WORLD TRADE ORGANIZATION

RESTRICTED

WT/DSB/M/118
18 February 2002

(02-0811)

Dispute Settlement Body
29 January 2002

MINUTES OF MEETING

Held in the Centre William Rappard
on 29 January 2002

Chairman: Mr. K. Bryn (Norway)

1. Tax treatment for "Foreign Sales Corporations": Recourse to Article 21.5 of the DSU by the European Communities

(a) Report of the Appellate Body (WT/DS108/AB/RW) and Report of the Panel (WT/DS108/RW)

1. The Chairman recalled that at its meeting on 20 December 2000, the DSB had decided, in accordance with Article 21.5 of the DSU, to refer to the original Panel the matter raised by the European Communities concerning the implementation by the United States of the DSB's recommendations in this case. The Report of the Panel contained in document WT/DS108/RW had been circulated on 20 August 2001. On 15 October 2001, the United States had notified the DSB of its decision to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel. The Report of the Appellate Body contained in document WT/DS108/AB/RW had been circulated on 14 January 2002. He recalled that in accordance with the Decision on Procedures for the Circulation and Derestriction of WTO Documents contained in WT/L/160/Rev.1, the Appellate Body Report and the Panel Report had been circulated as unrestricted documents. The Reports were now before the DSB for adoption at the request of the European Communities. He noted that the adoption procedure was without prejudice to the right of Members to express their views on the Reports.

2. The representative of the European Communities said that the EC welcomed the findings of the Panel and the Appellate Body confirming its view with regard to the WTO-incompatible nature of the FSC Replacement and Extraterritorial Income Exclusion Act (the ETI Act) adopted by the United States in November 2000. The ETI Act was found to be an illegal export subsidy in breach of the Agreement on Subsidies and the Agreement on Agriculture as well as in violation of Article III of the GATT 1994. In accordance with the findings, the ETI Act did not constitute proper implementation of the DSB's recommendations and rulings as the FSC scheme had been and was applicable after the expiry of the compliance period. Contrary to the arguments by the United States to justify its appeal that the Panel Report did not provide sufficient guidance as to what the United States needed to do to bring its legislation into conformity with WTO rules, the EC considered that both the Panel and the Appellate Body rulings were clear as to what was required from the United States, namely, to withdraw the prohibited subsidy.

3. The Panel and the Appellate Body had given clear indications with regard to the legal issues raised by the US legislation and now there was no room for further requests for clarifications and guidance. The Panel and the Appellate Body had been asked to rule on the WTO compatibility of the FSC measure and the ETI Act and they had done so in a precise, comprehensible and legally sound manner. The Appellate Body had not reversed any of the Panel's findings or criticized the Panel's reasoning. It had fully confirmed them and had developed a new reasoning in view of additional

arguments brought by the United States. The EC expected that these rulings would put an end to this long-standing dispute. He noted that in accordance with the procedural agreement concluded by the parties in September 2000[1], the arbitration on the amount of the countermeasures and suspension of concessions requested by the EC would be automatically reactivated on 29 January 2002.

4. The representative of the United States said that her country was disappointed with the Appellate Body Report and disagreed with its ultimate conclusions. Notwithstanding this disagreement, the United States would respect its obligation to comply with WTO rules, and was working with the EC to manage and resolve this dispute in a responsible and non-confrontational manner. Progress was being made toward that end. At the present meeting, the United States did not wish to re-argue the case or analyse each aspect of the Appellate Body's reasoning. She noted, however, that certain aspects of the Appellate Body Report were encouraging and constituted a vast improvement on the Panel's analysis.

5. The United States noted that, with regard to the existence of a subsidy under Article 1 of the SCM Agreement, the Appellate Body had clarified that the normative benchmark for determining whether "foregone" revenue was otherwise due involved a comparison of the fiscal treatment of comparable income, in the hands of taxpayers in similar situations (paragraph 98 of the AB Report). While the United States disagreed with the Appellate Body's application of this standard to the facts, it considered that the Appellate Body had made its standard clearer and more understandable. As such, that standard did not share the indeterminacy of the Panel's analysis, which included the assertion that a tax system needed to have an "overall rationale and coherence" to avoid having a measure labelled as a "subsidy".

6. However, more important was the Appellate Body's analysis of footnote 59 to the SCM Agreement. The Appellate Body had accepted the arguments that the United States had been making since the beginning of this dispute in November 1997. Specifically, the Appellate Body had agreed that a Member with a so-called "world-wide" tax system could apply, on an export-specific basis, the "exemption method" for avoiding double taxation of foreign-source income, which was a feature of so-called territorial systems. Furthermore, the Appellate Body had appeared to agree with the United States that the tax exclusion provided by the ETI Act constituted the incorporation of the exemption method into US tax law. However, while the Appellate Body had suggested that the ETI Act's tax exclusion, in principle, could qualify under footnote 59, as a factual matter it had found that the exclusion did not so qualify, primarily because it had found that the Act's arithmetic formulas might permit an exemption for some domestic-source income (paragraph 185 of the AB Report).

7. According to the United States this left several important questions unanswered. First, the status of "rules of thumb" was unclear. Certain portions of the Appellate Body Report could be interpreted as precluding "rules of thumb" altogether. If so, tax authorities around the world would be shocked by such a proposition. The United States believed that "rules of thumb" had a legitimate place in the administration of tax laws of many countries, as well as other types of laws, and WTO bodies should think twice before imposing an undue level of administrative precision. On the other hand, different portions of the Appellate Body Report suggested that "rules of thumb" might be acceptable as long as they generated results within some acceptable range. While this was a more reasonable approach, the Appellate Body had provided no guidance as to what might be considered an acceptable range, or what standards should be used to identify one. This lack of guidance would make it difficult for Members to avail themselves of the right provided in footnote 59 to the SCM Agreement. While the United States was pleased that the Appellate Body had modified the Panel's reasoning, it could not support the adoption of the Reports.

8. The representative of Canada said that his country had participated as a third party both at the original Panel and appeal stage, as well as before the Article 21.5 Panel and the Appellate Body.

[1] WT/DS108/12.

Throughout the proceedings, Canada had consistently expressed the view that the FSC scheme was inconsistent with the United States' WTO obligations. Canada was pleased that the Appellate Body had now made a definitive finding that the ETI Act violated the export subsidy provisions of the SCM Agreement and the Agreement on Agriculture. Canada also supported the Appellate Body's conclusions that the measure violated the national treatment obligations of the United States under Article III of the GATT 1994. Canada urged the United States to take the necessary steps to comply with the DSB's rulings without delay. In this regard, Article 3.5 of the DSU provided that "any solution to a dispute must be consistent with the covered agreements, and cannot nullify or impair benefits accruing to other Members". Finally, Canada noted with satisfaction that the Appellate Body had supported the position of the EC and Canada on the issue of third-party rights. The Appellate Body had found that third parties were entitled to receive all submissions i.e. both the principal and the rebuttal submissions prior to the first meeting of the Article 21.5 Panel. This determination would help ensure a more meaningful role for third parties in the dispute settlement process, and would help promote greater internal transparency in the WTO.

9. The representative of India said that his country had participated as a third party in the proceedings of the Article 21.5 Panel and the Appellate Body and had presented its views with regard to the following three issues. First, the ETI Act was not a compliance measure. Several restrictive conditions in the ETI Act provided benefits to the same set of beneficiaries as under the original FSC scheme. Therefore, it would amount to subsidies: i.e. forgoing of revenue which had otherwise been due under Article 1.1(a)(1)(ii) of the SCM Agreement. Second, with regard to export contingency, India had pointed out that extension of subsidy to both exporting and non-exporting firms would not absolve the ETI Act of the element of prohibited export subsidy under Article 3.1(a) of the SCM Agreement. Third, with regard to avoidance of double taxation under footnote 59 of SCM Agreement, while acknowledging that the objective of avoiding double taxation was a legitimate one, India had stated that the linkage between the measure at issue, namely the ETI and its objective, i.e. avoidance of double taxation, had to be clearly established.

10. India was pleased to note that the Article 21.5 Panel and the Appellate Body had affirmed these views, and welcomed the above-mentioned rulings. This decision would have far-reaching effects on the global trading environment. It revealed that major trading partners continued to use prohibited measures to promote their trade while penalizing, through countervailing measures, even legally permissible subsidies provided by developing countries for legitimate developmental objectives. This dispute had an impact not merely on the parties to the dispute but on all Members. Given the pervasive nature of the measure, which had been found to be inconsistent with the WTO covered agreements, and its adverse effects on all trading partners, India believed that the only way for the United States to implement the DSB's rulings was to remove subsidies found to be inconsistent with its WTO obligations.

11. The representative of Australia wished to register his country's interest in implementation by the United States in this dispute. The prohibited export subsidies provided by the United States had direct impact on the competitive trading opportunities of Australian exporters in all markets. Australia, therefore, urged the United States to comply as quickly as possible with the DSB's rulings and recommendations by withdrawing the prohibited export subsidies.

12. The DSB took note of the statements and adopted the Appellate Body Report contained in WT/DS108/AB/RW and the Panel Report contained in WT/DS108/RW, as modified by the Appellate Body Report.