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United States – Tax Treatment for "Foreign Sales Corporations": Second Recourse to Article 21.5 of the DSU by the European Communities

(AB-2005-9)

Oral Statement of the United States of America at the Meeting of the Appellate Body

January 9, 2006

Introduction

1. Mr. Chairman and members of the Division, the United States appreciates this opportunity to present its views.

2. At the outset, however, we wish to emphasize that we are not challenging all of the Panel's findings, but instead have limited our appeal to two issues that we consider to be of systemic importance. The EC appears to share our view that it is important "to avoid the creation of troublesome precedents."[1] However, the EC resists the U.S. substantive position on these issues at every turn. This is unfortunate, because the issues we have raised are important ones that go well beyond this dispute, and we would have hoped that the EC could have looked for points of agreement with us.

3. That not being the case, let us turn to the issues themselves. In today's statement, we will focus on the matters addressed in the U.S. appeal, beginning with the Panel's erroneous treatment of the EC's claim under Article 4.7 of the SCM Agreement.

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[1] *Appellee's Submission by the European Communities*, 9 December 2005, para. 15 ("EC Appellee Submission").

Article 4.7 of the SCM Agreement

4. With respect to Article 4.7, the central issue is whether the obligation on Members to refrain from granting or maintaining prohibited subsidies is found exclusively in Article 3 of the SCM Agreement, or whether a panel that makes a recommendation under Article 4.7 thereby creates a similar obligation and imposes it on the responding Member. This issue is raised in both the U.S. and the EC appeals. The United States believes that the obligation is found exclusively in Article 3. The Panel and the EC appear to believe – incorrectly – that the obligation also arises from recommendations made pursuant to Article 4.7.

5. As explained in the U.S. appellant submission, the Panel made a fundamental error in concluding that the United States had failed to implement a DSB recommendation and ruling under Article 4.7 to withdraw the ETI tax exclusion. This error flowed from several separate, but interrelated, legal errors committed by the Panel. While the EC, in its appellee submission, has sought to explain away the Panel's errors, the EC's efforts are unconvincing. Let us go through the Panel's errors, and the EC's defense thereof, in order.

6. First, there is the Panel's improper equation of the recommendation called for by Article 4.7 with a continuing obligation on Members to withdraw prohibited subsidies. As explained by the United States, the Panel's analysis ignores the text of Article 4.7 and, in particular, the facts that: (1) Article 4.7 is directed to panels and not to Members; and (2) Article 4.7 refers to the measure considered by the original panel – in this case, the FSC tax

exemption – and not any future measures taken to comply that might be found to constitute a prohibited subsidy.[2]

7. In its response, the EC ignores the text of Article 4.7. Instead, the EC tries to shift the discussion to Article 21.5 of the DSU, asserting that the focus of an Article 21.5 proceeding is to assess whether there has been compliance with an earlier recommendation and ruling.[3] However, the EC discussion simply begs the question of what a recommendation under Article 4.7 is and to what it pertains. In short, the EC fails to respond to the U.S. analysis of the text of Article 4.7.

8. The second error was the Panel's mischaracterization of the task of a panel under Article 21.5. Ignoring the text of Article 21.5, the Panel declared that the task of an Article 21.5 panel is to decide whether a Member has "fixed the problem." The Panel then declared that the "problem" was not the FSC tax exemption, but instead included any future measures that might be found to be "prohibited subsidies." Again, the Panel effectively rewrites Article 4.7, thereby blurring the distinction between the original measure and measures taken to comply.[4]

9. In defending the Panel, the EC simply repeats its argument that the focus of an Article 21.5 proceeding is to assess compliance with an earlier recommendation and ruling.[5] Again, however, the EC ignores the text of Article 4.7 of the SCM Agreement, which states that the subject of an Article 4.7 recommendation is the measure "found to be a prohibited subsidy."

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[2] *Appellant Submission of the United States of America*, November 21, 2005, paras. 23-25 ("U.S. Appellant Submission").

[3] EC Appellee Submission, paras. 34-37.

[4] *See* U.S. Appellant Submission, paras. 26-31.

[5] EC Appellee Submission, paras. 38-39.

The EC argument begs the question of how the Panel could properly transform a recommendation under Article 4.7 to withdraw a measure "found to be a prohibited subsidy" into a recommendation to "fix the problem" and withdraw "prohibited subsidies." Although the EC invokes the findings of the Appellate Body in *Brazil – Aircraft (Article 21.5)* to support its view that an Article 4.7 recommendation applies to future measures,[6] it appears that neither the parties, the panel nor the Appellate Body in that dispute considered the differences between Articles 3 and 4.7 of the SCM Agreement and the obligations that each of them does or does not impose. By contrast, the Appellate Body in *Canada – Aircraft (Article 21.5)* noted that "we disagree with the Article 21.5 panel that the scope of these Article 21.5 dispute settlement proceedings is limited to 'the issue of whether or not Canada has implemented the DSB recommendation'. . . That recommendation to 'withdraw' the prohibited export subsidy did not, of course, cover the new measure – because the new measure did not exist when the DSB made its recommendation."[7]

10. The Panel's third error was that it ignored the fact that the only finding made by the first Article 21.5 Panel concerning Article 4.7 pertained exclusively to the FSC tax exemption and section 5 of the ETI Act. The limited scope of the Article 4.7 finding was consistent with the fact that the only finding sought by the EC with respect to Article 4.7 in the first Article 21.5 proceeding related to section 5 of the ETI Act. While the Panel in its report before the Appellate Body today declared the 2000 DSB recommendation under Article 4.7 as "operative," the

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[6] EC Appellee Submission, paras. 43-44.

[7] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft: Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted on 4 August 2000, para. 40 (internal emphasis omitted).

Panel's failure to consider what the EC argued and what the Panel and the Appellate Body found in the first Article 21.5 proceeding begs the question: "operative with respect to what?"[8]

11. In defending the Panel's third error, the EC completely ignores what it argued in the first Article 21.5 proceeding and what the Panel found.[9] Instead, the EC says, these factors are irrelevant, because the EC says that once the ETI tax exclusion was found to be inconsistent with provisions of various covered agreements, a new recommendation under Article 21.5 was not needed for the United States to be under an obligation to withdraw the ETI tax exclusion.[10]

12. *But that is fundamentally the U.S. point.* The obligation of the United States not to maintain the ETI tax exclusion is found in the provisions of the covered agreements with which the exclusion was found to be inconsistent. No such "obligation" was created by the original Panel's recommendation under Article 4.7 or the recommendation of the Appellate Body in the first Article 21.5 proceeding. (And indeed, pursuant to DSU Articles 3.2 and 19.2, no such "obligation" could have been created by those recommendations.)

13. In addition, the EC defends the Panel's third error by asserting that the Appellate Body's recommendation in the first Article 21.5 proceeding to bring the ETI measure into conformity has to be interpreted as including a recommendation of withdrawal under Article 4.7. The EC does not clearly explain the basis for this assertion. However, the EC's logic appears to be that (1) the SCM Agreement was one of the agreements covered by the Appellate Body's

[8] U.S. Appellant Submission, paras. 32-38.
[9] EC Appellee Submission, paras. 45-47.
[10] EC Appellee Submission, para. 48.

recommendation; (2) Article 4.7 is contained in the SCM Agreement; and (3) Article 4.7 imposes an obligation on Members to withdraw prohibited subsidies.[11]

14. The problem with this argument is, again, that Article 4.7 does not impose obligations on Members. In addition, in paragraph 257 of the Appellate Body report in *US – FSC (Article 21.5)*, the Appellate Body's recommendation to bring the "ETI measure" into conformity was expressly limited – insofar as the SCM Agreement is concerned – to Article 3.1(a) of the SCM Agreement.

15. Finally, the EC asserts that the United States has tried to turn "findings" into "recommendations."[12] To the contrary, the U.S. point is simply that the recommendations set forth in paragraph 257 have to be interpreted in light of the Appellate Body's findings in paragraph 256, the findings of the first Article 21.5 Panel and the EC's own claims and arguments in the first Article 21.5 proceeding. When so interpreted, it is clear that the Appellate Body's recommendation under Article 4.7 was limited to section 5 of the ETI Act.

16. The Panel's final error regarding Article 4.7 was its erroneous conclusion that the effective operation of the WTO dispute settlement system would be entirely undermined if Article 4.7 recommendations were not interpreted as applying to new subsidies.[13] The EC's only defense of this error by the Panel is to misstate the U.S. argument.

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[11] EC Appellee Submission, para. 52.
[12] EC Appellee Submission, para. 54.
[13] *See* U.S. Appellant Submission, paras. 39-43.

17. According to the EC, the United States argued before the Panel that it had no obligation to withdraw the ETI tax exclusion.[14] The EC's assertion is just wrong. The United States expressly acknowledged to the Panel that it had implementation obligations regarding the ETI tax exclusion, but that these obligations arose under provisions other than Article 4.7.[15] Moreover, in the portions of the U.S. first written submission to the Panel cited by the EC – paragraphs 2 and 10 – it is clear that the United States was talking about the absence of an obligation *under Article 4.7*.[16]

18. In summary, based on the EC appellee submission, the United States and the EC appear to be in agreement that the United States had an obligation not to maintain the ETI tax exclusion, as the Panel found when it issued its finding of inconsistency of that exclusion with Article 3.1(a) of the SCM Agreement, a finding which the Appellate Body affirmed. The only point of disagreement is whether Article 4.7 imposed an additional obligation on the United States. In the view of the United States, Article 4.7 – like its generic counterpart in the DSU, Article 19.1 – does not impose obligations on Members. Moreover, the facts of this dispute indicate that there was no recommendation under Article 4.7 concerning the ETI tax exclusion. Therefore, the Appellate Body should reverse the Panel's finding that the United States failed to implement fully the DSB's recommendations and rulings under Article 4.7 of the SCM Agreement.

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[14] EC Appellee Submission, para. 57.

[15] *See Opening Statement of the United States of America at the Substantive Meeting of the Panel*, June 30, 2005, para. 8.

[16] *See* EC Appellee Submission, para. 57, note 46, citing to *First Written Submission of the United States of America*, June 2, 2005, paras. 2 and 10.

Section 5(c) of the ETI Act

19. We now would like to address briefly the other major error committed by the Panel; namely, the Panel's conclusion that section 5(c) of the ETI Act was within its terms of reference.

20. The EC sasy that the United States has failed to consider the EC's panel request as a whole.[17] To the contrary, it is the Panel and the EC that have engaged in a selective reading of the EC's panel request. We have discussed the Panel's errors in our appellant submission, so today we will discuss the EC's defense of the Panel, which basically is as follows.

21. The EC panel request consists of three sections.[18] Section 1 is entitled "The History of the Dispute." Section 2 is entitled "The Subject of the Dispute." Section 3 is entitled "Request for the Establishment of a Panel." Sections 1 and 3 refer to the findings and recommendations and rulings arising out of both the original panel proceeding and the first Article 21.5 proceeding. Because the original proceeding involved the FSC tax exemption, and because the first Article 21.5 proceeding involved the prolongation of the FSC tax exemption by means of section 5(c) of the ETI Act, these references – according to the EC – demonstrate that a subject of the EC panel request includes the failure to repeal section 5(c).

22. However, as the United States pointed out in its appellant submission, the EC claims that the ETI tax exclusion is subject to the Article 4.7 recommendation made by the original Panel. Therefore, the fact that sections 1 and 3 of the EC panel request refer to the original and first Article 21.5 proceedings does not shed light on whether this second Article 21.5 proceeding

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[17] *See, e.g.,* EC Appellee Submission, para. 63.
[18] WT/DS108/29 (14 January 2005).

applies to the FSC tax exemption, the ETI tax exclusion, or both.[19] To resolve the lack of precision in sections 1 and 3 regarding the scope of the dispute, one has to look at section 2 of the panel request. Section 2 clearly identifies the "subject of this dispute" as those provisions that section 101 of the AJCA "contains" that "will allow US exporters to continue benefiting from the tax exemptions ... ." As we have previously explained, the only benefits conferred by provisions contained in section 101 of the AJCA is in the form of limited continued availability of the ETI tax exclusion.[20]

23. Tellingly, neither the Panel nor the EC attempt to deal with the fact that section 2 of the EC panel request is expressly limited to what is "contained" in section 101 of the AJCA. Instead, they both ignore what section 2 actually says. In the view of the United States, it is their approach, and not ours, that constitutes a failure to consider the panel request as a whole.

24. In addition, to the extent that the EC is suggesting that its panel request should be subject to different rules than panel requests made in original proceedings (as opposed to Article 21.5 proceedings), the United States notes that the EC's panel request asked for standard terms of reference under Article 7 of the DSU.[21] That in turn shows that the EC meant for its panel request to set out the "matter" before the Panel -- that is, its panel request had to set out the measures at issue and the claims in respect of those measures.

25. Finally, the United States notes Australia's observation that the non-citation of section 5(c) in the EC panel request does not serve to convert a measure found to be WTO-

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[19] U.S. Appellant Submission, para. 52.
[20] U.S. Appellant Submission, paras. 48-50.
[21] WT/DS108/29 (14 January 2005), page 2.

inconsistent into a WTO-consistent measure.[22] The United States agrees, and notes that it made a similar point in its appellant submission.[23] Therefore, we continue to be puzzled by the fact that the Panel engaged in such an interpretative stretch with respect to a measure that already had been found to be WTO-inconsistent.

The EC's Cross-Appeal

26. Finally, with respect to the EC's cross-appeal, we note that the U.S. appellee submission is the latest filing before the Appellate Body. Therefore, we will not repeat the points made in that submission in this statement.

Conclusion

27. In summary, Mr. Chairman and members of the Division, for the reasons we have just stated as well as those in our written submissions, the United States respectfully requests that the Appellate Body reverse the specific findings of the Panel as set forth in our Appellant Submission and reject the contingent claims of error advanced by the EC. We stand ready to address any questions the Appellate Body may have, including questions regarding those issues that, given the time available, we have not been able to address in this statement. Thank you.

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[22] *Third Party Submission of Australia*, 9 December 2005, para. 9.
[23] U.S. Appellant Submission, para. 57, note 52.