INDIA – EXPORT RELATED MEASURES

(DS541)

INTEGRATED EXECUTIVE SUMMARY OF THE UNITED STATES OF AMERICA

April 30, 2019

EXECUTIVE SUMMARY OF THE U.S. FIRST WRITTEN SUBMISSION

I. INTRODUCTION

1. India provides subsidies to its exporters that are inconsistent with its obligations under the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). The SCM Agreement prohibits subsidies contingent upon export performance ("export subsidies"). India grants export subsidies through several schemes that are the focus of this dispute.

II. RELEVANT LEGAL STANDARD

2. In summary, under the SCM Agreement, for the complaining Member to establish that a Member provides a prohibited export subsidy, it must show the following three elements: (1) that the government or public body provided a financial contribution through the measure at issue (SCM Agreement Article 1.1(a)); (2) that the financial contribution conferred a benefit (SCM Agreement Article 1.1(b)); and (3) that the resulting subsidy is contingent - in law or in fact - on export performance (SCM Agreement Article 3.1(a)).

3. Although Article 27 of the SCM Agreement provides a limited exception to Article 3.1(a), India no longer qualifies for that limited exception.

III. FACTUAL BACKGROUND AND LEGAL ANALYSIS OF THE PROGRAMS

A. Export Oriented Units and Sector Specific Schemes

4. India designed the Export Oriented Units (EOU) Scheme and Sector Specific Schemes, including the Electronics Hardware Technology Parks (EHTP) Scheme and Bio-Technology Parks (BTP) Scheme, to "promote exports, enhance foreign exchange earnings, and attract investment for export production and employment generation." EOU, EHTP, and BTP units (collectively referred to as "units") agree to export their entire production of goods and services in exchange for exemption from import duties and taxes. Furthermore, throughout these documents, India stresses the requirement that an enterprise maintain a positive net foreign exchange (NFE).

1. Financial Contribution

5. The exemption provided by these schemes from customs and excise duty constitutes "government revenue that is otherwise due [that] is foregone or not collected" within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. This provision defines a financial contribution to include a measure through which the government foregoes the collection of revenue that would otherwise be due in the absence of the challenged measure.

6. Exporters participating in the EOU/EHTP/BTP schemes are exempt from the payment of customs and excise duty that would otherwise be due in the absence of the measure. Comparably situated enterprises in India, on the other hand, must pay customs duties according to India's national tariff schedule.

2. Benefit

7. The financial contribution confers a benefit on EOU/EHTP/BTP participants. A benefit analysis under Article 1.1(b) of the SCM Agreement requires considering whether the recipient is in a better position because of the financial contribution. Here, the EOU/EHTP/BTP units receive benefits because they are financially "better off" by receiving an exemption from paying the duties they would otherwise have paid.

3. Export Contingency

8. Article 3.1(a) provides that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" are prohibited. As evidenced throughout government documents, India conditions the availability of these benefits to the EOU/EHTP/BTP units upon the promise of agreeing to export their entire production and obtaining and maintaining of a positive NFE.

B. Merchandise Exports from India Scheme

9. The Merchandise Exports from India Scheme (MEIS) "provide[s] rewards to exporters to offset infrastructural inefficiencies and associated costs" and thus "promote[s] the manufacture and export of notified goods/products." India, through the MEIS, advances these objectives by providing to exporters transferable import duty credit scrips (scrips) as a reward for export of listed products to specified country markets These scrips offset the cost of multiple expenses and liabilities, including for: (1) basic customs duty related to import of inputs or goods, including capital goods; (2) central excise duties; (3) basic customs duty related to payment of fees; and (4) a shortfall in export obligation. After an exporter accrues scrips through the MEIS scheme, it may transfer the scrips, and the recipient of the transfer may use the scrips without the same export conditions as the original MEIS participant.

1. Financial Contribution

10. India awards scrips as a "direct transfer" of funds under Article 1.1(a)(1)(i) of the SCM Agreement. India provides the MEIS participants with scrips that serve as a financial claim for that participant. That participant can use the scrips to pay for customs and excise duties, fees, or to cover the difference between an enterprise's deficit in actual export performance for a year versus the export obligation for that year. It is also freely transferable and has cash value.

2. Benefit

11. The MEIS participants receive benefits for participating in this scheme. A benefit analysis under Article 1.1(b) of the SCM Agreement requires considering whether the recipient is in a better position because of the financial contribution. Here, the MEIS participants receive benefits because they are financially "better off" than they would be in the market by receiving scrips that can offset customs duty, central excise duties, and customs fees, and can be used to offset a shortfall in export obligation. These scrips are freely transferable, and can be sold on the open market for cash.

3. Export Contingency

12. Article 3.1(a) provides that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" are prohibited. An MEIS program participant receives scrips conditioned and tied to the value it exports, where the exports are sold, and of what product. Through an intensive monitoring process, India ensures that the value, place, and product of export, i.e., export performance, determine the MEIS reward.

C. Export Promotion Capital Goods Scheme

13. The Export Promotion Capital Goods Scheme (EPCG) "facilitate[s] import of capital goods for producing quality goods and services and enhance[s] India's manufacturing competitiveness." EPCG applicants promise to fulfill export obligations, i.e., meet export performance benchmarks. In return, participants receive advantages including exemption from paying import duties on capital equipment used to produce exports or duty credit scrips, similar to scrips in the MEIS scheme, which can be used to offset import duty for capital goods imported to produce exports.

1. Financial Contribution

14. Article 1.1(a)(1)(ii) defines a financial contribution to include a measure through which the government foregoes the collection of revenue that would otherwise be due in the absence of the challenged measure. The EPCG scheme exempts a participant from the payment of customs duties otherwise due on the import of capital goods used for export pre-production, production, and post-production. Comparably situated enterprises, not participating in this scheme, in India importing the same or similar capital goods must pay customs duties according to India's national tariff schedule.

2. Benefit

15. EPCG participants receive numerous benefits under the program. A benefit analysis under Article 1.1(b) of the SCM Agreement requires considering whether the recipient is in a better position because of the financial contribution. Here, the participants receive "benefits" because they are financially "better off" by not having to pay the import duties for the capital goods they use for their export operations.

3. Export Contingency

16. Article 3.1(a) provides that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" are prohibited. Here, a unit receives EPCG benefits conditioned and dependent on its fulfillment of its export obligations. An enterprise agrees to a specific export obligation of six times the duties, taxes, and cess saved on capital goods to be fulfilled in six years from date of issue authorization.

D. Special Economic Zones Scheme

17. Special Economic Zones are geographic areas that contain multiple exporting units (SEZ Units). India established the SEZ scheme for the express purpose of promoting exports by SEZ Units. An SEZ Unit is entitled to a number of tax reductions and customs duty exemptions: (1) Corporate income tax deduction of export earnings (100% for five years, and then 50% each of the subsequent five years); (2) Exemption from customs duty on goods imported into the SEZ; (3) Exemption from export duties; and (4) Exemption from India's Integrated Goods and Services Tax.

18. In the Annual Performance Report, the SEZ Unit reports export value (FOB value of exports for the most recent year) and import value of inputs and capital goods. Using this data, the SEZ Unit calculates the NFE earning for the year: "FOB value of exports for the year" minus total value of imports during the year. If the resulting number is positive, the unit has satisfied the NFE condition.

1. Financial Contribution

19. India makes a financial contribution to SEZ Units in the form of "government revenue that is otherwise due is foregone or not collected" as provided in Article 1.1(a)(1)(ii) of the SCM Agreement. The four tax reductions and duty exemptions identified above [] represent a decision by India to "[give] up an entitlement to raise revenue that it could 'otherwise' have raised." In each instance, as a result of the reduction or exemption provided to SEZ Units, India has foregone revenue that it would otherwise be due.

2. Benefit

20. In the case of each of the reductions or exemptions described above, India confers benefits to SEZ Units. A benefit analysis under Article 1.1(b) of the SCM Agreement requires considering whether the recipient is in a better position because of the financial contribution. Here, the financial contributions confer benefits to SEZ Units within the meaning of Article 1.1(b) to the extent of the tax reduction and customs duty exemptions.

3. Export Contingent in Law

21. Article 3.1(a) provides that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" are prohibited. The reductions and exemptions India provides through the SEZ scheme are contingent in law. If approved as an SEZ Unit, an enterprise commits to conditions that again relate to export performance. The Letter of Approval issued by India establishes the SEZ Unit's projected annual exports and the NFE earning for the first five years of operation. Finally, the enterprise must commit to achieve a positive NFE, a calculation that relies on the FOB value of exports as the starting point for the determination.

4. Export Contingent in Fact

22. The United States has demonstrated that the challenged subsidies are contingent in law upon export performance, and the Panel's analysis of export contingency may end there. For

completeness, the United States also demonstrates that the facts establish that the subsidies granted or maintained to SEZ Units are also contingent in fact upon export performance by the SEZ Unit.

E. Duty Free Imports for Exporters Scheme

23. The duty-free imports for exporters scheme exempts eligible exporters from customs import duties based on past export performance. The extent of the import duty exemption is contingent upon the FOB value of exports of a given product during the previous year.

1. Financial Contribution

24. India makes a financial contribution to participating enterprises in the form of "government revenue that is otherwise due is foregone or not collected," as defined in Article 1.1(a)(1)(ii). A participating enterprise receives a duty free import entitlement based on export value from the previous year, and is then entitled to import eligible goods duty free until it has exhausted the duty free import entitlement. The enterprise is not required to pay the customs duty that would otherwise be due in the absence of the measures. A comparably situated enterprise in India must pay customs duties according to India's national tariff schedule.

2. Benefit

25. India confers benefits to participating exporters through the exemption of customs duties normally due to the government to the extent of those exemptions. A benefit analysis under Article 1.1(b) of the SCM Agreement requires considering whether the recipient is in a better position because of the financial contribution. Here, the financial contribution confers benefits to a participating enterprise within the meaning of Article 1.1(b) to the extent of the customs duty exemptions.

3. Export Contingency

26. Article 3.1(a) provides that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" are prohibited. The availability of the duty exemption under the measure is contingent – or conditional – upon the value of the goods an enterprise exported in the previous year, and the value of the exemption is directly related to the value of exports.

EXECUTIVE SUMMARY OF THE U.S. SECOND WRITTEN SUBMISSION

I. ARTICLE 3 OF THE SCM AGREEMENT APPLIES TO INDIA

27. India claims that it is entitled to an eight-year phase out of its export subsidy programs pursuant to Article 27 of the SCM Agreement. India undertakes a convoluted interpretive exercise based largely on policy arguments and negotiating history to argue for a legal interpretation that the SCM Agreement still permits India to grant export subsidies otherwise prohibited by Article 3 of the SCM Agreement.

28. Article 31 of the Vienna Convention on the Law of Treaties, which reflects customary rules of interpretation of public international law, provides that "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The starting point of the interpretive exercise is the text of the applicable treaty.

29. Under Article 27.2(b), the prohibition of Article 3.1(a) shall not apply to certain developing country Members "for a period of eight years from the date of entry into force [January 1, 1995] of the WTO Agreement, subject to compliance with the provisions of paragraph 4" of Article 27. A "developing country" Member under Article 27.2(b) had its right to grant export subsidies end on January 1, 2003, unless it requested and was granted an extension, as provided for in Article 27.4.

30. Therefore, reading Annex VII and Article 27.2(b) of the SCM Agreement together, an Annex VII(b) developing country that graduates shall end its prohibited subsidies by the later of January 1, 2003, or the time it reaches $1,000 GNP per capita.

31. India has no textual support for its position that an additional eight-year phase out applies, and instead requests that the Panel consider such supplemental sources as negotiating history and amorphous language about the general support for giving developing country Members the opportunity to provide export subsidies. Such resort to reviewing supplemental sources is unnecessary when the ordinary meaning of the text, in context and in light of the object and purpose of the SCM Agreement, answers the question, and India's argument should be rejected.

II. ARTICLE 4 OF THE SCM AGREEMENT APPLIES TO THIS DISPUTE

32. India's argument that the special procedures of Article 4 of the SCM Agreement are inapplicable to this dispute fails for a number of reasons.

33. First, India's arguments ignore the plain text of Article 4. Article 4.1 provides that: "[w]henever a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member, such Member may request consultations with such other Member." Article 4.4 then provides that: "[i]f no mutually agreed solution has been reached within 30 days of the request for consultations, any Member party to such consultations may refer the matter to the Dispute Settlement Body ("DSB") for the immediate establishment of a panel, unless the DSB decides by consensus not to establish a panel." The threshold for invoking the procedures of Article 4 therefore is whether "a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member." Contrary to India's arguments, Article 4 does not require that there first be a determination that Article 27 does not apply. Here, the United States has properly invoked Article 4 because the United States "has reason to believe that a prohibited subsidy is being granted or maintained by" India.

34. India's claim that the U.S. statement of available evidence does not conform to Article 4.2 of the SCM Agreement is without merit. Article 4.2 of the SCM Agreement contains no

obligation to provide a statement of evidence that "establishes that the measures are, in fact, subsidies" - that is, meet the legal definition of a subsidy contained in Article 1 of the SCM Agreement. That would be a legal argument, not a statement of available "evidence." As demonstrated in the U.S. First Written Submission, the evidence cited in the statement of available evidence is indeed evidence regarding the existence and nature of the subsidies in question. India does not identify a legal basis for its claim that the United States was required to present arguments applying evidence to the applicable legal standard. India again appears to confuse what is evidence with what is legal argument.

35. India requests again that the Panel amend and extend the adopted timetable and working procedures for this dispute to include a second substantive meeting because holding one substantive hearing allegedly is not in accordance with Article 12.10 of the DSU and India's "due process rights." However, the parties have had and will have adequate opportunity to present their arguments and to be heard in this proceeding. Importantly, the setting of one substantive meeting rather than two reflects the expedited nature of the proceedings under Articles 4.4 and 4.6 of the SCM Agreement and contributes towards meeting the deadline specified in the SCM Agreement. The Panel's adopted timetable and working procedures for this dispute are consistent with Article 12.10 of the DSU.

III. INDIA'S CHALLENGED EXPORT SUBSIDIES ARE INCONSISTENT WITH ARTICLE 3.1(a) AND 3.2 OF THE SCM AGREEMENT BECAUSE THEY ARE SUBSIDIES CONTINGENT UPON EXPORT PERFORMANCE

36. India argues that the measures at issue fall under the SCM Agreement's exemption for duty drawback systems. India's response fails to address the elements of the schemes that are at issue. As reflected in Annex I of the SCM Agreement, a requisite feature of a duty drawback program is that imported inputs are "consumed" in the production of the exported product (making normal allowance for waste). Accordingly, the challenged schemes differ from drawback, exemption, and remission programs contemplated by Footnote 1 and Annexes I-III of the SCM Agreement.

A. Export Oriented Units and Sector Specific Schemes

37. India argues that it does not provide a financial contribution to these Units because these schemes provide an exemption from customs duties that falls under Footnote 1, and therefore, there is no subsidy under the SCM Agreement Article 1.1.

38. This argument misses the mark because the EOU/EHTP/BTP schemes do not meet the requirements under Footnote 1 since they are not duty drawback schemes. SCM Annex II defines a duty drawback scheme as one where "import charges levied on inputs that are consumed in the production of the exported product . . ." are remitted or drawn back. SCM Annex I(i) provides that the "remission or drawback of import charges in excess of those levied on imported inputs that are consumed in the production of the exported product" is an export subsidy.

39. Before reaching the question of whether a remission was in excess of the import charges levied, one must first determine whether, as part of the drawback scheme, imported inputs were consumed in the production of an exported product. Footnote 1 does not apply to EOU/BTP/EHTP units because they fail to meet this requirement. Units face no restriction that imported duty-free goods be consumed in the export production process. The imported duty-free goods need only be imported "for approved activity."

40. India also argues that imported capital goods under the EOU/EHTP/BTP schemes are inputs because they are "consumed" by contributing to the value of the final product. India's argument is contrary to the text of the SCM Agreement. The definition of "inputs" at Footnote 61 of the SCM Agreement does not directly or implicitly contemplate capital goods. The footnote concerns "inputs" that are consumed in the production process. By their very nature, capital goods are not physically incorporated or consumed in the goods being manufactured during the production process.

41. Annex I(i) provides no help to India either. Annex I(i) does not refer to goods contributing to the final cost of exports, but to "imported inputs that are consumed in the production of the exported product (making normal allowance for waste)."

42. India also cites to Annex I(h) to argue that the exemption on excise duties applies to the EOU/BTP/EHTP schemes and falls squarely within the meaning of prior-stage cumulative indirect taxes referred to in Annex I(h) to the SCM Agreement. Similarly here, this provision is inapplicable because Annex I(h) requires that "the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product."

B. Merchandise Exports from India Scheme

43. Next, India claims the MEIS scrips fall under the "ambit" of Footnote 1 of the SCM Agreement, and therefore, the scrips are not a subsidy. To support this theory, India states that the scrips recipient only receives as a refund (in the form of scrips) the money the Unit paid in indirect taxes. As a result, India suggests, the MEIS scrips are a proper remission of duties or taxes not in excess of that accrued.

44. Footnote 1 and Annex I of the SCM Agreement do not apply to the MEIS because the exemption or remission of indirect taxes is irrelevant to the MEIS. There is no requirement for a scrips holder to tie the scrips it receives to imports of certain products, or that the products be inputs to the exported product for which the company received the scrips. The value of the scrips received is tied only to the value, country and product of export, and has no relationship to an exporter's imports.

45. In fact, an MEIS beneficiary may use the scrips to offset an export obligation for other programs such as the EPCG scheme described below. Scrips can be freely bought and sold and are financial instruments. Various online marketplaces facilitate the exchange of scrips, and companies may sell their scrips. Thus, the MEIS program is not an "exemption, remission or deferral" as contemplated by Footnote 1 and Annex I.

C. Export Promotion Capital Goods Scheme

46. India's central argument is that the EPCG scheme falls within the scope of Footnote 1 and Annex I of the SCM Agreement as a duty drawback system that is deemed not to be a subsidy.

47. India first points to Annex I(g) and claims the EPCG scheme is an exemption for various indirect taxes on capital goods. India is mistaken because Annex I(g) is inapplicable to the EPCG scheme. Annex I(g) deals with the "exemption or remission, in respect of the production and distribution of exported products, of indirect taxes." In the EPCG scheme, there is no requirement to use the capital good, for which the exemption or remission of indirect tax was received, in "the production and distribution of exported products," as is required in Annex I(g).

48. India also argues that the EPCG scheme is not a subsidy under Annex I(i). This statement is factually incorrect. Annex I(i) concerns import charges "levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste)." Capital equipment - which is the focus of the EPCG scheme - is distinct from inputs. Footnote 61 of the SCM Agreement limits the applicable inputs to those "inputs physically incorporated" and "consumed," a definition that does not apply to capital goods.

49. The references in Annex I, items (h) and (i), to a "normal allowance for waste" supports an interpretation that Annex I, items (h) and (i), do not contemplate or permit for capital goods to be considered as inputs. Capital goods are not "consumed" in the production process, and do not thereby result in wastage during production for which a normal allowance can be made.

50. In addition, while Indian companies must export to receive advantages under EPCG, there is no requirement that capital goods imported duty-free only be utilized for export production. Rather, the duty-free capital goods imported under EPCG may be used for any amount of production bound for the domestic market so long as the EPCG participant also meets its export obligation.

D. Special Economic Zones Scheme

51. India also claims that a positive NFE can be reached without exporting to other countries. However, despite there being a number of ways listed in the SEZ Rules for a company to increase its NFE, the definition of "export" in the SEZ Act, 2005 is relatively straightforward:

- Item (m) "export" means (i) taking goods, or providing services, out of India, from a Special Economic Zone, by land, sea or air or by any other mode, whether physical or otherwise; or (ii) supplying goods, or providing services, from the Domestic Tariff Area to a Unit or Developer; or (iii) supplying goods, or providing services, from one Unit to another Unit or Developer, in the same or different Special Economic Zone.

- Item (ii), regarding supplying goods from the DTA to a Unit or a Developer, would only apply to suppliers of SEZ Units - located in the Domestic Tariff Area and not the SEZ -

and not to SEZ Units themselves. Thus, in the case of SEZ Units the SEZ Act defines export to cover two situations: SEZs "taking goods, or providing services, out of India," or providing goods or services to other SEZ units. In the case of the latter, these recipient Units then ultimately must either export those goods out of India (with or without further processing), or provide them to another SEZ Unit.

52. India claims that the U.S. evidence of export contingency in fact is insufficient. India first argues that the intent of the SEZ Act is not relevant to the Panel's analysis, but at no point disagrees with the evidence presented that the SEZ Act was enacted to promote exports from India. This policy rationale is useful evidence in considering whether the subsidy is tied to, or geared to induce, export performance.

53. India also errs in arguing that the SEZ application and approval processes are not in themselves tied to actual or anticipated exports. Consider the requirement to achieve a positive NFE. This requirement incentivizes an SEZ Unit to make export-market sales rather than domestic-market sales. Maintaining positive NFE is the critical requirement for being an SEZ Unit. The determination of whether an SEZ Unit has achieved positive NFE relies principally on the "Free on Board value of exports" by the SEZ Unit. Increased exports and the resulting higher export value will strengthen the likelihood of an SEZ Unit attaining positive NFE, meaning that an enterprise would be inclined to direct sales to the export market and support its effort to reach positive NFE. Thus, the granting of subsidies is tied to actual or anticipated exports, and the premise of this primary requirement of SEZ Units is to encourage exports.

54. India has also not addressed the fact that the SEZ Scheme structured the tax reduction benefit to induce exports by SEZ Units. SEZ Units are permitted to deduct from income tax liability 100% of profits from exports for the first five years, and then 50% of profits from exports during each of the subsequent five years. Any profits from domestic sales do not result in the same benefits to SEZ Units, raising again the question of the economic value to an SEZ Unit in pursuing domestic sales. Indeed, the structure of this tax reduction has a direct impact on the cost of a transaction to an export market, providing SEZ Units with greater flexibility to complete export sales. India tied the tax reduction entirely to export sales, creating a strong incentive for SEZ Units to export.

E. Duty Free Imports for Exporters Scheme

55. India argues that Articles 3.1(a) and 3.2 of the SCM Agreement do not apply to the DFIES because it is a duty drawback system under Footnote 1 of the SCM Agreement and Annex I(i) as "inputs consumed in the production of the export." India also argues that "duty exemptions are only provided on goods that are inputs to be used by manufacturer exporters."

56. As explained above, under DFIES, past export performance entitles the enterprise to an import duty exemption. In addition, while some of the products for which import duty exemptions may be applied can be inputs, it is not true for all of them.

EXECUTIVE SUMMARY OF THE U.S. OPENING STATEMENT

57. After filing its Second Written Submission in November 2018, India enacted additional, or expanded, benefits under the MEIS and EPCG schemes. India's actions betray its statement that it is making efforts to "reduce the impact of the duty and tax exemptions on government revenue."

58. India cites to Annex II of the SCM Agreement to advocate that the United States, as the complaining party, bears the burden to undertake an "examination of the inputs consumed," "a quantitative analysis of the amounts and prices of the inputs consumed," and "an examination of whether excess remissions have occurred." Elsewhere, India argues that the United States must offer a "data-driven, technical argument" to show that duty-free imported inputs are not consumed under the challenged schemes.

59. India fails to mention that the section of Annex II it relies upon is one that is only applicable to a countervailing duty investigation. The plain language of the SCM Agreement shows that the guidelines of Annex II apply to countervailing duty investigations.

60. In any event, India has structured the schemes without any regard for whether duty-free products imported by scheme participants are consumed in the production of the exported good (EOU, EPCG, DFIES) or to quantify the existence and amount of any indirect tax liability borne by the exported product (MEIS). Thus, such a "quantitative analysis" of amounts and prices of inputs consumed and whether excess remission occurred would be futile because there is no duty drawback or remission scheme to begin with.

61. With regard to capital goods, India has repeatedly proposed that capital goods be included in the definition of "inputs" for purposes of the SCM Agreement and acknowledged in a WTO filing that "[t]hus capital goods and consumables have been left out even though they can be said to have been used to the extent of their depreciation and actual consumption." India's proposal was opposed and rejected. For instance, a 2001 Chairman's Report recalls that India's proposal "advocates including capital goods in the definition in Footnote 61 of inputs consumed in the production process." In other words, capital goods were not already included. Contrary to India's assertion that "capital goods fall squarely within the definition of 'inputs' in Footnote 61 of the SCM Agreement," the SCM Agreement's negotiating history for Footnote 61 and subsequent discussions show that the question of whether to include capital goods as "inputs" was deliberated and the proposal was rejected.

EXECUTIVE SUMMARY OF U.S. RESPONSES TO THE PANEL'S QUESTIONS

U.S. RESPONSE TO PANEL QUESTION 35

62. The Appellate Body has applied a three-step approach that (i) identifies the tax treatment that applies to the income of the alleged subsidy recipients; (ii) identifies a benchmark for comparison; and (iii) compares the challenged tax treatment and the reasons for it with the

benchmark tax treatment. In the second step, the Appellate Body has noted that determining a benchmark may require examining the "structure" and "organizing principles" of a Member's domestic tax system. Both the United States and India agreed at the substantive meeting that there is no need to examine the structure and organizing principles of India's domestic tax regime.

63. First, while a three-step approach can serve as a useful analytical tool in certain cases, it is unnecessary in this dispute under these facts. Second, while the applied import duty rate may vary by product, exporters participating in the challenged schemes, who receive blanket import duty exemptions, do not pay import duties, and similarly situated exporters in India, absent participation in the challenged scheme, do. Third, the "reasons for the challenged tax treatment" in the case of the challenged schemes are clear: a reward for export performance.

U.S. RESPONSE TO PANEL QUESTION 36

64. The Appellate Body reasoning in its report in *EU - PET (Pakistan)* is not particularly relevant to this dispute. *EU - PET (Pakistan)* began with the unchallenged premise that the scheme at issue was a duty drawback scheme. Here, India has asserted that the challenged schemes are proper duty drawback or remission schemes. The United States has demonstrated that the challenged Indian schemes are not proper duty drawback or remission schemes to begin with because the schemes are not limited to inputs consumed in exported products and/or do not even attempt to connect the alleged drawback or remission to the import charges or indirect taxes accrued.

U.S. RESPONSE TO PANEL QUESTION 41

65. Regardless of whether they operate on what India labels a "post-export" basis, duty drawback schemes must limit their scope to "imported inputs that are consumed in the production of the exported product" and connect the "remission or drawback of import charges" with "those [import charges] levied." The challenged Indian schemes fail to meet these fundamental elements.

66. As explained previously, the SCM Agreement envisions the connection described above to be based on a firm's actual experience, including actual import duty liability incurred and input consumption, and not on an aggregate, estimated or industry or product-wide rate. For instance, paragraph 2 of Annex II specifies that the analysis involves the amount that is "actually levied" on inputs that are consumed in the production of the exported product.

U.S. RESPONSE TO PANEL QUESTION 46

67. The elements that Members agreed are required for a proper remission or exemption scheme differ depending on whether the scheme concerns indirect taxes, cumulative indirect taxes, or import charges.

68. A remission or exemption scheme may fall within the scope of Annex I(g) if it contains the following elements, as reflected in the text of item (g): (1) permits remission or exemption for indirect taxes applied to exported products; (2) permits remission or exemption for only production and distribution-related indirect taxes; and (3) requires determining the indirect taxes actually levied on the production and distribution of like products sold for domestic consumption so as not to provide excessive remission or exemption.

69. A remission or exemption scheme may fall within the scope of Annex I(h) if the exemption, remission or deferral of prior-stage cumulative indirect taxes: (1) is tied to actual prior stage cumulative indirect tax liability; (2) is limited to goods and services used in the production of the exported product; (3) is tied to inputs, as defined in Footnote 61, consumed in the production of exported products; and (4) is determined on actual taxes levied on inputs that are consumed in the production of the exported product.

70. A remission or exemption scheme may fall within the scope of Annex I(i) if: (1) there is an input as defined in Footnote 61; (2) the input is imported (with the exception of certain home market inputs described in Annex I, item (i)) and Annex III; (3) the input is consumed in the production of the exported product; and (4) the remission or drawback of import charges is not in excess of those levied on the imported inputs.

U.S. RESPONSE TO PANEL QUESTION 69

71. Despite this common understanding and the SEZ scheme's primary focus on foreign "export," India focuses on narrow domestic means to improve an enterprise's NFE that purportedly negates the scheme's export contingency. Section 2(m) of the SEZ Act provides for a limited exception under (iii) for domestic sales, and Rule 53 differentiates between exports on the one hand, and a narrowly defined list of exceptions in the form of encouraged domestic sales, subject to special conditions, by which an SEZ unit may improve its NFE.

72. The availability of these limited exceptions as a secondary means for an SEZ unit to fulfill its NFE does not diminish the primary means for an SEZ unit to fulfill its net foreign exchange requirement - foreign export. India has not and cannot explain why the SEZ scheme only incentivizes exports by SEZ units and not sales to other SEZ units. Also, the export contingency of a scheme is not lost even if a small number of "exports" made domestically can count toward positive NFE or a small number of exporters can meet their NFE requirement predominantly through domestic sales.

73. India's own examination of the SEZ scheme supports the U.S. view. The Comptroller and Auditor General of India (CAG), in a report entitled "Performance of Special Economic Zones (SEZs)," analyzed exports from SEZ units based on the common understanding of "exports." While the Department of Commerce noted the NFE impact of certain DTA sales, the CAG concluded that the possibility of an SEZ unit fulfilling its NFE requirement without making physical exports was an unintended loophole incompatible with the SEZ scheme. The CAG emphasized that reliance by SEZ units on domestic sales defeated "the basic objective of the

scheme of earning foreign exchange from overseas" through "actual physical exports to foreign countries…"

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74. There is a glaring disconnect between the import duty actually levied on the imported inputs, and India's reward of exemption. The SCM Agreement, on its face, necessitates connecting "the remission or drawback of import charges" with "those levied on imported inputs that are consumed in the exported product." Under DFIES, the amount of duty exemption granted for exports is uniform across broad categories of exports based on the FOB value of exports, regardless of what inputs were used, whether the inputs were themselves imported duty-free, or whether the inputs were even imported. As a result, one cannot connect the actual amount of import duty levied on the imported inputs with the amount of the import duty exemption. This fact is unsurprising because the amount of the duty exemption is a reward contingent upon the exporter's export performance.

EXECUTIVE SUMMARY OF U.S. COMMENTS TO INDIA'S RESPONSES TO THE PANEL'S QUESTIONS

U.S. COMMENT ON INDIA'S RESPONSE TO PANEL QUESTION 35

75. India argues that a three-step approach and an inquiry into the "structure" and "organizing principles" of its tax system are unnecessary in this dispute. India argues that, for measures falling under Footnote 1, the Panel need only compare the "amount of remission of such duties or taxes and those which have accrued…." For these reasons, the three-step approach and inquiry into the "structure" and "organizing principles" of India's tax system is unnecessary.

76. This "excess remissions principle," on which India relies, is that "in the context of duty drawback schemes, the financial contribution element of the subsidy (i.e. government revenue forgone that is otherwise due) is limited to the excess remission or drawback of import charges on inputs. . . ." However, this comparison presumes that a scheme is a proper duty drawback scheme that attempts to relate remission of duties to those duties actually accrued. The challenged schemes do not even attempt to connect the amount of remission and the amount of duties or taxes actually accrued. Thus, the schemes fail to meet a fundamental requirement of a drawback scheme. The challenged schemes also do not require exempted items to be consumed in production of the exported product, another fundamental requirement.

77. An inquiry into the "structure" and "organizing principles" of India's tax system is unnecessary. India provides: (1) a 100% exemption on duties or taxes under these schemes; (2) similarly-situated enterprises who do not participate in the schemes, all other things being equal, pay the duties or taxes from their income; and (3) the transparent reason for the challenged treatment is a reward for export performance. Under these facts, the "benchmark" treatment for comparison, the treatment of the income of a similarly situated non-scheme participant enterprise under Indian law, is readily identifiable.

78. Finally, to the extent the Panel finds a three-step approach appropriate in this proceeding, in the U.S. written submissions and responses to the Panel's questions, the United States has identified (i) the duty or tax treatment of the income that applies to the scheme participants and (ii) a benchmark for comparison. The United States then compares (iii) the challenged tax treatment and the reasons for it with the benchmark duty or tax treatment. This comparison shows that the challenged schemes result in India foregoing revenue and providing a financial contribution to scheme participants.

U.S. COMMENT ON INDIA'S RESPONSE TO PANEL QUESTION 38

79. India mistakenly applies the mandatory/discretionary distinction, which is a useful analytical tool for determining whether a measure irrespective of its application can be found WTO-inconsistent, to argue that the United States must establish that "the legislation [is] worded in such a manner as to preclude the possibility of imported inputs being consumed in the production of an exported product[], or, alternatively, the legislation [] explicitly prevent[s] the possibility of inputs being imported solely for the consumption of exported products." India misconstrues what will suffice to show the challenged measures are inconsistent with the SCM Agreement.

80. India erroneously contends that the United States must demonstrate how the "legislation [] explicitly prevent[s] or obstruct[s], either in i[t]s language or its operation, the fundamental aspects of a duty drawback program, in order for it to be held as inconsistent" with the SCM Agreement. But there is no basis in the SCM Agreement to require a complaining party to show that a measure could never operate in a WTO-inconsistent manner for it to be in breach.

81. To the contrary, if a complaining party can demonstrate that a measure will, in a defined circumstance, necessarily produce a WTO-inconsistent result, the measure may be found WTO-inconsistent "as such." That in other circumstances the measure may not necessarily produce a WTO-inconsistent result does not cure the inconsistency (for example, a measure that sets out a tariff in excess of a Member's binding, but only on Monday and not Tuesday-Friday). Similarly, the fact that the measures do not mandate, for example, the explicit preclusion of imported inputs being consumed in the production of the exported product does not mean that the challenged schemes do not confer export subsidies when domestic inputs are being consumed in the production of exported products. That is, there is no relevant "discretion" under the measure under the mandatory / discretionary distinction (the discretion not to engage in WTO-inconsistent behavior).

CONCLUSION

82. For the foregoing reasons, the United States respectfully requests that the Panel find that the measures at issue are export subsidies inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.