EXECUTIVE SUMMARY OF U.S. APPELLANT SUBMISSION

1. **Introduction.** The ETI Panel Report is analytically flawed and expands the meaning of provisions of the SCM Agreement. In addition, the Panel's analysis carries with it one of two broad implications, neither of which can be correct. One implication is that European tax systems that incorporate territorial principles would be inconsistent with the SCM Agreement. The alternative implication is that WTO subsidy rules incorporate a bias favoring one type of tax system over another.

2. The United States does not believe that the WTO subsidy rules are so free from ambiguity as to compel such a discriminatory outcome. The Panel utterly failed to address this issue, and it is imperative that the Appellate Body do so in this appeal. Although the United States does not believe this to be the case, if the Appellate Body concludes that the WTO subsidy rules are inconsistent with the principle of non-discrimination, then it should say so clearly. A failure by the Appellate Body to address this issue but would render a fiction the supposed freedom of each Member under WTO rules "to choose a particular type of tax system."

3. **The Panel Erred in Finding that the ETI Act Confers a Subsidy.** The Panel misapplied the comparison test established by the Appellate Body in *FSC (AB)*. First, the Panel oversimplified the U.S. tax code and misconstrued the relationship between section 61 and other provisions of the IRC. The Panel ignored the fact that "gross income" is defined not in section 61 alone, but in other parts of the IRC. As a result, the Panel failed to identify the proper "prevailing domestic standard" for purposes of the comparison test called for by the Appellate Body.

4. Second, the Panel created a corollary to the Appellate Body's standard based on a distinction between a "specific" and a "general" tax exclusion. The Panel stated that a Member may exclude a category of income only if it excludes "all of the income" in that category. The Panel cites no authority for this proposition, and the Panel's analysis improperly interchanges Articles 1 and 2 of the SCM Agreement.

5. Third, the Panel created another corollary to the Appellate Body's standard by stating that a tax exclusion must derive from "some kind of overall rationale and coherence" in order to avoid foregoing revenue that is otherwise due. Again, the Panel cites no authority for this proposition, and the proposition is inconsistent with the Appellate Body's prior statement that a Member is free to tax or not tax the categories of revenues that it chooses.

6. The Panel's new corollaries to the Appellate Body's standard, if not corrected, would have perilous systemic implications. Few tax systems in the world would pass muster under these corollaries. For example, exclusions provided by various EC member States are neither uniform, predictable by logic alone, or unqualified.

7. Fourth, the Panel failed to apply its own "but for" test, a test which the Appellate Body had affirmed. If the Panel had applied this test, it would have found that the ETI Act does not

forego revenue that is otherwise due, because the Act's exclusion of extraterritorial income is not a narrow tax-reducing rule.

8. Finally, the Panel erroneously found that extraterritorial income excluded by the Act necessarily would be taxed if the ETI Act did not exist. The Panel based this finding on the fact that, absent the ETI Act, extraterritorial income would constitute "gross income." However, the Panel ignored other provisions of the IRC and the fact that there are a number of reasons why, under the U.S. system of taxation, "gross income" may not be taxed.

9. **The Panel Erred in Finding that the ETI Act's Exclusion Is Contingent Upon Export Performance.** The EC's Article 3.1(a) claim is an exclusively *de jure* one. However, neither the text of the Act nor any necessary implication from that text supports a finding of *de jure* export contingency. By going beyond the text of the Act to an analysis of its supposed operation, the Panel improperly converted its *de jure* inquiry into a *de facto* challenge to the Act.

10. The Panel incorrectly transformed Article 3.1(a) into a "reverse national treatment" requirement under which domestic sales must be afforded no less favorable treatment than exports or other foreign sales. Such a requirement is not present in the text of Article 3.1(a). Other provisions of the WTO Agreement, such as Article III:4 of GATT 1994 and Article XVII of GATS, indicate that the drafters knew how to write such a requirement had they intended one.

11. The ETI Act is export-neutral, permitting excluded income to be earned without exporting. In finding the Act to be export-contingent, the Panel improperly said that a measure violates Article 3.1(a) if exportation is *one* way of obtaining a subsidy. However, the text of Article 3.1(a) and Appellate Body jurisprudence indicate that the mere fact that exporters are capable of earning excluded income is insufficient to establish that the exclusion is tied to, or contingent upon, exportation. Moreover, the Panel ignored the phrase in Article 3.1(a) which reads "whether solely or as one of several other conditions". This phrase means that exportation constitutes a prohibited contingency only where exportation is a mandatory condition.

12. In addition, the Panel incorrectly concluded that an export-contingent subsidy cannot be cured by expanding the universe of eligible recipients. This finding, if allowed to stand, would have a significant impact on both tax measures and subsidy programs around the world. Moreover, the Panel's analysis is internally inconsistent, because the Panel elsewhere acknowledged that the ETI Act could be saved by expanding it to include sales in the United States.

13. Finally, the Panel fabricated an export contingency by artificially bifurcating the ETI Act and considering it only as it relates to U.S.-produced goods. The Panel improperly examined the Act as if it had one category of treatment for U.S.-produced goods and a different one for foreign-produced goods. In so doing, the Panel created a distinction not found in the Act, which was purposefully drafted to provide tax relief based on export-neutral criteria.

14. **The Panel Erred in Finding that the ETI Act Is Not a Measure to Avoid Double Taxation Under the Fifth Sentence of Footnote 59.** The Panel read into the fifth sentence of footnote 59 detailed criteria for qualification as a measure to avoid double taxation, and, in so doing, established a new double taxation avoidance code. This supposed exercise of "interpretation" exercise constitutes an extraordinary and erroneous legislative act.

15. By way of background, footnote 59 is attached to paragraph (e) of Annex I to the SCM Agreement. Paragraph (e) applies to export-contingent tax measures. Footnote 59 qualifies paragraph (e) by permitting certain practices, notwithstanding that they are export-contingent. For example, the first sentence of footnote 59 permits export-contingent tax deferrals with interest. The Appellate Body has recognized that this sentence is "specifically related to" and "qualifies" paragraph (e). Likewise, the fifth sentence of footnote 59 expressly permits measures to avoid double taxation even if such measures could otherwise be said to confer "subsidies" that are export-contingent.

16. The fifth sentence does not define "double taxation" or indicate the types of measures that might appropriately serve to "avoid" it, but the ordinary meaning of the text would encompass measures to prevent the same item or type of income from being subjected to tax twice. Similarly, the fifth sentence does not define "foreign-source income," but the ordinary meaning of the term would include income arising, at least in part, outside the borders or territory of the Member instituting a measure to avoid double taxation.

17. While the fifth sentence does not identify the types of measures that may be used to avoid double taxation, two general categories of measures are well-accepted and used throughout the word for this purpose: the exemption (or non-taxation) method and the credit method. International tax conventions recognize that countries are free to use one or both methods, and that the methods used vary from country to country.

18. The ETI Act achieves avoidance of double taxation through the exclusion of extraterritorial income. The Act's legislative history expressly identifies double taxation avoidance as a primary objective of the Act, and the Act was designed to parallel aspects of the territorial systems of many EC member States. "Extraterritorial income" under the Act is income derived from foreign transactions, and, as such, comes within the ordinary meaning of "foreign-source income."

19. The Panel incorrectly imposed on the United States the burden of proving that the ETI Act is a measure to avoid double taxation. The Panel ignored the Appellate Body's teaching in *EC Hormones* that the burden of proof does not shift from the complainant to the respondent simply because a provision might be deemed as an "exception", and that where related provisions define key elements of the violations alleged, they form part of the elements of the *prima facie* showing that a complainant must make.

20. In rejecting the Act as a measure to avoid double taxation, the Panel articulated four new principles and a new standard of review that cannot be found in the fifth sentence of footnote 59. First, the Panel incorrectly stated that such a measure must apply to *all* income that is potentially subject to double taxation. However, no such requirement can be found in the text of the fifth sentence. If the Panel's statement were correct, then none of the leading methods for double taxation avoidance, as actually applied by countries throughout the world, would qualify under the fifth sentence.

21. Second, the Panel improperly found that to qualify under the fifth sentence, a measure cannot encompass income that might *not* be treated as taxable in other jurisdictions. Aside from the fact that the text of the fifth sentence affords Members broad flexibility in fashioning double taxation relief, the Panel's finding is inconsistent with its own recognition that "'precision' in the relief of double taxation is 'probably impossible' given the many differences in taxation systems from one country to another and the many different ways that international commerce can be structured."

22. Third, the Panel improperly created a requirement that a bona fide measure to avoid double taxation must contain a "permanent establishment" requirement. There is no international consensus, however, that countries should or must rely on the concept of a "permanent establishment" in imposing tax. Moreover, nothing in the SCM Agreement or footnote 59 imposed a "permanent establishment" requirement. The United States provided the Panel with examples of countries that do not rely on a "permanent establishment" standard in defining their taxing jurisdiction, one example being the United States itself. The Panel's adoption of a "permanent establishment" requirement denies WTO Members the ability to take measures to avoid double taxation that may befall enterprises that are taxed even though they do not have a "permanent establishment" in a foreign jurisdiction.

23. Fourth, the Panel incorrectly stated that a country cannot institute a measure to avoid double taxation if it has an extensive system of bilateral tax treaties. Not only is this proposition not supported by the text of the fifth sentence, it ignores the fact that most, if not all, WTO Members employ a mix of credits, exemptions, and treaties for the relief of double taxation.

24. In addition to articulating new principles that cannot be derived from the text of the fifth sentence of footnote 59, the Panel created a new standard for reviewing conformity with the fifth sentence: the "reasonable legislator" standard. In so doing, the Panel ignored the Appellate Body's teaching in *EC Hormones*, and inappropriately relied on jurisprudence involving other provisions of covered agreements that are altogether different from footnote 59. It is not for the Panel to substitute its judgment for that of a national legislature as to whether a measure is intended to avoid double taxation. Instead, the question is whether or not a measure serves to avoid double taxation.

25. Should the Appellate Body reverse the Panel and find that the ETI Act is a measure to avoid double taxation within the meaning of the fifth sentence, it should complete the Panel's analysis and find that the ETI Act is not a prohibited subsidy by virtue of footnote 5 of the SCM Agreement. Based on the ordinary meaning of the terms used, footnote 5 indicates that a measure need only be included or mentioned in Annex I in such a way as to be properly assigned or classified as not being an export subsidy. Indeed, a prior panel has suggested that a measure to avoid double taxation within the meaning of the fifth sentence would be covered by footnote 5.

26. Alternatively, if the Appellate Body should sustain the Panel's finding that the ETI Act is not a measure to avoid double taxation within the meaning of the fifth sentence, the United States requests that the Appellate Body provide clear guidance with respect to the particular aspects of the Act that render the Act deficient. The Panel's approach, which fails to identify dispositive issues, provides insufficient guidance to allow for a mutually acceptable resolution of this dispute.

27. **The Panel Erred in Finding that the ETI Act Is Inconsistent with U.S. Obligations under Articles 8 and 10.1 of the Agreement on Agriculture.** The Panel's finding that the ETI Act constitutes an export subsidy under Article 1(e) of the Agriculture Agreement was based entirely on its finding under the SCM Agreement. Because the Panel's finding of an export subsidy for purposes of the SCM Agreement was in error, the Panel's finding of an export subsidy for purposes of the Agriculture Agreement also was in error.

28. **The Panel Erred in Finding that the ETI Act Is Inconsistent with Article III:4 of GATT 1994.** The 50 percent rule on certain foreign value can be satisfied without any portion of the fair market value of a product being derived from U.S. sources. In finding the 50 percent rule to be inconsistent with GATT Article III:4, the Panel failed to establish a meaningful causal link between that rule and the discrimination against imports alleged by the EC. The 50 percent rule is a measure of general application, and is not directed at imports. The relationship between the measure at issue and the alleged effect on imported products cannot be so attenuated that any adverse effect on imported products incidental to the measure constitutes a violation of Article III:4.

29. **The Panel Erred in Finding that the ETI Act's Transition Rules Are Inconsistent with the Full Withdrawal of the FSC Subsidies.** The provision of transition relief is customary in the United States (and in other countries) when tax laws upon which taxpayers have relied in structuring transactions are changed. Failure to maintain a consistent practice of transition relief would result in significant and unjustified transaction costs for taxpayers.