BRAZIL – CERTAIN MEASURES CONCERNING TAXATION AND CHARGES

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THIRD PARTICIPANT SUBMISSION
OF THE UNITED STATES OF AMERICA

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SERVICE LIST

Participants

H.E. Mr. Evandro de Sampaio Didonet, Permanent Mission of Brazil
H.E. Mr. Marc Vanheukelen, Permanent Mission of the European Union
H.E. Mr. Junichi Ihara, Permanent Mission of Japan

Third Parties

H.E. Mr. Hector Marcelo Cima, Permanent Mission of the Republic of Argentina
H.E. Ms. Frances Mary Lisson, Permanent Mission of Australia
H.E. Mr. Stephen De Boer, Permanent Mission of Canada
H.E. Mr. Zhang Xiangchen, Permanent Mission of the People's Republic of China
H.E. Mr. Juan Carlos Gonzalez, Ambassador Permanent Mission of Colombia
H.E. Mr. J.S. Deepak, Permanent Mission of India
H.E. Mr. Choi Kyonglim, Permanent Mission of the Republic of Korea
H.E. Mr. Gennady Ovechko, Permanent Mission of the Russian Federation
H.E. Ms. Tan Yee Woan, Permanent Mission of Singapore
H.E. Mr. Xavier Carim, Permanent Mission of South Africa
Dr. C. Y. Cyrus Chu, Permanent Mission of the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu
H.E. Mr. Kemal Madenoglu, Permanent Mission of Turkey
H.E. Mr. Yurii Klymenko, Permanent Mission of Ukraine

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I. INTRODUCTION

1. The United States welcomes the opportunity to present its views on certain findings raised on appeal by Brazil, the European Union ("EU"), and Japan. In this submission, the United States will present its views on the proper legal interpretation of certain provisions of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") that are relevant to this dispute, in particular with respect to the Basic Productive Processes ("PPBs") and other production step requirements under the disputed information and communications technology ("ICT") programs.

II. BRAZIL'S CLAIMS OF ERROR WITH REGARD TO THE PANEL'S ANALYSIS UNDER ARTICLE III:8(b) OF THE GATT 1994

2. In its report, the Panel rejected Brazil's argument that the ICT programs at issue in this dispute fell outside the scope of Article III of the GATT 1994 because they provide subsidies paid exclusively to domestic producers under Article III:8(b) of the GATT 1994. According to the Panel, Article III:8(b) "makes explicit that Article III does not require subsidization of foreign producers in tandem with domestic producers. In other words, the provision of subsidies only to domestic producers and not to foreign producers cannot in itself be inconsistent with Article III."[1] However, to the extent that aspects of a subsidy result in product discrimination (including requirements to use domestic goods, as prohibited by Article 3.1 of the SCM Agreement), the Panel found those aspects are not exempted from the disciplines of Article III pursuant to Article III:8(b).[2] The Panel thus found that subsidies that are provided exclusively to domestic producers pursuant to Article III:8(b) are not *per se* exempted from the disciplines of Article III.

3. On appeal, Brazil argues that the Panel erred in finding that subsidies provided exclusively to domestic producers pursuant to Article III:8(b) are not *per se* exempted from Article III's disciplines.[3] According to Brazil, the Panel should have carried out a threshold analysis to determine whether the measures at issue were in fact domestic production subsidies.[4] Brazil claims that, if it had performed such an analysis, the Panel would have determined that the contested measures were indeed domestic production subsidies, at which point it should have concluded that the remaining paragraphs of Article III were not applicable, and that any adverse effects of these subsidies on imports are subject to the disciplines set forth in Part III of the SCM Agreement.[5]

4. In response, the EU and Japan argue against Brazil's attempt to draw a strict line between the disciplines of Article III of the GATT 1994 and those provisions that deal directly with subsidization. They note that, as the Panel observed, the provisions on discrimination in Article III of the GATT 1994 and the provisions of the SCM Agreement "can apply to the same measure

[1] Panel Report, para. 7.79.
[2] Panel Report, para. 7.88.
[3] Brazil's Appellant Submission, para. 16-17.
[4] Brazil's Appellant Submission, para. 78.
[5] Brazil's Appellant Submission, para. 78.

simultaneously."[6] The EU and Japan also argue that Article III:8(b) cannot be interpreted as excluding the manner in which WTO Members condition the granting of subsidies to domestic producers, just because the subsidies are ultimately given only to domestic producers (as opposed to foreign producers).[7]

5. The United States agrees with the EU and Japan that Brazil is incorrect in its assertion that subsidies paid exclusively to domestic producers are *per se* exempted from the disciplines of Article III of the GATT 1994 pursuant to Article III:8(b) and are, instead, subject solely to the disciplines of the SCM Agreement. The United States also agrees that Article III:8(b) does not exclude the manner in which WTO Members condition the granting of subsidies to domestic producers, including, for example, conditioning the grant of a subsidy on the use of local over imported goods. Below, the United States will discuss the relationship between Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement, as well as the scope of Article III:8(b).

6. Article III is concerned with, and prohibits, discrimination between imported and domestic products.[8] Article III:4 in particular requires that imported products "shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."[9] Panels and the Appellate Body have interpreted the scope of Article III:4 to "go[] beyond laws and regulations which directly govern the conditions of sale or purchase to cover also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products."[10]

7. A measure conditioning an advantage, such as a subsidy, on the use of a domestic good would breach Article III:4.[11] Such a measure affects the use of the domestic and imported goods and treats the imported good less favorably than the domestic good by incentivizing the use of the domestic good over the imported good.[12] With respect to subsidies, the panel in *EC – Commercial Vessels* observed that "violations of Article III:4 have been found where discrimination between domestic and imported products results from the conditions attached to the granting of subsidies."[13] Such conditions may include, for example, a requirement that the recipient of the subsidy use products of domestic origin, thereby discriminating against foreign-origin products.[14]

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[6] EU's Appellee Submission, para. 42 (citation omitted).
[7] EU's Appellee Submission, para. 45; Japan's Appellee Submission, para. 18.
[8] *See Indonesia – Autos (Panel)*, para. 14.30.
[9] GATT 1994, Article III:4.
[10] *India – Autos (Panel)*, para. 7.196 (emphasis omitted); *see also US – FSC (Article 21.5 – EC) (AB)*, paras. 209-213; *Italy – Agricultural Machinery (GATT)*, para. 12.
[11] *See, e.g., India – Autos (Panel)*, para. 7.197; *US – FSC (Article 21.5 – EC) (AB)*, paras. 211–213; *Indonesia – Autos (Panel)*, paras. 14.29-14.46.
[12] *See, e.g., India – Autos (Panel)*, para. 7.197; *US – FSC (Article 21.5 – EC) (AB)*, paras. 211–213.
[13] *EC – Commercial Vessels (Panel)*, para. 7.65 (citation omitted); *see also Indonesia – Autos (Panel)*, paras. 14.29-14.46.
[14] *EC – Commercial Vessels (Panel)*, para. 7.65.

8. Article III:8(b) provides a derogation to the obligations of Article III with respect to certain subsidies:

> The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article . . . .[15]

Thus, in light of Article III:8(b), Article III:4 must be interpreted as not prohibiting the provision of subsidies *because of* the exclusion of foreign producers as eligible subsidy recipients. Such a payment should not be understood, on the basis of this exclusion alone, to be in conflict with Article III:4 (including its requirement of national treatment for measures affecting the "use" of a product).

9. With regards to Brazil's argument that only the disciplines of the SCM Agreement, and not those of Article III of the GATT 1994, should apply to any subsidy provided to a domestic producer, such an argument does not appear to be supported by the text of the covered agreements.

10. While Article 3.1(b) of the SCM Agreement is more focused and specific than Article III of the GATT 1994, both share a similar discipline. Article 3.1(b), in conjunction with Article 3.2 of the SCM Agreement, prohibits the granting of subsidies that are contingent upon the use of domestic over imported goods. In particular, Article 3.1(b) prohibits "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."[16] Since both Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement discipline subsidies contingent on the use of domestic over imported goods, these provisions overlap with respect to such measures.

11. The negotiating history of the SCM Agreement confirms that the drafters intended for there to be overlap between Article 3.1(b) of the SCM Agreement and Article III of the GATT 1994. In particular, the *travaux préparatoires* state:

> Some participants [in the Uruguay Round Negotiating Group on Subsidies and Countervailing Measures] expressed their reservation on the proposed category of other trade-related subsidies [i.e., prohibited subsidies]. They considered that *subsidies proposed for this category were already covered by Article III of the General Agreement (subsidies that were contingent upon the use of domestic over imported goods)* or by Article XVI:4 (subsidies contingent upon export performance). Some other participants explained that although these subsidies were already prohibited by other provisions of the General Agreement, their inclusion into the category of prohibited subsidies would serve the purpose of better clarity and certainty.[17]

[15] GATT 1994, Article III:8(b).
[16] SCM Agreement, Article 3.1(b).
[17] Note by the Secretariat, Meeting of 26-27 September 1989, GATT Doc. MTN.GNG/NG10/13 (Oct. 16, 1989), para. 6 (emphasis added).

12. Thus, as the Panel explained in its report, a harmonious reading of Article 3.1(b) of the SCM Agreement (which prohibits subsidies contingent upon the use of domestic over imported products) and Article III:4 of the GATT 1994 (which prohibits laws, regulations and requirements that discriminate against imported products, including local content requirements), indicates that a subsidy contingent on the use of domestic over imported products would be inconsistent with *both* Article 3.1(b) of the SCM Agreement and Article III:4 of the GATT 1994.[18]

13. The Panel found further support for this view in the difference in wording between Article III:8(a), which states that the provisions of Article III "shall not *apply* to" government procurement, whereas Article III:8(b) states that the provisions of Article III "shall not *prevent* the payment of subsidies exclusively to domestic producers."[19] The Panel noted that this difference suggests that, "while discrimination resulting from government procurement is completely exempted from the application of Article III by virtue of Article III:8(a), Article III:8(b) stands for the more limited proposition that the national treatment obligation in Article III does not extend to, or prohibit, the act of limiting subsidization only to domestic (to the exclusion of foreign) producers."[20]

14. This interpretation is consistent with the Appellate Body's statements in the *Canada – Autos* report that "both Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement apply to measures that require the use of domestic goods over imports."[21] Similarly, the panel in *EC – Commercial Vessels* noted with regard to Article III:4:

> As to whether the measure at issue accords imported products less favourable treatment…, in respect of subsidies, violations of Article III:4 have been found where discrimination between domestic and imported products results from the conditions attached to the granting of subsidies. This is the case, for example, if a subsidy is granted on the condition that the recipient of the subsidy purchases products of domestic origin, thereby discriminating against the suppliers of the foreign-origin product.[22]

15. The Appellate Body's recent report in *US – Tax Incentives* also acknowledges the overlap between Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement. As the Appellate Body observed, "even if the granting of a subsidy is exempt from the GATT national treatment obligation by virtue of it being paid exclusively to domestic producers within the meaning of Article III:8(b) of the GATT 1994, it may still be found to be contingent upon the use by those producers of domestic over imported goods under Article 3.1(b) of the SCM Agreement."[23]

16. The Panel in this dispute was thus correct to proceed with its analysis of the contested programs under both Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement,

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[18] Panel Report, para. 7.45 (emphasis omitted).
[19] *See* Panel Report, para. 7.84.
[20] Panel Report, para. 7.84.
[21] *Canada – Autos (AB)*, para. 140.
[22] *EC – Commercial Vessels (Panel)*, para. 7.65 (internal citation omitted).
[23] *US – Tax Incentives (AB)*, para. 5.16.

notwithstanding Brazil's contention that, as subsidies paid exclusively to domestic producers, the programs are exempt from the disciplines of Article III pursuant to Article III:8(b). While Members must be free to define the domestic producers who are to receive subsidies, including the productive activities or manufacturing steps that make the recipient a domestic producer, the United States considers that a subsidy conditioned not solely on domestic production, but also on the use of domestic over imported products, would fall outside the scope of Article III:8(b)'s derogation.

III. BRAZIL'S CLAIMS OF ERROR WITH REGARD TO THE PANEL'S ANALYSIS UNDER ARTICLE III:4 OF THE GATT 1994

17. Brazil argues that the Panel erred in finding that the PPBs and other production step requirements under the disputed ICT programs are inconsistent with Article III:4 because they require the use of domestic products to the detriment of imported products.[24] In particular, Brazil claims that "the production step requirements under the ICT programmes do not contain any limitation with respect to the origin of the inputs and components that are used in the production processes that have to be performed in Brazil, or any language that would necessarily preclude the use of imported inputs in the production process," provided that the relevant production steps are undertaken in Brazil.[25]

18. The Panel found, and Brazil appears to agree, that in order to obtain the tax benefits offered under the ICT programs, accredited companies must produce covered goods in accordance with the terms of particular product-specific PPBs or other production step requirements.[26] These PPBs define the minimum stages or steps of the manufacturing process of a product that must be performed in Brazil.[27] For example, certain PPBs require the use of inputs that themselves conform to another PPB, which the Panel termed "nested PPBs."[28]

19. The Panel further found that, based on the prescriptive nature of the mandated manufacturing processes, every product produced in accordance with a PPB, without exception, must be domestic for purposes of Article III:4, and Brazil has not appealed this finding.[29] On this basis, the Panel found, for example, that every PPB with a nested PPB inside contains an explicit requirement to use domestic goods — namely, the components and subassemblies covered by the nested PPB.[30] The Panel therefore concluded that, with respect to the requirement to comply with nested PPBs, the disputed ICT programs are explicitly contingent on the use of domestic goods and, as a consequence, those aspects of the disputed programs are inconsistent with Article III:4.[31]

20. To support its arguments, Brazil attempts to draw an analogy between its PPB requirements and the domestic production subsidies in *US – Tax Incentives*, which the Appellate

[24] *See* Brazil's Appellant Submission, paras. 157-159.
[25] Brazil's Appellant Submission, para. 164.
[26] *See* Panel Report, para. 2.61; *see also* Brazil's Appellant Submission, para. 158.
[27] *See* Panel Report, para. 2.62; *see also* Brazil's Appellant Submission, para. 158.
[28] Panel Report, para. 7.291 (citations omitted).
[29] *See* Panel Report, para. 7.299.
[30] Panel Report, paras. 7.299-7.300.
[31] *See* Panel Report, para. 7.300.

Body determined were WTO-consistent.[32] In *US – Tax Incentives*, the Appellate Body found that domestic production subsidies contingent on the location of production activities, not the use of imported or domestic goods, were not inconsistent with Article 3.1(b) of the SCM Agreement.[33] As the Appellate Body observed, "while such subsidies may foster the use of subsidized domestic goods and result in displacement in respect of imported goods, such effects do not, in and of themselves, demonstrate the existence of a requirement to use domestic over imported goods."[34]

21. Brazil has not appealed any of the Panel's factual findings under Article 11 regarding the operation of the PPBs, nor, as noted above, has Brazil appealed the Panel's findings that these products are domestic for purposes of Article III:4.[35] Instead, Brazil argues that the Panel's findings "appear[] to imply that whenever the requirement to perform certain manufacturing steps in Brazil as a condition to receive the subsidy involves the production of a specific input, part or component that could have been sourced from foreign producers, there would be *ipso facto*, and without further examination, discrimination within the meaning of Article III:4."[36]

22. The United States does not understand the Panel's findings to suggest such an implication. Rather, the Panel found that all products produced in accordance with a PPB are Brazilian domestic products and, by extension, that the nested PPBs contain an explicit requirement to use domestic over imported goods.[37] Such a requirement, applicable to the particular goods identified through the nested PPBs, would be inconsistent with Article III:4.

IV. BRAZIL'S CLAIMS OF ERROR WITH REGARD TO THE PANEL'S ANALYSIS UNDER ARTICLE 3.1(b) OF THE SCM AGREEMENT

23. Brazil argues that the Panel erred in finding (1) that the tax suspensions or exemptions granted under the disputed programs to intermediate goods qualify as "government revenue that is otherwise due is foregone or not collected" under Article 1.1(a)(1)(ii) of the SCM Agreement, and (2) that the disputed ICT programs are contingent on the use of domestic over imported goods under Article 3.1(b) of the SCM Agreement.[38] In particular, with respect to the first claim of error, Brazil argues that "'cash availability' and 'implicit interests' in relation to the lapse of time between the moment the tax credit is generated [by an intermediate good] and the moment it is used are not a revenue otherwise due within the meaning of the SCM Agreement."[39]

24. Article 3.1(b) of the SCM Agreement prohibits "subsidies, within the meaning of Article 1," that are "contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."[40] Article 1.1 of the SCM Agreement provides, in relevant part, that a subsidy shall be deemed to exist if there is a financial contribution by a government where

[32] *See* Brazil's Appellant Submission, paras. 165-166.
[33] *See US – Tax Incentives (AB)*, paras. 5.79-5.81.
[34] *US – Tax Incentives (AB)*, para. 5.49.
[35] *See* Brazil's Appellant Submission, para. 121.
[36] *See* Brazil's Appellant Submission, para. 159.
[37] *See* Panel Report, paras. 7.299-7.300.
[38] Brazil's Appellant Submission, paras. 177, 195.
[39] Brazil's Appellant Submission, para. 201.
[40] SCM Agreement, Article 3.1(b).

"government revenue that is otherwise due is foregone or not collected" and "a benefit is thereby conferred."[41]

25. With respect to this element, the Appellate Body stated in *US – Large Civil Aircraft (2nd complaint)* that "the foregoing of revenue otherwise due implies that less revenue has been raised by the government than would have been raised in a different situation," and that "the word 'foregone' suggests that the government has given up an entitlement to raise revenue that it could 'otherwise' have raised."[42] The United States notes that if a measure *exempts* taxes that would otherwise have to be paid but for the measure, a financial contribution has been provided: government revenue, otherwise due, is clearly foregone. In addition, if a measure *suspends* taxes that are later paid further down the production chain, a financial contribution has still been provided: at the time in which government revenue would otherwise be due, it is foregone (albeit temporarily). Moreover, as the Panel found, suspending the collection of a tax may result in the foregoing of revenue in the form of implicit interest on the tax revenue that would otherwise have been collected.[43]

26. With respect to Brazil's second claim of error, the United States notes that Brazil has not appealed any of the Panel's factual findings under Article 11 regarding the operation of the disputed programs.[44] As explained above with respect to Article III:4 of the GATT 1994, the Panel found that all products produced in accordance with a PPB are Brazilian domestic products and, by extension, that nested PPBs explicitly require the use of domestic goods.[45] On this basis, the Panel further found that the disputed programs constitute a contingency on the use of domestic over imported goods for purposes of Article 3.1(b).[46] On the facts as found by the Panel, the tax advantages coupled with the requirement to comply with nested PPBs support a finding that government revenue is foregone and the advantage is contingent on the use of domestic over imported goods.

V. CONCLUSION

27. The United States appreciates the opportunity to provide its views in this appeal and hopes that its comments will be useful to the Appellate Body.

[41] SCM Agreement, Article 1.
[42] *US – Large Civil Aircraft (2nd complaint) (AB)*, para. 806; *see also US – FSC (AB)*, para. 90.
[43] *See* Panel Report, paras. 7.168–7.171, 7.437.
[44] *See* Brazil's Appellant Submission, para. 177.
[45] *See* Panel Report, paras. 7.299-7.300, 7.313.
[46] *See* Panel Report, para. 7.313.