UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS": SECOND RECOURSE TO ARTICLE 21.5 OF THE DSU BY THE EUROPEAN COMMUNITIES

WT/DS108

OPENING STATEMENT OF THE

UNITED STATES OF AMERICA

AT THE SUBSTANTIVE MEETING OF THE PANEL

June 30, 2005

Mr. Chairman, members of the Panel:

1. At the outset, on behalf of the United States, I would like to express our appreciation for your willingness to serve on this Panel. In particular, I would like to thank the Chairman for agreeing to step in at this stage in this dispute.

2. However, while we are grateful for your willingness to serve, it is unfortunate that you had to do so. In enacting the American Jobs Creation Act – or "AJCA" – U.S. officials consulted closely with EC officials, and we believed the legislation addressed the EC's primary concerns. Unfortunately, the EC has chosen to prolong this dispute involving a subsidy that, if this were a countervailing duty proceeding, would be regarded as *de minimis*.

3. In light of the speculation in the press that the EC decision to prolong this dispute was linked to the U.S. decision to challenge the massive subsidies provided to Airbus, the United States cannot help but note that in its counter-case against Boeing aircraft, the EC appears to have included a claim that the FSC tax exemption and the ETI Act tax exclusion have caused

adverse effects within the meaning of Article 5 of the SCM Agreement.[1] While the United States continues to hope that the aircraft disputes can be resolved without recourse to litigation, we must confess that we find tantalizing the prospect of the EC being required for the first time to demonstrate how these *de minimis* tax exemptions and exclusions have caused harm to EC trade interests.

4. In any event, the EC has decided that we need to get together again, so here we are. Today, we will focus on two issues: (1) the EC's claims under Article 4.7 of the SCM Agreement; and (2) the EC's claims regarding the transition provisions for the FSC tax exemption contained in section 5 of the ETI Act.

Article 4.7 of the SCM Agreement

5. Starting with Article 4.7, the EC's claim that the transition provisions of the AJCA are inconsistent with Article 4.7 is premised on the notion that the ETI Act tax exclusion was found to be inconsistent with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies. The U.S. response to this claim is straightforward: no such finding was ever made, nor did the DSB make a recommendation under Article 4.7 that the ETI Act tax exclusion be withdrawn. Thus, the premise of the EC's claim is simply in error.

6. Insofar as the ETI Act tax exclusion is concerned, the only findings made were that the tax exclusion was inconsistent with Article 3.1(a) of the SCM Agreement, Articles 3.3, 8 and 10.1 of the Agriculture Agreement, and Article III:4 of the GATT 1994. The corresponding recommendations of the DSB were that the United States bring the ETI measure into conformity

[1] WT/DS317/2 (3 June 2005).

with its obligations under these provisions. There was no finding that the ETI Act tax exclusion was inconsistent with the DSB's recommendation under SCM Article 4.7 to withdraw the FSC subsidies, nor was there a DSB recommendation under Article 4.7 to withdraw the ETI Act tax exclusion.

7. Contrary to what the EC asserts, this is not a mere "procedural" argument. No Member can be found to have failed to comply with a non-existent recommendation. The EC's assertion to the contrary raises important substantive and systemic issues.

8. In this regard, the EC errs when it suggests that the U.S. argument regarding Article 4.7 leads to the conclusion that the repeal of the ETI Act was a gratuitous act on the part of the United States.[2] To the contrary, as we will discuss later, repeal was appropriate in order to comply with the findings and recommendations that the United States bring the ETI measure into conformity with provisions of the WTO agreements other than SCM Article 4.7. However, the fact that implementation obligations existed with respect to these other provisions does not mean that there was an obligation under Article 4.7.

9. In its first written submission, the United States described the scope of the findings of the Article 21.5 Panel and the Appellate Body under Article 4.7, and explained how those findings were limited to the transition provisions in section 5 of the ETI Act that allowed for the continued use of the FSC tax exemption. Unfortunately, in its rebuttal submission, the EC presents an inaccurate version of the prior history of this dispute. According to the EC, the Appellate Body made a finding in the first Article 21.5 proceeding that the ETI Act tax exclusion

[2] *Rebuttal Submission of the European Communities*, 16 June 2005, para. 15 (hereinafter "EC Rebuttal").

resulted in non-compliance with the recommendation of the original Panel under Article 4.7 to withdraw the FSC subsidies.

10. The EC assertion is incorrect. In order to set the record straight, it is necessary to go over the prior history of this dispute one more time.

The Recommendations of the Article 21.5 Panel and the Appellate Body Under Article 4.7 Were Limited to Section 5 of the ETI Act

11. In its rebuttal submission, the EC refers to "[t]he Appellate Body's recognition that, by passing the ETI Act, the United States had not withdrawn its prohibited subsidy, and thus had not complied with the recommendations and rulings under Article 4.7 of the *SCM Agreement* contained in the original Panel Report ... ."[3] However, the Appellate Body recognized no such thing, because its finding and recommendation under Article 4.7 were limited to the transition provisions of the ETI Act that allowed for the continued use by taxpayers of the FSC tax exemption. The Appellate Body did *not* find that the ETI Act tax exclusion itself constituted a failure to comply with the recommendation under Article 4.7. Indeed, the EC did not even argue that the enactment of the ETI Act tax exclusion was inconsistent with that recommendation.

12. In the EC's first recourse to Article 21.5 of the DSU, the EC challenged various provisions of the ETI Act, alleging that they were inconsistent with one or more provisions of the WTO agreements. However, with respect to the issue of compliance with the DSB's recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy, the EC's claims were limited to section 5 of the ETI Act.

[3] EC Rebuttal, para. 15.

13. This can be seen from the first written submission of the EC in the first Article 21.5 proceeding. In the "Legal Analysis" section of the EC submission, the only reference by the EC to an alleged failure to withdraw the subsidy under Article 4.7 was made in connection with the transition provisions of section 5 of the ETI Act.[4] Likewise, in the "Conclusion" section, wherein the EC laid out the specific findings that it wanted the Article 21.5 Panel to make, the only finding sought by the EC with respect to Article 4.7 related to the transition provisions of section 5 of the ETI Act.[5]

14. Not surprisingly, the Article 21.5 Panel took the EC at its word. The Article 21.5 Panel's finding of a failure to comply with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies was limited to section 5 of the ETI Act. In paragraph 8.170 of the Article 21.5 Panel Report, which was contained in the section entitled "Transitional Issues", the Article 21.5 Panel found that the United States had not "*fully* withdrawn the FSC subsidies . . . and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the *SCM Agreement*."[6] This finding was repeated in paragraph 9.1(e) of the Article 21.5 Panel Report.[7] This was the only finding by the Article 21.5 Panel under Article 4.7. The Panel did not find that any other portion of the ETI Act constituted a failure to withdraw the FSC subsidies within the meaning of Article 4.7.

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[4] Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW, Annex A-1, para. 241 (hereinafter "*US – FSC (Article 21.5) (Panel)*").

[5] *US – FSC (Article 21.5) (Panel)*, Annex A-1, para. 259, sixth bullet.

[6] *US – FSC (Article 21.5) (Panel)*, paras 8.170 (emphasis added).

[7] *US – FSC (Article 21.5) (Panel)*, para. 9.1(e).

15. Neither party appealed the fact that the Article 21.5 Panel limited its findings under Article 4.7 to the transition provisions of section 5 of the ETI Act. In the case of the EC, how could it appeal? The Article 21.5 Panel had done exactly what the EC requested.

16. The lack of an appeal of this issue is relevant, because the EC makes the extraordinary assertion that the Appellate Body's findings regarding the ETI Act in general were closely linked to the original recommendations under SCM Article 4.7.[8] However, this assertion is belied by the fact that the Appellate Body upheld, rather than modified, the findings of the Article 21.5 Panel under Article 4.7. In paragraph 256(f) of its report, the Appellate Body stated that it

> upholds the Panel's finding, in paragraphs 8.170 and 9.1(e) of the Panel Report, that the United States has not *fully* withdrawn the subsidies . . . and that the United States has, therefore, failed *fully* to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the *SCM Agreement* ... .[9]

As previously noted, paragraphs 8.170 and 9.1(e) of the Article 21.5 Panel Report pertained to section 5 of the ETI Act.

17. In paragraph 257 of the Appellate Body report, the Appellate Body drew upon the language in paragraph 256 to recommend "that the DSB request the United States to implement *fully* the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."[10] Contrary to the EC's assertions,[11] this recommendation has nothing to do

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[8] EC Rebuttal, para. 13; *see also id*., para. 15.

[9] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, para. 256(f) (emphasis added) (hereinafter "*US – FSC (Article 21.5) (AB)*").

[10] *US – FSC (Article 21.5) (AB)*, para. 257 (emphasis added).

[11] EC Rebuttal, para. 13.

with the ETI Act tax exclusion. Instead, the Appellate Body referenced the recommendations and rulings in *US – FSC*, which were made before the ETI Act tax exclusion even existed.

18. In summary, the original Article 21.5 process resulted in two different sets of findings and recommendations. One set pertained to section 5 of the ETI Act and the transition provisions for the FSC tax exemption and involved a finding and recommendation under Article 4.7. The other set pertained to the ETI Act tax exclusion. With respect to the tax exclusion, there was no finding or recommendation under Article 4.7. Thus, the EC is simply incorrect when it asserts that the Appellate Body made a finding that the enactment of the ETI Act tax exclusion resulted in non-compliance with the DSB's recommendation under Article 4.7 to withdraw the FSC subsidies.

The Panel Should Reject the EC's Claims Under Article 4.7 of the SCM Agreement

19. To sum up, the EC's claim under Article 4.7 is based on the notion that the United States had an obligation under Article 4.7 to withdraw the ETI Act tax exclusion. According to the EC, the transition provisions of sections 101(d) and (f) of the AJCA are inconsistent with this obligation because they permit the continued use of the tax exclusion.

20. Insofar as the ETI Act tax exclusion itself is concerned, the United States had an obligation to bring the measure into conformity with Article 3.1(a) of the SCM Agreement, Articles 3.3, 8 and 10.1 of the Agriculture Agreement, and Article III:4 of the GATT 1994. However, the United States did not have an obligation under Article 4.7 of the SCM Agreement with respect to the ETI Act tax exclusion. As the United States has demonstrated, the first

Article 21.5 proceeding did not result in any findings that the ETI Act tax exclusion resulted in a failure to comply with Article 4.7.

Section 5 of the ETI Act Is Not Within the Panel's Terms of Reference

21. The United States now would like to turn to the EC's claims regarding section 5 of the ETI Act. Section 5, as the Panel will recall, is the transition provision in the ETI Act that allowed for the continued use of the FSC tax exemption for a period of time. As previously explained by the United States, section 5 is not within the Panel's terms of reference for several reasons. First, the only provisions of the AJCA identified by the EC in its panel request were sections 101(d) and (f), which are the transition provisions for the ETI Act tax exclusion and which do not concern the FSC tax exemption. Second, section 5 of the ETI Act was not mentioned in the EC's panel request.[12]

22. According to the EC, the U.S. position is wrong because the "United States considers the subsections of the [AJCA] expressly mentioned in a particular part of the request for the establishment of the Panel to be the sole subject of litigation in this proceeding."[13] Well, the United States must admit that it did rely on the fact that in Section 2 of the EC's panel request the EC was, in fact, purporting to identify the subject of the dispute. The United States reached the conclusion that it did because Section 2 is entitled "THE SUBJECT OF THE DISPUTE". Apparently, according to the EC, the title to Section 2 actually means "**A** SUBJECT OF THE DISPUTE".

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[12] *First Written Submission of the United States of America*, June 2, 2005, para. 20.
[13] EC Rebuttal, para. 19 (footnote omitted).

23. Section 2, consistent with the plain English reading of its title, identifies as the subject of the dispute sections 101(d) and (f), referring to them as "provisions which will allow US exporters to continue benefitting from the tax exemptions ... ."[14] However, the only tax exemption that these provisions allow to continue to be used is the ETI Act tax exclusion. Therefore, the only fair reading of the EC panel request is that the EC's claims related to the transition provisions for the ETI Act tax exclusion, and not the FSC tax exemption.

24. Thus, the EC's discussion of the nature of Article 21.5 proceedings and what can and cannot be raised therein is irrelevant.[15] Even if the EC could have made a claim regarding section 5 of the ETI Act and the continued use of the FSC tax exemption, the fact is that it did not do so in its request for the establishment of a panel. Therefore, the Panel must find that these claims are not within its terms of reference.

Conclusion

25. Mr. Chairman, that concludes our oral statement. The U.S. delegation stands ready to respond to any questions you may have.

[14] WT/DS108/29, page 2.
[15] *See, e.g.,* EC Rebuttal, paras. 21-23.