WORLD TRADE ORGANIZATION

WT/DS108/RW2
30 September 2005

(05-4147)

Original: English

UNITED STATES - TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Second recourse to Article 21.5 of the DSU
by the European Communities

Report of the Panel

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I. PROCEDURAL BACKGROUND

1.1 The original Panel and Appellate Body Reports in this dispute were adopted by the Dispute Settlement Body (the "DSB") on 20 March 2000. In its recommendations and rulings, the DSB requested the United States to bring the FSC measure that was found, in the Panel and Appellate Body Reports, to be inconsistent with its obligations under Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and under Articles 10.1 and 8 of the *Agreement on Agriculture*, into conformity with its obligations under those Agreements.[1] Adopting the recommendation of the original Panel made under Article 4.7 of the *SCM Agreement*, the DSB specified that the prohibited FSC subsidies had to be withdrawn "at the latest with effect from 1 October 2000". On 12 October 2000, at a special session, the DSB agreed to the United States' request to allow it a time period expiring on 1 November 2000 to implement the DSB recommendations and rulings.[2]

1.2 On 15 November 2000, the United States enacted the "*FSC Repeal and Extraterritorial Income Exclusion Act of 2000*"[3] (the "ETI Act"). With the enactment of this legislation, the United States considered that it had implemented the DSB's recommendations and rulings in the dispute and that the legislation was consistent with the United States' WTO obligations.[4]

1.3 Following consultations requested by the European Communities on 17 November 2000, the DSB, acting under Article 21.5 of the *DSU*, referred the matter back to the original Panel on 20 December 2000. On 29 January 2002, the DSB adopted the Article 21.5 Panel and Appellate Body reports. The Article 21.5 Panel found the ETI Act to be inconsistent with Articles 3.1(a), 3.2 of the *SCM Agreement*, 10.1 and 8 of the *Agreement on Agriculture* and III:4 of the GATT 1994. It further found:

> "the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement* and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 *SCM Agreement*."

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[1] Original Panel and Appellate Body Reports, *US – FSC*, para. 178. The original Panel concluded that the FSC scheme was inconsistent with the obligations of the United States under Article 3.1(a) of the *SCM Agreement* and under Articles 3.3 and 8 of the *Agreement on Agriculture*. The original Panel recommended at paras. 8.3-8.4:

> "With respect to our conclusions regarding the SCM Agreement, we *recommend*, pursuant to Article 4.7 of that Agreement, that the DSB request the United States to withdraw the FSC subsidies without delay." [i.e. by 1 October 2000 – see para. 8.8].
>
> "With respect to our conclusions regarding the Agreement on Agriculture, we *recommend* that the United States bring the FSC scheme into conformity with its obligations in respect of export subsidies under that Agreement....".

The Appellate Body upheld the Panel's *SCM Agreement* finding and modified the Panel's findings under the *Agreement on Agriculture* to find a violation of Articles 10.1 and 8. The original Appellate Body recommendation read:

> "The Appellate Body *recommends* that the DSB request the United States to bring the FSC measure that has been found, in this Report and in the Panel Report as modified by this Report, to be inconsistent with its obligations under Articles 3.1(a) and 3.2 of the *SCM Agreement* and under Articles 10.1 and 8 of the *Agreement on Agriculture*, into conformity with its obligations under those Agreements." (para. 178).

[2] See Minutes of the DSB meeting held on 12 October 2000, WT/DSB/M/90, paras. 6-7.

[3] United States Public Law 106-519, 114 Stat. 2423 (2000), Exhibit EC-2.

[4] Minutes of the DSB meeting held on 17 November 2000, WT/DSB/M/92, para. 143.

1.4 The 2002 Article 21.5 Panel Report contained no explicit new "withdrawal without delay" recommendation pursuant to Article 4.7 of the *SCM Agreement*, opining that the original DSB recommendation "remained operative".[5]

1.5 The Appellate Body upheld the 2002 Article 21.5 Panel's substantive findings (with modified reasoning). The 2002 Article 21.5 Appellate Body Report read, in part:

> "The Appellate Body *recommends* that the DSB request the United States to bring the ETI measure, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with its obligations under Article 3.1(a) of the *SCM Agreement*, under Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*, and under Article III:4 of the GATT 1994, into conformity with its obligations under those Agreements, and that the DSB request the United States to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."

1.6 On 22 October 2004, the United States enacted the "the American Jobs Creation Act of 2004" (the "Jobs Act").[6] The United States made the following statement in the DSB in November 2004:

> "...on 22 October 2004, President Bush had signed into law the American Jobs Creation Act of 2004 ("AJCA"). The AJCA had repealed the tax exclusion of the "FSC Repeal and Extraterritorial Income Exclusion Act of 2000" ("ETI Act"). It had thereby withdrawn the subsidy found to exist and brought the measure in question into conformity with US WTO obligations."[7]

1.7 On 5 November 2004, the European Communities requested consultations with the United States.[8] Consultations, held on 11 January 2005 in Geneva, did not lead to a satisfactory resolution of the matter.

1.8 On 14 January 2005, the European Communities requested the establishment of another Article 21.5 *DSU* Panel as there continued to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB between the United States and the European Communities, within the meaning of Article 21.5 of the *DSU*.[9] The European Communities made this request pursuant to Articles 6 and 21.5 of the *DSU*, Article 4 of the *SCM Agreement*, Article 19 of the *Agreement on Agriculture* and Article XXIII of the GATT 1994.

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[5] The interim review section of the 2002 Article 21.5 Panel Report, *US – FSC (Article 21.5 –EC)*, at para. 7.5, states:

> "The **European Communities** submits that it is not appropriate for us to make a recommendation in this case, as our mandate under Article 21.5 *DSU* is to decide a disagreement. In the EC view, this replaces the normal rule in Articles 7 and 11 *DSU* that a panel makes findings so as to assist the DSB in making recommendations and rulings. The European Communities argues that we have already made the recommendation referred to in Article 19 *DSU* in our original Report. The **Panel**, noting that the United States did not respond to this EC comment and that practice in this area has not been entirely consistent in Article 21.5 *DSU* proceedings[44], is of the view that the original recommendation adopted by the DSB on 20 March 2000 remains operative. We have therefore deleted what was originally paragraph 9.3 of the interim report (and made a consequential change in the title of Section IX of the Report)."

[44] Certain Article 21.5 *DSU* panels have made recommendations ... while others have not ....".

[6] Text of the Jobs Act is in Exhibit EC-1.

[7] WT/DSB/M/178, para. 38.

[8] The consultation request was circulated in document WT/DS108/27, dated 10 November 2004.

[9] The Panel request was circulated in document WT/DS108/29, dated 14 January 2005.

1.9 At its meeting on 17 February 2005, the DSB referred this dispute, if possible, to the original Panel in accordance with Article 21.5 of the *DSU* to examine the matter referred to the DSB by the European Communities in document WT/DS108/29. At that DSB meeting, it also was agreed that the Panel should have standard terms of reference, as follows:[10]

> "To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS108/29 the matter referred by the European Communities to the DSB in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.10 The Panel was composed on 2 May 2005 as follows:[11]

Chairman: Mr. Germain Denis

Members: Mr. Didier Chambovey
Professor Seung Wha Chang

1.11 Australia, Brazil and China reserved their rights to participate in the Panel proceedings as third parties.

1.12 The Panel met with the parties on 30 June-1 July 2005 and with third parties on 1 July 2005.

1.13 The Panel submitted its interim report to the parties on 22 July 2005. On 1 August 2005, both parties submitted written requests that the Panel review certain specific aspects of the interim report. On 5 August 2005, each party submitted written comments on the other party's written request. The Panel submitted its final report to the parties on 10 August 2005.

II. FACTUAL ASPECTS

A. INTRODUCTION

2.1 These proceedings of this Article 21.5 compliance panel follow the United States enactment of the Jobs Act in late 2004.

2.2 Before briefly describing the Jobs Act, we recall the relevant provisions of the original FSC and ETI subsidy measures.

B. THE ORIGINAL FSC SCHEME

2.3 A detailed description of the original FSC scheme was contained in paragraphs 2.1-2.8 of the original Panel Report.[12]

2.4 Briefly, Sections 921-927 of the US Internal Revenue Code provided for a US tax exemption on a portion of a FSC's earnings. This was "foreign trade income", the gross income of a FSC attributable to "foreign trading gross receipts". Foreign trading gross receipts meant the gross receipts of any FSC generated by qualifying transactions, which generally involved the sale or lease of certain

[10] See document WT/DS108/30.
[11] *Ibid.*
[12] Original Panel Report, *US – FSC*, paras. 2.1-2.8.

"export property".[13] A FSC had to meet certain requirements of foreign presence and foreign economic processes.[14]

2.5 A portion of the "foreign trade income" was deemed to be "foreign source income not effectively connected with a trade or business in the United States" and was therefore not taxed in the United States.[15] This untaxed portion was "exempt foreign trade income".[16] The remaining portion was taxable to the FSC. Dividends paid by the FSC out of exempt and non-exempt income to the shareholder (ordinarily, the "related supplier") generally qualified for a full dividends-received deduction.[17] Special rules applied for agricultural cooperatives.[18] The FSC scheme also contained certain income allocation (including two administrative pricing) rules in the case of a sale of export property to a FSC by a person described in Section 482 of the Internal Revenue Code (*i.e.*, by a related supplier). There were also certain requirements relating to distribution activities attributable to the export transaction.[19]

C. THE ETI ACT

2.6 A detailed description of the ETI Act was contained in paragraphs 2.2 to 2.8 of the 2002 Article 21.5 Panel Report.[20]

2.7 Briefly, the ETI Act consisted of five sections. Aspects of sections 2, 3 and 5 are most relevant.[21]

2.8 Section 3, entitled "Treatment of Extraterritorial Income", amended the Internal Revenue Code by inserting a new section 114, as well as a new Subpart E, which was in turn composed of new sections 941, 942 and 943. The ETI Act permitted certain US and foreign taxpayers to elect to have qualifying income taxed in accordance with the ETI provisions on a transaction-by-transaction basis.

2.9 Subject to certain exceptions, income from specific transactions would qualify for ETI fiscal treatment if it was attributable to "foreign trading gross receipts":[22] (i) from specific types of

[13] With certain exceptions, export property is:

- property held for sale or lease;
- manufactured, produced, grown, or extracted in the United States;
- by a person other than a FSC;
- sold, leased, or rented for use, consumption, or disposition outside the United States; and
- with no more than 50 per cent of its fair market value attributable to imports."

[14] Section 922(a) and Section 924(b) of the Internal Revenue Code.

[15] Such income is generally exempt from tax under section 882 of the Internal Revenue Code, if it is earned by a corporation resident outside the United States.

[16] See Section 923(a) of the Internal Revenue Code.

[17] Section 926(a) and 245(c) Internal Revenue Code.

[18] See Section 923(a)(4) and Section 245(c)(2)(B) of the Internal Revenue Code.

[19] See Section 925(c) and Section 924 (d) and (e) of the Internal Revenue Code.

[20] 2002 Article 21.5 Panel Report, *US – FSC (Article 21.5 – EC)*.

[21] The remaining provisions of the ETI Act consist of section 1 containing the short title of the ETI Act and section 4 which sets forth a number of "technical and conforming" amendments.

[22] Section 942(a) of the Internal Revenue Code designated as "foreign trading gross receipts" the receipts generated in transactions satisfying all three of these conditions. Under section 114(e) of the Internal Revenue Code, "extraterritorial income" was the gross income attributable to foreign trading gross receipts and, under section 941(b) of the Internal Revenue Code, "foreign trade income" was the taxable income attributable to foreign trading gross receipts.

transactions;[23] (ii) involving "qualifying foreign trade property";[24] and (iii) if the "foreign economic process requirement" was fulfilled.[25]

2.10 Section 114(a) of the Internal Revenue Code provided that a taxpayer's gross income "does not include extraterritorial income". Section 114(b) added that this exclusion of extraterritorial income from gross income "shall not apply" to that portion of extraterritorial income which is not "qualifying foreign trade income". Accordingly, the portion of extraterritorial income which was excluded from gross income – and, thereby, from United States taxation – was an amount which would result in a reduction of the taxable income of the taxpayer from the qualifying transaction.[26]

2.11 Section 2 of the ETI Act repealed the provisions of the Internal Revenue Code relating to FSCs.[27] Section 5(b) prohibited foreign corporations from electing to be treated as FSCs after 30 September 2000 and provided for the termination of inactive FSCs.

2.12 However, section 5(c) created a "transition period" and a "grandfathering clause" for certain transactions of existing FSCs. Specifically, section 5(c)(1) of the ETI Act stipulated that the repeal of the provisions of the Internal Revenue Code relating to FSCs "shall not apply" to transactions of existing FSCs which occur before 1 January 2002 or to any other transactions of such FSCs which occur after 31 December 2001, pursuant to a binding contract between the FSCs and an unrelated person which is in effect on 30 September 2000.

D. THE JOBS ACT

2.13 The Jobs Act applied from 1 January 2005 (section 101(c) of the Jobs Act). Thus, the ETI scheme continued until the end of 2004.

2.14 Section 101 of the Jobs Act is entitled "Repeal of exclusion for extraterritorial income". Section 101(a) of the Jobs Act stipulates: "Section 114 [of the Internal Revenue Code] is hereby repealed." Section 101(b), entitled "conforming amendments", provides, in its sub-paragraph (1): "Subpart E of Part III of subchapter N of chapter 1 (relating to qualifying foreign trade income) is hereby repealed".[28]

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[23]Foreign trading gross receipts could be earned through (i) any sale, exchange, or other disposition of qualifying foreign trade property; (ii) any lease or rental of qualifying foreign trade property; (iii) any services which are related and subsidiary to (i) and (ii); (iv) for engineering or architectural services for construction projects located (or proposed for location) outside the United States; and (v) for the performance of managerial services for a person other than a related person in furtherance of activities under (i), (ii) or (iii). (section 3 of the ETI Act, section 942(a) of the Internal Revenue Code).

[24] Qualifying foreign trade property was property: (A) manufactured, produced, grown or extracted within or outside the United States; (B) held primarily for sale, lease or rental, in the ordinary course of business, for direct use, consumption, or disposition outside the United States; and (C) not more than 50 per cent of the fair market value of which is attributable to: (i) articles manufactured, produced, grown, or extracted outside the United States; and (ii) direct costs for labour performed outside the United States. Section 3 of the ETI Act, section 943(a)(1) of the Internal Revenue Code. Section 943(a)(3) and (4) of the Internal Revenue Code set forth specific exclusions from this general definition.

[25] Section 3 of the ETI Act, section 942(b), (b)(2)(A)(ii), (b)(2)(B) and (b)(3) of the Internal Revenue Code.

[26] Pursuant to section 941(a)(1) and (2) of the Internal Revenue Code, qualifying foreign trade income would be calculated as the greatest of, or the taxpayer's choice of, the following three options: (i) 30 per cent of the foreign sale and leasing income derived by the taxpayer from such transaction; (ii) 1.2 per cent of the foreign trading gross receipts derived by the taxpayer from the transaction; or (iii) 15 per cent of the foreign trade income derived by the taxpayer from the transaction.

[27]Subpart C of part III of Subchapter N of chapter 1, consisting of sections 921-927 of the Internal Revenue Code.

[28] Section 101(b)(2) also contains other "conforming amendments", Exhibit EC-1.

2.15 However, pursuant to the "transition provision" in section 101(d) of the Jobs Act, for certain transactions in the period between 1 January 2005 and 31 December 2006, the ETI scheme remains available on a reduced basis. That is, a percentage of ETI benefits remain available in respect of each qualifying transaction (80 per cent in 2005 and 60 per cent in 2006).

2.16 In addition to that time-limited transition provision, section 101(f) of the Jobs Act indefinitely grandfathers the ETI scheme in respect of certain transactions.[29]

2.17 Moreover, Section 101 of the Jobs Act does not repeal section 5(c)(1) of the ETI Act, indefinitely grandfathering FSC subsidies in respect of certain transactions.[30] Nothing in the legislative language of the Jobs Act modifies, explicitly or implicitly, the transition rules for the FSC subsidies.[31]

III. REQUESTS BY THE PARTIES

3.1 In its request for establishment of the Panel, the European Communities asks the Panel to find:

> "– that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*.
>
> – that the United States continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994."[32]

3.2 In response to Panel questioning, the European Communities clarified that it "is not seeking repetition of" the findings, recommendations and rulings "already made in previous Reports and by the DSB in this dispute".[33] Rather, the European Communities seeks a finding that by promulgating the Jobs Act, "the United States has not fully complied with the findings and recommendations made by the Panel and the Appellate Body in the original proceeding and in the Article 21.5 proceeding, as adopted by the DSB."[34] The European Communities also clarified that we might legitimately exercise judicial economy with respect to the "claims" of the European Communities under Articles 19.1 and 21.1 of the *DSU*.[35]

3.3 The United States requests that "the Panel reject the EC claims".[36]

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[29] The amendments made by section 101 of the Jobs Act do not apply to any transaction in the ordinary course of a trade or business which occurs pursuant to a binding contract (1) which is between the taxpayer and an unrelated person, and (2) which was already in effect on 17 September 2003 (the last day prior to the introduction of the bill before the US Senate) and at all times thereafter.

[30] See, for example, US response to Panel Question 1.

[31] See, for example, US response to Panel Question 2.

[32] WT/DS108/29.

[33] See EC response to Panel Question 8. Although the European Communities, in its first written submission, requested that we make a further recommendation, it subsequently asserted that such a further recommendation was not necessary. According to the European Communities: "The Panel can confirm that [the] Article 4.7 recommendation made in the original proceedings remains operative and unsatisfied". See EC response to Panel Questions 8, 27 and 28.

[34] See EC response to Panel Question 8.

[35] See EC response to Panel Question 10.

[36] US first written submission, para. 21.

IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties are set out in their submissions to the Panel. The parties' submissions are attached to this Report as Annexes (see List of Annexes, page iv).

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of the third parties -- Australia, Brazil and China -- are set out in their submissions to the Panel and are attached to this Report as Annexes (see List of Annexes, page iv).

VI. INTERIM REVIEW

6.1 The Panel submitted its interim report to the parties on 22 July 2005. On 1 August 2005, both parties submitted written requests that the Panel review certain specific aspects of the interim report. On 5 August 2005, each party submitted written comments on the other party's written request.

A. COMMENTS BY THE EUROPEAN COMMUNITIES

6.2 The **European Communities** requested changes in the terminology or formatting in paragraphs 1.4, 7.35, 7.37 (footnote 65), 7.43 and 7.47.

6.3 The **United States** submitted no comments in respect of the EC comments on paragraphs 1.4 and 7.37.

6.4 However, in respect of paragraph 7.35, the United States asserts that the EC's suggested textual changes are designed to equate the "findings" of a panel with the "rulings" of the Dispute Settlement Body ("DSB"). Indeed, this same assumption appears to underlie the Panel's draft of paragraph 7.35. In the view of the United States, however, "findings" are distinct from both "recommendations" and "rulings". According to the United States, the EC's proposed approach is contradicted by the text of the *DSU* (*e.g.* Articles 7.1 and 11). At the same time, the United States agrees with the essence of the paragraph, that is, that a panel or Appellate Body recommendation only has effect when adopted by the DSB. The third sentence of this paragraph raises the question of how the recommendations in a single report could "meld" into DSB recommendations. This may have been meant to refer to the effect of an Appellate Body report on a panel report where the panel report may be modified. Furthermore, in reviewing the EC comments, the United States noted that the first sentence of paragraph 7.35 refers to "object and purpose considerations" but the remainder of the paragraph does not address "object and purpose." This first sentence would appear unnecessary and, to avoid confusion, may better be deleted. Accordingly, the United States would agree with the EC that paragraph 7.35 should be revised for greater accuracy, but the United States does not agree with the EC's proposed revisions and offers one of its own.

6.5 In respect of paragraph 7.43, the United States asserts that the first change suggested by the EC highlights the fact that the interim report has created the notion of "rulings" under Article 19 of the DSU. Article 19, however, does not use that term. Accordingly, the United States requests that the third sentence of paragraph 7.41 be revised to delete "and rulings". The United States recalls that the second change suggested by the EC regarding this paragraph would be to italicize the word "requirement" in line 5. The United States opposes this change, because it would suggest that an Article 21.5 panel would have the discretionary authority to make new recommendations. As previously explained by the United States, an Article 21.5 panel does not have the mandate to make recommendations.

6.6 With respect to paragraph 7.47, the United States disagrees with the EC proposal to add, at the end of the first sentence, the following phrase: "and the relevant recommendations and rulings." The United States asserts that this would be inconsistent with the text of Article 21.5 of the *DSU*,

which says nothing about consistency with "the relevant recommendations and rulings." DSB recommendations and rulings are themselves required to be consistent with the covered agreements. DSB recommendations and rulings do not – indeed cannot – amend the covered agreements nor can they "add to or diminish" the rights and obligations under the covered agreements. Accordingly, the question of "consistency" remains a question of consistency with the covered agreements, not with recommendations and rulings.

6.7 In considering the parties' comments, the **Panel** has remained mindful that: Article 19.1 of the *DSU* states that a panel "shall recommend"; Article 4.7 of the *SCM Agreement* states that "the panel shall recommend..."; and a panel report must be adopted by the DSB to produce operative DSB rulings and recommendations. We have made certain changes in paragraphs 1.4 and 7.43. For greater clarity, and noting that we address the issue of whether Article 21.5 *requires* a new *recommendation*, we have made certain changes in paragraph 7.35 and in paragraph 7.37 (footnote 65). Mindful of the text of Article 21.5 of the *DSU*, and observing that the covered agreements also subsume, and govern, recommendations and rulings, we declined to alter paragraph 7.47.

6.8 In line with the **European Communities**' request, and noting that the **United States** made no reply, **we** have also supplemented the references to the relevant Panel and Appellate Body reports in paragraphs 7.56 (footnotes 75 and 76) and 7.60 and footnote 79.

B. COMMENTS BY THE UNITED STATES

6.9 The **United States** requests changes in footnote 29. The **European Communities** agrees. **We** have made changes in that footnote to reflect more accurately the text of section 101(f) of the Jobs Act.

6.10 Taking note of the **United States** statement that it never argued that *de minimis* adverse effects are relevant to the required withdrawal of a prohibited subsidy, and noting the **European Communities** suggestion that the United States does not argue that they are, **we** have deleted what was footnote 73 of the interim report.

6.11 According to the **United States**, in paragraphs 7.42 and 7.46, the Panel refers to the "object and purpose" of various provisions of the *DSU* and the *SCM Agreement*. The United States asserts that this appears to reflect an incorrect application of customary rules of interpretation of public international law. Article 31(1) of the *Vienna Convention on the Law of Treaties*, which is generally regarded as reflecting such rules, provides that a treaty is to be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of *its* object and purpose" (emphasis added). Thus, according to the United States, it is the object and purpose of the *treaty* that is to be considered. The **European Communities** suggests that we could take into account the US comments by referring to the object and purpose of the *DSU*, which includes the prompt and effective resolution of disputes.

6.12 The **Panel** is well aware of the principles of treaty interpretation cited by the United States, which are already cited in paragraph 7.21 of this Panel Report and which have, indeed, guided the Panel's examination. In respect of object and purpose of treaty terms, we recall the following statement of the Appellate Body in *US-Shrimp*:

> "A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is *in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty* must first be sought. Where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light

from the *object and purpose of the treaty as a whole* may usefully be sought."[37] (emphasis added)

6.13 We believe that Article 3.2 of the *DSU* articulates a fundamental tenet relating to the object and purpose of the *DSU*, including its special and additional provisions, such as Article 4.7 of the *SCM Agreement*: "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system." The *DSU* aims to achieve the fair, prompt and effective resolution of trade disputes.[38] In respect of our interpretation of the terms of the *SCM Agreement*, we further recall and endorse the view of the 2002 Article 21.5 Panel that we must avoid an interpretation that "... is inherently contradictory to what may be viewed as the object and purpose of the *SCM Agreement* in terms of disciplining trade-distorting subsidies in a way that provides legally binding security of expectations to Members." (para. 8.39) In our view, our interpretation of the text of the relevant treaty provisions, in their context, is reflective of their object and purpose. Moreover, this interpretation is entirely consistent with, reflective of, and confirmed by, the object and purpose of the *DSU* (and the *SCM Agreement*), as a whole. We have slightly altered paragraphs 7.42 and 7.46, by, among other things, inserting footnotes 66 and 69.

6.14 The **United States** asserts that the European Communities made three primary claims in this proceeding: under Article 4.7 of the *SCM Agreement* and Articles 19.1 and 21.1 of the *DSU*. The EC also made some "consequential" claims that flowed from the supposed breaches of these three articles. According to the United States, none of these three articles appropriately serves as the basis for claims in this proceeding. As a result, those primary claims fail and, because they are "consequential," the EC's consequential claims fail as well. According to the United States, the US arguments need to be viewed in this context, but the interim report does not appear to reflect this. For example, continues the United States, paragraph 7.37 misstates the US argument and makes it broader than it is. The US argument is that the EC erred in claiming that the United States had breached Article 4.7 of the *SCM Agreement* with respect to the ETI Act. There was no Article 4.7 recommendation, nor, for the reasons found by the Panel, would it have been appropriate for there to have been one. The United States asserts that paragraph 7.51 similarly misstates the US argument. The United States was not taking a position in the abstract regarding Members' obligations under the *SCM Agreement* (indeed, even aside from the question of whether a party could ever ask a panel to undertake such a discussion, given the terms of reference for this proceeding, that issue is not one that the Panel needs to undertake), but rather was responding to the EC claim of a breach of Article 4.7. For the reasons set forth in the US submissions, including the fact that Article 4.7 is not directed to Members but rather to panels, the US asserts that the EC failed to meet its burden of proving a breach of Article 4.7. The United States requests that the interim report, including these paragraphs, be modified accordingly. For example, the US asserts, the first sentence of paragraph 7.37 would more accurately read: "Before us, the United States asserts that in order for the EC to establish a breach of Article 4.7 of the SCM Agreement, the EC would first need to establish that there was a recommendation under Article 4.7 that the United States withdraw the ETI Act." Similarly, the US asserts, paragraph 7.51 would more accurately read: "We recall the United States argument that, in order for the EC to establish a breach of Article 4.7 of the SCM Agreement the EC would first need to establish the existence of a recommendation under Article 4.7 of the SCM Agreement that the United States withdraw the ETI Act." According to the United States, footnotes 65 and 74 also reflect the same misunderstanding, and the United States requests that they be deleted. In particular, footnote 65 ascribes an argument to the United States that the United States did not make, in that the issue was not presented to this Panel in the abstract of what obligations attach in the event a Member were to adopt a new prohibited subsidy, and the United States did not opine on that issue.

6.15 According to the **European Communities**, the United States draws an unwarranted distinction between the different EC claims in this proceeding, which in the US view are "primary" or

[37] Appellate Body Report, *US-Shrimp*, para. 114.
[38] See, for example, Original Appellate Body Report, *US – FSC*, para. 166.

"consequential". The United States does not further clarify what would be in its view the "consequential" claims of the European Communities. Given that the United States designates as "primary" the claims relating to Article 4.7 of the *SCM Agreement* and to Articles 19.1 and 21.1 of the *DSU*, the European Communities infers that the "consequential claims" would be the other claims contained in its request for establishment of a panel. According to the European Communities, this would however be a gross misrepresentation of the European Communities' position (and one that the United States is making for the first time). There is no basis in the European Communities' request for the establishment of the Panel for this contention by the United States. The European Communities asserts that the word "consequential" is put by the United States in quotation marks but with no indication of from where it is quoted. And for good reason because the claims of violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the *GATT 1994* were never described as "consequential" to any others. They are a consequence of the US having failed to withdraw the prohibited subsidies – not of the violations of Article 4.7 of the *SCM Agreement* or Articles 19.1 and 21.1 of the *DSU.*

6.16 The European Communities asserts that each claim listed in the EC request for establishment of the panel in this proceeding has its own merit and is grounded in a self-standing provision of the WTO.[39] In particular, the claims based on provisions other than Articles 4.7 of the *SCM Agreement* and 19.1 and 21.1 of the *DSU* are claims that the United States continues to violate certain WTO provisions because the measures found to be in violation of those provisions have not been fully removed or brought into compliance. As for the Panel's summary of the US argument in para. 7.37, the European Communities notes that it is very close to the title of section III.A of the US first written submission, reading:

> "A. In the Absence of Any Recommendation of Withdrawal under Article 4.7, this Panel Cannot Find that the United States Has Failed to Withdraw Its Prohibited Subsidies Within the Meaning of Article 4.7 of the SCM Agreement"

6.17 The European Communities asserts that it is also very close to the first part of paragraph 19 of the US first written submission, reading:

> "Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion."

6.18 The European Communities asserts that, as for paragraph 7.51, the Panel does not seem to attribute to the United States a position "in the abstract", but rather in respect of the present dispute. The European Communities further notes that neither the distinction between "primary" and "consequential" claims, nor the alternative formulations suggested by the United States for paras. 7.37 and 7.51 of the Interim Report appear to find correspondence in the submissions of the United States, unlike the current drafting of the said two paragraphs. The United States has referred to no passage of its own submissions where the points it makes in its comments would be reflected. Accordingly, should the Panel consider that some modifications of paras. 7.37 and/or 7.51 are in order, the European Communities respectfully submits that they should be limited to adding references to, e.g., paragraph 19 of the US first written submission.

6.19 **We** are confident that our original formulations of the US arguments were faithful to the arguments of the United States as articulated, *inter alia*, in its first written submission[40] and its oral

[39] [Footnote reference not used.]

[40] In its first written submission, para. 2, the United States asserted:

statement.[41] We note that the United States did not specifically identify any perceived inaccuracy in our description of its arguments in Section VII.B.2 of this Report. We have nevertheless clarified the US arguments in paragraphs 7.37 - 7.39 and 7.51 for greater certainty. To the extent that the United States is suggesting that it is not possible to establish a Member's breach of Article 4.7 (which, according to the United States, is not directed to Members but rather to panels), we recall that an issue before us is whether there is an operative DSB recommendation that the United States withdraw the prohibited subsidy. A key point for us is that the operative recommendations and rulings are those flowing from the original proceedings; these remained operative through the 2002 compliance proceedings. Arising therefrom is an operative DSB recommendation, rooted in Article 4.7 of the *SCM Agreement*, that the United States withdraw the prohibited ETI subsidies. For the reasons we have given, we find that the US has not yet fully done so.

6.20 We declined, however, to make the requested deletions of footnotes 65 and 74. In our view, these footnotes accurately depict a logical extension of the United States argument. While that hypothetical scenario is not before us, we nevertheless believe it serves as a useful aid in analyzing the merits of the United States argument.

6.21 To eliminate *any* possibility that paragraph 7.47 could, as suggested by the **United States**, be misread as implying that the task of the Panel is to be determined without regard to its terms of reference, and noting no disagreement on the part of the **European Communities**, **we** have inserted footnote 71, cross-referencing earlier footnotes 47 and 48.

6.22 The **United States** asserts that, in footnote 77, we appear to "conflate" the two standards under Article 21.5 of the *DSU* of "existence" and "consistency". According to the United States, the question of whether a measure "exists" is distinct from the question of whether a measure that does exist is "consistent with" a covered agreement. Given that, in the United States' view, the two standards clearly are different, the United States requests that this footnote be deleted. The **European**

"...the transition provisions of the AJCA are not inconsistent with Article 4.7 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") because, in the prior proceeding under Article 4 of the SCM Agreement and Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), there was no recommendation or ruling, pursuant to Article 4.7, by the Dispute Settlement Body ("DSB") that the ETI Act tax exclusion should be withdrawn. Thus, while the United States has repealed the ETI Act tax exclusion, in the absence of any recommendation or ruling of withdrawal under Article 4.7, this Panel cannot find that the United States has failed to comply with a DSB recommendation or ruling to withdraw its prohibited subsidies within the meaning of Article 4.7 of the SCM Agreement."

At para. 19 of its first written submission, the United States asserted:

"Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion....Furthermore, there is no basis for an Article 21.5 panel to make a finding of compliance or noncompliance with a DSB recommendation or ruling under Article 4.7 of the SCM Agreement in this dispute, and thus the Panel should reject the EC's claims under Article 4.7 of the SCM Agreement."

[41] See United States oral statement at Panel meeting, para. 5:

"...the EC's claim that the transition provisions of the AJCA are inconsistent with Article 4.7 is premised on the notion that the ETI Act tax exclusion was found to be inconsistent with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies. The US response to this claim is straightforward: no such finding was ever made, nor did the DSB make a recommendation under Article 4.7 that the ETI Act tax exclusion be withdrawn."

Communities disagrees that there is necessarily a difference in standards between "existence" and "consistency" of a measure taken to comply. According to the European Communities, in the case of partial compliance such as exists in this case the situation can be described as inconsistency or partial non-existence of the measure taken to comply. Where, as in the present case, a measure "taken to comply" has been adopted and the measure achieves partial compliance, there is a measure taken to comply for the part for which compliance is achieved; for the remainder, there is no measure. For the European Communities, there is no reason why the formulation that is chosen to describe the situation (non-existence or inconsistency) should lead to a difference in outcome. **We** have made certain changes in footnote 77 to better reflect our view.

6.23 In response to the **United States** request that we clarify the "alternative" to which we referred in paragraph 7.69, and noting the **European Communities** suggestion that this is, in fact, "in addition" rather than "in the alternative", **we** have modified that paragraph.

6.24 The **United States** submits that the second sentence of paragraph 7.80 is inaccurate in describing the scope of section 101 of the Jobs Act. The **European Communities** suggests a certain re-formulation of this paragraph. **We** have made clarifying changes in paragraph 7.80.

VII. FINDINGS

A. INTRODUCTION

7.1 This is the second time that the European Communities has asked a Panel to rule on the WTO-consistency of measures taken by the United States to comply with DSB recommendations and rulings in this dispute.

7.2 The original WTO dispute settlement proceedings resulted in DSB recommendations and rulings, in 2000, that the United States withdraw the prohibited FSC subsidies and bring itself into conformity with its obligations under the relevant covered agreements. The time period for withdrawal of the prohibited subsidies pursuant to Article 4.7 of the *SCM Agreement* expired on 1 November 2000.

7.3 Subsequently, the 2002 Article 21.5 *DSU* compliance proceedings established that the ETI Act[42] had failed to withdraw completely the prohibited FSC subsidy and to bring the United States fully into conformity with its WTO obligations.

7.4 Since that time, the United States has enacted the Jobs Act.[43]

7.5 We now turn to the parties' main claims and arguments before this Article 21.5 *DSU* compliance Panel.

B. ARGUMENTS OF THE PARTIES

1. European Communities

7.6 Before this Article 21.5 compliance Panel, the European Communities asserts that two provisions of the Jobs Act continue inconsistencies with the United States' WTO obligations. These two provisions are:

- the "transition provision"[44], which provides for a two-year continuation of a percentage of ETI benefits (80 per cent in 2005 and 60 per cent in 2006); and

[42] Text of the ETI Act is in Exhibit EC-2.
[43] Text of the Jobs Act is in Exhibit EC-1.

- the "grandfathering provision"[45], which exempts certain transactions indefinitely from the repeal of the ETI scheme.

7.7 Moreover, the European Communities submits that, as the Jobs Act is silent as to the prohibited FSC subsidies grandfathered through section 5 of the ETI Act, the United States persists in failing to withdraw fully these prohibited subsidies.

7.8 According to the European Communities, by not entirely withdrawing FSC and ETI subsidies, the United States has failed to implement the DSB recommendations and rulings of March 2000 and January 2002 and is in violation of Article 4.7 of the *SCM Agreement* and Articles 19.1 and 21.1 of the *DSU*. The European Communities argues that the violations of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994 persist.

7.9 The European Communities asserts that the United States has sought to reduce unduly the content of the Panel's terms of reference as set out in the EC Panel request. When read as a whole, the EC Panel request contains a clear reference to the original recommendation under Article 4.7 of the *SCM Agreement* and to the findings in the 2002 Article 21.5 proceedings (including with respect to the FSC grandfathering provisions in section 5 of the ETI Act).

2. United States

7.10 According to the United States, the purpose of fiscal transition provisions contained in sections 101(d) and (f) of the Jobs Act is to provide a smooth and orderly transition in order to prevent the repeal of tax legislation from having a retroactive effect on taxpayers who entered into arrangements in reliance on pre-repeal law. Such transition rules are typically included in major US tax legislation.

7.11 The United States does not directly contest the substantive arguments of the European Communities stated *supra*, paras. 7.6-7.9. Rather, the United States makes the following arguments:

- there is no recommendation or ruling under Article 4.7 of the *SCM Agreement* resulting from the 2002 Article 21.5 compliance proceedings to withdraw the ETI subsidy "without delay". The Appellate Body recommendations in the 2002 compliance proceeding relating to Article 4.7 do not pertain to the ETI Act, as the Appellate Body in the 2002 compliance report referenced the recommendations and rulings in the original proceedings, which were made *before* the ETI Act tax exclusion even existed. Consequently, the United States has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the Jobs Act are not inconsistent with Article 4.7 of the *SCM Agreement*; and

- this Panel's terms of reference do not include section 5 of the ETI Act, indefinitely grandfathering original FSC subsidies for certain transactions. The measures before the Panel are sections 101(d) and (f) of the Jobs Act, concerning the ETI Act tax exclusion, and the EC Panel request does not refer to any other provision of the Jobs Act. While the European Communities makes references in its first written submission to section 5 of the ETI Act, section 5 is not mentioned in the EC Panel request, and, thus, is not within the Panel's terms of reference.

[44] Section 101(d) of the Jobs Act.
[45] Section 101(f) of the Jobs Act.

C. ARGUMENTS OF THE THIRD PARTIES

1. Australia

7.12 **Australia** submits that the pertinent Article 21.5 of the *DSU* "recommendations and rulings" are those made by the original Panel and Appellate Body, as adopted by the DSB in 2000. Hence, the purpose of the current Article 21.5 proceeding is to decide whether certain measures that the United States has taken to comply with these recommendations and rulings are consistent with the covered agreements.

7.13 According to Australia, the United States does not contest that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are measures taken to comply with the DSB's original recommendations and rulings. Under those circumstances, the measures at issue come within the mandate of an Article 21.5 proceeding.

7.14 Australia asserts that, given the absence of any substantive defence from the United States, the Panel should uphold the EC's arguments that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994. The obligation to withdraw the ETI scheme arises from the fact that the 2002 Article 21.5 Panel and Appellate Body Reports, as adopted by the DSB, found that the ETI scheme violated the covered agreements.

7.15 With respect to the Panel's terms of reference, Australia notes that section 5 of the *ETI Act* sets up, amongst other things, the grandfathering of the FSC scheme. The 2002 Article 21.5 Panel and Appellate Body Reports have already found this grandfathering to be a violation of the covered agreements. Australia also notes that it is section 101 of the Jobs Act that fails to repeal section 5 of the *ETI Act*. The former section was mentioned in the EC's Panel request.

2. Brazil

7.16 Citing Articles 3.3, 3.7, 21.1 and 21.3 of the *DSU*, **Brazil** asserts that prompt compliance and immediate withdrawal of WTO-inconsistent measures are core principles of WTO dispute settlement. The *SCM Agreement* (particularly Article 4.7) is even more stringent than the *DSU*.

7.17 According to Brazil, the transition and "grandfathering" provisions in the Jobs Act are an extension of a non-compliance situation. The United States attempts erroneously to split into two completely separate cases a situation where the facts and circumstances show that the cases are part of one same continuum (FSC – ETI – Jobs Act). Both the ETI Act and, now, the Jobs Act are measures taken to comply with the DSB's rulings and recommendations concerning the original proceedings.

3. China

7.18 Recalling the terms of Article 4.7 of the *SCM Agreement*, **China** submits that the obligation to withdraw prohibited subsidies without delay is not released simply because the 2002 compliance Panel did not specify a time-period in its conclusion. According to China, the party concerned failed to fully implement the DSB recommendations and rulings by introducing the transition period and grandfathering provisions for the FSC scheme, an export subsidy measure.

7.19 China also submits that a Member's obligation under Article 4.7 of *the SCM Agreement* to withdraw prohibited subsidies "without delay" is unaffected by contractual obligations that the Member itself may have assumed under municipal law. Likewise, a Member's obligation to withdraw prohibited export subsidies, under Article 4.7 of *the SCM Agreement*, cannot be affected by contractual obligations which private parties may have assumed *inter se* in reliance on laws

conferring prohibited export subsidies. China questions how transition period and grandfathering provisions for another prohibited subsidy measure can be justified.

D. EVALUATION BY THE PANEL

1. Introduction

7.20 We structure our evaluation as follows. First, we identify the relevant guiding principles in Article 21.5 proceedings in light of the text of Article 21.5 of the *DSU*. Second, we apply these guiding principles to the case before us. In so doing, we identify the "measures taken to comply with the recommendations and rulings" within the meaning of Article 21.5 of the *DSU* and consider whether those measures are consistent with the United States' obligations under the relevant covered agreements. Third, we consider our terms of reference. Finally, we state our conclusions.

7.21 We are guided by Article 3.2 of the *DSU*, which provides that Members recognise that the dispute settlement system serves to clarify the provisions of the covered agreements "in accordance with customary rules of interpretation of public international law." In this regard, Article 31.1 of the *Vienna Convention on the Law of Treaties* ("*Vienna Convention*")[46] provides:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

2. Guiding principles under Article 21.5 of the *DSU*

(a) Relevant treaty text

7.22 Article 21.5 of the *DSU* governs the proceedings of this Panel.[47] It states:

> "Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report."

7.23 Article 21.5 of the *DSU* operates in circumstances where there is a "disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings".

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[46] (1969) 8 *International Legal Materials* 679.

Article 32 of the *Vienna Convention* is also generally accepted as such a customary rule (see, for example, Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 11). It provides:

> "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
> (a)leaves the meaning ambiguous or obscure; or
> (b)leads to a result which is manifestly absurd or unreasonable."

[47] These proceedings are also framed by our terms of reference. We address our terms of reference, *infra*.

7.24 For the purposes of this case, we see three relevant textual elements in Article 21.5 of the *DSU*: i) "the existence or consistency with a covered agreement of..."; ii) "measures taken to comply with"; and iii) "the recommendations and rulings". We examine each in turn.

(b) "existence or consistency with a covered agreement"

7.25 An Article 21.5 panel adjudicates on disputes "as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings ...".[48] Article 21.5 panels may assess whether "measures taken to comply" implement specific "recommendations and rulings" adopted by the DSB in the original dispute[49],but must also examine either the "existence" of "measures taken to comply" or the "consistency with a covered agreement" of implementing measures.[50]

7.26 We also note that the expedited procedure in Article 21.5 of the *DSU* reinforces the principle of "withdrawal" of an inconsistent measure[51] and the requirement of "prompt compliance"[52] with recommendations and rulings, made under Article 19 of the *DSU*, as well as recommendations of "withdrawal" of prohibited subsidies under Article 4.7 of the *SCM Agreement.*[53]

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[48] As already mentioned, this is also informed by the Panel's terms of reference, which we discuss below.

[49] Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 40.

[50] *Ibid.*, paras. 40-41. The panels in *EC – Bananas III (Article 21.5 – Ecuador)* (paras. 6.8-6.9) and *Australia – Salmon (Article 21.5 – Canada)* (para. 7.10, subparagraph 9) reached essentially the same conclusion.

[51] See, e.g., Article 3.7 of the *DSU*, which states:

> "In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement."

[52] This is expressed in both Article 3.3 and Article 21.1 of the *DSU*. Article 3.3 of the *DSU* states:

> "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

Article 21.1 provides:

> "Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members."

See, for example, Panel Report, *Australia – Salmon (Article 21.5 – Canada)*, paragraph 7.10, subparagraph 9.

[53] That special and additional dispute settlement rule reads:

> "If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn."

Article 1.1 of the *DSU* applies the rules and procedures contained in the *DSU* to "disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1". This general rule is, under Article 1.2 of the *DSU*, subject to the special or additional rules and procedures on dispute settlement identified in Appendix 2 to the *DSU*. See, for example, Appellate Body Report, *US — Corrosion-Resistant Steel Sunset Review*, footnote 82 to para. 83. It is only where the provisions of the *DSU* and the

(c) "measures taken to comply"

7.27 We turn to the second textual element in Article 21.5 of the *DSU*: "measures taken to comply".

7.28 Article 21.5 of the *DSU* does not refer to just *any* measure[54] of a WTO Member, but rather to a "measure taken to comply". However, it does not further define what a "measure taken to comply" may be.

7.29 Read in its context, this term "measure taken to comply" is clearly informed by the particular "recommendations and rulings" which it implements. We discuss this further below.

7.30 At this point, however, we observe that a "measure taken to comply" within the meaning of Article 21.5 of the *DSU* may be different from the original measure and inconsistent with WTO obligations in ways different from the original measure.[55]

7.31 While the *measures* may change from the original to the compliance proceedings, the obligation to implement DSB recommendations and rulings *does not*. A "measure taken to comply" should be *fully consistent* with a Member's WTO obligations. In terms of prohibited subsidy disputes, this requires the withdrawal of the prohibited subsidy. A Member's obligation to withdraw a prohibited subsidy is a constant. It remains until *full* implementation of DSB recommendations and rulings is achieved.

(d) "recommendations and rulings"

7.32 We turn to the third textual element we have identified in Article 21.5 of the *DSU*: the "recommendations and rulings".

7.33 "Recommendations and rulings" are at the core of WTO dispute settlement.[56] As the title of Article 21 of the *DSU* makes clear, panel proceedings under Article 21.5 form part of the process of the "Surveillance of Implementation of the Recommendations and Rulings".

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special or additional rules and procedures of a covered agreement *cannot* be read as *complementing* each other that the special or additional provisions are to *prevail*. See, for example, Appellate Body Report, *Guatemala – Cement I*, para. 65.

[54] In *US – Corrosion-Resistant Steel Sunset Review*, para. 81, the Appellate Body addressed the concept of "measure". It stated:

> "... we start with the concept of "measure". Article 3.3 of the DSU refers to "situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by *measures taken by another Member*". (emphasis added) This phrase identifies the relevant nexus, for purposes of dispute settlement proceedings, between the "measure" and a "Member". In principle, any act or omission attributable to a WTO Member can be a measure of that Member for purposes of dispute settlement proceedings."

[55] Appellate Body Report, *Canada-Aircraft (Article 21.5 – Brazil)*, para. 36. The claims, arguments, and factual circumstances relating to the "measure taken to comply" may thus not, necessarily, be identical to those relating to the measure in the original dispute.

[56] Article 19.1 of the *DSU* provides: "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement". Article 19.2 *DSU* emphasizes that: "In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements". The special or additional rule in Article 4.7 of the *SCM Agreement* requires that, upon finding a prohibited subsidy, the "panel shall recommend" that the subsidizing Member withdraw the subsidy without delay.

7.34 The text of Article 21.5 of the *DSU* does not itself indicate *which* are the relevant "recommendations and rulings". Several provisions of the covered agreements indicate that panels and/or the Appellate Body make "recommendations".[57] We believe that, in its context[58], the text of Article 21.5 of the *DSU*, refers to "recommendations and rulings" emanating from the DSB[59], as the authority to articulate operative WTO recommendations and rulings.[60]

7.35 Recommendations by a panel and/or the Appellate Body under Article 19 of the *DSU* (or Article 4.7 of the *SCM Agreement*) become effective only upon their adoption by the DSB. Once the DSB adopts a dispute settlement report, the findings and recommendations in that report become collective, operative DSB rulings and recommendations. The very notion of "measures taken to comply with the recommendations and rulings" in the text of Article 21.5 of the *DSU* is predicated upon DSB adoption of a panel/Appellate Body report. No compliance obligation would arise unless and until panel and Appellate Body recommendations and rulings are adopted by the DSB to become DSB recommendations and rulings. [61]

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[57] For example: the title of Article 19 and Articles 19.1, 19.2 of the *DSU*, addressing "Panel and Appellate Body Recommendations"; and the stipulation in Article 4.7 of the *SCM Agreement* that the "*panel* shall recommend" (emphasis added). As mentioned, the latter is a special and additional rule in Appendix 2 of the *DSU*. See *supra*, note 53. All such panel and Appellate Body "recommendations" are conditional upon a finding of inconsistency with an obligation in the covered agreements. We do not consider that any of these provisions conflict with the general proposition that it is the DSB that is the authority to articulate operative WTO recommendations and rulings. We thus need not entertain the notion that the special or additional dispute settlement provision in Article 4.7 of the *SCM Agreement* could prevail over the general dispute settlement arrangements to the extent of obviating the need for DSB endorsement of any panel finding (or, where it exists, recommendation), or, conversely, entirely undermining the ability of the DSB to adopt operative recommendations and rulings in prohibited subsidy disputes. We recall the following statement in Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 334: "Upon adoption, this additional [panel Article 4.7 SCM] recommendation — that the subsidizing Member "withdraw the subsidy without delay" — will become a recommendation or ruling of the DSB."

[58] We find contextual support in the covered agreements for our view that recommendations and rulings emanate from the DSB after their adoption. For example: the reference in Article 4.10 of the *SCM Agreement* to "...the recommendation of the DSB..."; the reference in Article 3.4 of the *DSU* to: "Recommendations and rulings made by the DSB..."; the reference in Article 7.1 of the *DSU* stipulating the standard terms of reference of panels to examine "the matter referred to the DSB by" the complaining party's panel request and "to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements"; the reference in Article 11 of the *DSU* that panels should, *inter alia* "make such other findings as will assist the *DSB in making the recommendations or in giving the rulings* provided for in the covered agreements" (emphasis added);the *DSU* Article 21.1 statement: "Prompt compliance with *recommendations or rulings of the DSB* is essential in order to ensure effective resolution of disputes to the benefit of all Members" (emphasis added); and the *DSU* Article 21.3 reference to "intentions in respect of implementation of the *recommendations and rulings of the DSB*"(emphasis added).

[59] See, for example, Article 2.1 of the *DSU*.

[60] We find further support for our view that the operative recommendations and rulings flow from the DSB in prior (adopted) dispute settlement reports. For example, the Appellate Body has clarified that: "Proceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those "measures taken to comply with the recommendations and rulings" *of the DSB*" (emphasis added) (Appellate Body Report, *Canada — Aircraft (Article 21.5 — Brazil)*, para. 36); and "As the title of Article 21 makes clear, the task of panels under Article 21.5 forms part of the process of the "Surveillance of Implementation of the Recommendations and Rulings" *of the DSB*." (emphasis added) (Appellate Body Report, *US — Shrimp (Article 21.5 — Malaysia)*, paras. 86–88).

[61] This view is consistent with the letter and spirit of the original GATT dispute settlement provision, Article XXIII:2 of the *GATT 1947/1994*. We are well aware that the *WTO Agreement* is different from the GATT system which preceded it, but that it contains many elements of continuity. The previous system was made up of several agreements, understandings and legal instruments, the most significant of which were the GATT 1947 and the nine Tokyo Round Agreements, including the *Tokyo Round SCM Code*. Each of these major agreements was a treaty with different membership, an independent governing body and a separate

7.36 Article 21.5 compliance proceedings form part of a continuum of events[62] flowing from the various steps in dispute settlement proceedings, with the operative recommendations and rulings for the purposes of Article 21.5 compliance proceedings being those adopted by the DSB in the *original* proceedings. These remain operative through compliance panel proceedings under Article 21.5 of the *DSU* until the "problem" is entirely "fixed", in terms of *full* withdrawal of the prohibited subsidy.

(e) Does Article 21.5 of the *DSU* require a new recommendation?

7.37 Before us, the United States asserts:

> "Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion....Furthermore, there is no basis for an Article 21.5 panel to make a finding of compliance or noncompliance with a DSB recommendation or ruling under Article 4.7 of the SCM Agreement in this dispute, and thus the Panel should reject the EC's claims under Article 4.7 of the SCM Agreement."[63]

7.38 The United States also asserts that its answer to "...the EC's claim that the transition provisions of the [Jobs Act] are inconsistent with Article 4.7 is premised on the notion that the ETI Act tax exclusion was found to be inconsistent with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies .... is straightforward: no such finding was ever made, nor did the DSB make a recommendation under Article 4.7 that the ETI Act tax exclusion be withdrawn."[64]

7.39 We understand the United States to argue that, in order for the European Communities' Article 4.7 claim to prevail, and/or for the United States to be under any obligation to withdraw the relevant parts of the ETI Act, it would have been necessary for the 2002 Article 21.5 Panel to make a new recommendation under Article 4.7 of the *SCM Agreement* that the United States withdraw the ETI Act.[65] Recalling that an issue before us is whether there is an operative Article 4.7 recommendation in respect of a measure taken to comply, we therefore consider the issue whether an Article 21.5 Panel is required to make a new recommendation under Article 19 of the *DSU* and/or Article 4.7 of the *SCM Agreement*.

7.40 We note that the focus of Article 21.5 of the *DSU* is helping parties to resolve a dispute. Article 21.5 of the *DSU* does not contain the terms "make recommendations". Nor, beyond the reference to monitoring compliance with existing recommendations and rulings, does it contain an

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dispute settlement mechanism. See, for example, Appellate Body Report, *Brazil – Desiccated Coconut*, p. 11. The *GATT 1947* was administered by the CONTRACTING PARTIES (acting collectively). The *Tokyo Round SCM Code* was administered by the Tokyo Round SCM Committee, comprised of the signatories to that *Code*. The GATT-era dispute settlement arrangements made it clear that the collectivity of the relevant Committee, rather than the panel, was responsible for formulating operative recommendations. In the current institutional framework of the WTO, the corresponding "collective" entity would be the DSB.

[62] Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 121.

[63] United States first written submission, para. 19.

[64] See United States oral statement at Panel meeting, para. 5:

[65] We note with some surprise the additional United States view that an Article 21.5 panel does not have any mandate to make a recommendation under Article 4.7 of the *SCM Agreement*. See US response to Panel Question 24. The United States appears to be asserting that it is not under any obligation to withdraw the prohibited ETI subsidies because of the purported lack of a recommendation by the first compliance Panel that, in the United States view, it had no mandate to make in the first place. We note that a logical extension of the United States arguments would be that, in such a situation, a Member could enact a new prohibited subsidy as a "measure taken to comply" and then *never* be under an obligation to withdraw that subsidy. We cannot subscribe to these views of the United States.

explicit reference to the "recommendation" provisions of Article 19 of the *DSU*, or to Article 4.7 of the *SCM Agreement*. We see no express requirement in the text of Article 21.5 of the *DSU* that a compliance panel must formulate recommendations upon finding an inconsistency with a covered agreement, including a recommendation under Article 4.7 upon a finding of inconsistency with Article 3 of the *SCM Agreement*.

7.41 In particular, we see nothing in Article 21.5 of the *DSU* requiring a panel to make a recommendation under Article 19 of the *DSU* or Article 4.7 of the *SCM Agreement*.

7.42 This flows from both the text and context of Article 21.5, in view of the object and purpose of the *DSU*.[66] In particular, Article 21.5 comes after the "recommendation" provision in Article 19 of the *DSU*, and the principle of "prompt compliance" in Article 21.1, as part of the WTO dispute settlement process. The title of Article 21 -- "Surveillance of recommendations and rulings"-- is telling. It informs us that the proceedings are to follow the implementation of recommendations and rulings that have been made. This finds further support in the particular nature and purpose of *compliance* panel proceedings.

7.43 In this respect, an Article 21.5 compliance procedure occurs *after* the DSB has already made recommendations and rulings based on Article 19.1 of the *DSU* (and/or Article 4.7 of the *SCM Agreement*). It is linked to the post-recommendation implementation period envisaged in Articles 21.1 and 21.3 of the *DSU*. This necessarily implies that the textual reference in Article 21.5 of the *DSU* to have "recourse to these dispute settlement procedures" *cannot* include the requirement to, once again, formulate *additional* recommendations under Article 19 of the *DSU* (and/or Article 4.7 of the *SCM Agreement*).[67] Why would it be necessary for a panel to again tell a Member to remove a situation of WTO-inconsistency that it has already been told to remove?

7.44 If an Article 21.5 panel made a new recommendation under Article 19 which, upon adoption by the DSB, required an additional time period for implementation, this would give an *additional* period of time for the Member concerned to bring itself into conformity with the covered agreements. Similarly, in a dispute involving a subsidy already found to be prohibited, if an Article 21.5 panel made a recommendation under the first sentence of Article 4.7 of the *SCM Agreement* to withdraw the prohibited subsidy "without delay", the panel would also presumably be required to "specify … the time-period within which the measure must be withdrawn".[68] This would, in effect, amount to giving an *additional* period of time for the Member concerned to withdraw the prohibited subsidies.

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[66] We recall the principles of treaty interpretation, *supra*, para. 7.21, and incorporate our comments, *supra*, paras. 6.11 - 6.13. In particular, we believe that Article 3.2 of the *DSU* articulates a fundamental tenet relating to the object and purpose of the *DSU*, including its special and additional provisions, such as Article 4.7 of the *SCM Agreement*: "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system." The *DSU* aims to achieve the fair, prompt and effective resolution of trade disputes. See, for example, Original Appellate Body Report, *US – FSC*, para. 166. In respect of the *SCM Agreement*, we recall and endorse the view of the 2002 Article 21.5 Panel that we must avoid an interpretation that "is inherently contradictory to what may be viewed as the object and purpose of the *SCM Agreement* in terms of disciplining trade-distorting subsidies in a way that provides legally binding security of expectations to Members." (para. 8.39) We consider that our interpretation of the text of the relevant treaty provisions, in their context, is reflective of their object and purpose. Moreover, this interpretation is entirely consistent with, reflective of, and confirmed by, the object and purpose of the *DSU* (and the *SCM Agreement*), as a whole.

[67] We disagree with the United States assertion that Article 4.7 of the *SCM Agreement* would not be available to an Article 21.5 panel by virtue of the reference in Article 21.5 to "recourse to these dispute settlement procedures", which the United States appears to understand refers only to the provisions of the *DSU*. As already mentioned, Article 4.7 of the *SCM Agreement* is a special and additional dispute settlement rule in Appendix 2 of the *DSU*. It applies as articulated in Article 1.2 of the *DSU*. See *supra*, note 53.

[68] Pursuant to the second sentence of Article 4.7 of the *SCM Agreement*.

7.45 This would mean that Article 21.5 compliance proceedings should result in *adding* to the "non-implementing" Member's rights under the covered agreements through an extension of the time-period for implementation. The Article 21.5 proceeding would thus risk undermining the recommendations and rulings adopted by the DSB, by revisiting an issue already addressed and definitively resolved by the DSB. We are also mindful that a compliance panel must take what has been decided by the DSB as a given.

7.46 Nowhere do we find any indication in the text or context of Article 21.1/21.5 of the *DSU* or of Article 4.7 of the *SCM Agreement*, nor in the object or purpose of the *DSU* (nor, for that matter, the *SCM Agreement*)[69] that would require repeated extensions of the implementation period in Article 21.5 *DSU* compliance proceedings. Indeed, such an interpretation would reduce the textual treaty terms "prompt compliance" and "without delay" to redundancy and inutility. We are not permitted to adopt such an interpretation. Such an approach might lead to a potentially never-ending cycle, whereby a Member continues to adopt non-compliant measures in order to win more time to comply with adopted DSB recommendations and rulings. This would entirely undermine the effective operation of the WTO dispute settlement system.[70]

3. Panel's application of guiding principles

(a) Panel's task under Article 21.5 of the *DSU*

7.47 The task of this Article 21.5 compliance Panel is to examine whether measures that the United States has taken to comply with the recommendations and rulings are consistent with the relevant covered agreements.[71] For this purpose, we first identify the "measures taken to comply" and the "recommendations and rulings" at issue.

(b) "measures taken to comply with" "the recommendations and rulings"

7.48 The "measures taken to comply with" "the recommendations and rulings" for the purposes of Article 21.5 of the *DSU* necessarily flow from the particular "recommendations and rulings" in question.

7.49 As in the 2002 Article 21.5 case, we take the view that the operative "recommendations and rulings" within the meaning of Article 21.5 of the *DSU* are those adopted by the DSB in the *original* dispute settlement proceedings, that is, the recommendations and rulings adopted by the DSB in 2000. These remained operative through the findings of inconsistency established in the Article 21.5 compliance proceedings, as adopted by the DSB in 2002. These findings confirmed that the United States had not "fixed the problem" of WTO-inconsistency identified in the original proceedings by withdrawing fully the prohibited subsidies.

7.50 The "measures taken to comply" with these recommendations and rulings are the ETI Act and the subsequent Jobs Act.[72] In particular, pursuant to the "transition provision" in section 101(d) of the Jobs Act, for certain transactions in the period between 1 January 2005 and 31 December 2006, a percentage of ETI benefits remain available (80 per cent in 2005 and 60 per cent in 2006). In addition, section 101(f) of the Jobs Act indefinitely grandfathers the ETI scheme in respect of certain

[69] See *supra*, footnote 66.

[70] By this, we do not mean to suggest that other elements outlined in the *DSU*, such as the possibility of an appeal, would not apply in compliance proceedings under Article 21.5 of the *DSU*.

[71] As indicated *supra*, footnotes 47 and 48, this task is also governed by our terms of reference. We address our terms of reference below.

[72] Neither party disagreed that the ETI Act and the Jobs Act are "measures taken to comply with" "recommendations and rulings" for the purposes of Article 21.5 of the *DSU*. See EC and US responses to Panel Questions 16 and 17.

transactions.[73] Furthermore, Section 101 of the Jobs Act does not repeal section 5(c)(1) of the ETI Act, indefinitely grandfathering FSC subsidies in respect of certain transactions.

(c) Article 4.7 of the *SCM Agreement* in the 2002 Article 21.5 proceedings

7.51 We recall our understanding of the United States argument: in order for the European Communities' Article 4.7 claim to prevail, and/or for the United States to be under any obligation to withdraw the prohibited ETI scheme, it would have been necessary for the 2002 Article 21.5 Panel to make a new recommendation under Article 4.7 of the *SCM Agreement* that the United States withdraw the ETI Act.[74]

7.52 We disagree with the United States. This is simply because the operative "recommendations and rulings" remain those adopted by the DSB in the original proceedings in 2000. The purpose of the 2002 Article 21.5 compliance proceeding was to decide whether the measures taken by the United States to comply with these recommendations and rulings did, in fact, bring the United States into a situation of consistency with its WTO obligations. The DSB found, *inter alia*, that the United States had not fully withdrawn the prohibited subsidies.

7.53 This Panel is of the view that the United States' obligation to withdraw the ETI scheme arises from the fact that the original recommendations and rulings adopted by the DSB recommended withdrawal without delay of the prohibited subsidies pursuant to Article 4.7 of the *SCM Agreement*; and the 2002 Article 21.5 Panel and Appellate Body reports, as adopted by the DSB, found that the ETI scheme was WTO-inconsistent in that, *inter alia*, it failed to fully withdraw the prohibited subsidies.

7.54 Article 21.5 of the *DSU* indicates that there is a procedure to decide a disagreement as to whether a Member has implemented DSB recommendations and rulings and "fixed the problem". It seems to us that an Article 21.5 compliance panel in a prohibited subsidies dispute may basically find one of two things. It may find that a Member has indeed "fixed the problem", as it has withdrawn the prohibited subsidy. Or, it may decide that the Member has not withdrawn, or fully withdrawn, the prohibited subsidy. We believe that either of these findings mark the completion of the task of an Article 21.5 panel.

7.55 Thus, we see no material significance in the purported lack of an explicit "new" Panel recommendation under Article 4.7 of the *SCM Agreement* in the first compliance proceeding.

7.56 In any event, the 2002 Article 21.5 Panel expressly indicated the view that the original Article 4.7 recommendation "remain[ed] operative". For its part, the Appellate Body recommended "that the DSB request the United States to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."[75] Furthermore, the Appellate Body recommended that the United States bring the ETI measure into conformity with its obligations under the relevant covered agreements, *including the SCM Agreement*.[76] These adopted recommendations and rulings recognize the continuing non-withdrawal of the prohibited subsidies and the continuing obligation on the United States to withdraw them fully pursuant to Article 4.7 of the *SCM Agreement* and to bring itself into conformity with the relevant covered agreements, including the *SCM Agreement*. Thus, with our finding that Article 21.5 proceedings need not produce new recommendations and rulings, we observe that operative recommendations nonetheless persist.

[73] We recall and incorporate our description of the factual aspects of these measures, *supra*.

[74] We recall and incorporate our discussion of the US arguments, *supra*, paras. 7.37-7.39. We further recall our view *supra*, note 65, that it is difficult to reconcile this United States argument with the United States argument that the Article 21.5 panel had no mandate to make such a recommendation.

[75] 2002 Article 21.5 Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para.257.

[76] 2002 Article 21.5 Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para.257.

In light of the Panel's clear expression in the first compliance proceedings that the original recommendation remained operative, the United States could not reasonably have been unaware that operative withdrawal recommendations persisted.

7.57 The United States also asserts that the Appellate Body recommendations in the first compliance proceeding relating to Article 4.7 do not pertain to the ETI Act, as the Appellate Body in the first compliance report referenced the recommendations and rulings in the original proceedings, which were made before the ETI Act tax exclusion even existed.

7.58 We agree that the *original* recommendations and rulings predated the United States enactment of the ETI Act, which was, indeed, a measure "taken to comply" with these recommendations and rulings. However, we do not believe that this has the consequences advocated by the United States. In a prohibited subsidies case, the obligation upon a WTO Member to implement original DSB recommendations and rulings does not disappear until that Member has fulfilled the obligation by *fully* withdrawing a prohibited subsidy.

(d) existence or consistency of the measures taken to comply

7.59 We now address the existence or consistency of the identified "measures taken to comply". We turn first to the provisions of the Jobs Act continuing for a transition period and indefinitely grandfathering the ETI scheme in respect of certain transactions.[77]

7.60 The panel and Appellate Body findings in the first 21.5 compliance proceedings, as adopted by the DSB, established that the ETI scheme was in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994. Pursuant to Articles 101(d) and (f) of the Jobs Act, the ETI benefits remain available throughout 2005 and 2006 (albeit at reduced percentages[78]), and indefinitely (in the case of certain transactions). The inconsistencies with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of GATT 1994 remain.[79]

7.61 We further note the indefinite grandfathering of the original FSC subsidies for certain transactions, through the continued operation of section 5(c)(1) of the ETI Act.[80] As confirmed by the United States in response to Panel questioning, nothing in the legislative language of the Jobs Act modifies, implicitly or explicitly, these transition rules for the FSC subsidies.[81]

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[77] This dispute may be viewed as one on the "existence" of a measure which in its substance complies with prior recommendations and rulings. Nevertheless, this clearly can also be framed in terms of "consistency". We recall that we have before us claims regarding a measure that does certain things (repeals *e.g.* Sections 3 and 4 of the ETI Act, subject to transition and grandfathering provisions) and omits to do other things (i.e. affect the operation of the grandfathering of the original FSC). In any event, the result is unchanged whether we frame this in terms of "existence" or "consistency".

[78] Although the phased reduction in amount of subsidy available in 2005 and 2006 may be relevant in another type of proceeding, such as an arbitration under Article 22.6 of the *DSU* or Article 4.10 and 4.11 of the *SCM Agreement*, the fact that, in 2005 and 2006, the percentage of subsidy available is less than the entire amount that was available under the ETI Act before 2005 is not material to our inquiry under the Article 21.5 *DSU* proceeding. The conditions and circumstances surrounding the granting of this subsidy remain otherwise unaffected.

[79] See 2002 Article 21.5 Panel and Appellate Body Reports, *US – FSC (Article 21.5 – EC)*, paras. 8.168, 8.170 and 9.1; and paras. 229-231 and 256-257, respectively.

[80] In substance, these are the very same prohibited export FSC subsidies already found to be inconsistent with the United States WTO obligations in the original dispute settlement proceedings. Furthermore, in both substance and form, these are the very same ETI Act provisions grandfathering the original prohibited export FSC subsidies already found to be inconsistent with the United States WTO obligations in the 2002 Article 21.5 compliance proceedings.

[81] See, for example, US response to Panel Question 2.

7.62 It is clear that continuing to grant subsidies found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".[82]

7.63 As stated in the prior Article 21.5 proceedings in this dispute[83], this WTO obligation to withdraw prohibited subsidies is unaffected by contractual obligations that the Member itself may have assumed under its applicable domestic legislation or regulation. Similarly, this obligation cannot be affected by contractual arrangements which private parties may have made in reliance on laws conferring prohibited export subsidies.

7.64 Therefore, the United States obligation to implement the operative DSB recommendations and rulings to withdraw fully the prohibited subsidies under Article 4.7 of the *SCM Agreement* and to bring its measures fully into conformity with the obligations under the relevant covered agreements remains.[84]

7.65 Accordingly, we find that, to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through these 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.

4. Panel's terms of reference

7.66 The United States alleges that Section 5 of the ETI Act, indefinitely grandfathering the *original* FSC scheme in respect of certain transactions, is not within this Panel's terms of reference. The European Communities disagrees.

7.67 We recall that the terms of reference dictate the scope of a panel's mandate and determine its task. This obviously holds true in these Article 21.5 compliance proceedings.[85]

7.68 We first observe that, irrespective of whether or not section 5 of the ETI Act is within our terms of reference, it is a matter of fact that the Jobs Act neither repeals nor explicitly or implicitly affects the operation of section 5 of the ETI Act in any way. The United States remains under an

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[82] See, for example, Appellate Body Report, *EC – Export Subsidies on Sugar*, paras. 333-335.

[83] See 2002 Article 21.5 Panel Report, *US – FSC (Article 21.5 – EC)*, para. 8.168, and 2002 Article 21.5 Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 230.

[84] Having made these findings, it is not necessary for us, for the purposes of resolving this dispute, to consider whether or not Articles 19.1 and 21.1 of the *DSU* embody implicit obligations on Members. Accordingly, we exercise judicial economy with respect to the "claims" of the European Communities under those provisions. We note that the European Communities conceded that such an exercise of judicial economy would be appropriate. See EC response to Panel Question 10.

[85] We find support for this proposition in, *inter alia*, the following Appellate Body statements:

> "the task of a panel under Article 21.5 is to examine the "consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. That task is circumscribed by the specific claims made by the complainant when the matter is referred by the DSB for an Article 21.5 proceeding."
>
> Appellate Body Report, *US — Shrimp (Article 21.5 — Malaysia)*, paras. 86–88.
>
> "As in *original* dispute settlement proceedings, the "matter" in Article 21.5 proceedings consists of two elements: the specific *measures* at issue and the legal basis of the complaint (that is, the *claims*)."
>
> Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 78.

obligation to withdraw the prohibited subsidies without delay as a result of the original recommendations and rulings and the first compliance proceedings in this dispute.

7.69 In addition, and in any event, we examine whether or not section 5 of the ETI Act, grandfathering the original FSC subsidies, is within our terms of reference.

7.70 It is well established that a panel's terms of reference are governed by a complainant's panel request, and that a panel request must satisfy Article 6.2 of the *DSU*. Article 6.2 of the *DSU* reads:

> "The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In case the applicant requests the establishment of a panel with other than standard terms of reference, the written request shall include the proposed text of special terms of reference."

7.71 There are two distinct requirements in this provision, namely identification of *the specific measures at issue*, and the provision of a *brief summary of the legal basis of the complaint*. Together, they comprise the "matter referred to the DSB", which forms the basis for a panel's terms of reference under Article 7.1 of the *DSU*.

7.72 The issue before us does not involve the omission of a legal basis for a claim. Rather, it concerns an alleged failure to identify a *measure at issue* (Section 5 of the ETI Act, grandfathering original FSC subsidies).

7.73 This measure would be within our terms of reference to the extent that it is *adequately identified* in the EC request for the establishment of the Panel, as required by Article 6.2 of the *DSU*.

7.74 In general, when faced with a question relating to the scope of its terms of reference, a panel must "examine the request for the establishment of the panel very carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the *DSU*."[86] The task of assessing the sufficiency of a panel request for the purpose of Article 6.2 may be undertaken on a case-by-case basis, in consideration of the panel request as a whole, and in the light of the attendant circumstances.[87] There may be a need to consider whether the defendant's ability to defend itself was prejudiced in light of the text of the panel request.[88]

7.75 We thus begin our analysis by closely examining the text of the EC Panel request.[89]

7.76 First, we consider that the EC Panel request should be read as a whole.[90]

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[86] Appellate Body Report, *EC – Bananas III*, para. 142.

[87] Appellate Body Report, *US – Carbon Steel*, para. 127.

[88] A defending party is entitled to know what case it must answer and what violations have been alleged in order that it may begin preparing its defence. This fundamental due process requirement ensures a fair and orderly conduct of dispute settlement proceedings. Appellate Body Report, *Thailand-H-Beams*, para. 88. An inadequate panel request may prejudice a defendant's ability to defend itself, given the actual course of the panel proceedings. This consideration may be among the attendant circumstances entering into a panel's inquiry under Article 6.2 of the *DSU*. See for example, Appellate Body Report, *Korea-Dairy*, para. 127.

[89] The text of the EC Panel request, document WT/DS108/29, is attached to this report (Annex E).

[90] The EC Panel request contains three sections: "The history of the dispute"; "The subject of the dispute"; and "Request for establishment of a Panel". Given that there are no requirements as to the precise *formatting* (as opposed to the content) of Panel requests, we do not consider that these titles are dispositive. Thus, we reject the United States argument that our terms of reference should be limited to that part of the document entitled "subject of the dispute".

7.77 It begins with an overview of developments in this dispute since the original panel proceedings (including the DSB recommendations and rulings arising from the original proceedings and the 2002 Article 21.5 proceedings, and the enactment of the Jobs Act). This includes the following statements:

> "On 15 November 2000, the President of the United States signed into law the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, US Public law No 106-519 (the "ETI Act")."
>
> "On 20 December 2000, the matter was referred back to the Panel under Article 21.5 of the *DSU* and on 29 January 2002 the DSB adopted the Panel [WT/DS108/RW] and Appellate Body [WT/DS108/AB/RW] reports declaring that the ETI Act violates Articles 3.1(a), 3.2 and 4.7 of the *SCM Agreement*, Articles 8, 10.1 and 3.3 of the Agreement on Agriculture and Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), so that the US had failed to fully withdraw its prohibited subsidy scheme and failed to implement DSB recommendations and rulings in this dispute."

7.78 Therefore, the text of the Panel request refers to the ETI Act in its entirety, and to the original DSB recommendations and rulings and the DSB adoption of the 2002 Article 21.5 panel and Appellate Body reports containing, *inter alia*, findings of inconsistency of Article 5 of the ETI Act.

7.79 As to the subject of the dispute, the EC Panel request states:

> "Section 101 of the JOBS Act purports to repeal the ETI Act (Section 101 (a)). However, at the same time, it effectively maintains part of the ETI Act tax exemptions for a transitional period up to the end of 2006 (Section 101 (d)). Furthermore, the repeal of the ETI Act does not apply to certain contracts, without any time limits (Section 101(f))."

It continues:

> "In the light of the above, the European Communities considers that Section 101 of the JOBS Act contains provisions which will allow US exporters to continue benefiting from the tax exemptions already found to be WTO incompatible (a) in the years 2005 and 2006 with respect to all transactions, and (b) for an indefinite period with respect to certain contracts. Thus, the United States has failed to implement the DSB's recommendations and rulings by failing to withdraw without delay schemes found to be prohibited subsidies under the *SCM Agreement* and to bring its legislation into conformity with its obligations under the *SCM Agreement*, the Agreement on Agriculture and the GATT 1994."

7.80 The EC Panel request thus presents the "subject" of the dispute as Section 101 of the Jobs Act. That provision repeals the ETI scheme, except those transactions falling within the ETI transition and grandfathering provisions expressly cited, and the FSC grandfathering provisions in section 5 of the ETI Act. Thus, we reject the US argument that our terms of reference should be interpreted as excluding Section 5 of the ETI Act because this provision bears on the scope of effective repeal of the ETI Act: section 101 does not repeal the FSC grandfathering provisions in section 5 of the ETI Act.

7.81 The EC Panel request further refers to the procedural circumstances of this Article 21.5 proceeding and requests the Panel to find the following:

– "that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*.

– that the United States continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994."

7.82 On a holistic basis, the text of the EC Panel request cites the ETI Act, in its entirety, as well as both the 2000 and 2002 (Article 21.5) panel and Appellate Body reports, including recommendations and rulings adopted by the DSB. The Panel request also refers to a *failure* to withdraw prohibited subsidies and a *failure* to implement DSB recommendations and rulings from the original and first compliance proceedings. Article 6.2 of the *DSU* requires identification of the specific measure at issue, but not specific aspects of a specific measure.[91] We find no specific requirement in Article 6.2 concerning the manner or method for identifying a specific measure at issue. If its content is adequately described in the Panel request, then the particular measure may be adequately identified. Together, we believe that the textual references in the EC Panel request embrace the ETI provisions grandfathering the original FSC scheme, as well as Panel and Appellate Body findings of inconsistency of Article 5 of the ETI Act, as adopted by the DSB. In our view, this clearly meets the requirements of Article 6.2 of the *DSU*.

7.83 In assessing whether the United States may be prejudiced by any apparent defects in the EC's panel request, we consider whether the EC Panel request identified the measures with sufficient clarity to allow the United States to defend itself.[92] In this regard, we are mindful that defects in a panel request cannot be "cured" in a subsequent submission of a complainant during a panel proceeding.[93] Nevertheless, a complainant's first written submission may confirm the meaning of the words used in the panel request.[94]

7.84 In its first written submission, the European Communities states:

> "the grandfathering clause for FSC subsidies contained in section 5(c)(1)(B) of the ETI Act is still in force and so this violation [of] Article 4.7 of the *SCM Agreement* subsists....the transitional and grandfathering clauses in the Jobs Act are identical in all material respects to those in the ETI Act, except that they provide for continued availability of ETI subsidies rather than FSC subsidies."

7.85 We are satisfied that the European Communities clearly made the distinction between the grandfathering of the FSC scheme for certain transactions by the ETI Act and the grandfathering of ETI subsidies for certain transactions by the Jobs Act, and that it wishes to challenge both.

7.86 In this connection, we recall that the original recommendations and rulings required withdrawal of the prohibited subsidies by 1 October 2000.[95] The United States was well aware of its obligations since at least that point in time. While it is clear to us that we, as an Article 21.5 panel, may not address claims that are not in the Panel request, we recall that the prohibited, grandfathered,

[91] Panel Report, *EC – Trade Marks and Geographical Indications (US)*, p. 14, para. 11 of the Preliminary Ruling.

[92] Appellate Body Report, *Thailand – H-Beams*, para. 95.

[93] Appellate Body Report, *EC – Bananas III*, para. 143.

[94] Appellate Body Report, *US –Carbon Steel*, para. 127.

[95] As indicated in para. 1, *supra*, on 12 October 2000, at a special session, the DSB agreed to the United States' request to allow it a time period expiring on 1 November 2000 to implement the DSB recommendations and rulings.

FSC subsidies are before us for a *second* Article 21.5 Panel proceedings as part of a *continuum of events* flowing from the original and subsequent compliance proceedings. Consequently, we do not believe that the United States has been prejudiced in its ability to defend itself before us.

7.87 For these reasons, we find that section 5 of the ETI Act, grandfathering prohibited FSC subsidies, is within the terms of reference of this *second* Article 21.5 compliance Panel.

VIII. CONCLUSION

8.1 In light of the findings contained in Section VII above, we conclude that, to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through the transition and grandfathering measures at issue, 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.

8.2 Since the original DSB recommendations and rulings in 2000 remain operative through the results of the compliance proceedings in 2002, we make no new recommendation.

ANNEX A

FIRST SUBMISSIONS OF THE PARTIES

ANNEX A-1

FIRST WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

(19 May 2005)

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I. INTRODUCTION

1. It is with regret that the European Communities returns for a second time to the Panel to seek resolution of a disagreement as to the existence or conformity with the covered agreements of measures taken by the United States purportedly to comply with the previously adopted recommendations of the WTO Dispute Settlement Body (the "DSB") in this case.

2. However, the European Communities considers that compliance with DSB recommendations should not only be prompt, as required by Article 21.1 of the *Understanding on rules and procedures governing the settlement of disputes* (the "DSU") and Article 4.7 of the *Agreement on Subsidies and Countervailing Measures (*the "*SCM Agreement*"*)*, but should also be complete and consistent with the implementing Members' WTO obligations. As the European Communities will explain below, the actions of the United States in this case meet none of these requirements.

3. The European Communities will first set out the background to this dispute and the previous Article 21.5 proceedings (Sections II and III below). It will then set out the origins of this second Article 21.5 proceeding and describe the purported new US implementing measure, *The American Jobs Creation Act of 2004* (the "Jobs Act")[1] (Sections IV and V below). Thereafter it will set out its legal arguments (Section VI) and conclude (Section VII).

II. BACKGROUND

4. In the original proceeding in this dispute the Panel concluded that the FSC scheme, consisting of sections 921-927 of the United States Internal Revenue Code (the "IRC") and related measures establishing special tax treatment for Foreign Sales Corporations, was inconsistent with the obligations of the United States under Article 3.1(a) of the SCM Agreement and under Articles 3.3 and 8 of the *Agreement on Agriculture*.[2]

5. The Appellate Body upheld the Panel's finding that the FSC measure was inconsistent with the obligations of the United States under the *SCM Agreement* and modified the Panel's findings under the *Agreement on Agriculture* by finding a violation of Articles 10.1 and 8 instead.

6. On 20 March 2000, the DSB adopted the reports of the Panel and the Appellate Body. The DSB recommended that the United States bring the FSC measure into conformity with its obligations under the covered agreements and that the FSC subsidies found to be prohibited export subsidies within the meaning of the *SCM Agreement* be withdrawn without delay, namely, "at the latest with effect from 1 October 2000".[3] At its meeting on 12 October 2000, the DSB acceded to a request made by the United States to fix a new time-period for complying with the DSB recommendations and rulings in this dispute so as to expire on 1 November 2000.[4]

7. On 15 November 2000, the United States promulgated the *FSC Repeal and Extraterritorial Income Exclusion Act of 2000* (the "ETI Act").[5] A detailed description of the ETI Act was contained in paragraphs 2.2 to 2.8 of the Report of the Panel in the first Article 21.5 proceedings brought by the

[1] H.R. 4520, 118 Stat. 1418, Public Law 108–357— 22 October 2004 (excerpts in **Exhibit EC-1**, full text available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_public_laws&docid=f:publ357.108.pdf).

[2] Panel Report, *United States – Foreign Sales Corporations*, WT/DS108/R, adopted 20 March 2000 ("original Panel Report"), as modified by the Appellate Body Report, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619 ("original Appellate Body Report").

[3] *Ibid*., para. 8.8.

[4] WT/DSB/M/90, paras. 6-7. See also original Panel Report, para. 1.3.

[5] Original Appellate Body Report, paras. 16-18. The text of the ETI Act, attached to the First written submission of the European Communities in the original Article 21.5 proceeding, is submitted again for the convenience of the Panel as **Exhibit EC-2**.

European Communities.[6] However, it is useful to recall the fundamental aspects and key provisions of the ETI Act.

8. The ETI Act consisted of five sections of which elements of sections 2 and 5 were relevant for FSCs. Section 3, entitled "Treatment of Extraterritorial Income", amended the IRC by inserting into it a new section 114, as well as a new Subpart E, which was in turn composed of new sections 941, 942 and 943.[7]

9. The ETI Act was promulgated by the United States in purported compliance with the recommendations and rulings of the DSB of 20 March 2000. Thus, section 2 of the ETI Act repealed the provisions of the IRC relating to FSCs.[8] Section 5(b) prohibited foreign corporations from electing to be treated as FSCs after 30 September 2000 and provided for the termination of inactive FSCs.

10. Nevertheless, section 5(c) created a "transition period" and a "grandfathering clause" for certain transactions of existing FSCs. More specifically, under section 5(c)(1) of the ETI Act, it was explicitly stipulated that the repeal of the provisions of the IRC relating to FSCs "shall not apply" to transactions of existing FSCs which occur before 1 January 2002 or to any other transactions of such FSCs which occur after 31 December 2001, pursuant to a binding contract between the FSCs and an unrelated person which is in effect on 30 September 2000.

11. These provisions were challenged by the European Communities on the ground that the United States had not fully withdrawn the FSC subsidies, in accordance with Article 4.7 of the *SCM Agreement*.

12. Furthermore, sections 114, 941, 942 and 943 of the IRC were inserted into the IRC by virtue of section 3 of the ETI Act, and created new rules under which certain income was excluded from United States taxation.

13. The tax treatment provided by the ETI scheme was available to United States' citizens and residents, including natural persons, corporations and partnerships. In addition, the provisions of the ETI measure also applied to foreign corporations which elected to be treated, for tax purposes, as United States corporations.[9] The ETI measure permitted all these taxpayers to elect to have qualifying income taxed in accordance with the provisions of that measure. This election could be made by taxpayers on a transaction-by-transaction basis.

14. Generally, income from specific transactions would qualify for treatment in accordance with the provisions of the ETI measure if it was income attributable to gross receipts: (i) from specific types of transaction; (ii) involving "qualifying foreign trade property" ("QFTP"); and (iii) if the "foreign economic process requirement" was fulfilled with respect to each such transaction.[10]

15. As regards the first of these conditions, the rules contained in the ETI measure applied, in particular, to income arising from sale, lease or rental transactions. The ETI measure also applied to

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[6] Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW, DSR 2002:I, 119 ("Article 21.5 Panel Report").

[7] The remaining provisions of the ETI Act consist of section 1 containing the short title of the ETI Act and section 4 which sets forth a number of "technical and conforming" amendments.

[8] Subpart C of part III of Subchapter N of chapter 1, consisting of sections 921-927 of the IRC.

[9] Section 3 of the ETI Act, section 943(e) of the IRC.

[10] Under the ETI Act, the need to satisfy these three conditions is subject to a number of exceptions. We examine certain of these exceptions below, to the extent that they are pertinent to our analysis of the issues on appeal.

income earned from the performance of services "related or subsidiary to" qualifying sales or lease transactions, as well as to income earned from the performance of certain other services.[11]

16. The second condition is that these transactions involve QFTP. Section 943(a)(1) of the IRC defined QFTP as property: (A) manufactured, produced, grown or extracted within or outside the United States; (B) held primarily for sale, lease or rental, in the ordinary course of business, for direct use, consumption, or disposition outside the United States; and (C) not more than 50 per cent of the fair market value of which is attributable to: (i) articles manufactured, produced, grown, or extracted outside the United States; and (ii) direct costs for labour performed outside the United States.[12]

17. The third condition is that the "foreign economic process requirement" must be fulfilled with respect to each individual transaction.[13] This requirement is fulfilled if the taxpayer (or any person acting under contract with the taxpayer) participated outside the United States in the solicitation, negotiation, or making of the contract relating to the transaction. Furthermore, a specified portion of the "direct costs" of the transaction must be attributable to activities performed outside the United States.[14]

18. Section 942(a) of the IRC designated as "foreign trading gross receipts" the receipts generated in transactions satisfying all three of these conditions. Under section 114(e) of the IRC, "extraterritorial income" was the gross income attributable to foreign trading gross receipts and, under section 941(b) of the IRC, "foreign trade income" was the taxable income attributable to foreign trading gross receipts.

19. Section 114(a) of the IRC provided that a taxpayer's gross income "does not include extraterritorial income". Section 114(b) of the IRC added that this exclusion of extraterritorial income from gross income "shall not apply" to that portion of extraterritorial income which is not "qualifying foreign trade income" ("QFTI"). Accordingly, the only portion of extraterritorial income which was excluded from gross income – and, thereby, from United States taxation – was QFTI.

20. QFTI was an amount which, if excluded from the taxpayer's gross income, would result in a reduction of the taxable income of the taxpayer from the qualifying transaction. Pursuant to section 941(a)(1) and (2) of the IRC, QFTI would be calculated as the greatest of, or the taxpayer's choice of, the following three options: (i) 30 per cent of the foreign sale and leasing income derived by the taxpayer from such transaction;[15] (ii) 1.2 per cent of the foreign trading gross receipts derived

[11] The detailed rules of the ETI measure provide that foreign trading gross receipts may be earned through (i) any sale, exchange, or other disposition of qualifying foreign trade property; (ii) any lease or rental of qualifying foreign trade property; (iii) any services which are related and subsidiary to (i) and (ii); (iv) for engineering or architectural services for construction projects located (or proposed for location) outside the United States; and (v) for the performance of managerial services for a person other than a related person in furtherance of activities under (i), (ii) or (iii). (section 3 of the ETI Act, section 942(a) of the IRC) We will generally refer to sale and lease transactions as a shorthand reference to the transactions described in (i) and (ii) of this footnote.

[12] Section 3 of the ETI Act, section 943(a)(1) of the IRC. Section 943(a)(3) and (4) of the IRC set forth specific exclusions from this general definition.

[13] Section 3 of the ETI Act, section 942(b) of the IRC.

[14] The relevant activities are: (i) advertising and sales promotion; (ii) processing of customer orders and arranging for delivery; (iii) transportation outside the United States in connection with delivery to the customer; (iv) determination and transmittal of final invoice or statement of account or the receipt of payment; and (v) assumption of credit risk. A taxpayer will be treated as having satisfied the foreign economic process requirement when at least 50 per cent of the total costs attributable to such activities is attributable to activities performed outside the United States, or, for at least two of these five categories of activity, when at least 85 per cent of the total costs attributable to such category of activity is attributable to activities performed outside the United States (section 3 of the ETI Act, section 942(b)(2)(A)(ii), (b)(2)(B) and (b)(3) of the IRC).

[15] Foreign sales and leasing income is defined in section 941(c)(1) of the IRC.

by the taxpayer from the transaction;[16] or (iii) 15 per cent of the foreign trade income derived by the taxpayer from the transaction.[17]

21. The European Communities did not consider that the ETI Act complied with the original recommendations and rulings of the DSB. Specifically, it considered (a) that the United States continued to violate Article 3.1(a), item (e) of Annex I, Article 3.1(b) and Article 3.2 of the *SCM Agreement*, as well as Articles 3, 8 and 10.1 of the *Agreement on Agriculture*; and (b) that the ETI was contrary to Article III:4 of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994").[18]

22. On 20 December 2000, in accordance with Article 21.5 of the DSU, the DSB referred the matter to the original Panel.[19] The Panel report was circulated to the Members of the World Trade Organization (the "WTO") on 20 August 2001. As recalled in more detail in Section III.A below, the Panel found the ETI Act to be inconsistent with Articles 3.1(a), 3.2 of the *SCM Agreement*, 10.1 and 8 of the *Agreement on Agriculture* and III:4 of the GATT 1994. It further found that contrary to Article 4.7 of the *SCM Agreement*, the US had failed to fully withdraw its prohibited subsidy. To the extent the United States had acted inconsistently with the *SCM Agreement*, the *Agreement on Agriculture* and the GATT 1994, the United States had nullified or impaired benefits accruing to the European Communities under those agreements.[20]

23. Following this, on 15 October 2001 the United States notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel.[21] The Appellate Body fully upheld, with modified reasoning, the Panel's findings concerning the FSC and ETI subsidy schemes.

24. On 29 January 2002 the DSB adopted the Panel Report, as modified by the Appellate Body report, declaring that the ETI Act violated Articles 3.1(a), 3.2 and 4.7 of the SCM Agreement, Articles 8, 10.1 and 3.3 of the Agreement on Agriculture and Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), so that the United States had failed to fully withdraw its prohibited subsidy scheme and failed to implement DSB recommendations and rulings in this dispute.

25. On 11 October 2004 the US Senate passed the Jobs Act, completing the Congress approval procedure. On 22 October 2004 the Act was eventually signed into law by the President of the United States and enacted as "The American Jobs Creation Act of 2004". The Jobs Act entered into force on 1 January 2005.

III. THE FINDINGS IN THE ORIGINAL ARTICLE 21.5 PROCEEDING

A. THE PANEL'S FINDINGS

26. The Panel circulated its report in the original proceeding under Article 21.5 of the DSU on 20 August 2001. It found that the ETI Act violates a number of provisions of the *WTO Agreement* and came to the following conclusions:

(a) the Act is inconsistent with Article 3.1(a) of the *SCM Agreement* as it involves subsidies "contingent… upon export performance" within the meaning of

[16] Foreign trading gross receipts are defined in section 942(a) of the IRC.
[17] Foreign trade income is defined in section 941(b) of the IRC.
[18] WT/DS108/16, 8 December 2000.
[19] WT/DS108/19, 5 January 2001.
[20] WT/DS108/RW, para. 9.2.
[21] WT/DS108/21, 15 October 2001.

Article 3.1(a) of the *SCM Agreement* by reason of the requirement of "use outside the United States" and fails to fall within the scope of the fifth sentence of footnote 59 of the *SCM Agreement* because it is not a measure to avoid the double taxation of foreign-source income within the meaning of footnote 59 of the *SCM Agreement*;

(b) the United States has acted inconsistently with its obligation under Article 3.2 of the *SCM Agreement* not to maintain subsidies referred to in paragraph 1 of Article 3 of the *SCM Agreement*;

(c) the Act, by reason of the requirement of "use outside the United States", involves export subsidies as defined in Article 1(e) of the *Agreement on Agriculture* for the purposes of Article 10.1 of the *Agreement on Agriculture* and the United States has acted inconsistently with its obligations under Article 10.1 of the *Agreement on Agriculture* by applying the export subsidies, with respect to both scheduled and unscheduled agricultural products, in a manner that, at the very least, threatens to circumvent its export subsidy commitments under Article 3.3 of the *Agreement on Agriculture* and, by acting inconsistently with Article 10.1, the United States has acted inconsistently with its obligation under Article 8 of the *Agreement on Agriculture*;

(d) the Act is inconsistent with Article III:4 of the *GATT 1994* by reason of the foreign articles/labour limitation as it accords less favourable treatment within the meaning of that provision to imported products than to like products of US origin; and

(e) the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement* and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 *SCM Agreement*.

9.2 Since Article 3.8 of the *DSU* provides that "[i]n cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment", we conclude that to the extent the United States has acted inconsistently with the *SCM Agreement*, the *Agreement on Agriculture* and the *GATT 1994* it has nullified or impaired the benefits accruing to the European Communities under those agreements.

27. Specifically with respect to the transitional and "grandfathering" provisions, which were the subject of the claim relating to Article 4.7 of the *SCM Agreement*, the Panel stated:

> 8.167 We recall that the Act provides that "amendments made by this Act shall apply to transactions after 30 September 2000"[283], and that no new FSCs may be created after 30 September 2000.[284] However, in the case of a FSC in existence on 30 September 2000, the amendments made by the Act shall not apply to any transaction in the ordinary course of trade or business involving a FSC which occurs: (A) before 1 January 2002; or (B) after 31 December 2001, pursuant to a binding contract between the FSC (or any related person) and any unrelated person that is in effect on 30 September 2000.[285]
>
> 8.168 Thus, for FSCs in existence as of 30 September 2000, the FSC subsidies continue in operation for one year and, with respect to FSCs that entered into long-term, binding contracts with unrelated parties before 30 September 2000 the Act does not alter the tax treatment of those contracts for an indefinite period of time. We recall the statement of the Appellate Body in *Brazil - Export Financing Programme for Aircraft, Recourse by Canada to Article 21.5 of the DSU* that, "to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".[286]

> 8.169 We also observe that the United States does not dispute that prohibited FSC subsidies continue to be available after the time-period set for compliance in this dispute.[287]
>
> 8.170 In light of these considerations, we find that the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement* and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 *SCM Agreement*.

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[283] Act, section 5(a).
[284] Act, section 5(b)(1).
[285] Act, section 5(c)(1). The Act specifies that a binding contract shall include a purchase option, renewal option or replacement option which is included in such contract and which is enforceable against the seller or lessor.
[286] Appellate Body Article 21.5 Report, Brazil - Export Financing Programme for Aircraft, Recourse by Canada to Article 21.5 of the DSU, WT/DS46/AB/RW, adopted 4 August 2000, para. 45.
[287] See US first written submission, Annex A-2, para. 224.

B. THE APPELLATE BODY'S FINDINGS

28. The Appellate Body fully upheld the Panel's findings on the substance of this case.[22]

29. Specifically with respect to the claim relating to Article 4.7 of the *SCM Agreement*, the Appellate Body found that:

> 228 Under the ETI Act, no corporation may elect to be treated as an FSC after 30 September 2000.[193] However, for FSCs in existence as of that date, the repeal of the original FSC measure "shall not apply" to any transaction which occurs before 1 January 2002.[194] Moreover, even after that date, existing FSCs can continue to use the original FSC measure for transactions pursuant to a binding contract between the FSC and any unrelated person that was in effect on and after 30 September 2000.[195] Thus, by the United States' own acknowledgement, the original FSC measure continues to apply, unmodified, to existing FSCs in respect of a defined set of transactions.[196] The success of the United States' appeal depends on the success of its argument that prohibited FSC subsidies can continue to be granted to protect the contractual interests of private parties and to ensure an orderly transition to the regime of the new measure. In short, on the basis of these arguments, the United States seeks to have the time-period for the full withdrawal of the prohibited FSC subsidies extended, in some circumstances, indefinitely.
>
> 229 Article 4.7 of the *SCM Agreement* requires prohibited subsidies to be withdrawn "without delay", and provides that a time-period for such withdrawal shall be specified by the panel. We can see no basis in Article 4.7 of the *SCM Agreement* for extending the time-period prescribed for withdrawal of prohibited subsidies for the reasons cited by the United States. In that respect, we recall that, in *Brazil – Aircraft (Article 21.5 – Canada)*, Brazil made a similar argument to the one made by

[22] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55 ("Article 21.5 Appellate Body Report").

the United States in these proceedings. Brazil argued that, after the expiration of the time-period for withdrawal of the prohibited export subsidies, it should be permitted to continue to grant certain of these subsidies because it had assumed contractual obligations, under municipal law, to do so.[197] We rejected this argument, and observed that:

> … to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".[198]

230 Thus, as we indicated in that appeal, a Member's obligation under Article 4.7 of the *SCM Agreement* to withdraw prohibited subsidies "without delay" is unaffected by contractual obligations that the Member itself may have assumed under municipal law. Likewise, a Member's obligation to withdraw prohibited export subsidies, under Article 4.7 of the *SCM Agreement*, cannot be affected by contractual obligations which private parties may have assumed *inter se* in reliance on laws conferring prohibited export subsidies. Accordingly, we see no legal basis for extending the time-period for the United States to withdraw fully the prohibited FSC subsidies.

231 Accordingly, we uphold the Panel's finding, in paragraphs 8.170 and 9.1(e) of its Report, that the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the *SCM Agreement*. *(underlining added)*

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[193] Section 5(b)(1) of the ETI Act.
[194] Section 5(c)(1)(A) of the ETI Act.
[195] See section 5(c)(1)(B)(ii) of the ETI Act.
[196] Panel Report, para. 8.169.
[197] Appellate Body Report, Brazil – Aircraft (Article 21.5 – Canada), supra, footnote 86, para. 46.
[198] Ibid., para. 45.

IV. SUMMARY OF PROCEDURE LEADING TO THE PRESENT ARTICLE 21.5 PROCEEDING

30. On 5 November 2004, the European Communities requested consultations with the United States of America with a view to reaching a mutually satisfactory solution of the matter. The request was circulated in document WT/DS/108/27, dated 10 November 2004. Consultations were held on 11 January 2005 in Geneva. They have allowed a better understanding of the respective positions but have not led to a satisfactory resolution of the matter.

31. Therefore, there continues to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB between the United States and the European Communities, within the meaning of Article 21.5 of the DSU.

32. Accordingly, on 13 January 2005, pursuant to Articles 6 and 21.5 of the DSU, Article 4 of the *SCM Agreement*, Article 19 of the *Agreement on Agriculture* and Article XXIII of the GATT 1994, the European Communities requested the establishment of a Panel. The request was circulated in document WT/DS/108/29, dated 14 January 2005.

33. At its meeting on 17 February 2005, the DSB referred this dispute, if possible, to the original Panel in accordance with Article 21.5 of the DSU to examine the matter referred to the DSB by the European Communities in document WT/DS108/29. At that DSB meeting, the parties to the dispute also agreed that the Panel should have standard terms of reference. The Panel was composed on 2 May 2005.

V. THE JOBS ACT

A. SUMMARY OF THE JOBS ACT

34. The Jobs Act introduces a new US manufacturing tax deduction and makes numerous other changes to US tax rules, most of which are unrelated to the FSC or ETI subsidy schemes (section 102 ff. of the Jobs Act). It also provides for repeal of certain provisions of the ETI Act and is thus the purported US compliance with the previous Panel and Appellate Body reports in this dispute.

1. The limited scope of the repeal (section 101(a)-(b) of the Jobs Act)

35. Section 101 (a) of the Jobs Act repeals certain provisions inserted into the IRC by the ETI Act.

First, the Jobs Act repeals section 114 of the IRC (section 101(a) of the Jobs Act);

It further repeals "Subpart E of Part III of subchapter N of chapter 1 (relating to qualifying foreign trade income)", which were inserted into the IRC by section 3 of the ETI Act (section 101(b)(1) of the Jobs Act);

Last, the Jobs Act provides for certain "conforming amendments" of the IRC to take account of the fact that it repeals the parts of the IRC just mentioned (section 101(b)(2) to (6) of the Jobs Act).

2. What the Jobs does not repeal immediately, or does not repeal at all

36. Although section 101 of the Jobs Act repeals section 114 of the ETI Act, it does not repeal the provisions contained in other relevant sections of the ETI Act. In particular, it does not repeal section 2 (entitled "Repeal of Foreign Sales Corporation rules") and section 5 (entitled "Effective date"). This means that the repeal of the FSC scheme, set out in section 2 of the ETI Act, continues to operate, but it does so subject to the limitations in section 5. Of these limitations, the first one provided for the full survival of the FSC scheme for a transitional period which has now expired. The second one concerns the continuing effects (potentially indefinitely) of the scheme for transactions relating to certain binding contracts entered into by FSCs in existence on 30 September 2000 (see section 5 (c) of the ETI Act).

37. The continuing effect of section 5 of the ETI Act demonstrates that there is still no correct implementation of the original Panel report in this dispute. The FSC scheme is, in part, still effective.

38. Second, in the period between promulgation and 31 December 2004, the Jobs Act did not apply (section 101(c) of the Jobs Act). This means that US exporters have continued benefiting fully from the ETI scheme for all export transactions agreed up to the end of 2004.

39. Third, for export transactions in the period between 1 January 2005 and 31 December 2006, the ETI scheme remains available on a reduced basis (section 101(d) of the Jobs Act). Yet, during this transition period the ETI scheme is maintained for any transaction falling within its scope.

40. Fourth, for certain transactions the repeal of the ETI provisions simply does not apply (section 101(f) of the Jobs Act). The ETI scheme is "grandfathered" (that is, continues to apply) for the

benefit of all transactions pursuant to a binding contract (1) which is between the taxpayer and a person who is not a related person (as defined in section 943(b)(3) of such Code, as in effect on the day before the date of the enactment of this Act), and (2) which is in effect on 17 September 2003, and at all times thereafter.

B. TABLE COMPARING THE TRANSITIONAL AND "GRANDFATHERING" CLAUSES OF THE ETI AND JOBS ACT

41. The virtual identity of the "transitional" and "grandfathering" clauses in the Jobs Act with the ones included in the ETI Act is immediately apparent:

ETI ACT	JOBS ACT	RESULT/EFFECT
[…] Sec. 5. Effective date. (a) In General.–The amendments made by this Act shall apply to transactions after 30 September 2000. […] (c) Transition period for existing Foreign Sales Corporations.– (1) In general.–In the case of a FSC (as so defined) in existence on 30 September 2000, and at all times thereafter, the amendments made by this Act shall not apply to any transaction in the ordinary course of trade or business involving a FSC which occurs- (A) before 1 January 2002; or (B) after 31 December 2001, pursuant to a binding contract– (i) which is between the FSC (or any related person) and any person which is not a related person; and (ii) which is in effect on 30 September 2000, and at all times thereafter. For purposes of this paragraph, a binding contract shall include a purchase option, renewal option, or replacement option which is included in such contract and which is enforceable against the seller or lessor.	[…] Sec. 101 REPEAL ON EXCLUSION FOR EXTRATERRITORIAL INCOME […] (c) EFFECTIVE DATE.– The amendments made by this section shall apply to transactions after 31 December 2004. (d) Transitional rule for 2005 and 2006.– (1) In general.– In the case of transactions during 2005 or 2006, the amount includible in gross income by reason of the amendments made by this section shall not exceed the applicable percentage of the amount which would have been so included but for this subsection. (2) Applicable percentage.– For purposes of paragraph (1), the applicable percentage shall be as follows: (A) For 2005, the applicable percentage shall be 20 per cent. (B) For 2006, the applicable percentage shall be 40 per cent. […] (f) Binding contracts.– The amendments made by this section shall not apply to any transaction in the ordinary course of a trade or business which occurs pursuant to a binding contract– (1) which is between the taxpayer and a person who is not a related person (as defined in section 943(b)(3) of such Code, as in effect on the day before the date of the enactment of this Act), and (2) which is in effect on 17 September 2003, and at all times thereafter. For purposes of this subsection, a binding contract shall include a	*Transitional period**: → **ETI benefits will still be available during the transition period**, i.e. in 2005 and 2006, as follows: 80% in 2005, 60% in 2006 (on the contrary to the ETI Act, the JOBS Act does not provide for enjoyment in full during the transition period). → **Apart from the reduction in amount, the ETI Act continues to apply as usual during the transition period**. Therefore the violations of the SCM Agreement, of the Agreement on Agriculture and of Article III:4 of the GATT 1994 persist. (**See section C below*) *Grandfathering clause**: → The ETI Act will continue to be available to all exporters who have engaged themselves contractually to provide goods, i.e. via: - a binding contract (for sale or lease of goods that have already been sold or leased, or goods which may be sold or leased in the future through the exercise of an option); - or a purchase, option, renewal option or replacement option which is included in such a contract and which is enforceable against the seller or lessor ['enforceable' being interpreted in a flexible way –

ETI ACT	JOBS ACT	RESULT/EFFECT
	purchase option, renewal option, or replacement option which is included in such contract and which is enforceable against the seller or lessor.	see §50]. *(*See section D below*)

C. THE TRANSITIONAL PERIOD

42. For the years 2005 and 2006, pursuant to section 101(d) of the Jobs Act, the ETI benefits are still available as follows:

- 80 per cent in 2005
- 60 per cent in 2006.

43. Even taking as a basis (for purely illustrative purposes) the US$4043 million mentioned in the Arbitrator's Decision in this dispute[23] (which is a lesser amount than actually budgeted for the ETI Act in 2004), the ETI Act would still confer a subsidy for US$3234.4 million and US$2425.8 million for 2005 and 2006 respectively.

44. There are only three differences between the transitional clause of the ETI Act and that of the Jobs Act. First, the end dates are different. Second, the duration of the transition period of the Jobs Act is longer than the one of the ETI Act (from 1 January 2005 to 31 December 2006 in the Jobs Act, from 1 October 2000 to 31 December 2001 in the ETI Act.). Third, whereas for the transition period the ETI Act provided for continuing enjoyment in full, the transition period of the Jobs Act provides for enjoyment of 80 per cent and 60 per cent of the otherwise applicable benefits in the first and second year respectively.

45. These differences do not of course warrant any distinction from the situation reviewed by this Panel and the Appellate Body in the original Article 21.5 proceedings. The basis for the Panel's and the Appellate Body's findings was the fact that the WTO inconsistent subsidy continued to be available after the date set out in the original Panel report for its withdrawal "without delay". The same reasoning applies to the new transition and grandfathering provisions contained in the Jobs Act.

46. Apart from the gradual reduction in amount, during the transitional period the ETI Act will continue to apply as usual. Thus, the benefits will continue to be available to any US producer exporting goods in 2004, 2005 and 2006, provided those goods meet the "foreign content limitation" or "fair market value rule".

47. Therefore, the violations of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994 persist to this date.

48. Also, the United States will *inter alia* be maintaining prohibited export subsidies for 6 years beyond the deadline set in the original Panel Report for withdrawal "without delay", contrary to Article 4.7 of the *SCM Agreement*.

[23] Arbitrator Decision, *United States – Tax Treatment for "Foreign Sales Corporations", Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS108/ARB, 30 August 2002, para. A34.

D. *THE "GRANDFATHERING CLAUSE"*

49. The Jobs Act does not apply to any transaction in the ordinary course of a trade pursuant to a binding contract (1) which is between the taxpayer and a person who is not a related person (as defined in section 943(b)(3) of the IRC), and (2) which was already in effect on 17 September 2003 (the date of the introduction of the bill before the Senate). In other words, the ETI Act will continue to be available to all exporters who have engaged themselves contractually to provide goods. Moreover, just like the ETI Act the Jobs Act contains a provision according to which a "binding contract shall include a purchase option, renewal option, or replacement option which is included in such contract and which is enforceable against the seller or lessor."

50. The Joint Explanatory Statement of the Committee of Conference already interprets the term "binding contract" in a flexible way by specifying that

> a replacement option will be considered enforceable against a lessor notwithstanding the fact that a lessor retained approval of the replacement lessee.[24]

51. The grandfathering clause applies to both sale and leasing contracts. Furthermore, these contracts cover (1) goods that have already been sold or leased as well as (2) goods which may be sold or leased in the future if the buyer/lessee exercises an option.

52. With respect to goods already sold or leased, grandfathering covers sales contracts the goods relating to which have already been ordered but not yet exported, or lease contracts which expire some time in the future but which, under US accounting rules, only produce ETI benefits at the end of their life.

53. The differences between the "grandfathering" clause of the ETI Act and that of the Jobs Act are even fewer than for the transition clauses. The Jobs Act does no more than replacing "FSC" by "taxpayer" and provides an express cross-reference to the IRC provision defining "related persons".

VI. LEGAL ARGUMENT

A. INTRODUCTION

54. The essential reason why the Jobs Act is inconsistent with the WTO obligations of the United States is that it does not entirely remove the prohibited subsidies which were required to be withdrawn as a result of the previous recommendations of the DSB nor does it remove the violation of Article III:4 of the GATT 1994. This constitutes a violation of Article 4.7 of the *SCM Agreement* and of Articles 19.1 and 21.1 of the DSU. The European Communities sets out the reasoning leading to this conclusion in Section VI.B below.

55. As a consequence of the prohibited subsidies not having been withdrawn, the violations of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994, persist. This consequential conclusion is set out in Section VI.C below.

[24] House of Representatives, 108th Congress, 2nd Session, American Job Creation Act of 2004, Conference Report to accompany H.R. 4520, Report 108-755, 7 October 2004 (excerpt in **Exhibit EC-3**, full text available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_reports&docid=f:hr755.108.pdf), p. 265, footnote 7.

B. THE UNITED STATES CONTINUES TO VIOLATE ARTICLE 4.7 OF THE SCM AGREEMENT AND ARTICLES 19.1 AND 21.1 OF THE DSU

56. The Panel and the Appellate Body found in the first Article 21.5 proceeding that the transitional and "grandfathering" clauses permitting continued availability of FSC subsidies meant that the United States had failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the *SCM Agreement*.[25] The Panel exercised judicial economy in respect of the violation of Article 21 of the DSU claimed by the European Communities in that proceeding.[26]

57. The Appellate Body upheld this finding and expressly recognised that Article 4.7 of the *SCM Agreement* contains an obligation for an implementing Member to withdraw subsidies declared to be prohibited "without delay" and that there was no legal basis for extending the time-period in order to protect "private parties".[27]

58. As the European Communities has explained in Section V.A.2 above, the grandfathering clause for FSC subsidies contained in section 5(c)(1)(B) of the ETI Act is still in force and so this violation Article 4.7 of the *SCM Agreement* subsists.

59. Further, as the European Communities has explained in Sections V.B, C and D above, the transitional and grandfathering clauses in the Jobs Act are identical in all material respects to those in the ETI Act, except that they provide for continued availability of ETI subsidies rather than FSC subsidies. Accordingly, they are also inconsistent with the obligation of the United States to withdraw the ETI subsidies without delay pursuant to Article 4.7 of the *SCM Agreement* for the same reasons.

60. The fact that the FSC and ETI subsidies will remain available for quite some time is confirmed by the estimate of the budget effects of the Jobs Act circulated by the US Congress Joint Committee on Taxation on 5 October 2004, which stretches to year 2014.[28]

61. The continuing availability of FSC and ETI subsidies also gives rise to a continued violation of Article III:4 of the GATT 1994. This is not inconsistent with Article 4.7 of the *SCM Agreement* but only with Articles 19.1 and 21.1 of the DSU.

62. Article 19.1 of the DSU provides as follows:

> Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement. In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations. (footnotes omitted)

63. The first sentence of Article 19.1 of the DSU is virtually identical to the first sentence of Article 4.7 of the DSU. It therefore follows that the maintenance of the less favourable treatment of imported as compared to domestic products inherent in the ETI scheme is inconsistent with Article 19.1 of the DSU.

64. Article 21.1 of the DSU provides as follows:

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[25] Article 21.5 Panel Report, paras 8.170 and 9.1(e).

[26] Article 21.5 Panel Report, para. 8.171.

[27] Article 21.5 Appellate Body Report, paras. 230, 231 and 256(f).

[28] Joint Committee on Taxation, Estimated budget effects of the Chairman's mark relating to H. R. 4520, the "American Jobs Creation Act of 2004", 5 October 2004 (**Exhibit EC-4**), p. 1. The figures of this estimate are maintained in the Congressional Budget Office Cost Estimate for the American Jobs Creation Act of 2004, Revised 9 November 2004 (**Exhibit EC-5**), p. 2.

> Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.

65. Since there was no reasonable period of time for the implementation of the recommendations in the first Article 21.5 proceeding pursuant to Article 21.3, the United States was accordingly under a duty to remove the violation of Article III:4 of the GATT 1994 immediately. It has failed to do so and the violation is ongoing and continuing into the future. There is therefore also a violation of Article 21.1 of the DSU.

C. THE UNITED STATES CONTINUES TO VIOLATE ARTICLES 3.1(A) AND 3.2 OF THE SCM AGREEMENT, ARTICLES 10.1, 8 AND 3.3 OF THE AGREEMENT ON AGRICULTURE AND ARTICLE III:4 OF THE GATT 1994

66. Since, as established above, the Jobs Act still maintains the FSC and ETI subsidies (a) up to 2006 and (b) for transactions mentioned in section 101(f) of the Jobs Act, potentially indefinitely, it continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994.

67. The reasons for these inconsistencies are set out in the Appellate Body and Panel reports in the original proceeding and the first Article 21.5 proceeding and are incorporated by reference in this submission. These reports have all been adopted by the DSB and are *res judicata* and, thus, indisputable as between the parties. Article 17.14 of the DSU expressly provides that adopted Appellate Body reports shall be unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the reports (which it did not). The Appellate Body has confirmed that the same principle applies to panel reports by virtue of Articles 16.4 and 19.1, paragraphs 1 and 3 of Article 21, and Article 22.1 of the DSU.[29]

68. Accordingly, since it is established that the subsidies have not been withdrawn, it cannot be denied and the Panel has to find that these subsidies remain inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994 and the United States remains in violation of these provisions.

VII. CONCLUSION

69. For the above reasons the European Communities requests the Panel to find that:

- By not entirely withdrawing FSC and ETI subsidies, the United States has failed to comply with the recommendations and rulings of the DSB and Article 4.7 of the *SCM Agreement*;

- By not entirely withdrawing FSC and ETI subsidies and consequently maintaining the less favourable treatment of imported as compared to domestic products, the United States has failed to comply with the recommendations and rulings of the DSB and its obligations under Articles 19.1 and 21.1 of the DSU;

- These subsidies remain inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994 and the United States remains in violation of these provisions;

[29] Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, para. 93.

and consequently to find that there is nullification or impairment of benefits accruing to the European Communities and to recommend that the United States withdraw its prohibited subsidies without delay and otherwise bring the measures into conformity with the *WTO Agreement.*

LIST OF EXHIBITS

EC-1 *The American Jobs Creation Act of 2004*, H.R. 4520, 118 Stat. 1418, Public Law 108–357, 22 October 2004

EC-2 *FSC Repeal and Extraterritorial Income Exclusion Act of 2000*, 15 November 2000, US Public Law 106-519, 114 Stat. 2423 (2000)

EC-3 House of Representatives, 108th Congress, 2nd Session, American Jobs Creation Act of 2004, Conference Report to accompany H.R. 4520, Report 108-755, 7 October 2004

EC-4 Estimated budget effects of the Chairman's mark relating to H. R. 4520, the "American Jobs Creation Act of 2004", 5 October 2004

EC-5 Congressional Budget Office, Cost Estimate for the American Jobs Creation Act of 2004, Revised 9 November 2004

ANNEX A-2

FIRST WRITTEN SUBMISSION OF THE UNITED STATES

(2 June 2005)

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US – FSC (Article 21.5) (Panel)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW
US – FSC (Article 21.5) (AB)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002

I. INTRODUCTION

1. It is with regret that the United States makes this written submission. In the *American Jobs Creation Act of 2004* ("AJCA"),[1] the United States repealed the income tax exclusion provided for in the *Extraterritorial Income Exclusion Act of 2000* ("ETI Act"). However, the European Communities ("EC") has sought to prolong this dispute by challenging the transition provisions contained in the AJCA – specifically, sections 101(d) and (f). The EC has done so notwithstanding the fact that these transition provisions are reasonable, are consistent with standard practice regarding major tax legislation, and are the product of close consultations between US and EC officials.

2. Be that as it may, the EC's claims are unfounded. As demonstrated below, the transition provisions of the AJCA are not inconsistent with Article 4.7 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") because, in the prior proceeding under Article 4 of the SCM Agreement and Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), there was no recommendation or ruling, pursuant to Article 4.7, by the Dispute Settlement Body ("DSB") that the ETI Act tax exclusion should be withdrawn. Thus, while the United States has repealed the ETI Act tax exclusion, in the absence of any recommendation or ruling of withdrawal under Article 4.7, this Panel cannot find that the United States has failed to comply with a DSB recommendation or ruling to withdraw its prohibited subsidies within the meaning of Article 4.7 of the SCM Agreement.

3. In this submission, the United States first will describe the purpose of the transition provisions, and the process by which these provisions were developed. Thereafter, the United States will present its legal arguments.

II. FACTUAL BACKGROUND

4. The purpose of transition provisions, such as sections 101(d) and (f) of the AJCA, is to provide a smooth and orderly transition in order to prevent the repeal of tax legislation from having a retroactive effect on taxpayers who entered into arrangements in reliance on pre-repeal law. As such, this basic principle of non-retroactivity is similar to the principles of "legal certainty" and "legitimate expectations" that play such an important role in the legal regimes of many WTO Members.

5. The rules embodied in sections 101(d) and (f) are consistent with the transition rules that are typically included in major US tax legislation. Section 101(d) – the general transition provision – provides for a two-year phase out of the ETI Act tax exclusion. Section 101(f) – the "grandfather" provision – exempts certain pre-existing binding contracts from the repeal of the ETI Act tax exclusion.

6. During the development of the AJCA, US officials consulted closely with officials of the European Communities at all levels. US officials explained the types of transition rules that are standard in US tax legislation, and emphasized that such rules were essential in order to obtain Congressional passage of the repeal of the ETI Act tax exclusion.

7. With respect to the general transition provision, the EC stated that its primary concern was that the transition period not exceed two years. Although there were legislative proposals then pending for transition periods as long as five years, Congress accommodated the EC's concerns by limiting the transition period to two years, and by reducing the amount of the tax exclusion in each year. Congress did so with the understanding that, together with repeal, limiting the transition period to two years would resolve the dispute.

[1] Exhibit EC-1.

8. With respect to the grandfather provision of section 101(f), the EC officials never indicated to US officials that they had a problem with a grandfather provision *per se*. In the AJCA, Congress limited the grandfather provision to certain transactions that occur pursuant to a binding contract (1) between the taxpayer and an unrelated party (2) entered into before 17 September 2003, and (3) which has been binding on both parties at all times since that date. Congress chose 17 September 2003, because that was the date legislation to repeal the ETI Act was submitted in the US Senate. Because legislation to repeal the ETI Act tax exclusion previously had been submitted in the US House of Representatives, as of 17 September 2003, taxpayers were on notice that there was legislation in both houses of Congress to repeal the ETI Act tax exclusion and that, when entering into new contracts, they no longer could count on the continued existence of the ETI Act tax exclusion. Adoption by the AJCA of an earlier date also would have been inconsistent with common practice regarding tax legislation that effectuates major changes in tax law. In any event, the cut-off date of 17 September 2003, significantly limited the availability of the grandfather provision, because the AJCA was not enacted until 22 October 2004.

9. Sections 101(d) and (f) did not contain any surprises for the EC. Each element of these provisions was contained in either the House or Senate versions of the legislation, and each element had been explained to EC officials prior to passage of the AJCA. In particular, by limiting the general transition period to two years, Congress accommodated what EC officials had indicated was their primary concern. In so doing, Congress understood that this would resolve the dispute. Regrettably, however, the EC has chosen to prolong the dispute.[2]

III. LEGAL ARGUMENT

A. IN THE ABSENCE OF ANY RECOMMENDATION OF WITHDRAWAL UNDER ARTICLE 4.7, THIS PANEL CANNOT FIND THAT THE UNITED STATES HAS FAILED TO WITHDRAW ITS PROHIBITED SUBSIDIES WITHIN THE MEANING OF ARTICLE 4.7 OF THE SCM AGREEMENT

10. In commencing this proceeding against sections 101(d) and (f) of the AJCA, the EC, as it did in the first Article 21.5 proceeding, has alleged that the United States has "failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002" because it has "failed to withdraw its prohibited subsidies as required by Article 4.7 of the SCM Agreement."[3] However, the United States has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the AJCA are not inconsistent with Article 4.7 of the SCM Agreement, for the simple reason that, as explained below, there was no DSB recommendation or ruling under Article 4.7 to withdraw the subsidy insofar as the ETI Act tax exclusion is concerned.

11. This dispute began with an EC challenge to the Foreign Sales Corporation ("FSC") provisions of US tax law. The original Panel found that the FSC provisions constituted export subsidies that were prohibited by Articles 3.1(a) and 3.2 of the SCM Agreement.[4] Pursuant to Article 4.7 of the SCM Agreement, the original Panel recommended that the United States withdraw the FSC subsidy with effect from 1 October 2000.[5] The Appellate Body subsequently modified the original Panel's reasoning, but affirmed the original Panel's findings under the SCM Agreement.[6]

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[2] While the United States is not in a position to speculate on the EC's reasons for prolonging this dispute, such speculations have appeared in the press. *See Lamy Links Airbus Case to EU Willingness to Accept FSC Repeal Bill*, INSIDE US TRADE (1 Oct. 2004), page 23.

[3] WT/DS108/29 (14 January 2005), page 2.

[4] *US – FSC (Panel)*, para. 8.1(a).

[5] *US – FSC (Panel)*, para. 8.8. The DSB later modified the withdrawal deadline to 1 November 2000.

[6] *US – FSC (AB)*, para. 177(a).

12. Subsequently, the United States enacted the ETI Act. The ETI Act repealed the FSC tax exemption, but also contained a general transition provision and a grandfather provision that allowed the FSC tax exemption to be claimed after 1 November 2000. The EC initiated a proceeding under Article 4 of the SCM Agreement and Article 21.5 of the DSU in which it essentially complained of two things. First, it claimed that the ETI Act's transition provisions resulted in a failure to withdraw the FSC tax exemption as required by the original Panel's recommendation pursuant to Article 4.7. Second, it alleged that the ETI Act tax exclusion constituted an export subsidy in its own right.

13. With respect to the ETI Act's transition provisions relating to the FSC tax exemption, the Article 21.5 Panel found that these provisions resulted in a failure on the part of the United States to withdraw the FSC subsidies found to be prohibited in the original proceeding and, thus, to implement the recommendations and rulings of the DSB pursuant to Article 4.7 of the SCM Agreement.[7] The Appellate Body affirmed this finding.[8] The EC acknowledges that the transition provision has expired and is not at issue in this dispute.[9]

14. With respect to the ETI Act tax exclusion, the Article 21.5 Panel found that the exclusion constituted an export subsidy inconsistent with Article 3.1(a) of the SCM Agreement.[10] The Appellate Body affirmed this finding.[11] However, while the Article 21.5 Panel found that the ETI Act tax exclusion constituted a prohibited export subsidy, it did not make a recommendation pursuant to Article 4.7 that the subsidy be withdrawn, notwithstanding the fact that the EC had initiated the panel proceeding pursuant to Article 4 of the SCM Agreement.[12]

15. For its part, the Appellate Body recommended that the DSB request the United States to bring the ETI measure into conformity with its obligations under Article 3.1(a) of the SCM Agreement, as well as provisions of the *Agreement on Agriculture* and Article III:4 of the *GATT 1994*.[13] However, with respect to the ETI Act tax exclusion, the Appellate Body did not make any recommendations pursuant to Article 4.7 of the SCM Agreement. To the extent that the Appellate Body made a recommendation referencing Article 4.7, it recommended "that the DSB request the United States to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."[14] By citing to the original proceeding regarding the FSC provisions, the Appellate Body clearly was referring to the recommendation that the FSC subsidy – not the ETI Act subsidy – be withdrawn.

16. Thus, the DSB did not recommend or request pursuant to Article 4.7 that the ETI Act subsidy be withdrawn or that it be withdrawn within a particular time. In the absence of any such recommendation or request, it cannot be found that by including reasonable transition provisions in the AJCA – which pertain to the ETI Act tax exclusion, not the FSC tax exemption – the United States has failed to comply with some DSB recommendation or ruling to withdraw, within the meaning of Article 4.7, the ETI Act tax exclusion.

17. The jurisdiction of a panel under Article 21.5 of the DSU is limited - it is limited to "measures taken to comply with the recommendations and rulings." Here, the EC has chosen to invoke the

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[7] *US – FSC (Article 21.5) (Panel)*, paras. 8.170 and 9.1(e).
[8] *US – FSC (Article 21.5) (AB)*, para. 256(f).
[9] *First Written Submission of the European Communities* (19 May 2005), para. 36.
[10] *US – FSC (Article 21.5) (Panel)*, paras. 8.75 and 9.1(a).
[11] *US – FSC (Article 21.5) (AB)*, para. 256(b).
[12] WT/DS108/16 (8 December 2000). The absence of a recommendation appears to have been the result of the EC's insistence that the Article 21.5 Panel not make any recommendation, notwithstanding the fact that it was the EC that had invoked Article 4 of the SCM Agreement. *US – FSC (Article 21.5) (Panel)*, para. 7.5 (discussing EC comment on the Article 21.5 Panel's interim report).
[13] *US – FSC (Article 21.5) (AB)*, para. 257.
[14] *US – FSC (Article 21.5) (AB)*, para. 257.

aspect of the Panel's jurisdiction involving the alleged failure of the United States to comply with a DSB recommendation or ruling concerning Article 4.7 of the SCM Agreement. However, there is no such recommendation or ruling.

18. Article 4.7 of the SCM Agreement provides as follows:

> If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time period within which the measure must be withdrawn.

19. Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion. Therefore, while the United States has repealed the ETI Act, it was not precluded from adopting reasonable transition provisions to govern the phase-out of the ETI Act tax exclusion. Furthermore, there is no basis for an Article 21.5 panel to make a finding of compliance or noncompliance with a DSB recommendation or ruling under Article 4.7 of the SCM Agreement in this dispute, and thus the Panel should reject the EC's claims under Article 4.7 of the SCM Agreement.

B. SECTION 5 OF THE ETI ACT IS NOT WITHIN THE PANEL'S TERMS OF REFERENCE

20. The measures before this Panel are sections 101(d) and (f) of the AJCA, the transition provisions concerning the ETI Act tax exclusion. In its panel request, the EC does not allege that other provisions of the AJCA are inconsistent with US obligations under the WTO agreements.[15] Moreover, while the EC makes references in its first written submission to section 5 of the ETI Act[16], which included transition provisions for the FSC tax exemption, section 5 is not mentioned in the EC's panel request, and, thus, is not within the Panel's terms of reference.[17]

IV. CONCLUSION

21. For the foregoing reasons, the United States respectfully requests that the Panel reject the EC claims.

[15] WT/DS108/29 (14 January 2005).
[16] *See, e.g., First Written Submission of the European Communities* (19 May 2005), paras. 36-37.
[17] WT/DS108/29 (14 January 2005).

ANNEX B

SECOND SUBMISSIONS OF THE PARTIES

ANNEX B-1

SECOND WRITTEN SUBMISSION OF THE EUROPEAN COMMUNITIES

(16 June 2005)

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I. INTRODUCTION

1. The US First Written Submission in this proceeding does not call for a long reply on the part of the European Communities.

2. The United States has not contested the substance of the EC claims. It does not argue that the JOBS Act is WTO-compatible in respect of any of the claims advanced by the European Communities (although it makes certain unsubstantiated and irrelevant assertions as to the "understanding" by the US Congress and others about the "EC's concerns" on which the European Communities will not comment further).[1] Rather, the United States confines itself to raising two procedural arguments. As demonstrated below, those arguments are without merit and should be dismissed.

3. The European Communities will first examine the US argument according to which, in the absence of a recommendation under Article 4.7 of the SCM Agreement expressly addressing the ETI Act, the United States can keep the transition and "grandfathering" provisions of the JOBS Act in force. It will then turn to the United States argument that section 5 of the ETI Act is not before the Panel.

II. LEGAL ARGUMENT

A. INTRODUCTION

4. The United States does not contest the substance of the EC claims. In particular it does not contest that, by partially maintaining in force the ETI Act and the FSC provisions, even after the promulgation of the JOBS Act, it continues to violate a number of obligations which it has under the WTO Agreement (specifically, under Articles 3.1(a) and 3.2 of the SCM Agreement, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture, and Article III:4 of the GATT 1994).[2]

5. The United States also does not contest the violation of Articles 19.1 and 21.1 of the DSU.

B. WHETHER THE UNITED STATES MAY MAINTAIN THE ETI SCHEME

6. The focus of the US procedural defence is the extraordinary proposition that

> in the absence of any recommendation or ruling of withdrawal under Article 4.7, this Panel cannot find that the United States has failed to comply with a DSB recommendation or ruling to withdraw its prohibited subsidies within the meaning of Article 4.7 of the SCM Agreement[3]
>
> and that
>
> the United States has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the AJCA are not inconsistent with Article 4.7 of the SCM Agreement, for the simple reason that, as explained below, <u>there was no DSB recommendation or ruling under Article 4.7</u> to withdraw the subsidy <u>insofar as the ETI Act tax exclusion is concerned</u>.[4]

[1] US First Written Submission, para. 6.
[2] EC First Written Submission, para. 55.
[3] US First Written Submission, para. 2.
[4] US First Written Submission, para. 10 (emphasis added).

1. The DSB adopted rulings concerning the ETI scheme

7. The United States is rather playing with words in making this procedural objection. For one thing, even if the DSB did not make a new recommendation, it certainly made rulings by adopting the reports of the Panel and the Appellate Body containing findings to the effect that the ETI Act is inconsistent with the SCM Agreement, the Agreement on Agriculture and the GATT 1994. These rulings comprise in particular the findings set out in paragraph 9.1(a)-(d) of the Article 21.5 Panel Report and upheld in paragraph 256 (b)-(e) of the Article 21.5 Appellate Body Report. If the reports did not contain the necessary findings or recommendations, it would mean that the DSB achieved nothing at its special meeting convened to adopt the reports which was held on 29 January 2002.[5]

8. The United States does not contest that section 101 of the JOBS Act was adopted to comply with these rulings.

2. Article 4.7 of the SCM Agreement

9. The US position quoted above also seems to erroneously assume that a recommendation under Article 4.7 of the SCM Agreement specifically addressing the ETI Act, and additional to the original recommendation under the same provision concerning the withdrawal of the FSC subsidy scheme, is necessary in order for it to be under an obligation to withdraw the ETI subsidy scheme.

10. This position misunderstands the function of the Article 21.5 proceedings. Such proceedings, as noted by the United States elsewhere in its submission[6], concern measures taken to comply with recommendations and rulings.[7] Thus, it logically follows that in the first Article 21.5 proceeding it was sufficient for the Panel to find that, by promulgating the ETI Act, the United States has not withdrawn its prohibited subsidy (in other words, that the United States had not complied with the original recommendation to withdraw the prohibited subsidy).

11. Precisely because a measure challenged in an Article 21.5 proceeding is "taken to comply" with earlier recommendations and rulings, and because "compliance" is the focus of such proceeding, a panel is not required to also make a new recommendation under Article 4.7 specifically concerned with the measure "taken to comply" (although it will need to make findings concerning the consistency of the new measure with the covered agreements).

12. In the same way, if the measure under review in such a proceeding is found not to be "consistent with a covered agreement", the defaulting Member is not entitled to a new deadline to "withdraw the subsidy without delay" within the meaning of Article 4.7 of the SCM Agreement, contrary to what the United States seems to suggest.[8] Otherwise, the defaulting Member would be rewarded for its continuing non-compliance. Therefore, a new recommendation would also not perform any function additional to that performed by the one in the original proceeding.

13. The Appellate Body confirmed this approach in its Report in the original Article 21.5 proceedings and, contrary to the US assumption,[9] the fact that the Panel or the Appellate Body did not

[5] WT/DSB/M/118, 18 February 2002.

[6] US First Written Submission, para. 17.

[7] Even though, as clarified by the Appellate Body in its Article 21.5 Report in *Canada - Aircraft (Article 21.5)*, a panel is not confined to examining the "measures taken to comply" from the perspective of the claims, arguments and factual circumstances relating to the measure originally challenged, but may also examine further claims which are pertinent to the "measure taken to comply" under review (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 4 August 2000 ("*Canada - Aircraft – Article 21.5*"), DSR 2000:IX, 4299, para. 41).

[8] US First Written Submission, para. 16.

[9] US First Written Submission, para. 15.

make a new recommendation under Article 4.7 does not help the US case. First, as recalled in the EC First Written Submission, the Appellate Body clearly upheld the Panel's finding that the transition and "grandfathering" clauses of the ETI Act do not conform with the original recommendation and rulings.[10] Moreover, the Appellate Body closely linked its findings on the ETI Act and the original recommendation under Article 4.7 of the SCM Agreement, in the following terms:

> 257. The Appellate Body *recommends* that the DSB request the United States to bring the ETI measure, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with its obligations under Article 3.1(a) of the *SCM Agreement*, under Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*, and under Article III:4 of the GATT 1994, into conformity with its obligations under those Agreements, and that the DSB request the United States to implement fully the recommendations and rulings of the DSB in US – FSC, made pursuant to Article 4.7 of the SCM Agreement.[11]

14. Had a new recommendation under Article 4.7 been needed, the Appellate Body would not have come to such conclusion. The reason why the Appellate Body did not come to a different conclusion is that the findings on a measure "taken to comply" within the meaning of Article 21.5 of the DSU and the recommendations and rulings of the DSB, the compliance with which is at issue, are inextricably linked.[12]

15. Furthermore, as recalled by the European Communities in its First Written Submission[13], the Appellate Body found that Article 4.7 of the SCM Agreement requires prohibited subsidies to be withdrawn "without delay" (while it mandates panels to specify the time-period prescribed for the withdrawal). The Appellate Body's recognition that, by passing the ETI Act, the United States had not withdrawn its prohibited subsidy, and thus had not complied with the recommendation and rulings under Article 4.7 of the SCM Agreement contained in the original Panel Report, rules out that the United States is authorized to keep the ETI scheme in place. If the US argument were correct, then the partial repeal of the ETI scheme would represent an act of generosity vis-à-vis other WTO Members which was not sufficiently publicised by the US authorities to their constituencies.

16. In reality, the repeal of the ETI scheme has consistently been presented by the US legislator as a necessary action to bring an end to a violation of US WTO obligations.[14] The fact that the United States itself has found that repeal of the ETI scheme is required in order to fulfil US treaty obligations may be considered "subsequent practice" within the meaning of Article 31 of the Vienna Convention on the Law of Treaties.[15]

17. The United States also suggests that in commenting on the interim Panel Report in the first Article 21.5 proceeding the European Community asked that the Panel make no recommendation.[16] It does so to explain the fact that the Article 21.5 Panel Report does not contain a new recommendation under Article 4.7 of the SCM Agreement. In reality, the passage of the Article 21.5 Panel Report referenced by the United States records that the European Communities pointed out that a new

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[10] Article 21.5 Appellate Body Report, paras. 230-231 and 256(f), referred to in EC First Written Submission, para. 57 and footnote 27.

[11] Article 21.5 Appellate Body Report, para. 257 (emphasis added).

[12] See also Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW, adopted 4 August 2000, as modified by the Appellate Body Report, WT/DS70/AB/RW (*Canada - Aircraft – Article 21.5*), DSR 2000:IX, 4315, paras. 6.1 and 6.2.

[13] EC First Written Submission, para. 29, quoting the Article 21.5 Appellate Body Report, para. 229.

[14] See e.g. the background to the JOBS Act, as described in the Conference Report (Exhibit EC-3, p. 262).

[15] Concluded at Vienna on 23 May 1969, *United Nations Treaty Series*, Vol. 1155, I-18232.

[16] US First Written Submission, para. 14 and footnote 12, referring to para. 7.5 of the Article 21.5 Panel Report.

recommendation under Article 19 of the DSU was not needed (and that the Panel followed this approach, noting that several other earlier Panel reports also did so).[17] The United States also conveniently omits to recall that to the extent it felt this was required, the Appellate Body did make a recommendation to the DSB that it request the United States to bring the ETI Act into conformity with its obligations.[18]

18. As a last remark, it should be recalled that panels are required to make the recommendations which are necessary under Article 4.7 of the SCM Agreement[19] and that panels and the Appellate Body are required to make the recommendations which are necessary under Article 19 of the DSU, if they have found a violation of Article 3 of the SCM Agreement or other "covered agreements" respectively. These recommendations must thus be made irrespective of a specific request of the complaining party.

C. WHETHER SECTION 5 OF THE ETI ACT IS WITHIN THE PANEL'S TERMS OF REFERENCE

19. The other procedural argument brought forward by the United States is that section 5 of the ETI Act does not fall within the Panel's terms of reference. The reason for this position seems to be that the United States considers the subsections of the JOBS Act expressly mentioned in a particular part of the request for the establishment of the Panel[20] to be the sole subject of litigation in this proceeding.[21]

20. The European Communities cannot accept the US approach, which is unduly reducing the content of its request in this proceeding. To begin with, section 2 of its request for establishment of the Panel only summarizes the text of the part of the JOBS Act which are pertinent to this panel proceeding. However, the EC request for findings by the Panel is contained in section 3, which is inextricably linked to section 2. Section 3 contains a clear reference to the original recommendation under Article 4.7 of the SCM Agreement and to the findings made in the first Article 21.5 proceeding in respect of the ETI Act. Amongst these are, as indicated above, findings that the ETI Act partly keeps in force the FSC scheme through its "grandfathering" provision.

21. In fact, elsewhere in its submission, the United States admits that Article 21.5 proceedings are concerned with measures taken to comply with (earlier) recommendations and rulings.[22] As found by the Panel and confirmed by the Appellate Body in the first Article 21.5 proceedings in this dispute, the ETI Act did not achieve compliance with the recommendations and rulings in the original proceedings, including the recommendation under Article 4.7 of the SCM Agreement.[23] Quite to the contrary, by passing the ETI Act the United States continued to violate a number of WTO provisions,

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[17] See e.g. Article 21.5 Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather - Recourse to Article 21.5 of the DSU by the United States*, WT/DS126/RW, adopted 20 March 2000; Article 21.5 Panel Report, *Brazil – Export Financing Programme for Aircraft - Recourse By Canada To Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000; Article 21.5 Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, adopted 4 August 2000, WT/DS70/RW), all quoted in the Article 21.5 Panel Report, footnote 44.

[18] Article 21.5 Appellate Body Report, para. 257.

[19] See also e.g. Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, 8 September 2004 ("*US – Upland Cotton*"), para. 8.3(b); Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999, as upheld by the Appellate Body Report, WT/DS70/AB/R ("*Canada - Aircraft*"), DSR 1999:IV, 1443, para. 8.3; Panel Report, *Korea – Measures affecting trade in commercial vessels*, WT/DS273/R, 7 March 2005 ("*Korea – Vessels*"), para. 8.4.

[20] WT/DS108/29.

[21] US First Written Submission, para. 20.

[22] US First Written Submission, para. 17.

[23] See in particular Article 21.5 Appellate Body Report, paras. 228-231 and the passages of the Article 21.5 Panel Report referenced therein.

and also the recommendation under Article 4.7 of the SCM Agreement to withdraw the FSC scheme without delay. As a result, effective withdrawal of the FSC scheme under the SCM Agreement also required withdrawal of the measure that (*inter alia*) maintained the FSC scheme in effect. The European Communities is precisely complaining about the US failure to do so.[24]

22. Article 21.5 proceedings concern not only what the defaulting Member has done, but also, and primarily, what it has failed to do. They cover not only the question of whether what has been done is consistent with the covered agreements. They also cover the question of whether measures which ought to have been taken to comply exist.

23. Since the United States has failed to take any action to repeal section 5 of the ETI Act, there is no provision in the JOBS Act that the European Communities could have quoted in its request for establishment of the Panel in connection with this failure. It was no more necessary to explicitly cite section 5 of the ETI Act in the request than it would have been necessary to cite any other provision of the ETI Act or the FSC legislation that remains partially applicable today contrary to the obligations of the United States.

24. Furthermore, the EC would recall that the fact that the ETI Act, including section 5 thereof, is inconsistent with the obligations of the United States under the WTO is *res iudicata* between the parties to this dispute.[25] The United States has an obligation to withdraw it and does not contest that it has not done so.

25. Even assuming, *quod non*, that the only relevant part of the EC request for establishment of the Panel is the one contained in section 2 thereof, that section also includes a general reference to certain contracts which are kept in force by the JOBS Act. Section 2 of the request clearly indicates that

> the European Communities considers that Section 101 of the JOBS Act contains provisions which allow US exporters to continue benefiting from the tax exemptions already found to be WTO incompatible … (b) for an indefinite period with respect to certain contracts.[26]

26. The language quoted above covers both the contracts benefiting from the ETI scheme which are expressly "grandfathered" by the JOBS Act and the "older" contracts benefiting from the FSC scheme which were "grandfathered" by the ETI Act through section 5. The United States does not contest that the JOBS Act allows section 5 of the ETI Act to remain in effect. And there is no doubt that the FSC and ETI schemes were already "found to be WTO incompatible".

III. CONCLUSION

27. For the reasons above the European Communities maintains its request to the Panel and its conclusions set out in its First Written Submission.

[24] WT/DS108/29, p. 2.
[25] EC First Written Submission, para. 67.
[26] WT/DS108/29, p. 2 (emphasis added).

ANNEX B-2

SECOND WRITTEN SUBMISSION OF THE UNITED STATES

(16 June 2005)

Dear Mr. Chairman:

In our First Written Submission of 2 June 2005, in the dispute *United States – Tax Treatment for "Foreign Sales Corporations": Second Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108), the United States responded to the arguments of the European Communities ("EC") set forth in its First Written Submission of 19 May 2005. Since then, there have been no further arguments submitted by the EC for the United States to rebut. Therefore, this letter constitutes the United States rebuttal submission. Of course, should the EC rebuttal submission contain new arguments, the United States will respond to them at the 30 June 2005, meeting with the Panel.

The United States is providing a copy of this submission directly to the EC, Australia, Brazil, and China.

ANNEX C

THIRD PARTY SUBMISSIONS

ANNEX C-1

THIRD PARTY SUBMISSION OF AUSTRALIA

(9 June 2005)

TABLE OF CONTENTS

1. Introduction

1. This submission concentrates on three issues of relevance to this proceeding.

2. First, it considers the mandate of an Article 21.5 proceeding. Second, it considers whether the United States is under any obligation to withdraw the ETI scheme. Third, it discusses the relevance of section 5 of the *ETI Act*.[1]

2. The Mandate of an Article 21.5 Proceeding

3. The mandate of an Article 21.5 proceeding is to adjudicate on disputes "as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB.

4. Australia submits that the "recommendations and rulings" referred to are those made by the original Panel and Appellate Body (if the Panel decision was appealed), as adopted by the DSB. In this dispute, the relevant "recommendations and rulings" are those made by the DSB on 20 March 2000 when it adopted the Panel and Appellate Body reports in *United States – Tax Treatment of "Foreign Sales Corporations"*.[2] In relevant part, those recommendations and rulings were that:

[1] In this submission, the term "*ETI Act*" is used to refer to the *FSC Repeal and Extraterritorial Income Exclusion Act of 2000*.

[2] WT/DS108/R and WT/DS108/AB/R, respectively (the "Panel Report" and "Appellate Body Report", respectively).

(a) the FSC subsidies be withdrawn at the latest with effect from 1 October 2000;[3] [4] and

(b) the United States bring the FSC measure into conformity with its obligations under the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and the *Agreement on Agriculture*.[5]

5. Hence, the purpose of the current Article 21.5 proceeding is to decide whether certain measures that the United States has taken to comply with the recommendations and rulings set out above are consistent with the covered agreements. For its part, the EC has argued that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of *GATT 1994*.[6]

6. The United States does not contest that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are measures taken to comply with the DSB's original recommendations and rulings. Under those circumstances, the measures at issue come within the mandate of an Article 21.5 proceeding.

7. In addition, the United States does not appear to contest that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of *GATT 1994*. The Panel should therefore uphold the EC's arguments in this respect.

3. Is the United States Under an Obligation to Withdraw the ETI Scheme?

8. The United States submits that in order for it to be under any obligation to withdraw the ETI scheme it would have been necessary for the Panel Report (First Article 21.5)[7] to make a finding under Article 4.7 of the *SCM Agreement*.[8] It follows that the Article 21.5 Panel would have been required to "specify … the time-period within which the measure must be withdrawn".[9] The United States' argument would thus require that it be given a period of time to withdraw the ETI scheme (e.g. from the adoption of the Article 21.5 reports until the first practicable date by which the United States could have withdrawn the ETI scheme). However, such a ruling would be outside the Article 21.5 mandate, which is to decide whether "measures taken to comply with the recommendations and rulings" of the DSB exist or are consistent with a covered agreement.

9. Once a decision has been made, as in this dispute, that a measure "taken to comply" is inconsistent with a covered agreement, it necessarily follows that the Member has failed to take "measures … to comply with the recommendations and rulings"[10] of the DSB in the original proceeding and that the original, and any replacement, measures must be brought into consistency immediately.

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[3] Paragraph 8.8 of the Panel Report.

[4] At its meeting on 12 October 2000, the DSB acceded to the United States' request to extend until 1 November 2000 the time by which the United States was required to comply with the DSB's recommendations and rulings (see WT/DSB/M/90).

[5] Paragraph 178 of the Appellate Body Report.

[6] Paragraphs 36, 46, 58, 59 and 69 of the First Written Submission of the European Communities. See also the second dash point on page 2 of the EC's Request for the Establishment of a Panel.

[7] Panel Report in *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108/RW).

[8] Paragraph 19 of the First Written Submission of the United States of America.

[9] As required by the second sentence of Article 4.7 of the *SCM Agreement*.

[10] See Article 21.5 of the *DSU*.

10. Australia thus submits that the obligation to withdraw the ETI scheme arises from the fact that the Panel Report (First Article 21.5) and Appellate Body Report (First Article 21.5)[11], as adopted by the DSB, found that the ETI scheme violated the covered agreements (including Article 3 of the *SCM Agreement*).

11. As stated by the Panel in *Australia – Measures Affecting Importation of Salmon - Recourse to Article 21.5 by Canada*:[12]

> "The text [of Article 21.5 of the *DSU*] refers generally to "consistency with a covered agreement". The *rationale* behind this is obvious: a complainant, after having prevailed in an original dispute, should not have to go through the entire DSU process once again if an implementing Member in seeking to comply with DSB recommendations under a covered agreement is breaching, inadvertently or not, its obligations under other provisions of covered agreements. In such instances an expedited procedure should be available. This procedure is provided for in Article 21.5. It is in line with the fundamental requirement of "prompt compliance" with DSB recommendations and rulings expressed in both Article 3.3 and Article 21.1 of the DSU".[13]

12. A similar point was made by the Panel in *European Communities - Anti-Dumping Duties on Imports of Cotton-Type Bed Linen From India - Recourse To Article 21.5 of the DSU by India*[14] when it stated that:

> "[A] Member found to have violated a provision in an Article 21.5 proceeding pursuant to a claim that could have been pursued in the original dispute but was not would be deprived of the opportunity to seek a mutually acceptable solution, of the opportunity to bring its measure into conformity, and might, depending on the nature of the violation, be subjected to suspension of concessions".[15]

13. A recommendation or ruling under Article 4.7 of the *SCM Agreement* for the United States to withdraw the ETI scheme would have been outside the mandate of a panel constituted under Article 21.5 of the *DSU*. The requirement for the United States to withdraw the ETI scheme follows logically from the fact that it was required to withdraw the FSC scheme – a replacement for the FSC scheme that is itself a violation of a covered agreement should not have been granted or maintained. The United States cannot argue that such a measure should not be withdrawn.

4. The Relevance of Section 5 of the *ETI Act*

14. In defence of the EC's assertions regarding the grandfathering of the FSC scheme, the United States asserts that section 5 of the *ETI Act* is not within the Panel's terms of reference.[16]

15. Australia notes that section 5 of the *ETI Act* sets up, amongst other things, the grandfathering of the FSC scheme. The Panel Report (First Article 21.5) and Appellate Body Report (First Article 21.5) have already found this grandfathering to be a violation of the covered agreements.[17]

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[11] Appellate Body Report in *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108/AB/RW).

[12] WT/DS18/RW.

[13] Paragraph 7.10, subparagraph 9.

[14] WT/DS141/RW.

[15] Paragraph 6.45.

[16] Paragraph 20 of the First Written Submission of the United States of America.

[17] Paragraph 9.1(e) of the Panel Report (First Article 21.5) and paragraph 256(f) of the Appellate Body Report (First Article 21.5).

16. Australia also notes that it is section 101 of the *Jobs Act*[18] that fails to repeal section 5 of the *ETI Act*. The former section was mentioned in the EC's request for the establishment of a panel.

5. Conclusion

17. The mandate of an Article 21.5 proceeding is to adjudicate on disputes "as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. Given the absence of any defence from the United States, the Panel should uphold the EC's arguments that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of *GATT 1994*.

18. A ruling under Article 4.7 of the *SCM Agreement* in the Panel Report (First Article 21.5) would have been outside of the mandate discussed above. The requirement for the United States to withdraw the ETI scheme follows logically from the fact that the United States was required to withdraw the FSC scheme and that its replacement, the ETI scheme, also violates the covered agreements.

19. The Panel Report (First Article 21.5) and Appellate Body Report (First Article 21.5) have already found the grandfathering of the FSC scheme to be a violation of the covered agreements.[19]

[18] The term "*Jobs Act*" is used to refer to the *American Jobs Creation Act of 2004*.

[19] Paragraph 9.1(e) of the Panel Report (First Article 21.5) and paragraph 256(f) of the Appellate Body Report (First Article 21.5).

ANNEX C-2

THIRD PARTY SUBMISSION OF BRAZIL

(9 June 2005)

TABLE OF CONTENTS

I. INTRODUCTION

1. Brazil, as a third party, offers its contribution in view of systemic interests in the discussions to be held and the interpretations to be developed by parties and the Panel in this dispute. Brazil recalls, however, that in *United States – Subsidies on Upland Cotton* (DS 267), the *FSC Repeal and Extraterritorial Income Act of 2000* ("ETI Act"), which is at the very core of the present case brought by the European Communities (EC), constituted one of the measures Brazil claimed to be inconsistent with the Agreement on Agriculture ("AoA") and the Agreement on Subsidies and Countervailing Measures ("SCM Agreement").[1]

2. In this submission, Brazil will limit itself to comment on the following issues:

(a) *Prompt* compliance as a core principle and central objective of the WTO dispute settlement mechanism; and

(b) The transition and "grandfathering" provisions in the *American Jobs Creation Act of 2004* ("AJCA") as an extension of a non-compliance situation.

3. Brazil reserves the right to present, at the third parties' session of the meeting with the Panel, more elaborated views or additional points.

[1] *See inter alia US – Subsidies on Upland Cotton,* Report of the Panel (WT/DS267/R, 8 September 2004), at para. 3.1(iv), and Report of the Appellate Body (WT/DS267/AB/R, 3 March 2005), at paras. 189-193.

II. *PROMPT* COMPLIANCE AS A CORE PRINCIPLE AND CENTRAL OBJECTIVE OF THE WTO DISPUTE SETTLEMENT MECHANISM

4. If a person not acquainted with the WTO dispute settlement mechanism were asked to comment on the relevance of the present dispute, it could well be that he or she would be tempted to classify this second recourse by the EC to Article 21.5 of the DSU on the FSC-related matters as a legal action of minor importance. Let us not be easily deceived, however, by the first impression caused by the conciseness of the first written submissions of the EC and the United States. These less-than-30-pages (in total) briefs cannot dismiss or disguise the density of the systemic implications this controversy has for all WTO Membership.

5. The United States is basically arguing that "*in the absence of any recommendation or ruling of withdrawal under Article 4.7* [of the SCM Agreement in the prior proceeding under Article 4 of the SCM Agreement and Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU")] *this Panel cannot find that the United States has failed to comply with a DSB recommendation or ruling to withdraw its prohibited subsidies*"[2] as a result of maintaining in the AJCA transition provisions that extend the life of previously found prohibited subsidies.

6. Brazil will submit in the next section that, as the United States itself recognizes, the AJCA is nothing more than a new chapter of the same story. But, first, Brazil wishes to draw the Panel's attention to the central role played by the principle and objective of *prompt* compliance within the WTO dispute settlement mechanism. It goes without saying that we find the United States to be in breach of the prompt compliance requirement under the DSU as regards both the original FSC dispute and its offspring.

7. The DSU drafters made it clear that *prompt* compliance is, at once, (i) one of the central tenets for the optimal functioning of the WTO dispute settlement mechanism and (ii) a fundamental objective of this mechanism. Such principle and objective not only permeates the whole system but is also enshrined in the text of several provisions of the Understanding. Article 3.3 summarizes what has just been stated:

> *The* **prompt** *settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is* **essential** *to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members*. (emphasis added)

8. Article 21.1, in turn, develops further such a principle in the context of implementation of the DSB's rulings and recommendations. It reads:

> **Prompt** *compliance with recommendations or rulings of the DSB is* **essential** *in order to ensure effective resolution of disputes to the benefit of all Members*. (emphasis added)

9. In addition, Articles 3.7 and 21.3 place the ***immediate withdrawal*** of the measure found to be WTO-incompatible or ***the immediate compliance*** with DSB's rulings and recommendations at the top of the objectives to be pursued in and by the system, in the absence of a mutually satisfactory solution.

[2] US First Written Submission, at para. 2.

10. In our view, these abundant references to the principle of *prompt* compliance are far from being a vain exercise of exhortatory style or text-embellishment. These textual references must be given concrete meaning where disputes take place. At a minimum, these provisions definitively demonstrate that long-standing non-compliance situations are in complete disconnection with the letter and spirit of the DSU. In fact, such situations operate against the very credibility of the system to the detriment of all WTO Members.

11. Should any WTO Member still oddly consider that the DSU does not provide a sufficient basis for the conclusion that *prompt* compliance is a critical feature of the WTO dispute settlement mechanism, it is noteworthy that the present dispute involves previous findings and conclusions relating to prohibited subsidies under the SCM Agreement. Given the inherently distorting nature of the prohibited subsidies, this Agreement is even more stringent than the DSU in respect of the *prompt* compliance requirement. Article 4.7 establishes that

> *If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time within which the measure must be withdrawn.*

12. In case a defendant Member does not implement the DSB's recommendation in a prohibited subsidy dispute within the time-period specified under Article 4.7, Article 4.10 of the SCM Agreement obliges the DSB to grant authorization to the complaining party to take appropriate countermeasures. These countermeasures are not bound by the more restrictive (to complaining parties' discretion) "equivalency test" under Article 22.4 of the DSU. Therefore, they may be even more onerous to the party complained against that a DSU-only suspension of concessions or other obligations.

III. THE TRANSITION AND "GRANDFATHERING" PROVISIONS IN THE *AMERICAN JOBS CREATION ACT OF 2004* ("AJCA") AS AN EXTENSION OF A NON-COMPLIANCE SITUATION

13. Brazil takes the EC's summary of the relevant sections of the AJCA as a fair and accurate description of the US measure under review.[3] The United States does not appear to disagree with that factual description.

14. According to the EC, the FSC scheme is, in part, still effective, since section 101 of the AJCA did not repeal section 5 of the ETI Act (entitled "Effective date"), thereby providing room for the continuation of the effects of the scheme of transactions relating to certain binding contracts entered into by FSCs in existence on 30 September 2000.[4]

15. The EC also points out other aspects of the AJCA, in particular the "grandfathering" provision contained in section 101(f) for the benefit of all transactions pursuant to a binding contract (1) which is between the taxpayer and a person who is not a related person, and (2) which is in effect on 17 September 2003, and at all times thereafter.[5]

16. As to the "grandfathering clause", the treatment of transactions involving FSCs in existence on 30 September 2000, and pursuant to a "binding contract", is sufficient to illustrate that both the FSC and ETI Act subsidies will continue to be available, at least, for some of the beneficiaries of the subsidies found to be WTO-incompatible by the original Panel in this dispute. Almost 5 years after the expiry of the time-period for the withdrawal of the FSC-prohibited subsidies, part of these

[3] *See* Section V of EC's First Written Submission.
[4] *See* paras. 36-37 of EC's First Written Submission.
[5] *See* para. 40 of EC's First Written Submission.

subsidies would still remain in place in the situation Brazil has just outlined. The two US legislations adopted purportedly to comply with the previous recommendations of the DSB in the case may have altered the original scenario, but have not withdrawn *in totum*, as required by the SCM Agreement and the DSU, the subsidies held illegal by the DSB.

17. The United States submits that it "*has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the AJCA are not inconsistent with Article 4.7 of the SCM Agreement, for the simple reason that* [...] *there was no DSB recommendation or ruling under Article 4.7 to withdraw the subsidy insofar as the ETI Act tax exclusion is concerned*."[6] The United States attempts to erroneously split into two completely separate cases a situation where the facts and circumstances show that the cases are part of one same continuum (FSC – ETI – AJCA).

18. Both the ETI Act and, now, the AJCA are measures taken to comply with the DSB's rulings and recommendations concerning the original proceedings. This is the premise on which hinges the Appellate Body's conclusion upholding the Panel's finding that the "*United States has not fully withdrawn the subsidies found, in the original proceedings, to be prohibited export subsidies under Article 3.1(a) of the* SCM Agreement, *and that the United States has, therefore, failed fully to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the* SCM Agreement."[7] On this basis, the Appellate Body recommended the DSB to request the United States to implement fully the recommendations and ruling of the DSB in *US – FSC*, made pursuant to Article 4.7 of the SCM Agreement.[8]

19. The United States asserts that "*while the Article 21.5 Panel found that the ETI Act tax exclusion constituted a prohibited export subsidy, it did not make a recommendation pursuant to Article 4.7 that the subsidy be withdrawn* [...]".[9] In doing so, the United States is simply asking that a compliance panel - having found that a prohibited subsidy expected to be eliminated in light of the original panel's findings is still in place – should recommend – again! – that the very same (maybe under new clothes) prohibited subsidy be withdrawn. Consequently, the defendant would "deserve" a new time-period for removing the prohibited subsidy.

20. Brazil notes that, as recalled in paragraph 18 above, the ETI Act Panel found that the United States has not fully withdrawn the subsidies found, *in the original proceedings*, to be prohibited export subsidies, and that the United States has, therefore, failed to fully implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the SCM Agreement.

21. This being the case, the US argument in the *present proceedings* amounts to claiming that the ETI Act proceedings should have resulted in DSB's recommendations or rulings adding to US rights under the covered agreements, in violation to Article 19.2 of the DSU, through an extension of the time-period for the full withdrawal of the prohibited FSC subsidies.[10]

IV. CONCLUSION

22. In light of the above, Brazil considers that this Panel should find that the United States has not yet fully withdrawn the subsidies found to be WTO-incompatible in previous proceedings relating to the matter being dealt with in the present dispute. Accordingly, the Panel should recommend the

[6] *See* para. 10 of US first written submission.

[7] *See* Report of the Appellate Body in *US – Tax treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the EC* (WT/DS108/AB/RW, 14 January 2002), at para. 256(f).

[8] *Idem*, at para. 257.

[9] *See* para. 14 of the US first written submission.

[10] *See* also para. 228 of the Report of the Appellate Body in *US – FSC – Recourse to Article 21.5 of the DSU by the EC* (WT/DS108/AB/RW).

United States to promptly abide by its multilateral commitments in accordance with the relevant provisions of the SCM Agreement and the DSU.

ANNEX C-3

THIRD PARTY SUBMISSION OF THE PEOPLE'S REPUBLIC OF CHINA

(9 June 2005)

1. China welcomes this opportunity to present its view on the dispute between the European Community and the United States concerning the implementation of the DSB recommendations or rulings in the case of *United States – Tax Treatment for "Foreign Sales Corporations"*.

2. Members agree to develop an integrated, more viable and durable multilateral trading system, since they believe that all members will preserve the principles and rules of such a system so that all members will benefit from such a system. In this regard, members are aware that "the dispute settlement system of the WTO is a central element in providing *security and predictability* to the multilateral trading system."[1] (*emphasis added*) That is the reason why effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of members essentially relies on the prompt settlement of any dispute. However, dispute resolution does not end by the adoption of the DSB recommendations or rulings. "Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all members."[2]

3. *The SCM Agreement* contain strict disciplines on export-contingent subsidies. A member shall neither grant nor maintain export subsidies, except as provided in *the Agreement on Agriculture*. Article 4 of *the SCM Agreement* includes proceedings for enforcement and remedies. Any measure founded to be prohibited subsidies must be withdrawn. To continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited subsidies.[3]

4. In regard to the situation in this case, China cannot share the view that "the United States has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the AJCA are not inconsistent with Article 4.7 of the SCM Agreement, for the simple reason that, … there was no DSB recommendation or ruling under Article 4.7 to withdraw the subsidy insofar as the ETI Act tax exclusion is concerned."[4]

5. The DSB made recommendations and rulings under article 4.7 when adopting the panel and Appellate Body report on 20 March 2000, which requested the US to withdraw the FSC subsidies within certain time-period. Subsequently, the United States enacted the ETI Act with a view to complying with the recommendations and rulings of the DSB in *US-FSC*. In the first compliance panel proceeding, the ETI scheme was found inconsistent with article 3.1(a) of the SCM Agreement and the US was requested to bring it into conformity with its obligations under relevant Agreement, including *the SCM Agreement*.[5]

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[1] DSU Article 3.2.
[2] DSU Article 21.1.
[3] Brazil-Aircraft 21.5, AB Report para.45.
[4] US First Written Submission para. 10.
[5] US-FSC 21.5 AB Report para. 257.

6. Article 4.7 of *the SCM Agreement* requires prohibited subsidies to be withdrawn "without delay", and provides that a time-period for such withdrawal shall be specified by the panel.[6] The obligation to withdraw prohibited subsidies without delay is not released simply because the first compliance panel did not specify a time-period in its conclusion. The party concerned failed to fully implement the DSB recommendations and rulings by introducing transition period and grandfathering provisions for FSC scheme, an export subsidy measure. How can transition period and grandfathering provisions for another prohibited subsidy measure be justified?

7. The Appellate Body has made it clear why a long transition period and grandfathering provision are not in conformity with the obligation to withdraw the prohibited subsidies without delay. A Member's obligation under Article 4.7 of *the SCM Agreement* to withdraw prohibited subsidies "without delay" is unaffected by contractual obligations that the Member itself may have assumed under municipal law. Likewise, a Member's obligation to withdraw prohibited export subsidies, under Article 4.7 of *the SCM Agreement*, cannot be affected by contractual obligations which private parties may have assumed *inter se* in reliance on laws conferring prohibited export subsidies.[7]

8. China would like to conclude its submission by recalling that the primary objective of the dispute settlement mechanism is to secure the withdrawal of the measures found to be inconsistent with the covered agreements.

[6] US-FSC 21.5 AB Report para. 229.
[7] US-FSC 21.5 AB Report para. 229.

ANNEX D

ORAL STATEMENTS, MEETING WITH THE PANEL

ANNEX D-1

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

(30 June 2005)

Mr. Chairman, distinguished Members of the Panel,

1. The European Communities would first like to thank you all for agreeing to serve on this Panel. And we also thank the Secretariat for the assistance that it is providing to the Panel in this case.

2. Although this case is relatively straightforward and may appear to relate to a temporary and residual problem, it is nonetheless important.

3. It is important that adopted recommendations and findings in WTO dispute settlement proceedings are respected and implemented properly and promptly. Moreover, given their inherently distortive character, it is important that prohibited subsidies are withdrawn without delay. As will no doubt be clear to you, this has not happened in this case. Indeed, the continuing violations at issue in this proceeding are either identical or similar in all relevant respects to those that have already been condemned in the previous Article 21.5 proceeding. Long-standing non-compliance situations operate against the very credibility of the WTO system to the detriment of all Members.

4. The original Panel report in this case was circulated in 1999 and adopted by the DSB on 20 March 2000 after an unsuccessful appeal by the United States. The United States was given a generous period to withdraw the FSC scheme but simply replaced it with a partly identical scheme that was duly condemned in turn (as were the transitional and grandfathering provisions that the United States accorded itself for its original FSC scheme).

5. More than five years after the circulation of the original Panel Report, the United States finally adopted a measure (the JOBS Act) that, with effect from 1 January 2005, starts to *phase out* the export subsides under the ETI scheme.

6. Of course, phasing out is not withdrawal. And the phasing out in this case occurs over an indefinite period of time. Although new users of this export subsidy scheme can only obtain 80 per cent of the previously available benefit for transactions occurring in 2005 and only 60 per cent of the benefit for transactions occurring in 2006, certain old users can continue to obtain the full benefit, potentially forever, where they can show that the transaction is "pursuant to" a "binding contract", entered into on or before 30 September 2000 in the case of the FSC scheme, and 17 September 2003 in the case of the ETI scheme.

7. Thus, in practice, a US producer of widgets that has a 30 year distribution contract with a Japanese company to distribute its widgets in Japan, will continue to benefit from these illegal export subsidies for thirty years. And if the distribution contract has a renewal option, then, no doubt, the illegal subsidies will continue for even longer.

8. The United States does not appear to contest that it is still violating its WTO obligations by partially maintaining the FSC and ETI schemes. Rather, it confines itself to raising two exceedingly weak procedural arguments. First, the United States contends, that the Panel can make no finding that

the United States has failed to withdraw its prohibited subsidy as required by Article 4.7 of the *SCM Agreement* because in the previous Article 21.5 proceeding the Panel merely *found* that the ETI scheme was inconsistent with the obligations of the United States under the *SCM Agreement* and did not make a new recommendation under Article 4.7 of the *SCM Agreement*. Second, the United States contends that where there is *no* measure taken to comply (as in the case of the FSC grandfathering provisions contained in the ETI Act), the continuing violation is not within the Panel's terms of reference unless the WTO-inconsistent measure is again included in the Panel request under Article 21.5.

9. Mr. Chairman, distinguished Members of the Panel, one only needs to restate these procedural arguments to realise they are unfounded. The European Communities has set out in its rebuttal submission detailed reasons why they are without merit and should be dismissed accordingly. The European Communities does not wish to repeat the arguments it has made in writing but would stress two points:

- First, an Article 21.5 panel need not make new recommendations since its purpose is to rule on a disagreement as to whether previous recommendations and rulings have been complied with. In the first Article 21.5 proceeding, the Panel ruled that they had not been and the United States has not advanced any arguments in the present proceeding as to why they have been complied with (manifestly, there are none). In any event, the obligation to withdraw a prohibited subsidy is created by Art. 4.7 of the *SCM Agreement* as such, not by the panel recommendations foreseen in the same provision. This clearly results from the Appellate Body Report in the first Article 21.5 proceeding;[1]

- Second, where, as here, the Article 21.5 proceeding relates to the *failure* to remove previously found violations of the *WTO Agreement*, the provisions that give rise to these violations need not be repeated in the request for the establishment of a panel. In any case, the US measure of purported compliance (section 101 of the Jobs Act) fails to remove the FSC grandfathering provisions and is mentioned in the request for an Article 21.5 panel.

10. As already observed, the United States does not seek to defend itself on substance. In particular, it gives no arguments as to why the subsidies that it continues to provide are no longer inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994. It also does not respond to the EC demonstration of violations of Articles 19.1 and 21.1 of the DSU.

Mr Chairman, Members of the Panel, thank you for your attention. We look forward to responding to any questions the Panel may have.

[1] Art. 21.5 Appellate Body Report, para. 229.

ANNEX D-2

ORAL STATEMENT OF THE UNITED STATES

(30 June 2005)

Mr. Chairman, members of the Panel:

1. At the outset, on behalf of the United States, I would like to express our appreciation for your willingness to serve on this Panel. In particular, I would like to thank the Chairman for agreeing to step in at this stage in this dispute.

2. However, while we are grateful for your willingness to serve, it is unfortunate that you had to do so. In enacting the American Jobs Creation Act – or "AJCA" – US officials consulted closely with EC officials, and we believed the legislation addressed the EC's primary concerns. Unfortunately, the EC has chosen to prolong this dispute involving a subsidy that, if this were a countervailing duty proceeding, would be regarded as *de minimis*.

3. In light of the speculation in the press that the EC decision to prolong this dispute was linked to the US decision to challenge the massive subsidies provided to Airbus, the United States cannot help but note that in its counter-case against Boeing aircraft, the EC appears to have included a claim that the FSC tax exemption and the ETI Act tax exclusion have caused adverse effects within the meaning of Article 5 of the SCM Agreement.[1] While the United States continues to hope that the aircraft disputes can be resolved without recourse to litigation, we must confess that we find tantalizing the prospect of the EC being required for the first time to demonstrate how these *de minimis* tax exemptions and exclusions have caused harm to EC trade interests.

4. In any event, the EC has decided that we need to get together again, so here we are. Today, we will focus on two issues: (1) the EC's claims under Article 4.7 of the SCM Agreement; and (2) the EC's claims regarding the transition provisions for the FSC tax exemption contained in section 5 of the ETI Act.

Article 4.7 of the SCM Agreement

5. Starting with Article 4.7, the EC's claim that the transition provisions of the AJCA are inconsistent with Article 4.7 is premised on the notion that the ETI Act tax exclusion was found to be inconsistent with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies. The US response to this claim is straightforward: no such finding was ever made, nor did the DSB make a recommendation under Article 4.7 that the ETI Act tax exclusion be withdrawn. Thus, the premise of the EC's claim is simply in error.

6. Insofar as the ETI Act tax exclusion is concerned, the only findings made were that the tax exclusion was inconsistent with Article 3.1(a) of the SCM Agreement, Articles 3.3, 8 and 10.1 of the Agriculture Agreement, and Article III:4 of the GATT 1994. The corresponding recommendations of the DSB were that the United States bring the ETI measure into conformity with its obligations under these provisions. There was no finding that the ETI Act tax exclusion was inconsistent with the

[1] WT/DS317/2 (3 June 2005).

DSB's recommendation under SCM Article 4.7 to withdraw the FSC subsidies, nor was there a DSB recommendation under Article 4.7 to withdraw the ETI Act tax exclusion.

7. Contrary to what the EC asserts, this is not a mere "procedural" argument. No Member can be found to have failed to comply with a non-existent recommendation. The EC's assertion to the contrary raises important substantive and systemic issues.

8. In this regard, the EC errs when it suggests that the US argument regarding Article 4.7 leads to the conclusion that the repeal of the ETI Act was a gratuitous act on the part of the United States.[2] To the contrary, as we will discuss later, repeal was appropriate in order to comply with the findings and recommendations that the United States bring the ETI measure into conformity with provisions of the WTO agreements other than SCM Article 4.7. However, the fact that implementation obligations existed with respect to these other provisions does not mean that there was an obligation under Article 4.7.

9. In its first written submission, the United States described the scope of the findings of the Article 21.5 Panel and the Appellate Body under Article 4.7, and explained how those findings were limited to the transition provisions in section 5 of the ETI Act that allowed for the continued use of the FSC tax exemption. Unfortunately, in its rebuttal submission, the EC presents an inaccurate version of the prior history of this dispute. According to the EC, the Appellate Body made a finding in the first Article 21.5 proceeding that the ETI Act tax exclusion resulted in non-compliance with the recommendation of the original Panel under Article 4.7 to withdraw the FSC subsidies.

10. The EC assertion is incorrect. In order to set the record straight, it is necessary to go over the prior history of this dispute one more time.

The Recommendations of the Article 21.5 Panel and the Appellate Body Under Article 4.7 Were Limited to Section 5 of the ETI Act

11. In its rebuttal submission, the EC refers to "[t]he Appellate Body's recognition that, by passing the ETI Act, the United States had not withdrawn its prohibited subsidy, and thus had not complied with the recommendations and rulings under Article 4.7 of the *SCM Agreement* contained in the original Panel Report ... .[3] However, the Appellate Body recognized no such thing, because its finding and recommendation under Article 4.7 were limited to the transition provisions of the ETI Act that allowed for the continued use by taxpayers of the FSC tax exemption. The Appellate Body did *not* find that the ETI Act tax exclusion itself constituted a failure to comply with the recommendation under Article 4.7. Indeed, the EC did not even argue that the enactment of the ETI Act tax exclusion was inconsistent with that recommendation.

12. In the EC's first recourse to Article 21.5 of the DSU, the EC challenged various provisions of the ETI Act, alleging that they were inconsistent with one or more provisions of the WTO agreements. However, with respect to the issue of compliance with the DSB's recommendation under Article 4.7 of the SCM Agreement to withdraw the subsidy, the EC's claims were limited to section 5 of the ETI Act.

13. This can be seen from the first written submission of the EC in the first Article 21.5 proceeding. In the "Legal Analysis" section of the EC submission, the only reference by the EC to an alleged failure to withdraw the subsidy under Article 4.7 was made in connection with the transition

[2] *Rebuttal Submission of the European Communities*, 16 June 2005, para. 15 (hereinafter "EC Rebuttal").

[3] EC Rebuttal, para. 15.

provisions of section 5 of the ETI Act.[4] Likewise, in the "Conclusion" section, wherein the EC laid out the specific findings that it wanted the Article 21.5 Panel to make, the only finding sought by the EC with respect to Article 4.7 related to the transition provisions of section 5 of the ETI Act.[5]

14. Not surprisingly, the Article 21.5 Panel took the EC at its word. The Article 21.5 Panel's finding of a failure to comply with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies was limited to section 5 of the ETI Act. In paragraph 8.170 of the Article 21.5 Panel Report, which was contained in the section entitled "Transitional Issues", the Article 21.5 Panel found that the United States had not "*fully* withdrawn the FSC subsidies . . . and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the *SCM Agreement*."[6] This finding was repeated in paragraph 9.1(e) of the Article 21.5 Panel Report.[7] This was the only finding by the Article 21.5 Panel under Article 4.7. The Panel did not find that any other portion of the ETI Act constituted a failure to withdraw the FSC subsidies within the meaning of Article 4.7.

15. Neither party appealed the fact that the Article 21.5 Panel limited its findings under Article 4.7 to the transition provisions of section 5 of the ETI Act. In the case of the EC, how could it appeal? The Article 21.5 Panel had done exactly what the EC requested.

16. The lack of an appeal of this issue is relevant, because the EC makes the extraordinary assertion that the Appellate Body's findings regarding the ETI Act in general were closely linked to the original recommendations under SCM Article 4.7.[8] However, this assertion is belied by the fact that the Appellate Body upheld, rather than modified, the findings of the Article 21.5 Panel under Article 4.7. In paragraph 256(f) of its report, the Appellate Body stated that it

> upholds the Panel's finding, in paragraphs 8.170 and 9.1(e) of the Panel Report, that the United States has not *fully* withdrawn the subsidies . . . and that the United States has, therefore, failed *fully* to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the *SCM Agreement* ... .[9]

As previously noted, paragraphs 8.170 and 9.1(e) of the Article 21.5 Panel Report pertained to section 5 of the ETI Act.

17. In paragraph 257 of the Appellate Body report, the Appellate Body drew upon the language in paragraph 256 to recommend "that the DSB request the United States to implement *fully* the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement"*.[10] Contrary to the EC's assertions[11], this recommendation has nothing to do with the ETI Act tax exclusion. Instead, the Appellate Body referenced the recommendations and rulings in *US – FSC*, which were made before the ETI Act tax exclusion even existed.

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[4] Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW, Annex A-1, para. 241 (hereinafter "*US – FSC (Article 21.5) (Panel)*").

[5] *US – FSC (Article 21.5) (Panel)*, Annex A-1, para. 259, sixth bullet.

[6] *US – FSC (Article 21.5) (Panel)*, paras 8.170 (emphasis added).

[7] *US – FSC (Article 21.5) (Panel)*, para. 9.1(e).

[8] EC Rebuttal, para. 13; *see also id*., para. 15.

[9] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, para. 256(f) (emphasis added) (hereinafter "*US – FSC (Article 21.5) (AB)*").

[10] *US – FSC (Article 21.5) (AB)*, para. 257 (emphasis added).

[11] EC Rebuttal, para. 13.

18. In summary, the original Article 21.5 process resulted in two different sets of findings and recommendations. One set pertained to section 5 of the ETI Act and the transition provisions for the FSC tax exemption and involved a finding and recommendation under Article 4.7. The other set pertained to the ETI Act tax exclusion. With respect to the tax exclusion, there was no finding or recommendation under Article 4.7. Thus, the EC is simply incorrect when it asserts that the Appellate Body made a finding that the enactment of the ETI Act tax exclusion resulted in non-compliance with the DSB's recommendation under Article 4.7 to withdraw the FSC subsidies.

The Panel Should Reject the EC's Claims Under Article 4.7 of the SCM Agreement

19. To sum up, the EC's claim under Article 4.7 is based on the notion that the United States had an obligation under Article 4.7 to withdraw the ETI Act tax exclusion. According to the EC, the transition provisions of sections 101(d) and (f) of the AJCA are inconsistent with this obligation because they permit the continued use of the tax exclusion.

20. Insofar as the ETI Act tax exclusion itself is concerned, the United States had an obligation to bring the measure into conformity with Article 3.1(a) of the SCM Agreement, Articles 3.3, 8 and 10.1 of the Agriculture Agreement, and Article III:4 of the GATT 1994. However, the United States did not have an obligation under Article 4.7 of the SCM Agreement with respect to the ETI Act tax exclusion. As the United States has demonstrated, the first Article 21.5 proceeding did not result in any findings that the ETI Act tax exclusion resulted in a failure to comply with Article 4.7.

Section 5 of the ETI Act Is Not Within the Panel's Terms of Reference

21. The United States now would like to turn to the EC' s claims regarding section 5 of the ETI Act. Section 5, as the Panel will recall, is the transition provision in the ETI Act that allowed for the continued use of the FSC tax exemption for a period of time. As previously explained by the United States, section 5 is not within the Panel's terms of reference for several reasons. First, the only provisions of the AJCA identified by the EC in its panel request were sections 101(d) and (f), which are the transition provisions for the ETI Act tax exclusion and which do not concern the FSC tax exemption. Second, section 5 of the ETI Act was not mentioned in the EC's panel request.[12]

22. According to the EC, the US position is wrong because the "United States considers the subsections of the [AJCA] expressly mentioned in a particular part of the request for the establishment of the Panel to be the sole subject of litigation in this proceeding."[13] Well, the United States must admit that it did rely on the fact that in Section 2 of the EC's panel request the EC was, in fact, purporting to identify the subject of the dispute. The United States reached the conclusion that it did because Section 2 is entitled "THE SUBJECT OF THE DISPUTE". Apparently, according to the EC, the title to Section 2 actually means "**A** SUBJECT OF THE DISPUTE".

23. Section 2, consistent with the plain English reading of its title, identifies as the subject of the dispute sections 101(d) and (f), referring to them as "provisions which will allow US exporters to continue benefiting from the tax exemptions ... ."[14] However, the only tax exemption that these provisions allow to continue to be used is the ETI Act tax exclusion. Therefore, the only fair reading of the EC panel request is that the EC's claims related to the transition provisions for the ETI Act tax exclusion, and not the FSC tax exemption.

24. Thus, the EC's discussion of the nature of Article 21.5 proceedings and what can and cannot be raised therein is irrelevant.[15] Even if the EC could have made a claim regarding section 5 of the

[12] *First Written Submission of the United States*, 2 June 2005, para. 20.
[13] EC Rebuttal, para. 19 (footnote omitted).
[14] WT/DS108/29, page 2.
[15] *See, e.g.*, EC Rebuttal, paras. 21-23.

ETI Act and the continued use of the FSC tax exemption, the fact is that it did not do so in its request for the establishment of a panel. Therefore, the Panel must find that these claims are not within its terms of reference.

Conclusion

25. Mr. Chairman, that concludes our oral statement. The US delegation stands ready to respond to any questions you may have.

ANNEX D-3

THIRD PARTY ORAL STATEMENT OF AUSTRALIA

(1 July 2005)

Mr Chairman, Members of the Panel

Australia welcomes the opportunity to present its views to the Panel in this dispute.

I will not repeat the points Australia has made in its written submission other than to reiterate the importance that Australia places on an interpretation of the DSU that ensures prompt compliance with the recommendations and rulings of the DSB. As stated in Article 21.1of the DSU, such compliance is "essential in order to ensure effective resolution of disputes to the benefit of all Members".

Australia looks forward to participating further in the panel's consideration of the issues before it.

ANNEX D-4

THIRD PARTY ORAL STATEMENT OF BRAZIL

(1 July 2005)

Mr. Chairman and Distinguished Members of the Panel,

1. Brazil welcomes the opportunity to appear before you today at this third party session of the meeting with the Panel in the present dispute.

2. In light of the conciseness of the submissions presented by the parties and third parties in this proceeding, it would not come as a surprise to the Panel if Brazil says that it will *briefly* touch on some of the issues in question in this case. As you will see, we will give the word *briefly* its full ordinary meaning, by any test according to the Vienna Convention on Treaty Law.

3. Not only will this intervention be short, but it will also be reiterative of what Brazil has already put forward in its submission of 9 June. As a third party, Brazil has had no access to whatever the United States and the European Communities (EC) might have submitted to the Panel after their rebuttal briefs of 16 June, particularly in terms of the EC's claims of violation under Article 3 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), Articles 3, 8 and 10 of the Agreement on Agriculture ("AoA"), Article III:4 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"), and Articles 19 and 21 of the DSU.

4. Introductory explanations given, Brazil takes the opportunity to emphasize the following points we raised on 9 June:

(a) Prompt compliance as a central element for the appropriate functioning of the WTO dispute settlement system; and

(b) The continuation of a non-compliance situation through the *American Jobs Creation Act of 2004* ("AJCA").

Prompt Compliance

5. Reduced to its essence, the central argument of the United States in the present case is that a WTO Member would be allowed to maintain a subsidy previously found to be prohibited pursuant to WTO law insofar as a *compliance* panel does not make a recommendation under Article 4.7 of the SCM Agreement to the effect that that WTO Member withdraw a subsidy with respect to which there already existed a multilateral recommendation by the DSB that it be withdrawn *without delay*.

6. To say the least, it is hard to reconcile such an argument with the basic principles of WTO dispute settlement, especially that of *prompt* compliance.

7. Even though the mere fact that this argument is made may suggest otherwise, Brazil does not believe it necessary to reproduce here the text of several provisions in the DSU requiring Members to promptly comply with DSB's rulings and recommendations.

8. Brazil only notes that the adjective the drafters of the DSU choose to signify the relevance to be attached to this principle is ***essential***. Among its meanings, we will find those of ***necessary, fundamental, indispensable.*** It is not a light word, for sure.

9. The drafters, however, did not use the term only once. In two DSU provisions – Articles 3.3 and 21.1 – this adjective appear to qualify the obligation of *prompt* compliance. A meaning must be attached to this. Unlike Brazil in this statement, the drafters were not simply reiterative. By recurring twice to this word, the drafters emphasized how important *prompt* compliance is for the appropriate operation of the multilateral dispute settlement system.

10. As Brazil expressed in its submission, this is not only a DSU-case. It involves prohibited subsidies, as defined by the SCM Agreement. There, the *prompt* compliance principle is even further reinforced through especial remedies, as those established by Article 4.7.

Non-compliance

11. To avoid additional repetitions, Brazil – on the issues of the extension and "grandfathering" – will only highlight the argument presented in paragraphs 19 to 21 of our third party submission and, in slightly different terms, captured in paragraph 12 of the EC's rebuttal submission.

12. In analyzing this case, one should bear in mind that the extension and "grandfathering" provisions in the AJCA simply extend subsidies held WTO-inconsistent in two previous proceedings. This constitutes a delay of the long-overdue implementation of the recommendations deriving from the original proceedings on the *Foreign Sales Corporations* subsidies.

13. In this respect, by asserting that the United States is under no obligation to withdraw the ETI Act subsidies because no recommendation pursuant to Article 4.7 of the SCM Agreement was made by the first compliance panel is tantamount to arguing for a new deadline for implementation. In our view, should a *compliance* panel, having found that the WTO-inconsistencies remain, be required to reward the non-compliant Member with a new time-period for implementation, Articles 3.2 and 19.2 of the DSU would be depleted of any significance.

Conclusion

14. In our view, this Panel should conclude that the United States has not yet complied with the DSB's recommendations and rulings concerning this matter in the sense that the United States has not yet fully withdrawn prohibited subsidies found by previous related proceedings to be inconsistent with the multilateral rules.

Thank you.

ANNEX D-5

THIRD PARTY ORAL STATEMENT OF THE PEOPLE'S REPUBLIC OF CHINA

(1 July 2005)

1. Thank you, Mr. Chairman, and members of the Panel. China appreciates this opportunity to present its views on the issues raised in this Panel proceeding.

2. In regard to the situation in this case, China cannot share the view that "the United States has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the AJCA are not inconsistent with Article 4.7 of the SCM Agreement, for the simple reason that, … there was no DSB recommendation or ruling under Article 4.7 to withdraw the subsidy insofar as the ETI Act tax exclusion is concerned."[1]

3. The DSB made recommendations and rulings under article 4.7 when adopting the panel and Appellate Body report on 20 March 2000, which requested the US to withdraw the FSC subsidies within certain time-period. Subsequently, the United States enacted the ETI Act with a view to complying with the recommendations and rulings of the DSB in *US-FSC*. In the first compliance panel proceeding, the ETI scheme was found inconsistent with article 3.1(a) of the SCM Agreement and the US was requested to bring it into conformity with its obligations under relevant Agreement, including *the SCM Agreement*.[2]

4. Article 4.7 of *the SCM Agreement* requires prohibited subsidies to be withdrawn "without delay", and provides that a time-period for such withdrawal shall be specified by the panel.[3] The obligation to withdraw prohibited subsidies without delay is not released simply because the first compliance panel did not specify a time-period in its conclusion. The party concerned failed to fully implement the DSB recommendations and rulings by introducing transition period and grandfathering provisions for FSC scheme, an export subsidy measure. How can transition period and grandfathering provisions for another prohibited subsidy measure be justified?

5. The Appellate Body has made it clear why a long transition period and grandfathering provision are not in conformity with the obligation to withdraw the prohibited subsidies without delay. A Member's obligation under Article 4.7 of *the SCM Agreement* to withdraw prohibited subsidies "without delay" is unaffected by contractual obligations that the Member itself may have assumed under municipal law. Likewise, a Member's obligation to withdraw prohibited export subsidies, under Article 4.7 of *the SCM Agreement*, cannot be affected by contractual obligations which private parties may have assumed *inter se* in reliance on laws conferring prohibited export subsidies.[4]

[1] US First Written Submission para. 10.
[2] US-FSC 21.5 AB report para. 257.
[3] US-FSC 21.5 AB report para. 229.
[4] US-FSC 21.5 AB report para. 229.

6. China would like to conclude its submission by recalling that the primary objective of the dispute settlement mechanism is to secure the withdrawal of the measures found to be inconsistent with the covered agreements.

Thank you, Mr. Chairman.

ANNEX E

REQUEST FOR THE ESTABLISHMENT OF A PANEL

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REQUEST FOR THE ESTABLISHMENT
OF A PANEL

WORLD TRADE ORGANIZATION

WT/DS108/29
14 January 2005

(05-0183)

Original: English

UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Second Recourse to Article 21.5 of the DSU by the European Communities

Request for the Establishment of a Panel

The following communication, dated 13 January 2005, from the delegation of the European Communities to the Chairperson of the Dispute Settlement Body, is circulated pursuant to Article 21.5 of the DSU.

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1. THE HISTORY OF THE DISPUTE

On 8 October 1999, the Panel in this dispute found that the United States of America's "Foreign Sales Corporations" scheme violated Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (the "*SCM Agreement*") and Article 3.3 of the *Agreement on Agriculture* [WT/DS108/R]. On 24 February 2000 the Appellate Body confirmed the findings of the Panel with respect to the violations of the *SCM Agreement* and modified the findings concerning the Agreement on Agriculture, concluding that the Foreign Sales Corporations scheme violated Articles 10.1 and 8 of the Agreement on Agriculture [WT/DS108/AB]. On 20 March 2000, the Dispute Settlement Body (the "DSB") adopted the Appellate Body report and the report of the Panel, as modified by the Appellate Body. The resulting DSB recommendations and rulings include the recommendation that the United States bring its measures found to be inconsistent with the *SCM Agreement* and the Agreement on Agriculture into conformity with the provisions of those agreements, and that the United States withdraw its export subsidies at the latest with effect from 1 October 2000.

On 12 October 2000, at a special session, the DSB agreed to the United States' request to allow it a time period expiring on 1 November 2000 to implement the DSB recommendations and rulings.

On 15 November 2000, the President of the United States signed into law the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, US Public law No 106-519 (the "ETI Act").

On 20 December 2000, the matter was referred back to the Panel under Article 21.5 of the DSU and on 29 January 2002 the DSB adopted the Panel [WT/DS108/RW] and Appellate Body [WT/DS108/AB/RW] reports declaring that the ETI Act violates Articles 3.1(a), 3.2 and 4.7 of the

SCM Agreement, Articles 8, 10.1 and 3.3 of the Agreement on Agriculture and Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), so that the US had failed to fully withdraw its prohibited subsidy scheme and failed to implement DSB recommendations and rulings in this dispute.

On 22 October 2004, the United States enacted the "the American JOBS Creation Act of 2004" (the "JOBS Act"). In purported implementation of the above DSB recommendations and rulings in case WT/DS108, the JOBS Act fails to properly implement them and is inconsistent with the same provisions of the *WTO Agreement* as its predecessor legislation.

2. THE SUBJECT OF THE DISPUTE

Section 101 of the JOBS Act purports to repeal the ETI Act (Section 101 (a)). However, at the same time, it effectively maintains part of the ETI Act tax exemptions for a transitional period up to the end of 2006 (Section 101 (d)). Furthermore, the repeal of the ETI Act does not apply to certain contracts, without any time limits (Section 101(f)).

In the light of the above, the European Communities considers that Section 101 of the JOBS Act contains provisions which will allow US exporters to continue benefiting from the tax exemptions already found to be WTO incompatible (a) in the years 2005 and 2006 with respect to all transactions, and (b) for an indefinite period with respect to certain contracts. Thus, the United States has failed to implement the DSB's recommendations and rulings by failing to withdraw without delay schemes found to be prohibited subsidies under the *SCM Agreement* and to bring its legislation into conformity with its obligations under the *SCM Agreement*, the Agreement on Agriculture and the GATT 1994.

3. REQUEST FOR THE ESTABLISHMENT OF A PANEL

On 5 November 2004, the European Communities requested consultations with the United States of America with a view to reaching a mutually satisfactory solution of the matter. The request was circulated in document WT/DS/108/27 dated 10 November 2004. Consultations were held on 11 January 2005 in Geneva. They have allowed a better understanding of the respective positions but have not led to a satisfactory resolution of the matter.

Therefore, there continues to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB between the United States and the European Communities, within the meaning of Article 21.5 of the DSU.

Accordingly, pursuant to Articles 6 and 21.5 of the DSU, Article 4 of the *SCM Agreement*, Article 19 of the Agreement on Agriculture and Article XXIII of the GATT 1994, the European Communities hereby requests the establishment of a Panel. In particular, the European Communities respectfully requests the Panel to find the following:

– that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*.

– that the United States continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994.

In accordance with Article 21.5 of the DSU, the European Communities requests that this matter be referred to the original Panel. It further requests that the Panel examines the matter above in accordance with the standard terms of reference set out in Article 7 of the DSU.

The European Communities asks that this request be placed on the agenda for the meeting of the Dispute Settlement Body to be held on 25 January 2005.