

# GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Subsidies and  
Countervailing Measures

Original: Spanish

## COMMENTS BY CHILE CONCERNING DRAFT GUIDELINES ON PHYSICAL INCORPORATION (SCM/W/74/Rev.1)

For some time past, within the framework of the Group of Experts, the Committee on Subsidies and Countervailing Measures has been considering certain criteria and guidelines to assist national investigating authorities in calculating the amount of a subsidy when a countervailing duty has to be applied. Accordingly, one can conclude that in some way criteria and directives are also being established for tax remission in pursuance of the General Agreement and the Subsidies Code.

Our country can support the document establishing guidelines on physical incorporation (SCM/W/74/Rev.1), drawn up by the Group of Experts, except as regards paragraph 4(b) of that draft. In the view of this Mission, the wording of that paragraph involves certain problems because it is ambiguous and is a potential source of conflict. As may be seen from that document, it considers the following categories of inputs:

- (i) The input is physically incorporated, with the same identity, in the final product. The amount of waste can be calculated for purposes of rebate or remission.
- (ii) The input serves a function in the production process and in the final product, but loses its identity. Only the amount actually present in the final product is deemed physically incorporated.
- (iii) The input is necessary only for the production process, it leaves traces in the final product, having lost its identity. Only the amount actually present in the final product is deemed physically incorporated.
- (iv) The input is necessary for the production process, but leaves no trace in the final product (catalysts). This matter has not yet been solved.

From an examination of these cases, one can conclude that:

- (a) If the proposed draft were accepted and some solution found to case (iv) mentioned above, to the effect that inputs of this type would be deemed waste, the investigating authority would find itself in the absurd situation of differentiating between two essentially similar cases. Indeed, it is absurd to consider that inputs which disappear can be eligible for tax remission or rebate, and not take account of that portion of the raw materials which is not present in the final product because "traces" have been left.

- (b) Furthermore, what would happen as regards taxes and charges which the exporter has paid proportionally on such remainders of material, in case (iii), which would not be eligible for a rebate? Such remainders are not waste and are not eligible for any rebate. In this way taxes would be exported, since they would constitute a net cost that would have to be reflected in the final price of the product.
- (c) We have to recognize that the question of "physically incorporated" is somewhat open to dispute. Because what has to be deemed eligible for rebate will depend on the interpretation given to that term. It should also be noted that paragraph (h) of the Illustrative List annexed to the Code explicitly recognizes the possibility of tax remission in respect of goods and services used in the production of exported products - and services are obviously not physically incorporated in the final product.

Consequently, and in the light of the above analysis, this Mission considers that the Group of Experts should revert to this matter with a view to avoiding the possible conflicts that could arise from the draft text.

Without prejudice to the foregoing, we have thought it appropriate to prepare an alternative wording for paragraph 4(b) of the draft (annexed to the present letter) which remedies the potential cases of conflict and at the same times leaves open the option for deciding on case (iv) mentioned in the second paragraph of this note.

On the basis of the definitions of "physically incorporated" and "waste" established by the document, the alternative proposed is to deem and calculate as eligible for rebate and remission any quantity of inputs physically incorporated in the final product. As regards physical remainders of such inputs, actually present in the final product, the definition of waste would be applicable to them. In the event that such "remainders" fulfil the requirements of the definition, they should be eligible for tax remission or rebate; if that is not the case, they would not be eligible.

This proposal overcomes the difficulties mentioned, establishes a uniform and general criterion, obviates the problem of loss of identity of the input in the production process, and makes no determination regarding inputs which disappear in the production process. Furthermore, a decision is still needed for case (iv) and for inputs which partly disappear in the production process and are in any quantity physically incorporated in the final product.

ANNEX

A. Definition of concepts

1. Physically incorporated: Any quantity of an input which is actually present in a material manner in the final product and where such input serves a function both in the production process and in the final product (paragraph 4(b)).
2. Waste: The term "waste" refers to that portion of an input which does not serve an independent function in the production process, is not physically present in the final product (for reasons such as inefficiencies) and is not recovered, used nor sold by the same manufacturer (paragraph 4(b) of the document).

B. Paragraph proposed in place of 4(b)

"If the input serves a function both in the production process and in the final product, and is actually present in a material manner in the latter - in any amount - it should be deemed physically incorporated in the final product. The physical remainder of such input will be deemed waste if it fully complies with the definition of the term "waste". If the physical remainder fully complies with that definition, it should be deemed "waste" within the meaning of paragraphs (h) and (i), and therefore should be considered to be physically incorporated in the final product."