

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

SCM/68

31 October 1985

Special Distribution

Committee on Subsidies and
Countervailing Measures

GUIDELINES ON PHYSICAL INCORPORATION

I

1. Indirect tax rebate schemes can allow for exemption, remission or deferral of prior stage cumulative indirect taxes levied on goods that are physically incorporated (making normal allowance for waste) in the exported product. Similarly, drawback schemes can allow for the remission or drawback of import charges levied on goods which are physically incorporated (making normal allowance for waste) in the exported product.

2. The Illustrative List of Export Subsidies annexed to the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement (the Code) makes reference to the term "physically incorporated" in paragraphs (h) and (i). Pursuant to paragraph (h), indirect tax rebate schemes can constitute an export subsidy to the extent that they result in exemption, remission or deferral of prior stage cumulative indirect taxes in excess of the amount of such taxes actually levied on goods physically incorporated in the exported product. Pursuant to paragraph (i), drawback schemes can constitute an export subsidy to the extent that they result in a remission or drawback of import charges in excess of those actually levied on goods that are physically incorporated in the exported product. Both paragraphs stipulate that normal allowance for waste must be made in findings regarding physical incorporation. Paragraph (i) also provides for substitution, where appropriate.

II

In examining whether inputs are physically incorporated, as part of a countervailing duty investigation pursuant to the Code, investigating authorities should proceed on the following basis:

1. Where it is alleged that an indirect tax rebate scheme, or a drawback scheme, conveys a subsidy by reason of over-rebate or excess drawback of indirect taxes or import charges on inputs physically incorporated, the investigating authorities should first determine whether the government of the exporting country has in place and applies a system or procedure to confirm which inputs are physically incorporated and in what amounts. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the system or procedure to see whether it is reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. The investigating

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authorities may deem it necessary to carry out, in accordance with Article 2:8 of the Code, certain practical tests in order to verify information or to satisfy themselves that the system or procedure is being effectively applied.

2. Where there is no such system or procedure, where it is not reasonable, or where it is instituted and considered reasonable but is found not to be applied or not to be applied effectively, a further examination by the exporting country based on the actual products involved would need to be carried out in the context of determining whether an excess payment occurred. If the importing country deemed it necessary, a further examination would be carried out in accordance with paragraph 1 above.

3.* Investigating authorities should treat inputs as physically incorporated if such inputs are used in the production process and are physically present in the product exported. The signatories note that an input need not be present in the final product in the same form in which it entered the production process.

4.* In determining the amount of a particular input which is physically incorporated, a "normal allowance for waste" should be taken into account, and such waste should be treated as physically incorporated. The term "waste" refers to that portion of a given 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.

5. The investigating authority's determination of whether the claimed allowance for waste is "normal" should take into account the production process, the average experience of the industry in the country of export, and other technical factors, as appropriate. The investigating authority should bear in mind that an important question is whether the authorities in the exporting country have reasonably calculated the amount of waste, when such an amount is intended to be included in the tax or duty rebate or remission.

* With respect to inputs, such as catalysts, which are consumed in the course of their use to obtain the exported product and which are not mere aids to manufacture, the relationship between signatories rights to grant remission or drawback of import charges in accordance with the rules laid down in the International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention) and its annexes and paragraphs 3 and 4 of these guidelines was not decided.