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

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[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

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[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]
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> 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]
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> 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.
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> 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

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[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.

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[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;

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[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).