measures do not change the customs classification. Applied to the example of AD measures against bicycles from China and the anti-circumvention measures against imports of major bicycle parts, this would mean that the imports of parts would be subject to an AD duty for bicycles, but the customs duty will remain the one applicable for bicycle parts. This is explicitly stated in Article 13(5) of regulation 384/96.

650. The anti-circumvention duty is never applied on products leaving the assembly factory in the EC. Rather, an investigation is carried out and if it is found that the imports of parts constitute circumvention, the Antidumping Duty is extended to the parts.

133. (*All parties*) In the parties' view, does the treatment accorded to the products at issue under China's measures correspond to China's concessions for the tariff rates for these products that the WTO Members negotiated at the time of China's accession to the WTO?

Response of China

651. Yes. China negotiated a Schedule of Concessions that contains a higher bound rate for motor vehicles than the bound rate for parts and assemblies of motor vehicles. The essence of the dispute before the Panel is that *each side* believes it is at risk of being deprived of the benefit of the tariff concessions that it negotiated. The complainants believe that the difference in tariff rates between motor vehicles and parts of motor vehicles allowed their exporters to arbitrage the tariff rate difference by importing parts and components in multiple shipments, even if China could properly classify the imported parts and components as a motor vehicle if they were to enter China in a single shipment. China, on the other hand, considers that the importation and assembly of parts and components in multiple shipments deprives it of the revenue and market access benefits that it obtained when it negotiated a higher bound tariff rate for motor vehicles.

652. The question before the Panel is how to resolve these conflicting claims. China considers that the rules of the Harmonized System, as interpreted by the HS Committee and the WCO, provide the most relevant context for the resolution of this interpretive issue. Those rules, as they existed at the time of China's accession to the WTO, and as they exist today, have a specific rule for determining the relationship between a tariff provision for a complete article (such as a motor vehicle) and a tariff rate for parts of that article (such as auto parts and assemblies of auto parts). That rule is GIR 2(a). Long before China's accession to the WTO, the WCO had interpreted GIR 2(a) to allow members of the Harmonized System to apply its principles to the importation and assembly of parts and components in multiple shipments. As members of the Harmonized System, the complainants were aware of this interpretation, which, as China has noted previously, dates back to the adoption of GIR 2(a) in the early 1960s. Moreover, this application of GIR 2(a) to multiple shipments is indistinguishable from the manner in which the United States and the European Communities, at least, have sought to address the circumvention of anti-dumping duties that apply to complete articles, including prior to China's accession to the WTO.

653. These were the circumstances surrounding China's accession to the WTO, and the negotiation of the specific tariff provisions that are now the subject of this dispute. In China's view, the decision of the WCO concerning GIR 2(a), and its general recognition that substance should prevail over form

in the administration of customs duties, establishes the baseline against which to evaluate the tariff concessions that the parties negotiated concerning motor vehicles and parts of motor vehicles. If the complainants had a different expectation – that China would not be allowed to apply GIR 2(a) as interpreted by the WCO, or that China would be required to give effect to the form of a manufacturer's import transactions over their substance – it was incumbent upon the complainants to negotiate this result. It is the *complainants'* interpretation of the term "motor vehicles" – not China's – that is contrary to the rules and decisions of the WCO against which these tariff concessions were negotiated.

654. To state the matter differently, there is an important question here concerning the burden of proof. The Appellate Body has stated that "the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof."[101] China has provided evidence to support its position that the Harmonized System permits China to interpret the term "motor vehicles" as it has done in the challenged measures. On the other hand, the complainants' argument under Article II of the GATT rests on the proposition that China is *not* allowed to interpret the term "motor vehicles" as it has done in the challenged measures. The complainants have provided no evidence to support this fact.

Response of the European Communities (WT/DS339)

655. No. The European Communities has provided the details how China breaches its commitments in its first written submission relating to Article II of the GATT (paragraphs 237 to 281).

Response of the United States (WT/DS340)

656. The United States submits that China's measures impose an internal charge, over and above the 10 tariff rate for automotive parts negotiated at the time of China's accession to the WTO. The United States thus views the additional charge as a breach of Article III:2, as opposed to Article II.

657. However, if the Panel were to determine that China's measures imposed "ordinary customs duties" within the meaning of Article II, then China would not be providing the tariff rate negotiated for parts.

658. In addition, the United States submits that China, in paragraph 93 of the working party report, agreed to provide a 10 per cent rate of duty on CKDs and SKDs. Because China's measures impose a 25 per cent rate of duty on CKDs and SKDs, the United States does not consider China to be providing the tariff rate negotiated at the time of accession for these items.

Response of Canada (WT/DS342)

659. No. Canada negotiated a tariff rate of 10%, generally, for all imported auto parts, including intermediate products. The measures deem auto parts to be whole vehicles based on their end-use and subject them to a 25% tariff rate. This denies Canada the tariff rate it negotiated for auto parts. In respect of CKDs and SKDs, China is obligated to provide Canada with a tariff rate of 10% as a result of the commitment it made in paragraph 93 of the Working Party Report.

134. (*China*) Does China consider that how imported products are going to be used can be considered for the customs classification purpose? If so, how do you reconcile your position

[101] *US – Wools Shirts and Blouses*, at p. 14.

that the measures are "border" measures with the fact that a consideration of factors such as how products are used in the domestic market is related to the events that take place in the importing country's internal market after importation?

Response of China

660. China does not consider that the challenged measures base a tariff classification on "how imported products are going to be used," or on "events that take place in the importing country's internal market after importation." As China has sought to explain and document, any customs procedure that seeks to address the importation and assembly of parts and components through multiple shipments needs some process to determine whether different shipments of parts and components are related to each other through their common assembly into a single finished article. Any such process necessarily entails an examination of the importer's practice or intention of assembling multiple shipments of parts and components into a finished article.

661. There are different ways in which customs authorities approach this determination of whether multiple shipments of parts are related to each other through their common assembly into a single finished article. At the first meeting of the Panel, Canada referred to this process as an "investigation" in describing its treatment of imported furniture parts. The EC, in the context of its anti-dumping measures, makes a presumption that *all* imported parts and components from the subject countries or exporters will be assembled into the complete article, but grants "certificates of non-circumvention" to importers who can demonstrate that they do not import and assemble parts and components above the thresholds specified by the EC in its measure. Under this system, importers who can present a "certificate of non-circumvention" are not assessed the applicable anti-dumping duties. The United States, because it has a retrospective system of duty assessment, can suspend the customs liquidation of entries and later determine, in the context of an administrative review, whether multiple shipments of parts and components were *actually assembled* into the complete article.

662. Whatever one calls this process, and however it is structured, its purpose is to establish the relationship among multiple shipments of parts and components for the purpose of assessing duties that apply to the complete article. As described in response to previous questions, it is a form of customs procedure under which the goods remain subject to customs control in order to complete the customs formalities related to those imports. This type of customs procedure is provided for in the *Kyoto Convention*, and gives effect to an application of GIR 2(a) that is consistent with the rules of the Harmonized System. It is a border procedure.

663. To be clear, this type of procedure cannot be invoked for any purpose, and does not justify tariff classification determinations that are impermissibly based on the end use of the product. For example, a WTO Member could not defer the tariff classification of lumber to see whether it was used to manufacture furniture or to manufacture toys, and then base the tariff classification accordingly. The type of customs procedure at issue in this dispute relates only to the importer's obligation to pay the duty rate for the complete article when it imports parts and components that have the essential character of that article. It seeks to establish *what was imported*, not *how it was used*.

Comments by the United States on China's response to question 134

664. China's practice of determining the identity of an imported good based on its post importation use is not a border measure. According to China, its process of "establish[ing] the relationship among multiple shipments of parts and components for assessing duties that apply to the completed article" is permissible because "[I]t seeks to establish what was imported, not how it was used." However, for tariff classification purposes (and under GRI 2(a) specifically) the identity of the good that is imported

must be demonstrable by the good in its condition "as presented" for entry into the customs territory, that is, at the time of importation. Shipments of other parts and components with which the good will be assembled in the importing country's internal market cannot be considered in the classification of the good because there is no assembly of the good and the other parts and components at the time that the good is imported.

665. Even though customs formalities may not be completed until some time period after imported goods have entered the country's customs territory, any domestic assembly, which transpires during this interim period between importation and completion of customs formalities, is not a basis for classification under the Harmonized System.

666. China postulates that the United States has the authority to implement similar measures while United States customs formalities are ongoing. Specifically, China asserts that the United States could conduct administrative reviews after the importation of goods to determine "whether multiple shipments of parts and components were actually assembled into the completed article." The United States, howver, does not conduct such administrative reviews, for the simple reason that the United States does not classify multiple shipments of different parts and components as a completed article for the purpose of assessing duties that apply to the completed article.

135. (*China*) In relation to Article II:1(b), first sentence, please elaborate on your position that duties imposed under the measures are *related to the importation* of the merchandise into China, as evidenced by the fact that the measures themselves do not impose any duty, fee or charge, but rather serve to classify these merchandise under the correspondent tariff provisions. (first written submission of China, para. 44).

Response of China

667. China has explained that Decree 125 is a customs procedure to ensure the correct tariff classification of multiple shipments of parts and components that are related to each other through their common assembly into a particular vehicle model. This is a procedure to apply the classification rules of GIR 2(a) to multiple shipments of parts and components, consistent with the interpretation of GIR 2(a) adopted by the WCO. Nothing in Decree 125 establishes or imposes any type of duty or charge. Rather, as stated in Article 28 of Decree 125, the Customs General Administration makes classification determinations and collect duties under this measure in accordance with the applicable customs laws and regulations of China.

136. (*European Communities and the United States*) Please comment on the EC and the US regulations allowing classifying multiple shipments as a single entry as referred to by China in paragraphs 157-159 of its first written submission.

Response of the European Communities (WT/DS339)

668. In the EC (and we understand also in the US) the customs authorities allow the importer of multiple shipments to choose between the application of ordinary tariff classification rules (each shipments is classified alone at the time of importation as presented to customs) and special rules designed to favor importers who prefer that the goods at issue should be considered and classified as if they were presented to customs at the same time and place.

Response of the United States (WT/DS340)

669. Paragraph 157 of China's first written submission references 19 U.S.C. § 1484(j)(1) and the publication in the Federal Register of the Final Rule for the regulation that implements the statute, 19 C.F.R. § 141.58, 71 Fed. Reg. 31, 921 (June 2, 2006). Under the limited circumstances set forth therein, the United States permits the single entry of unassembled or disassembled entities imported on multiple conveyances. As explained in the Federal Register publication, "[a]n unassembled or disassembled entry consists of merchandise which is not capable of being transported on a single conveyance, but which is purchased and invoiced as a single classifiable entity. By necessity, due to its size or nature, the entity is placed on multiple conveyances, which arrive at different times at the same port of entry in the United States. The subject arriving portions are consigned to the same person in the United States."

670. China interprets the United States law as permitting an importer to "import a vehicle in unassembled or disassembled condition in multiple shipments, and still have the combined entries classified as a complete vehicle, even if no one shipment would satisfy the essential character test for the complete vehicle." At a prima facie level, an automobile imported in unassembled or disassembled condition in multiple shipments does not meet the requirements for single entry treatment under the United States regulation because an automobile is capable of being transported on a single conveyance. Under the regulation, the size or nature must necessitate shipment in the unassembled or disassembled condition. Contrast automobiles with fiber production plants, which would likely be eligible for single entry treatment when imported on separate conveyances in unassembled or dissembled condition because of their substantial size. Often times the components of automobiles are sourced from many different countries, and such would disqualify them from eligibility for single entry treatment. As stated in the Federal Register publication, it is the position of the United States that "the legislation [19 U.S.C. § 1484(j)(1) was intended to apply to the components of articles with a single point of origin which are shipped from the same port of export at approximately the same time."

671. China interprets 19 C.F.R. § 141.58 as being "necessarily based on an understanding of the 'condition as imported' rule that looks beyond the contents of a single import entry, and that rests instead on the stated intention of the importer to assemble the separate shipments into a complete article." First, as cited in the Federal Register publication, the United States does not believe that single entry treatment for unassembled or disassembled entities imported on multiple conveyances "should act as a means to control an importer's inventory or manufacturing processes." Second, the "stated intention of the manufacturer to assemble the separate shipments into a complete article" must be manifest from the documents presented at the time of entry. The Federal Register publication notes that "[w]hen making a determination as to whether to approve or deny a particular application, the port director must rely on the information that is supplied on the application." The decision to grant single entry treatment and classify unassembled or disassembled merchandise imported on multiple conveyances is made on the basis of the information available at the time of importation. We also note that all of the multiple conveyances intended to qualify for single entry treatment must be imported within a maximum of 25 days of each other.

672. Paragraph 158 asserts "it was the practice of the US customs [sic] authorities to combine 'split shipments' for tariff classification purposes." In support of this assertion, China relies upon the decision of the Court of International Trade's (CIT) decision in Zomax Optical Media, Inc. v. United States, 366 F. Supp. 2d 1326 (2005), wherein China alleges that the CIT "has observed that this practice represented a departure from the prior practice of basing tariff classification determinations strictly on the condition of merchandise 'as imported.'" The split shipments and practice referred to by the CIT in that case are codified at 19 U.S.C. § 1484(j)(2), which provides for single entry treatment

of merchandise that is purchased and invoiced as a single entity but …is shipped in separate shipments due to the inability of the carrier to include all of the merchandise in a single shipment (at the instruction of the carrier)." See 19 C.F.R. § 141.57.

673. This provision covers "split shipments," which "consist [] of merchandise that is capable of being transported on a single conveyance, and that is delivered to and accepted by a carrier in the exporting country as one shipment under one bill of lading or waybill, and is thus intended by the importer to arrive as a single shipment. However, the shipment is thereafter divided by the carrier into different parts which arrive in the United States at different times, often days apart." 68 Fed. Reg. 8713 (Feb. 25, 2003). Single entry treatment for split shipments is also limited to very narrow circumstances, is at the election of the importer, and certification that the entry was split at the election of the importer must be made when the goods are imported. 19 C.F.R. § 141.57.

137. (*All parties*) Please clarify whether, and if so, how, a new tariff line can be *de facto* created.

Response of China

674. China does not consider that a Member can create a new tariff line "*de facto*". The process of creating a new tariff line involves amending the Member's tariff schedule to include the new tariff line. As it pertains to paragraph 93 of the Working Party Report, the relevant consideration is that China is allowed to classify CKD/SKD kits in accordance with GIR 2(a) and the customs practices of other WTO Members, unless and until it decides to do otherwise through the creation of a new tariff line for CKD/SKD kits.

Response of the European Communities (WT/DS339)

675. A tariff commitment can be created when a member, which committed itself to provide certain tariff treatment if it creates a tariff line for a specific good *in effect* does so by enacting a measure that pronounces how that good is to be treated. The European Communities also refers to the more detailed reply provided by Canada.

Response of the United States (WT/DS340)

676. The United States understands this question to refer to China's obligations under paragraph 93 of the Working Party report, and to China's defense that it did not breach those obligations because China did not create a new tariff line for CKDs/SKDs. The United States submits that paragraph 93, in context, shows that Members were concerned with tariff treatment of CKDs/SKDs, and that those Members wanted to ensure that China did not change its classification policies or practices so as to apply a whole-vehicle rate to those items. Although China did not create a *de jure* new tariff line, China achieved the same result by specifying in Decree 125 that CKDs/SKDs would be deemed whole vehicles, and assessed at the whole-vehicle rate. Thus, China adopted a measure – whether labeled a *de facto* tariff line or anything else – that is contrary to the obligations China assumed with respect to the tariff treatment of CKDs/SKDs.

Response of Canada (WT/DS342)

677. See Canada's answer to Question 61(b).

138. (*All parties*) The Harmonized System Committee Decision on the interpretation of General Interpretative Rule 2(a) (Exhibit CHI-29) refers to the questions of "split consignments" and "the classification of goods assembled from elements originating in or arriving from different country" in paragraph 10. Please explain differences between these two situations.

Response of China

678. In relevant part, a "consignment" is generally understood to mean a set of goods handed over to the custody of a transport carrier for delivery, whether those goods are packed in one container or in multiple containers. A consignment is "split" when the carrier breaks the consignment into multiple modes or stages of delivery (e.g., it loads the containers making up the consignment onto two different vessels). There are a variety of reasons why this could occur, such as the need to balance loads (a consideration that is particularly relevant in air transport) or an opportunity to take advantage of costs savings in shipment.

679. The classification of "goods assembled from elements originating in or arriving from different countries" refers to the classification of goods assembled from imported parts and components (or "elements") that arrive in the customs territory in multiple shipments.[102] This circumstance is, in the context, distinguished from a "split consignment," in that the imported parts and components were not necessarily part of a single consignment.

Response of the European Communities (WT/DS339)

680. These are inter-related issues that concern trade facilitation. In the context of some very large or complex machinery that are difficult to transport in one single consignment the importer may wish to declare the product as a single product irrespective of the fact that the elements of the product are split into different consignments and may not be presented to customs precisely at the same time. In some instances an element of the product may need to be transported from two or more countries or may originate from two countries. The classification of split consignments as the complete product even when some elements arrive from different countries is an option for the importer.

Response of the United States (WT/DS340)

681. The context of the decision identified in paragraph 10 of the Harmonized System Committee Decision on the Interpretation of General Interpretative Rule 2(a) (Exhibit CHI-29) does not include a definition of "split consignments" or "the classification of goods assembled from elements originating in or arriving from different countries."

682. US Customs authorities have not formally defined "split consignments". A consignment, generally speaking, is a shipment of goods that is imported by or for a consignee who will sell or deliver the goods to or for benefit of a consignor after the importation of the goods into the United

[102] As China noted above, the reference to "different countries" cannot, in the context, mean that the decision of the HS Committee applies only in the case of goods assembled from parts and components that arrive from more than one exporting country. The number and identity of the exporting country or countries would only be relevant, if at all, for the purpose of applying Rules of Origin – a matter that is not within the scope of GIR 2(a). Moreover, there is no reason why the classification of goods assembled from parts and components that arrive from a single exporting country should be any different than the classification of goods assembled from parts and components that arrive from more than one exporting country.

States. A consignment may also refer to a shipment of goods in the custody of a shipper and transported on behalf of another party.

683. Presumably, "the classification of goods assembled from elements originating in or arriving from different countries" refers to the determination of the country of origin of imported goods when such goods consist of parts or components that originated in more than one country."

Response of Canada (WT/DS342)

684. As discussed in response to Question 112, any discretion that might be afforded to Members on how to classify split shipments must naturally be limited to application in a manner that does not violate their tariff commitments. It is not uncommon in customs practice to allow an importer, *at its discretion*, to seek to have split shipments classified together. This could include situations where the elements for constitution into some larger product (such as in the case of heavy or complex equipment shipped only rarely) originate in different countries.

Comments by the United States on China's response to question 138

685. The United States does not agree with China's definition of "goods assembled from elements originating in or arriving from different countries" in the context of the Harmonized System Committee decision on GIR 2(a) contained in Exhibit CHI-29. According to China, this phrase means "the classification of goods assembled from imported parts and components (or 'elements) that arrive in the customs territory in multiple shipments." China's definition is mere conjecture given that decision identified in paragraph 10 does not include a definition of this phrase and China has not identified any other documents promulgated by the Committee which would support its interpretation.

686. China's interpretation also disregards the Committee's reference to "different countries" and claims that this reference "cannot mean that the decision of the HS Committee applies only in the case of goods assembled from more than one exporting country" because this issue would be relevant only in the context of the application of the Rules of Origin. We agree with China that the Rules of Origin are beyond the scope of GIR 2(a). Consistent with this position, the HS Committeee's decision in paragraph 10 is an indication that matters involving goods of mixed origin are beyond the scope of GIR 2(a).

687. Finally, the decision of the Harmonized System Committee cannot be used by China as a tool to abrogate its obligation to comply with the GIRs under the HS Convention. China must still classify goods as presented, using the entire nomenclature, rather than selectively applying the nomenclature (headings of the HS) to goods (auto parts) based on a condition that is not existent (assembly into motor vehicle) until after the goods are released into the domestic market.

139. (*Complainants*) The complainants have expressed a view during the first substantive meeting that the General Interpretative Rule 2(a) is irrelevant to Article II of the GATT 1994. Could you please elaborate on your position.

Response of the European Communities (WT/DS339)

688. Rule 2(a) is not relevant in interpreting a Member's Schedule generally unless one assumes a very specific product that is presented to customs at the same time. It is a rule that assists the Customs in instances where a given incomplete or unfinished article as presented to customs appears to have the essential characteristics of the complete or finished article. See also the reply to question 115.

Response of the United States (WT/DS340)

689. Please see the United States response to Question 129.

Response of Canada (WT/DS342)

690. Canada agrees that Rule 2(a) is relevant as an element of the Harmonized System, used so as to interpret Members' scheduled commitments. However, when applied to the instant case, Rule 2(a) is irrelevant to China's tariff commitments for auto parts. Generally, Rule 2(a) is not relevant unless one is considering incomplete or unfinished articles as presented to customs officials that may have the essential characteristics of a finished article. Rule 2(a) cannot be used independently to trump clear obligations to provide a specific duty rate, if a Member later wishes to alter its classification for that product. Rule 2(a) does not address, nor can it alter, tariff commitments mutually agreed between Members.

691. If a Member wishes to renegotiate its tariff commitment because it believes, later in time, the common intention reflected an erroneous classification, it may do so as provided for under Article XXVIII of GATT 1994.

140. (*Complainants*) China has referenced various antidumping anti-circumvention decisions as support for its contention that Members are permitted to treat "parts" of products the same as the "whole" to prevent circumvention of its appropriately applied duties. The complaining parties have all said that antidumping practice is not relevant to the dispute. Can the complaining parties please give specific reasons why they believe antidumping anti-circumvention practice is distinguishable from the measures concerned?

Response of the European Communities (WT/DS339)

692. See reply to question 132.

Response of the United States (WT/DS340)

693. For several reasons, China cannot justify its measures by invoking the practices by which some Members impose anti-dumping duties when they are concerned about circumvention.

694. First, and most fundamentally, China's GATT Article II obligations, not obligations under GATT Article VI, are at issue in this dispute. In other words, anti-dumping duties and the circumvention of such duties are governed by the rules of GATT Article VI and the Anti-Dumping Agreement, not GATT Article II. In addition, Article VI anti-dumping measures are authorized only in certain circumstances, i.e., where the investigating Member makes findings of dumping, injury and causal link (as explained above in response to question 67).

695. Second, under GATT Article VI and the Anti-Dumping Agreement, the investigating Member is not required to impose anti-dumping duties on the basis of tariff lines and, in fact, investigating Members rarely do it. Rather, the anti-dumping duties are applied to imports of the products under investigation, as defined in the scope of the products covered by the anti-dumping order. That product coverage can be defined in numerous ways. It can be defined to apply to some but not all products that fall under a particular tariff line or to products falling under or within a variety of tariff lines. In addition, the product coverage can apply to finished products or to parts or both. That is what the rules of GATT Article VI and the Anti-Dumping Agreement allow. The only requirements are those set out in the Anti-Dumping Agreement, such as findings of dumping, injury and causal link.

Thus, in the anti-dumping context, unlike the GATT Article II context, tariff lines and how tariff concessions are set forth in a Member's Schedule are not relevant.

696. Third, while the WTO Agreement does not define circumvention, Members have traditionally recognized two patterns of trade which they have considered to be circumvention, both of which arise in the context of trade remedies applied under Article VI of GATT 1994, i.e., anti-dumping measures and countervailing duty measures. The first type of trade pattern involves marginal alterations to the product itself, and the second involves marginal alterations in the patterns of shipment and assembly. Most Members recognize that circumvention takes place when such marginal modifications or alterations of the physical characteristics, production or shipment of merchandise otherwise subject to an anti dumping or countervailing duty measure are done in a manner which undermines the purpose and effectiveness of trade remedies provided for under the WTO Agreement. In addition, the concept of circumvention in the antidumping context has also been recognized in a Ministerial Decision, i.e., the *Ministerial Decision on Anti-Circumvention*, adopted by Members at Marrakesh and forming an integral part of the *Final Act Embodying the Results of the Uruguay Round Multilateral Trade Negotiations*. The Decision acknowledged the problem of circumvention in the trade remedies context and recognized the desirability of applying "uniform rules in this area as soon as possible" to prevent the evasion of anti dumping and countervailing measures through circumvention. The Decision confirms that the topic of circumvention formed part of the negotiations which preceded the Anti-Dumping Agreement and referred this matter to the Committee on Anti-Dumping Practices for resolution. To fulfil this mandate, the Committee on Anti-Dumping Practices established the Informal Group on Anti Circumvention to examine and resolve which rules should apply uniformly to address the problem of circumvention. In contrast, the United States is not aware of any generally held concept of circumvention under GATT Article II.

697. Fourth, when anti-dumping duties are imposed in the circumvention context, they are not applied in the way that China seeks to apply its GATT Article II "duties" under the measures at issue. The investigating Member does not impose the same anti-dumping duties on the products governed by a circumvention ruling as it does on the products that were clearly within the scope of the anti-dumping order from the outset. Indeed, there is not one uniform amount of duty imposed on any of the products within the scope of the anti-dumping order (at least under the US system). Rather, the anti-dumping duties are assessed based on the amount of dumping found for particular transactions involving particular products.

698. In sum, China's analogy to Members' anti-dumping practices is irrelevant in the absence of any proceeding initiated by China under the rules of GATT Article VI and the Anti-Dumping Agreement. Simply put, the rules governing anti-dumping are different from the GATT Article II rules, and therefore they have no relevance to China's measures.

Response of Canada (WT/DS342)

699. There exists no generally recognized WTO basis for the application of internal "anti-circumvention" measures related to tariffs. Anti-circumvention of anti-dumping duties is legally recognized. Canada and many other WTO Members only use the notion of "anti-circumvention" in application to anti-dumping duties. No parallel concept applies in respect of tariff concessions.

700. There is a fundamental difference between an ordinary customs duty and an anti-dumping duty. An anti-dumping duty is applied to remedy a situation where imports from another Member are being dumped in a Member's internal market and are causing injury to domestic producers of those like products. In contrast, an ordinary customs duty does not correct a situation of injury, nor does it relate to activity within the internal marketplace. Instead, an ordinary customs duty is in respect of,

and solely relates to, entry of a product in the "importation" phase and is not applied with an underlying notion to correct "wrongdoing" (i.e., injury). This lack of "wrongdoing" and the need to "correct" such actions is the reason that the concept of anti-circumvention measures does not apply to valid and legitimate customs duties, and is only spoken of in terms of anti-dumping duties, which by their nature are designed to combat actions already found to be illegal under a Member's domestic law. There is also a separate regime governing application of anti-dumping duties under the *AD Agreement*. In fact, as set out in answer to Question 96(b), anti-dumping duties are measures that do *not* qualify as either "ordinary customs duties" or "other duties or "charges". Indeed, there is a separate agreement for anti-dumping duties that governs their use, and they are not covered under Article II of the GATT.

701. Customs tariffs are applied for the purpose of affording domestic producers a measure of protection from foreign import competition (although in some countries, particularly developing, they can also represent an important source of revenue). In an effort to ensure predictability as to tariff classification and liability, the Harmonized System bases the tariff classification of goods on their physical description at the time of their importation and admits of only one heading (or subheading) for each product. To countenance China's attempt to increase the tariff on auto parts under the guise of enforcing the customs duty on automobiles instead of renegotiating their tariff concession on this item under the relevant provisions of the WTO would undermine the predictability and value of WTO tariff concessions made by Members on parts, more broadly.

702. By contrast, anti-dumping duties are special and generally temporary measures that are intended to address the injurious effects on a domestic industry of unfairly traded goods from one or more sources. Such duties, which are based on findings resulting from investigations conducted in accordance with the *AD Agreement* that unfairly traded specified goods from specified sources are causing or threatening injury to the domestic industry, are remedial in nature.

141. (*Complainants*) Do the complainants have any specific procedures and criteria for determining whether an antidumping order is being circumvented? Please explain them with citations to the relevant legislation or regulations.

Response of the European Communities (WT/DS339)

703. Article 13 of regulation 384/96 as amended by regulation 461/2004 on protection against dumped imports from countries not members of the European Community, which reads as follows:

> "Circumvention
>
> 1. Anti-dumping duties imposed pursuant to this Regulation may be extended to imports from third countries, of the like product, whether slightly modified or not; or to imports of the slightly modified like product from the country subject to measures; or parts thereof, when circumvention of the measures in force is taking place. Anti-dumping duties not exceeding the residual anti-dumping duty imposed in accordance with Article 9(5) of this Regulation may be extended to imports from companies benefiting from individual duties in the countries subject to measures when circumvention of the measures in force is taking place. Circumvention shall be defined as a change in the pattern of trade between third countries and the Community or between individual companies in the country subject to measures and the Community, which stems from a practice, process or work for which there is insufficient due cause or economic justification other than the imposition of the duty, and where there is evidence of injury or that the remedial effects of the duty are being undermined in terms of the prices and/or quantities of the like product, and where there is evidence of dumping in

relation to the normal values previously established for the like product, if necessary in accordance with the provisions of Article 2.

The practice, process or work referred to in paragraph 1 includes, inter alia, the slight modification of the product concerned to make it fall under customs codes which are normally not subject to the measures, provided that the modification does not alter its essential characteristics; the consignment of the product subject to measures via third countries; the reorganisation by exporters or producers of their patterns and channels of sales in the country subject to measures in order to eventually have their products exported to the Community through producers benefiting from an individual duty rate lower than that applicable to the products of the manufacturers; and, in the circumstances indicated below under Article 13(2), the assembly of parts by an assembly operation in the Community or a third country.

2. An assembly operation in the Community or a third country shall be considered to circumvent the measures in force where:

(a) the operation started or substantially increased since, or just prior to, the initiation of the anti-dumping investigation and the parts concerned are from the country subject to measures; and

(b) the parts constitute 60 % or more of the total value of the parts of the assembled product, except that in no case shall circumvention be considered to be taking place where the value added to the parts brought in, during the assembly or completion operation, is greater than 25 % of the manufacturing cost, and

(c) the remedial effects of the duty are being undermined in terms of the prices and/or quantities of the assembled like product and there is evidence of dumping in relation to the normal values previously established for the like or similar products.

3. Investigations shall be initiated pursuant to this Article on the initiative of the Commission or at the request of a Member State or any interested party on the basis of sufficient evidence regarding the factors set out in paragraph 1. Initiations shall be made, after consultation of the Advisory Committee, by Commission Regulation which may also instruct the customs authorities to make imports subject to registration in accordance with Article 14(5) or to request guarantees. Investigations shall be carried out by the Commission, which may be assisted by customs authorities and shall be concluded within nine months. When the facts as finally ascertained justify the extension of measures, this shall be done by the Council, acting on a proposal submitted by the Commission, after consultation of the Advisory Committee. The proposal shall be adopted by the Council unless it decides by a simple majority to reject the proposal, within a period of one month after its submission by the Commission. The extension shall take effect from the date on which registration was imposed pursuant to Article 14(5) or on which guarantees were requested. The relevant procedural provisions of this Regulation with regard to initiations and the conduct of investigations shall apply pursuant to this Article.

4. Imports shall not be subject to registration pursuant to Article 14(5) or measures where they are traded by companies which benefit from exemptions. Requests for exemptions duly supported by evidence shall be submitted within the time limits established in the Commission Regulation initiating the investigation. Where the circumventing practice, process or work takes place outside the Community, exemptions may be granted to producers

of the product concerned that can show that they are not related to any producer subject to the measures and that are found not to be engaged in circumvention practices as defined in Article 13(1) and 13(2). Where the circumventing practice, process or work takes place inside the Community, exemptions may be granted to importers that can show that they are not related to producers subject to the measures.

These exemptions are granted by decision of the Commission after consultation of the Advisory Committee or decision of the Council imposing measures and shall remain valid for the period and under the conditions set down therein.

Provided that the conditions set in Article 11(4) are met, exemptions may also be granted after the conclusion of the investigation leading to the extension of the measures.

Provided that at least one year has lapsed from the extension of the measures, and in case the number of parties requesting or potentially requesting an exemption is significant, the Commission may decide to initiate a review of the extension of the measures. Any such review shall be conducted in accordance with the provisions of Article 11(5) as applicable to reviews pursuant to Article 11(3).

5. Nothing in this Article shall preclude the normal application of the provisions in force concerning customs duties."

704. For explanation, reference is made to the reply given to question 132.

Response of the United States (WT/DS340)

705. The United States has had a statutory provision addressing circumvention since 1988. See 19 U.S.C. 1677j. Under this provision, the US Department of Commerce is authorized to take action to prevent or address attempts to circumvent an outstanding antidumping or countervailing duty order. The statute addresses four particular types of circumvention: (1) assembly of merchandise in the United States, (2) assembly of merchandise in a third country, (3) minor alterations of merchandise, and (4) later-developed merchandise. The Department of Commerce has promulgated implementing regulations, found at 19 C.F.R. 351.225

Response of Canada (WT/DS342)

706. Canada's anti-dumping legislation, the *Special Import Measures Act*, contains no specific criteria for determining whether an anti-dumping order is being circumvented, nor does it contain any remedy to address possible instances of circumvention.[103] If the authorities identify a practice that constitutes a possible fraud or other customs violation, Canada will resort to the usual civil and criminal mechanisms for dealing with such matters. If there is a perceived evasion of an anti-dumping order that involves the importation of goods that are not within the scope of the anti-dumping order, a new anti-dumping investigation is required to establish dumping, causality and injury to domestic producers of like goods. This would be the only available remedy by which to address instances of possible circumvention.

[103] Special Import Measures Act, R.S. 1985, c. S-15 (Exhibit CDA-9); online at: http://lois.justice.gc.ca/en/.

142. (*Complainants*) Do the complainants have any specific procedures and criteria for determining whether an ordinary customs duty is being circumvented? Please explain them with citations to the relevant legislation or regulations.

Response of the European Communities (WT/DS339)

707. No. In EC Customs law the concept of "circumventing a customs duty" does not exist. There are situations in which operators could try to avoid paying the ordinary customs duties such as for instance falsely declaring that the goods they are importing come from a country that has a preferential trade agreement with the EC and therefore such goods are subject to 0% custom duty. Such false declaration can give rise to sanctions and penalties that are however applied at the national level in the EC and they are more related to fraud than to circumvention.

Response of the United States (WT/DS340)

708. Importers may try to avoid the payment of the proper amount of ordinary customs duties in any number of ways, such as the undervaluation of the goods, the fraudulent certification of eligibility for duty-free treatment under a free trade agreement, or the misclassification of goods under an incorrect tariff heading with a lower rate of duty.

709. There is no legislation or regulation in which the United States sets forth specific criteria and procedures for determining whether an importer is avoiding payment of the correct amount of ordinary customs duty. Where there is a suspicion that an importer is attempting to avoid the payment of ordinary customs duties owing on imported merchandise, the United States may initiate an audit of its records or initiate a criminal investigation. Depending on the outcome, the United States may then impose penalties or file criminal charges against the importer.

Response of Canada (WT/DS342)

710. Canada has no procedures for determining whether an ordinary customs duty is being "circumvented". Other than the specific guidance relating to furniture purchased as one unit at the retail level and shipped separately to which China has already referred, there are no situations where attempts to "evade" customs duties by separate shipments of parts result in those separate shipments being treated separately for purposes of increasing duty beyond the applicable tariff commitments in Canada's Schedule. There are no instances where activities taking place after prestentation at the border are taken into account in increasing duty beyond the applicable tariff commitments in Canada's Schedule.

143. (*United States*) Please comment on China's reference to Temporary Importation under Bond ("TIB") in paragraphs 32-35 of its oral statement. Could you also please explain the TIB process in the United States with reference to specific legislation, regulations, and/or Customs procedures.

Response of the United States (WT/DS340)

711. China's statement that a good entered under a TIB entry becomes liable for duty if the importer fails to export or destroy the good within the TIB period is not accurate. The provision that appears to be the subject of the statement is subheading 9813.00.05, HTSUS. The TIB period is set by US Note 1(a) of subchapter XIII, Chapter 98, HTSUS, and is one year, although that period can be extended for up to three years from importation. The procedure for extension is set by 19 C.F.R. § 10.37. If an importer fails to timely export or destroy the article, an importer becomes liable for

liquidated damages under the bond contract, but the importer would not incur any liability for duty. The goods do not become liable for duty as a result of a failure to export or destroy the goods.

712. The last sentence in comment 33 that if the importer does not alter or process the good within one year, the importer will become liable for duty is not accurate. So long as there is no evidence that the importer negligently or fraudulently made the TIB entry, the importer would not incur any liability, even under the bond contract, if the good was timely exported or destroyed. If the importer intended to alter or process the good but was unable to do so, the failure to execute that on intent would not breach the importer's bond obligation or eliminate the importer's entitlement to duty free entry.

144. (*European Communities*) Please elaborate on your statement in paragraph 247 of your first written submission that "[a] part of a whole vehicle has no use as such and its only function is to be fitted together with other parts in order to build a whole vehicle." Does this statement extend to auto parts used as repair parts? If this statement were to be accepted, does this mean that it can be assumed that all imported parts have only one purpose – i.e. to be used for assembling a whole vehicles?

Response of the European Communities (WT/DS339)

713. This statement extends also to spare parts i.e. the word "build" should be understood as meaning "be part of". It is a general consideration on the nature of automotive parts that have no function without being a part of a complete vehicle.

145. (*Complainants*) China states in paragraph 82 of its first written submission that the very nature of General Interpretative Rule 2(a) is to establish that there is never a "clear separation" between a complete article and the parts and components of that article. Do the complainants agree with this statement? If not, why?

Response of the European Communities (WT/DS339)

714. As already touched upon in replies to questions 129 and 139 Rule 2(a) is not relevant in interpreting a Member's Schedule generally. It is a rule that assists the Customs in instances where a given incomplete or unfinished article as presented to customs appears to have the essential characteristics of the complete or finished article.

715. China is attempting to use rule 2(a) for the purposes of blurring the clear basic distinction between complete motor vehicles and part thereof at the level of China's schedules. Rule 2 (a) operates at a different level namely as tool for assessing situations *in casu.*

Response of the United States (WT/DS340)

716. The United States does not agree with the statement in paragraph 82 because it is contrary to the terms of General Interpretative Rule 2(a) and the structure of the Harmonized System. The Harmonized System is made up of 96 chapters grouped into 21 sections consisting of approximately 5,000 article descriptions in the headings and subheadings. The Harmonized System is divided into categories or product headings beginning with crude and natural products and continuing in further degrees of complexity through advanced manufactured goods. General Interpretative Rule 2(a) requires that customs officials make a determination as to whether components entered together impart the essential character of a complete or finished article. If not, then the components are to be individually classified. This view is supported by the structure of the Harmonized System itself by

specifically naming certain parts in their own headings (e.g., spark-ignition reciprocating or rotary internal combustion piston engines of heading 84.07, transmission shafts of heading 84.83, chassis fitted with engines of heading 87.06, bodies (including cabs) of heading 87.07) or the creation of parts headings (e.g., heading 87.08 which provides for parts and accessories of the motor vehicles of headings 87.01 to 87.05). To classify all parts eventually incorporated into complete motor vehicles as motor vehicles would empty many headings and subheadings of the goods specified therein.

Response of Canada (WT/DS342)

717. As discussed in response to Questions 112, 129 and 139, there are limited circumstances, as set out in Rule 2(a),where the determination of the "essential character" of parts contained in a single shipment requires some additional analysis. However, Canada disagrees that there is *never* a clear separation between a complete article and the parts that may, at some point, make up that article.

718. Further, Canada does not agree with the thrust of China's argument that the lack of a clear separation allows China unfettered discretion to deem parts as whole vehicles. China ignores the requirement in Rule 1 first to classify auto parts in their appropriate category, including intermediate categories. See also Canada's response to Question 113. China neglects to mention that Rule 2(a) is only used if Rule 1 is not applicable. Parts presented at the border as parts should be classified under the appropriate parts heading.

D. ARTICLE III OF THE GATT 1994

146. (*China*) If the Panel were to consider the measures at issue as "internal measures", does China concede to the *specific* arguments advanced by the complainants in relation to their claims under Articles III:2, III:4 and III:5 GATT and the TRIMs Agreement?

Response of China

719. For the reasons that China has explained, China does not consider that the measures at issue can be characterized as internal measures within the scope of Article III of the GATT and the TRIMs Agreement. If the Panel were to find otherwise, China submits that, at a minimum, the Panel would need to evaluate carefully whether there are specific aspects or elements of the measures that fall within the scope of Article II. As discussed in response to question 101, different rules or norms within the same measure may relate to different rights or obligations of a Member, and can be subject to different WTO disciplines. If the Panel were to consider that certain aspects or elements of the measures are subject to the disciplines of Article III and the TRIMs Agreement, China considers that it would be important, from the standpoint of making recommendations to the DSB, for the Panel to identify those specific aspects or elements.

147. (*China*) China states in paragraph 39 of its oral statement that "[e]ven if the complainants were able to demonstrate that the challenged measures result in the imposition of excess customs duties when applied to a specific combination of parts and components, this would not mean that the measures result in the imposition of excess customs duties *in all cases*" (emphasis added). Please clarify what "in all cases" means.

Response of China

720. There is an important distinction in this dispute between the validity of the challenged measures *per se* and the validity of the challenged measures as applied to the facts of specific cases. China has demonstrated that it is consistent with GIR 2(a), and consistent with the practices of other

WTO Members under like circumstances, to classify multiple shipments of parts and components on the basis of the importer's demonstrated practice of assembling those parts and components into the complete article. As China has explained in response to previous questions, this application of GIR 2(a) is constrained by the limits of GIR 2(a) itself, including the essential character test and the types of assembly operations detailed in Explanatory Note VII to GIR 2(a).

721. As China understands the complainants' position, it is their view that there is no set of facts to which China could apply the challenged measures that would result in the correct interpretation and application of China's tariff provisions for motor vehicles. China does not consider that this view can possibly be correct. Because it helps to illustrate the extreme and absolute character of their position, let us consider an extreme example. Suppose that an auto manufacturer in China imports 100 per cent of the parts necessary to assemble a particular vehicle model. Further suppose that the auto manufacturer imports the parts and components from a single corporate affiliate located in a single country, and that each shipment of parts and components is the subject of a single invoice between the manufacturer and its affiliate. Now suppose that the auto manufacturer directs its logistics company to break each consignment of parts and components into five separate shipments, and to arrange the shipments so that they arrive at the same port, but on different days. The manufacturer, as the importer of record, declares each shipment as "parts," and proceeds to assemble them into motor vehicles.

722. Under the complainants' apparent position, the challenged measures would result in an incorrect tariff classification even as applied to these facts. China considers that this extreme position: (1) is inconsistent with the purpose and intent of GIR 2(a); (2) is inconsistent with the decision of the WCO that the application of GIR 2(a) to this circumstance is a matter to be addressed under national laws and regulations; (3) is inconsistent with how other WTO Members, including the complainants, have addressed this type of problem in customs administration; (4) is inconsistent with accepted customs practices as they existed at the time of China's accession to the WTO; and, most importantly, (5) is utterly contrary to the object and purpose of the GATT 1994, as reflected in Article II, to preserve the value of reciprocal and mutually advantageous tariff concessions.

723. Thus, when China states that the complainants have not demonstrated that the challenged measures result in the imposition of excess customs duties *in all cases*, what China means is that the complainants need to distinguish between the measures *per se* and the determinations of duty liability that result when the measures are applied to specific sets of facts. The EC has suggested, for example, that it does not agree with where China has drawn the line for purposes of the essential character test under GIR 2(a). Canada, for its part, has suggested that the design of the challenged measures is not entirely consistent with its "snapshot" theory of how GIR 2(a) can be applied to multiple shipments, although it did not detail the specific points of divergence during the first meeting of the Panel. The parties may have these and other disagreements about how the challenged measures operate in specific cases, but the existence of these disagreements cannot support the conclusion that the measures are inconsistent with China's Article II commitments in all cases to which they might be applied.

148. (*China*) If the Panel were to consider that the measures at issue are "internal measures", how would China reconcile the minimum 41% domestic-value requirement in Article 21(3) of Decree 125 with Article III:4 GATT or Article 2 TRIMs, in conjunction with paragraph 1(a) of the Illustrative List?

Response of China

724. As discussed in response to question 146, China does not consider that the measures at issue are subject to the disciplines of Article III of the GATT or the *TRIMs Agreement*.

149. (*Canada and the United States*) The Panel notes that the European Communities has submitted an alternative claim under Article III:2 GATT, second sentence, in the case the Panel was to consider that the measures at issue do not violate Article III:2, first sentence GATT. Canada has explicitly reserved itself the right to return to this issue in its rebuttal submission. Could Canada and the United States please clarify their positions on this issue?

Response of the United States (WT/DS340)

725. The United States, like Canada, intends to address this matter further in its rebuttal submission, including in particular China's argument that GIR 2(a) presents a defense to China's breaches of Article II with respect to any charges imposed under China's measures that might be considered "ordinary customs duties" under Article II.

Response of Canada (WT/DS342)

726. As Canada set out in paragraphs 90 and 91 of its first written submission, Canada believes that it is clear that the imported and domestic auto parts are "like" products. Canada has heard nothing to suggest that China disagrees with this conclusion. It is therefore not necessary to consider an argument under Article III:2, second sentence. If, however, China seeks to challenge the question of "likeness" under Article III:2, first sentence, Canada has reserved the right to argue in the alternative that even if the measures do not apply to "like" products in violation of the first sentence, they violate the second sentence.

150. (*Complainants*) In respect of imported products to be compared to like domestic products in the context of Article III of the GATT 1994,

(a) Is it the complainants' view that the imported products that should be compared to domestic products under Article III:2 GATT are "all imported auto parts" and not "imported auto parts characterized as complete vehicles"?;

Response of the European Communities (WT/DS339)

727. Article III:2 GATT requires a comparison between imported and domestic products that are "like". The European Communities set out in its first written submission that imported and domestic auto parts are "like products" within the meaning of Article III:2 GATT since the only distinction made in the measures is on the basis of the origin of the auto parts (EC's first written submission, paras 164 to 167). Consequently, all imported auto parts are "like" domestic auto parts. In the view of the European Communities, the imported products that should be compared to domestic products under Article III:2 GATT are therefore "all imported auto parts".

Response of the United States (WT/DS340)

728. With respect to subquestion (a), yes, the United States considers the proper comparison as between "all imported auto parts" and domestic parts.

Response of Canada (WT/DS342)

729. Yes, Canada considers that all imported auto parts are the proper comparator, since the measures distinguish on the basis of origin between imported and like domestic auto parts. All imported auto parts are subject to the administrative requirements of the measures, and even the *potential* for a charge on imported parts affects the competitive relationship between imported parts and the "like" domestic product, Chinese auto parts.

(b) Please clarify what imported products are taxed "in excess of" domestic auto parts within the meaning of Article III:2, first sentence; and

Response of the European Communities (WT/DS339)

730. In its first written submission, the European Communities compared the internal taxation of imported and domestic auto parts and found that imported auto parts can be subject to the charges pursuant to Article 28 of Decree 125 whereas this is not the case for domestic auto parts (see first written submission of the European Communities, paragraphs 57 to 58 and 168 to 170). Thus, all imported auto parts can be subject to internal charges "in excess of those applied (…) to like domestic products". According to Article 28 of Decree 125, these charges are actually imposed, on those imported auto parts that were assembled and manufactured into vehicles with an insufficient level of local content.

Response of the United States (WT/DS340)

731. With respect to subquestion (b), the excess of charges on imported parts as compared to domestic parts, as prohibited by Article III:2, occurs whenever China characterizes an imported part as a having the essential characteristic of a complete vehicle.

Response of Canada (WT/DS342)

732. Under Article 28 of Decree 125, *all* imported auto parts may be the subject of internal taxation that is not applied to like domestic auto parts, as described in Canada's first written submission. All imported auto parts may therefore be subject to taxes in excess of those applied to domestic auto parts, specifically because those imported parts are used in vehicles that do not have the requisite levels of domestic content.

(c) Is the complainants' position on this issue the same with respect to their claims under Article III:4?

Response of the European Communities (WT/DS339)

733. With respect to its claim under Article III:4, the European Communities equally considers that the imported products to be compared with domestic products are "all imported auto parts".

734. Concerning the second aspect of the issue, the European Communities is of the position that all imported auto parts are "accorded treatment (…) less favourable" than that accorded to like domestic auto parts in respect of internal regulation within the meaning of Article III:4. As set out in the EC first written submission, the measures negatively modify the conditions of competition for all imported automotive parts since all imported auto parts may be subject to the internal charges pursuant to Article 28 of Decree 125 and because all imported auto parts are subject to stringent

administrative procedures (see first written submission of the European Communities, paras 153 to 158).

Response of the United States (WT/DS340)

735. The comparison is the same: that is, under Article III:4, the United States considers the proper comparison as between "all imported auto parts" and domestic parts. The scope of the auto parts subject to the breach, however, is wider under Article III:4. That is, China's measures adversely affect the internal sale, purchase and use of all imported parts, regardless of whether those parts are treated as whole vehicles. This is true for two reasons: first, every imported part used by a manufacturer will bring the manufacturer closer to the thresholds (and thus to the additional charges), regardless of whether in any particular instance the thresholds are exceeded. Thus, the measures create a strong disincentive to the use of imported parts. Second, so long as a vehicle manufactured in China contains a single imported part, the manufacturer of that vehicle is faced with all of the administrative burdens inherent in China's measures. A manufacturer can only avoid those burdens by solely using domestic parts.

Response of Canada (WT/DS342)

736. Yes, with respect to the "likeness" question. In respect of part (b) of the question, the appropriate criterion by which to judge under Article III:4 is whether the charges "adversely modify the conditions of competition". The same criterion applies when assessing the administrative requirements applicable to vehicle manufacturers that use imported parts.

151. (*Complainants*) If the Panel were to find that the disputed "charge" is in violation of Article III:2 GATT, would the complainants consider it necessary for the Panel to also examine their claims relating to "the charge" under Article III:4 GATT? Or in the alternative, if the Panel were to find that "the challenged measures in their entirety" are inconsistent with Article III:4 GATT, would the complainants consider it necessary for the Panel to also examine "the charge" under Article III:2 GATT?

Response of the European Communities (WT/DS339)

737. In the view of the European Communities, the Chinese measures in their entirety are inconsistent with Article III:2 and Article III:4 GATT. If the Panel finds that the internal charges to which imported auto parts can be subject are inconsistent with Article III:2 GATT, it would not be necessary – albeit possible - to also find that this aspect of the Measure, i.e. the internal charges, are also inconsistent with Article III:4 GATT. In this scenario, the Panel would however still need to examine whether the other aspects of the measures, in particular the internal administrative burden on vehicle manufacturers using imported parts, violate Article III:4 GATT.

738. Were the Panel to find that the measures "in their entirety", i.e. the internal charges and the internal administrative burden, both violate Article III:4 GATT, it would for the Panel to consider whether it wishes to examine the charges also under Article III:2 GATT.

Response of the United States (WT/DS340)

739. The United States considers the most essential claims in this dispute as the breach of Article III:4 and/or the TRIMs Agreement, because China's measures impose a local content requirement that discriminates against all imported parts as well as administrative burdens that discourage the use of imported auto parts, and Article III:2, because China imposes an internal charge

on certain imported parts in excess of any charges with no comparable charge on like domestic parts. With respect to other claims, the United States understands that questions of judicial economy are to be decided at the discretion of the panel, so long as the all findings are made that are necessary for the resolution of the dispute.

Response of Canada (WT/DS342)

740. See Canada's response to Question 85. The charges that would be the subject of analysis under Article III:2 are related to the overall burden imposed by the measures that should properly be examined under Article III:4, even if a violation of Article III:2 is found. Since the actual nature of the national treatment violation under the measures varies depending on whether one considers the differential charges, the overall legislative regime that gives rise to those charges, or the administrative requirements that are related to, but ultimately distinct from, the charges themselves, one may consider independent violations under both Articles III:2 and III:4.

152. (*Complainants*) What is the view of the complainants on the relationship between Article III:5 and Article III:4 GATT? Would a finding under Article III:4 render unnecessary a finding under Article III:5? Or, alternatively, would a finding under Article III:5 render unnecessary a finding under Article III:4?

Response of the European Communities (WT/DS339)

741. The panel in *US – Tobacco stated* that "*both Article III:5 and Article III:4 deal with internal regulations, but that Article III:5 is the more specific of the two provisions*".[104] Therefore, the European Communities considers that a finding of inconsistency with the general provision of Article III:4 would not render unnecessary a finding under the more specific provision of Article III:5 since the latter provision contains criteria that are not contained in Article III:4.

742. Alternatively, a finding of inconsistency with the specific provision under Article III:5 would necessarily indicate that the measures are also inconsistent with Article III:4. Any internal quantitative regulation that requires specific proportions of a product to be supplied from domestic sources (within the meaning of Article III:5) discriminates merely on the basis of the origin of these products and, thus, necessarily treats imported products less favourably than like domestic products (within the meaning of Article III:4).

743. However, other aspects of the measures in particular the administrative burden of the general system of registration, controls etc. would still need to be examined under Article III:4.

Response of the United States (WT/DS340)

744. Article III:4 and Article III:5 have different elements. In the circumstances of this dispute, however, the United States understands that a breach of Article III:4 would also indicate a breach of Article III:5, and *vice versa*. Aside from this, the United States again notes its understanding that questions of judicial economy are generally left to the discretion of the panel.

[104] GATT Panel Report in *US – Tobacco*, at para 72.

Response of Canada (WT/DS342)

745. As the panel in *US – Tobacco* noted, both Article III:5 and Article III:4 deal with internal regulations but Article III:5 is the more specific of the two provisions.[105] An internal quantitative regulation found to be inconsistent with the first sentence of Article III:5 would also be inconsistent with Article III:4. That is, a regulation constraining the use of foreign inputs in order to give preference to domestic inputs would discriminate solely on the basis of origin and be inconsistent with Article III:4.

746. However, while the various elements of Article III are necessarily related by the principle, expressed in Article III:1, that internal measures should not be applied so as to afford protection to domestic production, Articles III:4 and III:5 are legally distinct expressions of that principle. Article III:5 contains criteria that are distinct from those found in Article III:4, despite the fact that the same measure may be the subject of the same broad review under both provisions. Not all aspects of a measure that may violate Article III:4, such as otherwise-inconsistent administrative requirements that discriminate against imported goods, would necessarily be covered by Article III:5. A finding solely under Article III:5 may leave certain aspects of a measure's consistency with Article III:4 unaddressed. Similarly, a finding solely under Article III:4 would not necessarily address criteria in Article III:5 that are absent from Article III:4.

153. (*Canada and the United States*) On the basis of the Appellate Body statement in *Bananas III* (paras. 202-204). that the agreement which is more specific to the claim before the Panel should be considered first, the European Communities has presented its legal arguments under Article 2 TRIMs first and then its arguments under Article III of the GATT 1994. What is the position of Canada and the United States in relation to the European Communities' approach?

Response of the United States (WT/DS340)

747. The United States considers that Article III:4 and TRIMs Article 2 are closely related, and in these circumstances, the United States considers that the order of analysis is within the discretion of the Panel.

Response of Canada (WT/DS342)

748. Canada does not take issue with the European Communities' approach. We note that the measures are not only in the nature of investment measures, but also measures that affect trade in goods. This, together with the fact that a TRIM is defined in part with reference to Article III, caused Canada to adopt the approach taken in *India – Autos* and deal first with Article III.

E. CHINA'S ACCESSION PROTOCOL

154. (*All parties*) Could the parties confirm that the commitments found in China's Accession Protocol, including the specific commitments referred to in paragraph 342 of the Working Party Report, are legally binding upon China and enforceable in WTO dispute settlement proceedings?

[105]GATT Panel Report *US –Tobacco*, DS44/R – BISD 41S/131, adopted 4 October 1994 at para 72.

Response of China

749. China addressed this issue in paragraphs 187 to 189 of its first written submission. In sum, China considers that the specific provisions of a working party report that are incorporated by reference into a protocol of accession, and from the protocol of accession into the WTO Agreement, are akin to a Member's Schedule of Concessions from the standpoint of its rights and obligations, and for purposes of interpretation under the *Vienna Convention.* As China noted in paragraph 189 of its first written submission, China consider that its is appropriate for dispute settlement panels to take into account the context of a commitment made in a working party report, and to exercise special care in interpreting these commitments.

Response of the European Communities (WT/DS339)

750. The European Communities confirms that the commitments found in China's Accession Protocol, including the specific commitments referred to in paragraph 342 of the Working Party Report, are legally binding upon China and enforceable in WTO dispute settlement proceedings.

751. The legally binding nature of these commitments follows from Part I, paragraph 1.2 of the Accession Protocol which provides that "*[t]his Protocol, which shall include the commitments referred to in paragraph 342 of the Working Party Report, shall be an integral part of the WTO Agreement*". Being an integral part of the WTO Agreement which is one of the "covered agreements" listed in Appendix 1 to the DSU, the aforementioned commitments are also enforceable in WTO dispute settlement proceedings.

Response of the United States (WT/DS340)

752. As set out in the first US submission, the United States believes that commitments in paragraph 342 of the Working Party Report are legally binding upon China.

Response of Canada (WT/DS342)

753. Canada confirms that the commitments in China's *Accession Protocol*, including those referred to in paragraph 342 of the Working Party Report, are legally binding upon China and enforceable in WTO dispute settlement proceedings, as set out in paragraphs 75 to 77 of Canada's first written submission.

F. SCM AGREEMENT

155. (*Canada*) Could Canada please confirm that it is not pursuing any claim under the SCM Agreement.

Response of Canada (WT/DS342)

754. Canada confirms that it is not pursuing any claim under the *SCM Agreement*.

156. (*United States*) Could the United Sates clarify whether its claims under the SCM Agreement are in the alternative to its claims under Articles II and III GATT as well as those under the TRIMs Agreement.

Response of the United States (WT/DS340)

755. The US claims under the SCM Agreement are not stated in the alternative – that is, they do not depend on whether or not China's charges are internal taxes or "ordinary customs duties." As noted above, however, questions of judicial economy are generally left to the discretion of the panel, so long as the findings resolve the issues in dispute.

157. (*Complainants*) With respect to "revenue foregone" under Article 1.1(a)(1)(ii) of the SCM Agreement, could the complainants please clarify the following:

(a) What is the specific factual basis for your argument that the default rate of import duties and charges that would apply to imported parts and components would be 25 per cent, and that the lower rate of 10 per cent would only be available upon demonstration that local content requirements were met?;

Response of the European Communities (WT/DS339)

756. The European Communities has not argued that 25% would be "the default rate" of charges applied to imported auto parts and that the 10% rate would "only be available upon demonstration that local content requirements were met".

757. In its first written submission, the European Communities set out, following the Appellate Body Report in *US – FSC*, that in order to determine whether "government revenue that is otherwise due is foregone or not collected" it is necessary to compare the revenues due under the contested measure and the revenues that would have been raised otherwise taking into account a normative benchmark governing such comparison.[106]

758. Under the contested Chinese measures, imported auto parts that satisfy the local content requirements of Article 21 of Decree 125 are charged at a rate of generally 10%. This rate of 10% does not depend on any "demonstration", as the Panel's question suggests, but is available for imported parts "that have been verified as not being Deemed Vehicles" (see Article 28 of Decree 125). In order to determine the revenue "otherwise due", the European Communities had recourse to the normative benchmark provided by the Chinese treatment of imported auto parts that do not satisfy the local content requirements of Article 21 of Decree 125 and which are charged at a rate of typically 25%. This rate of 25% is no "default rate", as the Panel's question implies, but is available for imported parts "that have been verified by the Center as Deemed Whole Vehicles" and that are charged "according to the duty rate for whole vehicles" (see Article 28 of Decree). As this 25% rate is explicitly foreseen for certain imported auto parts in the Chinese measures, it is, in the words of *US - FSC*, no "entitlement in the abstract" but a "definitive, normative benchmark". By charging imported auto parts that satisfy the local content requirements "only" with a 10% rate, China has, in the words of *US – FSC*, "given up an entitlement to raise revenue that it could 'otherwise' have raised"[107]

Response of the United States (WT/DS340)

759. The "normative benchmark" concept described by the Appellate Body in *US - FSC (Article 21.5 - EC)* does not require reference to a default rate, as implied in the above question, when determining whether revenue has been foregone. The Appellate Body stated that Article 1.1(a)(1)(ii)

[106] European Communities' first written submission, paras 285 to 288.
[107] Appellate Body Report in *US – FSC*, at para. 90.

of the SCM Agreement does not require panels to identify a "general" rule of taxation and "exceptions" to that "general" rule. Rather, panels should compare the domestic fiscal treatment of "legitimately comparable income" to ascertain whether the measure under consideration involves the foregoing of revenue that is "otherwise due." The Appellate Body further considered that the comparison ought to be made with respect to taxpayers in "comparable situations."

760. In this dispute, taxpayers in comparable situations pay different amounts of money to the Chinese government, depending on whether or not they source a sufficient amount of goods locally. That is, automobile manufacturers that use imported parts in quantities that exceed certain thresholds when assembling complete vehicles pay a combination of import duties and internal charges to the Chinese government equal to 25 per cent of the value of all imported parts used in the assembly of a complete vehicle. Specifically, these automobile manufacturers pay import duties equal to 10 per cent of the value of all imported parts used in the assembly of a complete vehicle and internal charges equal to 15 per cent of the value of all imported parts used in the assembly of a complete vehicle. In contrast, automobile manufacturers that use sufficient quantities of domestic parts when assembling complete vehicles pay import duties equal to 10 per cent of the value of all imported parts used in the assembly of a complete vehicle and no internal charges. As a result, automobile manufacturers that use imported parts in quantities that exceed certain thresholds when assembling complete vehicles pay internal charges that the Chinese government entirely foregoes in the case of automobile manufacturers that use sufficient quantities of domestic parts when assembling complete vehicles.

761. According to China, the measures at issue only impose payment requirements in the form of import duties, not internal charges. However, even if all of the payments due to the Chinese government are classified as import duties, it is still clear that the Chinese government foregoes revenue. Specifically, automobile manufacturers that use imported parts in quantities that exceed certain thresholds when assembling complete vehicles pay 25 per cent duties on all imported parts used in the assembly of a complete vehicle, while the Chinese government foregoes revenue by only requiring payment of 10 per cent import duties on all imported parts used in the assembly of a complete vehicle in the case of automobile manufacturers that use sufficient quantities of domestic parts when assembling complete vehicles. The amount of the revenue foregone equals the difference between the 25 per cent import duties and the 10 per cent import duties.

762. From a practical standpoint, there are situations where it may make sense to talk in terms of a "default rate," and there are situations where it will not. The concept of a default rate implies that it is the rate that is normally applied or applied in most situations. In the case of measures like those at issue in this dispute, the rate normally applied will likely change as business practices change in response to those measures, so that it does not make sense to talk in terms of a default rate. For example, when measures like those at issue in this dispute are first enforced, the rate normally applied will likely be the higher payment rate - in the case of China's measures, this default rate would be the combination of import duties and internal charges payable to the Chinese government in an amount equal to 25 per cent of the value of all imported parts used in the assembly of a complete vehicle. The reason for this situation is obvious. The purpose of measures like those at issue in this dispute is to change how business is normally conducted and to create an incentive for manufacturers to begin sourcing more parts locally rather than importing them. Over time, unless the measures are withdrawn, manufacturers will change their business practices and source more parts locally in order to avoid the higher payment rate and remain competitive. As this change in business practices takes place, the rate normally applied under the measures will change as well. Manufacturers will normally pay the lower payment rate because they have responded to the incentive to source more parts locally - in the case of China's measures, this new default rate would be the payment of import duties to the Chinese government in an amount equal to 10 per cent of the value of all imported parts used in the assembly of a complete vehicle, with no internal charges.

(b) Is it relevant to the Panel's analysis of the question of the "normative benchmark" in the context of the claims under the SCM Agreement that the bonding rate on imported parts and components is, according to the parties' oral arguments, 10 per cent?;

Response of the European Communities (WT/DS339)

763. No, the question of the bonding rate is not relevant for the "normative benchmark" indicating whether revenue is foregone within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. As set out in response to the previous sub-question, the normative benchmark provided by the Chinese measures is the treatment of imported auto parts that do not satisfy the local content requirements of Article 21 of Decree 125. Pursuant to Article 28 of Decree 125, charges "according to the duty rate for whole vehicles" (i.e. 25%) are imposed on such parts, after their manufacture, if they were verified as "Deemed Whole Vehicles". The bonding rate does not have any impact on this normative benchmark.

Response of the United States (WT/DS340)

764. The 10 per cent bonding rate on imported parts is not relevant, regardless of whether the domestic fiscal treatment at issue is considered to be a combination of import duties and internal charges (in the complainants' view) or only import duties (in China's view). As explained above, the Appellate Body has stated that Article 1.1(a)(1)(ii) of the SCM Agreement does not require panels to identify a "general" rule of taxation and "exceptions" to that "general" rule, but rather allows panels to compare the domestic fiscal treatment of "legitimately comparable income," with respect to taxpayers in "comparable situations," to ascertain whether the measure under consideration involves the foregoing of revenue that is "otherwise due". In other words, it is not necessary to identify a default rate, which this question implies could be the bonding rate.

765. Furthermore, in the complainants' view, the import duties imposed under China's measures total 10 per cent of the value of all imported parts used in the assembly of a complete vehicle, regardless of the local content used by an automobile manufacturer when assembling a complete vehicle in China. As explained above, automobile manufacturers that use imported parts in quantities that exceed certain thresholds when assembling complete vehicles pay import duties equal to 10 per cent of the value of all imported parts used in the assembly of a complete vehicle, plus internal charges equal to 15 per cent of the value of all imported parts used in the assembly of a complete vehicle. Automobile manufacturers that use sufficient quantities of domestic parts when assembling complete vehicles similarly pay import duties equal to 10 per cent of the value of all imported parts used in the assembly of a complete vehicle; the difference is that they do not pay any internal charges.

(c) What is the legal test to be applied to determine the normative benchmark in a subsidy claim in which the alleged financial contribution takes the form of revenue foregone in the sense of SCM Article 1.1(a)(1)(ii)?; and

Response of the European Communities (WT/DS339)

766. The Appellate Body in *US – FSC* interpreted Article 1.1(a)(1)(ii) of the *SCM Agreement* in the following way:

> "In our view, the "*foregoing* " of revenue "*otherwise* due" implies that less revenue has been raised by the government than would have been raised in a different situation, or, that is, "otherwise". Moreover, the word "foregone" suggests that the government has given up an entitlement to raise revenue that it could "otherwise"

> have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax *all* revenues. There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised "otherwise". We, therefore, agree with the Panel that the term "otherwise due" implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation. We also agree with the Panel that the basis of comparison must be the tax rules applied by the Member in question."[108]

767. On the basis of this test, the European Communities considers that the revenues actually raised need to be compared not with "an entitlement in the abstract" but with "some defined, normative benchmark" as already existing in the legal system of the Member in question.

768. In the present case, China's treatment of imported auto parts that do not satisfy the local content requirements of Article 21 of Decree 125 provides such a benchmark. It is not "an entitlement in the abstract", but a pre-existing "defined" rule in the Chinese legal system.

Response of the United States (WT/DS340)

769. Please see the response to subquestion (a) above.

(d) In your oral statements, in the context of other claims, you have characterized the measures in question as involving the additional "charge" of 15 per cent on imported auto parts only when those parts are treated as whole vehicles. For example, the United States argued that:

> **"the additional charge only applies if domestically-produced autos include an amount ... of imported auto parts that exceeds specified thresholds" (US oral statement, paragraph 3, emphasis added); and "the measures ... require that a specified amount or proportion of an automobile be supplied from domestic sources or else a penalty in the form of an additional charge is assessed" (US oral statement, paragraph 18, emphasis added).**

Response of the European Communities (WT/DS339)

770. Question 158 (the European Communities understands that the question that begins under question 157 (d) is put to it under question 158)

Response of the United States (WT/DS340)

771. Please see the response to subquestion (a) above.

158. (*European Communities*) The European Communities argued that:

> **"*Only* the [imported parts] that will be used in complete vehicles that do NOT attain the necessary domestic content will be subject to the higher duty on complete vehicles" (EC oral statement, paragraph 55, italic emphasis added); and " ...[China] will ... verify whether the [parts] will be used in a complete vehicle or not and whether the complete vehicle will contain sufficient local**

[108] Appellate Body Report in *US – FSC*, at para. 90.

content *before deciding* whether to apply *an additional charge* on the products after they have already been manufactured in China" (EC oral statement, paragraph 57, emphasis added).

How can these arguments be reconciled with your position that the 25 per cent rate is the "normative benchmark" or default rate that would apply to <u>all</u> imported auto parts <u>unless</u> there is a demonstration that local content requirements are fulfilled?

Response of the European Communities (WT/DS339)

Question 158 (the European Communities understands that the question that begins under question 157 (d) is put to it under question 158)

772. In the view of the European Communities, there is no contradiction between these quotes from the EC oral statement and its position that China foregoes revenue "otherwise due" when it charges imported auto parts that satisfy local content requirements at a rate of (only) 10% whereas it charges imported auto parts that do not satisfy local content requirements at a rate of 25%.

773. As set out in response to the previous sub-questions, the European Communities has not argued that the 25% rate is a "default rate" applying to "all imported parts unless there is a demonstration that local content requirements are fulfilled" and does not consider this to be part of the relevant legal test in order to determine the "normative benchmark" under Article 1.1(a)(1)(ii) of the SCM Agreement.

159. (*China*) With respect to "revenue foregone" under Article 1.1(a)(1)(ii) of the SCM Agreement, could China please:
(a) Clarify the specific factual basis for its argument that the 10 per cent rate and the 25 per cent rate of import duties and charges have separate and independent scopes of application and operation, such that the 25 per cent is not the default rate, as alleged by the complaining parties; and
(b) Indicate what would be the appropriate normative benchmark in its view.

Response of China

774. The Appellate Body has stated that "the term 'otherwise due' implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation."[109] The "basis of comparison must be the tax rules applied by the Member in question. … What is 'otherwise due', therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself."[110] The Appellate Body has further observed that "the comparison under Article 1.1(a)(1)(ii) of the *SCM Agreement* must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question."[111] In making these comparisons, "panels must obviously ensure that they identify and examine fiscal situations which it is legitimate to compare."[112]

775. Decree 125 concerns the obligation of auto manufacturers to pay the applicable duty rates for motor vehicles when they import parts and components of motor vehicles that, in their entirety, have

[109] *US – FSC*, at para. 90.
[110] *US – FSC*, at para. 90.
[111] *US – FSC (Article 21.5 – EC)*, at para. 89.
[112] *US – FSC (Article 21.5 – EC)*, at para. 90.

the essential character of a motor vehicle under GIR 2(a). These are the "revenues due under the contested measure." When auto manufacturers import auto parts and components that do *not* have the essential character of a motor vehicle, China classifies these imports under the applicable headings for *parts*, also in accordance with the rules of the Harmonized System. These are not the same "fiscal situations" for purposes of making a proper comparison. The application of GIR 2(a) to imported parts (whether one shipment of parts or multiple shipments of parts) leads to a different classification depending on whether the parts have the essential character of the complete article.

776. It is therefore not the case, as the US and EC argument necessarily presumes, that the benchmark rate of taxation is the duty rate that applies to motor vehicles. The benchmark rate of taxation depends on what is imported – parts that have the essential character of the complete article, or parts that do not have the essential character of the complete article. China therefore does not "forego revenue" when it applies the applicable duty rates for parts to imports of parts that do not have the essential character of a motor vehicle. This is, as China has explained, the "independent scope and effect of China's separate tariff provisions for auto parts and components."[113]

Comments by the United States on China's response to question 159

777. In its response to question 159, China does not dispute the basic formulation laid down by the Appellate Body in *US - FSC (Article 21.5 – EC)* that the term "otherwise due" in the context of Article 1.1(a)(1)(ii) of the Agreement on Subsidies and Countervailing measures (SCM Agreement) "implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation." China also does not seem to directly dispute the US position set forth in response to question 157, to the extent that the United States argues that (1) a government foregoes revenue when it imposes a 10 per cent internal charge on an imported part if it is used in the assembly of a vehicle with insufficient local content but imposes no internal charge on that same imported part if it is used in the assembly of a vehicle with sufficient local content or, alternatively, that (2) a government foregoes revenue when it imposes 25 per cent duties on an imported part if it is used in the assembly of a vehicle with insufficient local content but imposes only 10 per cent duties on that same imported part if it is used in the assembly of a vehicle with sufficient local content. Instead, China argues that neither of these scenarios accurately portrays how the measures at issue in this dispute operate. According to China, the measures at issue are border measures that simply apply the duty rates set forth in China's Schedule of Concessions. In other words, China insists that its measures properly classify imported parts as motor vehicles (and apply 25 per cent duties) if they will be assembled into a vehicle with insufficient local content within one year, and its measures properly classify imported parts as parts (and apply 10 per cent duties) if they will be assembled into a vehicle with sufficient local content.

778. The United States, of course, disagrees with China's view that the measures at issue are border measures that properly apply China's Schedule of Concessions. But the United States would agree in general that in the case of true border measures properly applying a Member's Schedule there may well be no "revenue foregone" within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement.

779. But since China's measures are internal measures or border measures that misclassify parts as motor vehicles for tariff purposes, the Chinese government foregoes revenue under the measures at issue, as the United States describes above and explains more fully in response to question 157(a).

[113] China first written submission at para. 177.

G. ARTICLE XX(D) GATT

160. (*China*) China submits in paragrah 211 of its first written submission that the example of [ ] "illustrates both the importance of the interests furthered by the challenged measures as well as the contribution that these measures make towards the realization of those interests." China further submits in paragraph 21 of its first written submission that the example provided by [ ] is "not an isolated incident". Could China please provide the Panel with further *specific* examples.

Response of China

780. The following table provides several more examples of motor vehicles that are assembled in China from imported parts and components that have the essential character of a motor vehicle, and that are imported into China in multiple shipments:

Assembly	[ ]	[ ]	[ ])	[ ])
Body	X	X	X	X
Engine	X	X	X	X
Transmission	X	X	X	X
Driving Axle	X	X	X	X
Driven Axle		X	X	
Frame	X		X	X
Steering System	X	X		X
Braking System	X	X		

781. The example of the [ ] is particularly interesting, as it highlights the nature of the tariff classification issue that China sought to resolve through Decree 125. In 2003, [ ] produced the [ ] almost entirely from imported CKD kits. Beginning in 2004, however, [ ]'s importation of CKD kits for the [ ] dropped dramatically, while its importation of auto parts surged. By 2005, [ ] produced 38,600 [ ], and imported only 24 CKD kits in that year. As verified under the provisions of Decree 125, [ ] continues to import seven out of the eight major assemblies for the production of the [ ]. Thus, [ ] has gone from the importation of CKD kits – classified as motor vehicles under GIR 2(a) – to the importation of parts and components that, in their entirety, have the essential character of a motor vehicle. In essence, nothing has changed except the manner in which it structures its imports.

161. (*China*) Could China please clarify whether the alleged customs circumvention is also related to the importation of CKD/SKD kits? If so, could China please reconcile its response with the statement in paragraph 39 of China's first written submission that "major car manufacturers have imported CKD/SKD into China and *declared these imports as complete vehicles, both before* and after the challenged measure took effect" (emphasis added).

Response of China

782. As China has explained, there is no tariff classification issue associated with CKD/SKD kits, as China classifies CKD/SKD kits as motor vehicles in accordance with GIR 2(a). China's point in paragraph 39 of its first written submission was simply that this classification of CKD/SKD kits has never been contested by importers of CKD/SKD kits into China.

Comments by the United States on China's response to question 161

783. The United States disagrees with China's statement in response to this question that China's classification of CKD and SKD kits as motor vehicles "has never been contested by importers." As the United States explained above under question 2, from 1992 until China began to implement the measures at issue, China normally did not apply the motor vehicle tariff rates to CKDs and SKDs. Instead, the applicable rate for CKDs and SKDs (and parts) was negotiated between an individual auto manufacturer and the Chinese authorities. The key factors in this negotiation were the amount of the auto manufacturer's investment in China and the extent to which the auto manufacturer used local content in the assembly of its vehicles, both at the time of the negotiation and under the auto manufacturer's future plans. Normally, an auto manufacturer with a larger amount of investment and a larger percentage of local content would be able to negotiate a lower tariff rate than would an auto manufacturer with a smaller amount of investment and a smaller percentage of local content. Particularly for the auto manufacturers that the Chinese authorities viewed as committed to China based on these factors, the negotiated tariff rates for CKDs and SKDs (and parts) were substantially below the tariff rates for motor vehicles. But, for an auto manufacturer that the Chinese authorities viewed as insufficiently committed to China, as may have been the case for one manufacturer,[114] it is very possible that the Chinese authorities would insist on applying higher tariff rates.

162 (*China*) Concerning the trade effect of the measure, China, in paragraph 213, refers to an observation that several of the world's largest auto manufacturers and auto parts suppliers have noted that the challenged measures have had no impact on trade and investment as provided in Exhibit CHI-33 (Fan Yan, *Big car parts makers unfazed by China tax row*). Please comment on the indication in the same source that the policy might block small European auto part suppliers as well as hurt car makers of luxury brands such as BMW and DaimlerChrysler AG's Mercedez-Benz.

Response of China

784. China is unaware of any basis for the assertion that the challenged measures could affect smaller European auto parts suppliers. As for makers of luxury brands such as BMW and Mercedes-Benz, the article explains the reason why they could be relatively more affected by the challenged measures. Quoting a securities analyst, the article explains that these companies import parts and components that "make up as much as 90 per cent of locally assembled vehicles."[115] To the extent that these companies import these levels of parts and components in multiple shipments and assemble the parts and components into specific vehicle models, the effect of Decree 125 is that these companies now have to pay the applicable duty rates for motor vehicles. That is precisely the tariff classification issue that the challenged measures seek to resolve, by ensuring that the substance of the auto manufacturer's import transactions prevail over their form.

H. ARTICLE XXIII:1(B) GATT

163. (*Canada*) In paragraph 159 of its first written submission, Canada requests the Panel to find that the measures at issue nullify or impair benefits, as understood under GATT Article XXIII:1(b), accruing to Canada *in respect of CKD and SKD*. Could Canada please confirm that its claim under Article XXIII:1(b) GATT is limited to CKD and SKD kits?

[114] See China's first written submission, pages 15-16.
[115] CHI-33.

Response of Canada (WT/DS342)

785. Canada confirms that this claim is limited to CKD and SKD kits.

I. OTHER CLAIMS

164. (*United States*) In its request for the establishment of the Panel, the United States submitted that the measures at issue were inconsistent with *inter alia* Article 2 TRIMs in conjunction with paragraph 2(a) of the Illustrative List. Could the United States confirm that it is not pursuing an additional claim under Article 2 TRIMs in conjunction with paragraph 2(a) of the Illustrative List.

Response of the United States (WT/DS340)

786. Please see the following response to Question 165.

165. (*United States*) In its request for the establishment of the Panel, the United States submitted that the measures at issue were inconsistent with *inter alia* Article XI:1 GATT. Could the United States please confirm that it is not pursuing a claim under Article XI:1 GATT.

Response of the United States (WT/DS340)

787. The United States included claims under Article XI of the GATT 1994 and paragraph 2(a) of the TRIMs Agreement Illustrative List in the event that China tried to buttress its argument that its charges were "ordinary customs duties" by claiming that China's measures actually prohibit the import of auto parts until after the parts were used in the manufacture of a complete vehicle. In that case, China's measures would indeed result in breaches of the two above-cited provisions. Given that China is not pursuing such an argument, and on the condition that China does not in the future pursue such an argument, the United States likewise is not pursuing its claims under these two provisions.

788. It is worth noting, however, that the existence of an Article XI obligation means that China necessarily must agree that the auto parts at issue in this dispute are in fact "imported" when the parts are presented at the border. Otherwise, as noted, if China's measures forbid the importation of auto parts until after those parts were assembled into complete vehicles, China's measures would result in a breach of Article XI of the GATT 1994.

166. (*European Communities*) In its request for the establishment of the Panel, the European Communities submitted that, with the adoption of the measures at issue, China has nullified or impaired the benefits accruing to the European Communities under Article XXIII:1(b) GATT, in conjunction with China's Protocol of Accession and in particular paragraph 93 of the Working Party Report. Could the European Communities please confirm that it is not pursuing a claim under Article XXIII:1(b) GATT.

Response of the European Communities (WT/DS339)

789. The European Communities confirms that it is not pursuing claims under Article XXIII:1(b) GATT.