BRAZIL – CERTAIN MEASURES CONCERNING TAXATION AND CHARGES

(DS472/497)

RESPONSE OF THE UNITED STATES OF AMERICA TO THE EUROPEAN UNION'S QUESTIONS TO THIRD PARTIES

March 17, 2016

1. The European Union seeks the views of the Third Parties with respect the interpretation of Article 3.1(b) of the SCM Agreement. In particular, please provide your views as to whether the following scenarios would fall under that provision:

a. Country A grants a subsidy to a company contingent upon making and selling bicycles in Country A (for instance, if the company makes the bicycles in Country A, it does not pay sales taxes otherwise due);

b. Country A grants a subsidy to a company contingent upon making and selling wheels for bicycles in Country A (for instance, if the company makes wheels for bicycles in Country A, it does not pay sales taxes otherwise due); and

c. Country A grants a subsidy to a company when selling bicycles made in Country A provided that those bicycles incorporate wheels made or sourced in Country A. Please specify whether your answer is different if the measure states that "in order to obtain the subsidy, producers of bicycles in Country A shall assemble all the parts of the wheels (i.e. the spokes, the rims, the tyres, etc) in Country A and incorporate those wheels into the incentivised bicycles sold in Country A" (for instance, if the company makes bicycles in Country A and assembles all the basic components of their wheels in that country and incorporates them into the bicycle, it does not pay sales taxes otherwise due).

2. Do third parties think that there is a difference between the scope of products falling within the notion of "domestic" in Article 3.1(b) of the SCM agreement and "domestic" in Article III:2, "products from domestic sources" in Article III:5 and "products of national origin" in Article III:4 of the GATT 1994? If the scope is different with respect to the term "domestic", can you please explain what this difference consists of?

1. The United States refers the European Union to paragraphs 116 to 124 of the U.S. First Written Submission in *United States – Conditional Tax Incentives for Large Civil Aircraft* (DS487), reproduced below.[1]

C. Article 3.1(b) Does Not Discipline Production Subsidies.

116. The EU's claims rely on an incorrect interpretation of Article 3.1(b) of the SCM Agreement that equates the payment of subsidies to domestic producers for

[1] The full First Written Submission of the United States in *United States – Conditional Tax Incentives for Large Civil Aircraft* (DS487) is available at https://ustr.gov/sites/default/files/enforcement/DS/US.Sub1.Non.BCI.Version.pdf.

engaging in production activities in the grantor's territory with subsidies contingent upon the use of domestic over imported goods. The ordinary meaning of the language in Article 3.1(b) does not discipline subsidies by virtue of the fact that they are provided for production activities in the territory of the grantor. This is consistent with the object and purpose of the SCM Agreement, which is to regulate trade in goods.[2]

117. Article III of the GATT 1994 further makes clear that subsidies provided for domestic production cannot be equated with subsidies contingent upon the use of domestic over imported goods. Both the Initial Siting Provision and the Future Siting Provision are silent regarding the use of goods, whether domestic or imported. Rather, they limit the relevant tax treatment to production activities, as well as non-production activities like retail and wholesale selling, in Washington. And the conditions in ESSB 5952 relate solely to manufacturing activities in Washington. Thus, the EU's claims fail because the challenged measures are contingent on domestic manufacturing, not on the use of domestic products.

118. As has been explained, Article 3.1(b), by its terms, is directed to subsidies contingent on "the use of domestic over imported goods." That is, the conditionality for the subsidy must relate to "use." Article 3.1(b) does not speak to subsidies conditional for their granting on domestic manufacturing. Rather, such subsidies (and "any" subsidy) would appear to be disciplined by Part III of the SCM Agreement (or potentially susceptible to a countervailing duty pursuant to Part V). Part III does not impose any prohibitions based on the type of subsidy but disciplines subsidies to the extent they cause certain adverse effects to the interests of other Members.

119. As the Appellate Body has noted, Article III of the GATT 1994 provides relevant context for the interpretation of Article 3.1(b) of the SCM Agreement.[3] The negotiating history of Article 3.1(b) confirms that the drafters intended for there to be overlap between Article 3.1(b) and Article III. 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

[2] This is evident from the fact that the SCM Agreement is part of Annex 1A to the WTO Agreement, which is entitled the Multilateral Agreement on Trade in Goods. This is distinct from Annex 1B on the General Agreement on Trade in Services, as well as the other elements of the WTO Agreement.
[3] *Canada – Autos (AB)*, para. 140.

> General Agreement, their inclusion into the category of prohibited subsidies would serve the purpose of better clarity and certainty.[4]

In fact, Article 32.1 of the SCM Agreement suggests that provisions of the GATT 1994 are interpreted by the SCM Agreement, and the Appellate Body has noted that the SCM Agreement is generally understood to elaborate upon the disciplines in the GATT 1994.[5] The overlap in what is disciplined by Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement therefore calls for a degree of consistency in interpreting the provisions of those two articles.

120. As the Panel in *Indonesia – Autos* stated: "Article III has always been a provision that is concerned with (and prohibits) discrimination between imported and domestic products."[6] Article III:4 in particular states:

> The products of the territory of any contracting party imported into the territory of any other contracting party 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.

121. The panel in *Indonesia – Autos* 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 suppliers of the foreign-origin product.[7]

Thus, as the Appellate Body has stated, "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."[8]

122. Yet, while Article III:4 disciplines measures that require the use of domestic over imported goods, Article III:8(b) states:

> The provisions of this Article *shall not prevent the payment of subsidies exclusively to domestic producers*, including payments to

[4] Note by the Secretariat, Meeting of 26-27 September 1989, GATT Doc. MTN.GNG/NG10/13 (Oct. 16, 1989), para. 6.
[5] *See Brazil – Desiccated Coconut (AB)*, p. 14.
[6] *Indonesia – Autos (Panel)*, para. 14.30.
[7] *EC – Commercial Vessels (Panel)*, para. 7.65 (internal citation omitted).
[8] *Canada – Autos (AB)*, para. 140.

> domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.[9]

Thus, in light of Article III:8(b), Article III:4 must be interpreted must be interpreted as not prohibiting the provision of subsidies exclusively to domestic producers for reason of their production activities. That is, a subsidy recipient's status as a "domestic producer" necessarily is defined through its domestic production activity. Such a payment to a producer should not be understood to be in conflict with Article III:4 (including its requirement of national treatment for measures affecting the "use" of a product). And given that disciplining subsidies contingent upon the use of domestic over imported goods is an area of overlap between Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement, subsidies provided exclusively to domestic producers by conditioning their receipt on defined domestic production activities must also not be equated with requiring the use of domestic over imported goods for purposes of the SCM Agreement.

123. In sum, Article 3.1(b) of the SCM Agreement disciplines subsidies contingent on the use of domestic over imported goods, but there is nothing in that text that supports the interpretation that subsidies provided only to producers that engage in production activities in the territory of the grantor are to be equated with subsidies contingent on the use of domestic over imported goods. In other words, it is insufficient for the purposes of Article 3.1(b) to establish that a Member has granted domestic production subsidies.

124. Yet, even ignoring several other deficiencies in the EU's argument, this is at best what the EU has even tried establish. Both the Initial Siting Provision and Future Siting Provision are completely silent on the use of domestic or imported goods. They instead establish a condition exclusively in relation to production activities performed in Washington. Thus, for this reason as well, the EU's claims fail.

[9] Emphasis added.