

US – FSC¹ (DS108)

| PARTIES | | AGREEMENTS | TIMELINE OF THE DISPUTE | |
|-------------|-----------------------------|--|-----------------------------|--------------------------|
| Complainant | <i>European Communities</i> | <i>ASCM Arts. 1 and 3</i> <i>AA Arts. 10, 8</i> | Establishment of Panel | <i>22 September 1998</i> |
| | | | Circulation of Panel Report | <i>8 October 1999</i> |
| Respondent | <i>United States</i> | | Circulation of AB Report | <i>24 February 2000</i> |
| | | | Adoption | <i>20 March 2000</i> |

1. MEASURE AND PRODUCT AT ISSUE

- **Measure at issue:** US tax exemptions for Foreign Sales Corporations (FSC)² in respect of their export-related foreign-source trade income.
- **Product at issue:** All foreign goods, including agricultural products, affected by the US measure.

2. SUMMARY OF KEY PANEL/AB FINDINGS

- **ASCM Art. 1.1(a): (1): (ii) (definition of a subsidy – financial contribution):** The Appellate Body upheld the Panel's finding that the FSC measure constituted government revenue foregone that was "otherwise due" and, thus a "financial contribution" within the meaning of Art. 1.1.
- **ASCM Art. 3.1(a) (prohibited subsidies – export subsidies):** The Appellate Body upheld the Panel's finding that the FSC measure constituted prohibited export subsidies under Art. 3.1(a) because the FSC exemptions (i) were based upon foreign trade income derived from "export property" and (ii) fell within the language of item (e) (full or partial exemption remission ... of direct taxes ...) of Annex I (Illustrative List of Export Subsidies). The Appellate Body (and the Panel) rejected the US argument that footnote 59 to item (e) exempted the FSC measure from constituting export subsidies.
- **AA Arts. 3.3 (export subsidy commitments) and 9.1 (export subsidies – provision of subsidies to reduce the marketing costs):** The Appellate Body reversed the Panel's finding that the FSC tax exemptions were an export subsidy under AA Art. 9.1(d) and thus violated Art. 3.3. The Appellate Body considered that "income tax liability" that was exempted or reduced under the FSC tax regime could not be considered as "the costs of marketing exports" of agricultural products that were subject to reduction commitment within the meaning of Art. 9.1(d).
- **AA Arts. 10.1 (export subsidies not listed in Art. 9.1) and 8 (export competition commitments):** The Appellate Body found that the United States violated Art. 10.1 and subsequently Art. 8 because through the FSC exemptions, which were unlimited in nature (i.e. no limitation on the amount of the exemption and no discretionary element to its grant), the United States acted inconsistently with its export subsidy commitments under the AA, first, not to provide export subsidies for *scheduled* products (Art. 9.1) *in excess of* the scheduled commitments; and, second, not to provide *any* Art. 9.1 export subsidies for *unscheduled* products.
- **ASCM Art. 4.7 (recommendation to withdraw a prohibited subsidy):** Pursuant to Art. 4.7, the Panel recommended that the United States "withdraw the FSC subsidies without delay. The parties agreed that the date for withdrawal would be 1 November 2000.

3. OTHER ISSUES³

- **Burden of proof (AA Art. 10.3):** The Panel concluded that an AA Art. 10.3 claim contains a special burden of proof whereby once the complainant has proved that the respondent is exporting a certain commodity in quantities exceeding its commitment levels, then the respondent must prove that such an excessive amount of exports is not subsidized. The Panel found that this rule only applies to Members' "scheduled" products.

¹ *United States – Tax Treatment for "Foreign Sales Corporation"*

² FSCs are foreign corporations in charge of specific activities with respect to the sale or lease of goods produced in the United States for export outside the US. In practice, many FSCs are controlled foreign subsidiaries of US corporations, as FSCs affiliated with its United States supplier receive greater benefits under the programme.

³ Other issues addressed: ASCM Art. 4.2 (statement of available evidence); new arguments before the Appellate Body; interpretation of footnote 59 to item (e) of Annex I; panel's jurisdiction (appropriate tax forum); DSU Art. 6.2 (identification of products (agricultural) at issue); order of consideration of ASCM issues.

US – FSC (ARTICLE 21.5 – EC)¹ (DS108)

| PARTIES | | AGREEMENTS | TIMELINE OF THE DISPUTE | |
|-------------|-----------------------------|---|--------------------------------|-------------------------|
| Complainant | <i>European Communities</i> | <i>ASCM Arts. 1, 3 and 4</i> <i>AA Arts. 3, 8 and 10</i> | Referred to the Original Panel | <i>20 December 2000</i> |
| | | | Circulation of Panel Report | <i>20 August 2001</i> |
| Respondent | <i>United States</i> | | Circulation of AB Report | <i>14 January 2002</i> |
| | | | Adoption | <i>29 January 2002</i> |

1. MEASURE TAKEN TO COMPLY WITH THE DSB RECOMMENDATIONS AND RULINGS

- The US “FSC Repeal and Extraterritorial Income Exclusion Act of 2000” (the “ETI” Act).

2. SUMMARY OF KEY PANEL/AB FINDINGS

- **ASCM Art. 3.1(a) (prohibited subsidies – export subsidies):** The Appellate Body first upheld the Panel's finding that a “financial contribution” within the meaning of Art. 1.1(a)(1)(ii) existed under the ETI Act, as the United States had foregone revenue otherwise due when it excluded a portion of foreign-source income from tax obligations under the ETI Act, while taxing foreign-source income under the normal US tax rules. The Appellate Body upheld the Panel's finding that the ETI Act granted subsidies contingent, in law, upon export performance within the meaning of Art. 3.1(a) with respect to property produced within the United States by conditioning the availability of the subsidy on the sale, lease or rent “outside” the United States of the good produced within the United States.
- **ASCM footnote 59 (double taxation exception):** The Appellate Body upheld the Panel's finding that the ETI Act was not justified as a measure to avoid the double taxation of foreign-source income under footnote 59 (fifth sentence), because the Act did not exempt only “foreign-source income”, but exempted both foreign and domestic-source income. The flexibility under footnote 59 does not allow Members to adopt allocation rules that systematically result in a tax exemption for income that has no link with a “foreign” country and that would not be regarded as foreign-source.
- **ASCM Art. 4.7 (recommendation to withdraw a prohibited subsidy):** As the ETI Act included certain transitional rules that effectively extended the application of the prohibited FSC provisions, the Appellate Body upheld the Panel's finding that the United States failed to implement the DSB's recommendations made under Art. 4.7 to withdraw the export subsidies without delay because it could find no legal basis for extending the time-period for the withdrawal of the subsidies.
- **AA Arts. 3.3 (export subsidy commitments), 8 (export competition commitments) and 10.1 (export subsidies not listed in Art. 9.1):** The Appellate Body upheld the Panel's finding that the ETI Act involved export subsidies under AA Art. 1(e) with respect to qualifying property produced within the United States and that it was inconsistent with Art. 10.1 (and thus with Art. 8) by applying export subsidies in a manner that threatened to circumvent US export subsidy commitments under Art. 3.3.
- **GATT Art. III:4 (national treatment – domestic laws and regulations):** The Appellate Body upheld the Panel's finding that the so-called “fair market value rule”² under the ETI Act accorded less favourable treatment to imported products than to like US domestic products in violation of Art. III:4 by providing a “considerable impetus” to use domestic products over imported products for the tax benefit under the ETI Act.

3. OTHER ISSUES³

- **Burden of proof (ASCM footnote 59):** As footnote 59 (fifth sentence) constitutes an exception to the legal regime under Art. 3.1(a) and thus is an “affirmative defence” with respect to measures taken to avoid the double-taxation of foreign-source income, the Appellate Body found that the burden of proof is on the party invoking the exception (i.e. United States in this case).

¹ *United States – Tax Treatment for “Foreign Sales Corporations” – Recourse to Article 21.5 of the DSU by the European Communities*

² Under the “fair market value rule”, any taxpayer that sought an exemption under the ETI Act had to ensure that in the manufacture of qualifying property, it did not “use” imported input products, whose value comprised more than 50 per cent of the fair market value of the end-product.

³ Other issues addressed: third parties' right to rebuttal submissions in Art. 21.5 proceedings (DSU Art. 10.3).

US – FSC (ARTICLE 21.5 – EC II)¹ (DS108)

| PARTIES | | AGREEMENT | TIMELINE OF THE DISPUTE | |
|-------------|-----------------------------|---------------|--------------------------------|--------------------------|
| Complainant | <i>European Communities</i> | ASCM Art. 4.7 | Referred to the Original Panel | <i>17 February 2005</i> |
| | | | Circulation of Panel Report | <i>30 September 2005</i> |
| Respondent | <i>United States</i> | | Circulation of AB Report | <i>13 February 2006</i> |
| | | | Adoption | <i>14 March 2006</i> |

1. MEASURE TAKEN TO COMPLY WITH THE DSB RECOMMENDATIONS AND RULINGS

- The “American Jobs Creation Act of 2004” (the “Jobs Act”)² as well as the continued operation of Section 5 of the ETI Act (i.e. the indefinite grandfather provision for FSC subsidies in respect of certain transactions) that had already been found to constitute “prohibited subsidies” in the first Art. 21.5 proceedings.

2. SUMMARY OF KEY PANEL/AB FINDINGS

- ASCM Art. 4.7 (recommendation to withdraw a prohibited subsidy):** Having concluded that the “recommendation under Art. 4.7 remains in effect until the Member concerned has fulfilled its obligation by fully withdrawing the prohibited subsidy”, the Appellate Body upheld the Panel’s finding that “to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through the transitional and grandfathering measures, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.” In this regard, it agreed with the Panel that “the relevant recommendations adopted by the DSB in the original proceedings in 2000, and those in the first and these second Art. 21.5 proceedings, form part of a continuum of events relating to compliance with the recommendations and rulings of the DSB in the original proceedings”.

3. OTHER ISSUES

- Requirements of panel request (DSU Art. 6.2):** The Appellate Body explained that in order for a panel request under Art. 21.5 to satisfy the requirements under DSU Art. 6.2, the complainant party in an Art. 21.5 proceeding must identify, at a minimum, the following in its panel request: (i) the recommendations and rulings made by the DSB in the original dispute as well as in any preceding Art. 21.5 proceedings that have allegedly not been complied with; (ii) the measures allegedly taken to comply with those recommendations and rulings, as well as any omissions or deficiencies therein; and (iii) the legal basis for its complaint, by specifying how the measures taken, or not taken, fail to remove the WTO-inconsistencies found in the previous proceedings, or whether they have brought about new WTO-inconsistencies. On the question of whether Section 5 of the ETI Act (i.e. grandfathering prohibited subsidies) was properly identified in the European Communities’ panel request so as to put the United States on sufficient notice, the Appellate Body upheld the Panel’s finding that it was within the Panel’s terms of reference as the European Communities’ panel request referred to the *entirety* of the prohibited subsidies, including Section 5 of the ETI Act, found to exist in the original and first Art. 21.5 proceedings. The Appellate Body agreed with the Panel that the panel request should be read as a whole in this regard.

¹ *United States – Tax Treatment for “Foreign Sales Corporations” – Second Recourse to Article 21.5 of the DSU by the European Communities*

² Although the Jobs Act allegedly “repealed” the tax exclusion in the ETI Act: it contains (1) the “transition provision” in Section 101(d) of the Jobs Act for certain transactions between 1 Jan. 2005 and 31 Dec. 2006 pursuant to which the ETI scheme remained available on a reduced basis (80 per cent in 2005 and 60 per cent in 2006); and (2) the grandfather provision in Section 101(f) for certain transactions. Moreover, it did not repeal Section 5(c)(1) of the ETI Act, which had indefinitely grandfathered certain FSC subsidies in respect of certain transactions.