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

WT/DS108

COMMENTS OF THE UNITED STATES ON THE EC'S ANSWERS TO THE PANEL'S QUESTIONS TO THE PARTIES IN CONNECTION WITH THE SUBSTANTIVE MEETING

July 15, 2005

Table of Reports

Short Form	Full Citation
US – FSC (Article 21.5) (AB)	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
US – German Corrosion-Resistant Steel (AB)	Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, adopted 19 December 2002
US – OCTG from Argentina (AB)	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, adopted 17 December 2004
US – OCTG from Mexico	Panel Report, *United States – Anti-Dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico*, WT/DS282/R, circulated 20 June 2005 (unadopted)

8. What is/are the "measure(s)" challenged in this dispute? In these compliance proceedings, is the EC seeking new findings, recommendations and rulings, or a confirmation that pre-existing inconsistencies persist, or something else?

1. With respect to the first part of the Panel's question, the EC asserts that the measures challenged "are the FSC scheme, the ETI Act and the JOBS Act ... ."[1] The United States disagrees, because it is clear from the EC panel request in this dispute that the only measures challenged are sections 101(d) and (f) of the American Jobs Creation Act (AJCA).[2]

2. The limited scope of the EC challenge is borne out by the very next paragraph of the EC Replies, in which the EC states as follows:

> The direct subject of this Article 21.5 proceeding is the existence or consistency with the covered agreements of the US measures "taken to comply" with earlier DSB recommendations and rulings in this dispute in respect of which there are not yet panel and Appellate Body findings and recommendations which are *res iudicata* between the parties.[3]

3. The only measure that fits the EC's description[4] – *i.e.*, the only measure with respect to which there are not yet findings and recommendations – is the AJCA, and the only portions of the AJCA that the EC, in its panel request, identifies as "The Subject of the Dispute" are sections 101(d) and (f). As the United States has previously demonstrated, sections 101(d) and (f) pertain exclusively to the ETI Act tax exclusion, and have nothing to do with the FSC tax exemption.

4. With respect to the second part of the Panel's question, the EC asserts that it is seeking only findings, and not recommendations. However, this assertion is contradicted by the EC's prior submissions. In the "Conclusion" section of its first written submission, the EC asks the Panel "to recommend that the United States withdraw its prohibited subsidies without delay and otherwise bring the measures into conformity with the *WTO Agreement*."[5] In its rebuttal submission, the EC repeats this request when it states that it "maintains its request to the Panel and its conclusions set out in its first written submission."[6]

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[1] EC Replies to Panel Questions to the Parties, 1 July 2005, para. 2 (hereinafter "EC Replies").

[2] *See First Written Submission of the United States of America*, June 2, 2005, para. 20 ("U.S. First Submission); *Opening Statement of the United States of America at the Substantive Meeting of the Panel*, June 30, 2005, paras. 21-24 ("U.S. Opening Statement"); and *Answers of the United States to the Panel's Questions to the Parties in Connection with the Substantive Meeting*, July 11, 2005, paras. 8-11, 37-40 (hereinafter "U.S. Answers").

[3] EC Replies, para. 2.

[4] Although the Panel need not resolve this issue, the United States notes that it does not agree with the implication in the quoted EC statement that the principle of *res judicata* is applicable for purposes of WTO dispute settlement.

[5] *First Written Submission of the European Communities*, 19 May 2005, para. 69 ("EC First Submission").

[6] *Rebuttal Submission of the European Communities*, 16 June 2005, para. 27.

9. What are the specific "recommendations and rulings" at issue within the meaning of Article 21.5 of the *DSU* (i.e. from the original and/or first compliance proceedings)?

5. Having reviewed the EC's answer to this question, the United States continues to maintain that the recommendations and rulings at issue are those that the Appellate Body made in the first Article 21.5 proceeding and that the DSB subsequently adopted.[7]

10. The EC Panel request states, in part:

"In particular, the European Communities respectfully requests the Panel to find the following:

that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*."

Do Parties consider that Articles 19.1 and 21.1 of the DSU give rise to independent and enforceable obligations? If so, what is their nature and extent?

6. In its answer to this question, the EC asserts that "Article 19.1 and 21.1 embody implicit obligations ... ."[8] The United States disagrees with the EC assertion, and refers the Panel to the U.S. answer to this question.[9] In addition, the United States notes that Australia and Brazil also disagree with the EC assertion.[10] Finally, the United States notes that the EC does not explain what an "implicit" obligation is, nor does it explain how Articles 19.1 and 21.1 give rise to such an obligation.

7. Although the Panel's question did not ask about Article 4.7 of the SCM Agreement, the EC nonetheless addressed Article 4.7 in its answer. As with Articles 19.1 and 21.1 of the DSU, the EC asserts that Article 4.7 imposes an "implicit obligation" – whatever that may be – on the Member found to have provided a prohibited subsidy. Although the EC acknowledges that "the wording of Article 4.7 expressly refers only to a duty of the panel to issue a recommendation [to

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[7] *See* U.S. Answers, para. 13.

[8] EC Replies, para. 11.

[9] U.S. Answers, para. 14.

[10] *Australia Response to the Questions from the Panel to Australia*, 11 July 2005, Answer to Question 10; *Responses by Brazil to Questions Posed by the Panel*, 11 July 2005, Answer to Question 10.

withdraw the subsidy]", the EC claims that in *US – FSC (Article 21.5)* the Appellate Body interpreted Article 4.7 so as to create an "implicit obligation."[11]

8. The United States disagrees with the EC position. First, Article 4.7 of the SCM Agreement, like Articles 19.1 and 21.1 of the DSU, is not addressed to Members.[12] Second, the Appellate Body cannot create an "implicit obligation" because Article 19.2 of the DSU expressly provides that in its findings and recommendations, the Appellate Body "cannot add to or diminish the rights and obligations provided in the covered agreements."

9. Third, in the paragraph of *US – FSC (Article 21.5)* cited by the EC, the Appellate Body states that: "Article 4.7 of the *SCM Agreement* requires prohibited subsidies to be withdrawn 'without delay', and provides that a time-period for such withdrawal shall be specified by the panel."[13] This passing statement by the Appellate Body is not inconsistent with the notion that a panel must make a recommendation to trigger the effects of Article 4.7.

10. Finally, any doubt as to what the Appellate Body meant is removed by *EC – Sugar Subsidies*. There, the Appellate Body stated that

> in declining to rule on the Complaining Parties' claims under Article 3 of the *SCM Agreement*, the Panel failed to discharge its obligation under Article 11 of the DSU by failing to make "such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements", namely, a recommendation or ruling by the DSB pursuant to Article 4.7.[14]

Thus, the Appellate Body is of the view that Article 4.7 imposes an obligation on panels, not Members.

> **11. How would a general obligation to bring a measure into conformity relate to the recommendation of the first 21.5 Appellate Body report: "...and 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*."**

11. The United States has several comments regarding the EC's answer to this question. First, with respect to the quoted language from paragraph 257 of the Article 21.5 Appellate Body report, the EC continues to insist that the reference to the DSB's recommendations and rulings

[11] EC Replies, para. 10.
[12] U.S. Answers, para. 32.
[13] *US – FSC (Article 21.5) (AB)*, para. 229.
[14] *EC – Sugar Subsidies (AB)*, para. 335 (emphasis added).

made pursuant to Article 4.7 of the SCM Agreement pertain to the ETI Act exclusion.[15] However, as the United States previously has explained:

(1) in the first Article 21.5 proceeding, the only allegation that the EC made regarding a failure to withdraw the subsidy within the meaning of Article 4.7 pertained to section 5 of the ETI Act and the FSC tax exemption;

(2) consistent with what the EC argued, the only finding that the Article 21.5 panel and the Appellate Body made regarding a failure to withdraw the subsidy within the meaning of Article 4.7 pertained to section 5 of the ETI Act and the FSC tax exemption; and

(3) when one reads the quoted language from paragraph 257 together with paragraph 256 of the Article 21.5 Appellate Body report, it is apparent that the Appellate Body's recommendation under Article 4.7 pertained solely to section 5 of the ETI Act and the FSC tax exemption.[16]

The EC has never responded to the U.S. argument.

12. Second, with respect to the EC's reference to the U.S. statement at a DSB meeting,[17] nothing in that statement can be construed as an acknowledgment by the United States that there was an Article 4.7 recommendation or ruling to withdraw the ETI Act tax exclusion. Instead, the United States merely made the factual statement that it had withdrawn the subsidy.

13. Finally, with respect to the EC's discussion of the relationship between a recommendation to "withdraw the subsidy" and a recommendation to "bring the measure into conformity", the EC asserts that "[w]ithdrawal is a special way of bringing a WTO-inconsistent measure into conformity."[18] The United States disagrees that "withdrawal" is merely a subset of "bringing a WTO-inconsistent measure into conformity." As the United States has explained, prior panels and the Appellate Body have recognized that the two recommendations are different.[19] While it may be true that, in a given case, a single action may serve to satisfy both types of recommendations,[20] the two recommendations are distinct.

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[15] EC Replies, para. 14.
[16] *See* U.S. Opening Statement, paras. 11-18.
[17] EC Replies, para. 15.
[18] EC Replies, para. 18.
[19] *See* U.S. Answers, paras. 16-17.
[20] U.S. Answers, para. 20.

15. Is the European Communities requesting this Panel to make a ruling on Article 5 of the ETI Act? If so, what are the applicable obligations ?

14. In its answer to this question, the EC attempts to respond to the U.S. argument that the EC's claims regarding the grandfathering of the FSC tax exemption are not within the Panel's terms of reference. The EC says that "section 5 of the ETI Act is not repealed by section 101 of the JOBS Act."[21] However, section 2 of the EC's panel request – which, again, purports to describe "The Subject of the Dispute" – complains specifically about what section 101 "contains", not what it does not "contain," as a result of sections 101(d) and (f).[22] Thus, the EC panel request simply cannot be construed as including a claim that the AJCA fails to "contain" a provision repealing section 5 of the ETI Act.

15. In addition, the EC argues that any error by the EC should be excused due to an alleged lack of impairment of the U.S. ability to defend itself.[23] However, where, as here, a matter is not within a Panel's terms of reference because a claim, a measure or both are not included in the panel request, there is no need for a responding Member to show prejudice.[24] For example, in *US – OCTG from Mexico*, the panel found that a particular claim by Mexico was not within its terms of reference, even though the United States had not made any preliminary objection to that effect. According to the panel, "we consider this issue to be 'a defect that, by its very nature, deprives a panel of its authority to deal with and dispose of a matter, and that, accordingly, ... [it is] one which a panel must examine even if both parties to the dispute remain silent thereon."[25] Thus, without considering whether or not the United States had been prejudiced, the panel declared that it would make no findings with respect to the claim in question.

20. Is the EC complaining about the time the US has taken beyond the original implementation period? If so, what are the relevant WTO obligations?

16. In its answer to this question, the EC asserts that it "is simply requesting a finding that the JOBS Act has not brought about compliance ... ."[26] The United States disagrees with this assertion, because it does not accurately reflect the Panel's terms of reference, which are limited to the transition provisions of the AJCA regarding the ETI Act tax exclusion. As previously explained, the EC's panel request does not complain about the AJCA in general, but rather about two specific provisions of the AJCA – sections 101(d) and (f) – that establish transition rules for the ETI Act tax exclusion.

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[21] EC Replies, para. 21.

[22] WT/DS108/29, 14 January 2005, page 2.

[23] EC Replies, para. 23.

[24] Although the Panel need not address this issue, the United States notes that it disagrees with prior panel and Appellate Body reports that have found that a failure to present the problem clearly within the meaning of Article 6.2 of the DSU can be excused by the absence of prejudice to the responding Member.

[25] *US – OCTG from Mexico*, para. 7.20 (brackets and ellipses in original).

[26] EC Replies, para. 30.

23. If an Article 21.5 *DSU* panel does not have the authority to alter previously adopted recommendations and rulings, what are the implications for this case of the purported lack (in the first Article 21.5 panel report) of any explicit recommendation under Article 4.7 of the *SCM Agreement*?

17. In its answer to this question, the EC asserts that a panel can make additional findings, if necessary to resolve the dispute. The United States notes, however, that the potential findings a panel can make are limited by its terms of reference. Thus, for the reasons discussed elsewhere, this Panel may not make findings regarding the grandfathering of the FSC tax exemption because this is not a matter that is within the Panel's terms of reference.

24. Does an Article 21.5 *DSU* panel dealing with prohibited subsidies have the mandate and/or the obligation to make a recommendation under Article 4.7 of the *SCM Agreement*?

18. In its answer to this question, the EC repeats its assertion that Article 4.7 of the SCM Agreement imposes an "implicit obligation" on Members.[27] For the reasons set forth above in connection with the U.S. comments on the EC's answer to Question 10, the United States disagrees with the EC assertion.

25. How does this relate to the issue of whether that panel has the mandate and/or the obligation to "specify in its recommendation the time period within which the measure must be withdrawn" under Article 4.7 of the *SCM Agreement*?

19. In its answer to this question, the EC implies that a panel would have the discretionary authority to specify a time period for withdrawal.[28] The United States disagrees. Because an Article 21.5 panel does not have a mandate to recommend withdrawal under Article 4.7, it also would not have a mandate to specify a time period for withdrawal.[29]

29. What is your opinion of any implications for this Panel of the first Article 21.5 panel's view that the original recommendation "remains operative"?[3]

[3] **"The Panel, noting that the United States did not respond to this EC comment and that practice in this area has not been entirely consistent in Article 21.5 *DSU* proceedings, is of the view that the original recommendation adopted by the DSB on 20**

[27] EC Replies, para. 35 ("Members' obligation to withdraw a prohibited subsidies is already implied ... .").
[28] EC Replies, para. 37.
[29] U.S. Answers, paras. 29-31.

> **March 2000 remains operative. We have therefore deleted what was originally paragraph 9.3 of the interim report...." (footnote omitted)**

20. In its answer to this question, the EC accuses the United States of elevating form over substance.[30] The United States simply notes that in the first Article 21.5 proceeding, the Appellate Body's findings and recommendations – and, thus, the recommendations and rulings of the DSB – were directly shaped by the manner in which the EC chose to pursue its complaint. Specifically, the EC did *not* claim that the ETI Act tax exclusion constituted a failure to comply with the DSB's earlier recommendation under Article 4.7 to withdraw the subsidy. Instead, the EC claimed only that the transition provisions for the FSC tax exemption in section 5 of the ETI Act gave rise to a failure to comply with the DSB's recommendation under Article 4.7.

> **31. The third section of the EC Panel request, entitled "Request for establishment of a Panel", requests the Panel to find the following:**
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> **– "that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has *failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002*, as required by Articles 19.1 and 21.1 of the *DSU*." (emphasis added)**
>
> **Does the text in italics encompass the grandfathering of the original FSC subsidies? Why or why not?**

21. In its answer to this question, the EC argues that the use of the term "prohibited subsidies" in the quoted portion of the EC panel request is a reference to the grandfathering of the FSC tax exemption under section 5 of the ETI Act. Therefore, according to the EC, the alleged failure to repeal the grandfather provision for the FSC tax exemption is within the Panel's terms of reference.

22. The EC argument fails, however, because it fails to consider the panel request as a whole.[31] As the United States has explained, section 2 of the EC panel request states that the subject matter of the dispute is sections 101(d) and (f) of the AJCA. Sections 101(d) and (f) contain transition provisions with respect to the ETI Act tax exclusion. Therefore, the subject matter of the dispute is the ETI Act tax exclusion, and the reference to "prohibited subsidies" in the quoted portion of the EC panel request can only be a reference to the ETI Act tax exclusion.

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[30] EC Replies, para. 41.

[31] *US – German Corrosion-Resistant Steel (AB)*, para. 127 ("Moreover, compliance with the requirements of Article 6.2 [of the DSU] must be determined on the merits of each case, having considered the panel request as a whole ... ."); *see also US – OCTG from Argentina (AB)*, para. 169.