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United States – Conditional Tax Incentives for Large Civil Aircraft

(AB-2016-8 / DS487)

EXECUTIVE SUMMARY
OF THE APPELLEE SUBMISSION
OF THE UNITED STATES OF AMERICA

February 8, 2017

1. The Panel correctly found that neither the First Siting Provision nor the Second Siting Provision makes the 0.2904 percent Business and Occupation tax rate (the "B&O aerospace tax rate"), as extended into 2040, *de jure* contingent on the use of domestic over imported fuselages or wings. The Panel also correctly found that the First Siting Provision does not make the subsidy *de facto* contingent on the use of domestic over imported fuselages or wings.

2. The EU's appeal of these findings raises technical arguments, which themselves are meritless. But perhaps more importantly, in arguing that the two siting provisions create a prohibited import-substitution subsidy, the EU fundamentally misunderstands the nature of the measure at issue. The extension from 2024 to 2040 of the tax treatment that was found to be a subsidy was aimed at the employment and related economic activities associated with siting manufacturing activity in the grantor's territory. It simply did not concern the "use" of "goods," whether domestic or imported, within the meaning of Article 3.1(b) of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

3. Article III:8(b) of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") establishes that production subsidies (*i.e.*, subsidies paid exclusively to producer of a good in the grantor's territory) are not inconsistent with the provisions of the GATT 1994 and the SCM Agreement that prohibit conditioning a subsidy on the use of domestic over imported goods as a condition for a subsidy. Just as the SCM Agreement, read together with Article III:8(b) of the GATT 1994, does not preclude production subsidies (assuming they do not cause adverse effects), it does not preclude a Member from defining the scope or extent of the production activity necessary to receive the subsidy, and thereby defining who qualifies as a domestic producer. If a Member provides subsidies to domestic airplane producers, it can define what it means to produce an airplane and, therefore, who qualifies as a domestic airplane producer. To find otherwise would be to severely limit the discretion protected by Members in Article III:8(b) of the GATT 1994 and which informs the interpretation of Article 3.1(b) of the SCM Agreement.

4. The panel in *EC – Large Civil Aircraft (21.5)* recognized as much when it found that subsidies requiring the production of A350 XWB components in the EU as well as production of the A350 XWB airplane in the EU did not breach Article 3.1(b).

5. The siting conditions in Engrossed Substitute Senate Bill 5952 ("ESSB 5952") aimed only at ensuring that the manufacturing activity Washington sought was indeed sited in Washington. As such, it falls squarely within Article III:8(b).

6. The basis for finding a breach of Article 3.1(b) of the SCM Agreement in this dispute is far weaker than in *EC – Large Civil Aircraft (21.5)*, where the panel found that Article 3.1(b) did not prohibit the EU from requiring the production of certain A350 XWB parts – which were unquestionably inputs – along with the finished A350 XWB in the territory of the EU. Here, the measure at issue does not even require the production of parts in the grantor's territory.

7. The First Siting Provision ensured that the extension of the B&O aerospace tax rate would only take effect if a manufacturer sited a new commercial airplane program in

Washington. The Second Siting Provision ensured that, as time progressed, the relevant manufacturer would not site the wing assembly and final assembly associated with that program somewhere else.

8. These conditions have nothing to do with disciplining the use of goods. There are millions of parts that go into an LCA, and this measure is silent with respect to the domestic or imported character of all of them.

9. Because fuselages and wings are structural elements that can be identified on a finished airplane, merely referring to fuselages and wings says nothing meaningful about how an airplane will be manufactured or what inputs will be used in that process. For the 777X, fuselages and wings are simply elements of the output of Boeing's production process. Again, the most fundamental way to describe the main elements of a commercial airplane is with reference to its fuselage and wings. Boeing remains free to have the millions of components or parts produced wherever it chooses.

10. Because the extended B&O aerospace tax rate with respect to the manufacture and sale of the 777X is conditioned only on the location of production activities, and not on the use of goods, it is not contingent on the use of domestic over imported goods within the meaning of Article 3.1(b). This is what the panel found in *EC – Large Civil Aircraft (21.5)*, and this interpretation of Article 3.1(b) should be confirmed in this appeal.

11. The EU's arguments throughout its Other Appellant Submission erroneously assume the "use" of fuselages and wings. In Section II, the United States demonstrates that, under the proper interpretation of the term "use," airplane manufacturing does not necessarily involve the "use" of fuselages and wings. The United States further shows that there is nothing inherent to LCA manufacturing that requires that fuselages or wings be produced as separate articles and then used as inputs in downstream production of airplanes.

12. In Section III, the United States demonstrates that the Panel did not err in interpreting and applying Article 3.1(b) in finding that the First Siting Provision does not make the B&O aerospace tax rate for the 777X *de jure* contingent on the use of domestic over imported goods. The EU is also wrong that the Panel misapplied Article 3.1(b) because, according to the EU, under any scenario, domestic goods must be used for at least some period of time. As the Panel found, the First Siting Provision calls for a one-time determination regarding a decision to site manufacturing activities in Washington that occurred prior to the use of any goods. It placed no requirements on the use of goods.

13. In Section IV, the United States demonstrates that the Panel did not err in the interpretation of Article 3.1(b) or fail to make an objective assessment in finding that the First Siting Provision is not *de facto* contingent on the use of domestic over imported goods. There are no undisputed facts or Panel factual findings that even suggest that the First Siting Provision contains a prohibited contingency.

14. In Section V, the United States demonstrates that the Panel did not err in finding that the EU failed to establish that the Second Siting Provision contains a *de jure* prohibited import-substitution contingency. As the Panel found, the Second Siting Provision is silent as to the use of goods. It merely refers to the siting of production activities. Contrary to the EU's appeal, the Panel did not interpret Article 3.1(b) as requiring the use of exclusively domestic goods. Nor did the Panel improperly fail to consider a supposed U.S. "admission or to make an objective assessment in reaching its *de jure* finding. The EU's argument to the contrary merely re-packages its complaint that the erroneous conclusion reached in the Panel's *de facto* analysis should have informed the Panel's *de jure* analysis.