BRAZIL – CERTAIN MEASURES CONCERNING TAXATION AND CHARGES

(DS472 / DS497)

THIRD PARTY EXECUTIVE SUMMARY OF THE UNITED STATES OF AMERICA

April 1, 2016

EXECUTIVE SUMMARY OF THE U.S. THIRD PARTY WRITTEN SUBMISSION

I. INTERPRETATION AND APPLICATION OF ARTICLE III:2 OF THE GATT 1994

1. The European Union and Japan assert that the disputed programs result in imported ICT products being taxed in excess of domestic ICT products, contrary to the first sentence of Article III:2 of the GATT 1994. Brazil claims that any differences in taxation between imported and domestic goods resulting from the disputed programs "do not relate to the origin of the goods, but rather to the participation of the producing company" in the programs.

2. However, if the Panel agrees with the facts as presented by complainants, the requirements imposed by the disputed programs would appear to limit the benefits of the programs to goods of Brazilian origin. For example, the programs at issue condition certain tax benefits on the sale of products that conform to a Brazilian Productive Process ("PPB"). Brazil does not dispute that these PPBs require that a number of manufacturing steps take place in Brazil, including manufacturing of intermediate components and the assembly of various components into a final product. For example, the main PPB for IT products requires the following production steps take place in Brazil: (1) "assembly and soldering of all components on the printed circuit boards"; (2) "assembly of the electrical and mechanical parts, totally separated, at a basic component level"; and (3) "integration of the printed circuit boards and the remaining electrical and mechanical parts in the formation of the final product". If the Panel finds that the facts are as presented by the complainants, it would appear that the number and type of manufacturing steps required to comply with such PPBs would lead to the resultant products being of Brazilian origin. It would not appear that imported products could meet the domestic manufacturing requirements of PPBs, and therefore imported products could not receive the same tax benefits that are available to domestic goods that comply with PPBs. Thus, only Brazilian products would be able to comply with a PPB and receive preferential tax treatment under these programs.

II. INTERPRETATION AND APPLICATION OF ARTICLE III:4 OF THE GATT 1994

3. The European Union and Japan assert that the disputed programs result in imported ICT products being accorded less favorable treatment than domestic ICT products contrary to Article III:4 of the GATT 1994, because they provide tax benefits for domestic ICT products that are unavailable to imported ICT products and because, in certain instances, they incentivize the purchase and use of domestic inputs over imported inputs. Brazil claims that the requirements of the disputed programs do not affect products in the marketplace, but instead "deal with *pre-market* activities," and are therefore outside the scope of Article III:4.

4. The distinction that Brazil attempts to draw between measures that deal with "pre-market activities" and measures that affect "products" is not a useful one, nor is it a distinction that is found in the text of Article III:4. Simply because a measure imposes a so-called "pre-market" requirement does not mean it does not *affect* the "internal sale, offering for sale, purchase, transportation, distribution or use" of a product. As the Appellate Body has noted, "[t]he ordinary meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a broad scope of application." Based in part on the breadth of this definition, 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." Measures that otherwise fall within this scope should not be excluded simply because they impose requirements on production or development. To the extent that any such measures "affect" the "internal sale, offering for sale, purchase, transportation, distribution or use" of products, the text of Article III:4 clearly would cover those measures.

5. In this case, for example, PPBs require that a number of production steps take place in Brazil, including intermediate manufacturing steps and final assembly. Although Brazil claims that PPBs "are not related to the product, but to production," PPBs do appear to relate to products. Specifically, PPBs define the "minimum set of operations performed at a manufacturing facility that characterises the actual industrialisation *of a given product*." Under the disputed programs, such products may be exempt from certain taxes when they are sold, thereby modifying the conditions of competition in the marketplace to the benefit of covered products and to the detriment of non-covered products. Moreover, since companies cannot obtain these tax advantages until the product is sold on the market, Brazil's characterization of the disputed measures as strictly "pre-market" would not seem to be accurate.

6. The disputed programs also affect the purchase and use of inputs that are used in the production of certain covered products. As all the parties agree, certain PPBs require the use of inputs that themselves conform to another PPB. As discussed above, if the Panel finds that the facts are as presented by the complainants, foreign inputs would not appear to be able to satisfy the relevant PPBs, because they would not have been produced and assembled in Brazil. By providing tax benefits for products that are manufactured according to these "nested" PPBs, the disputed programs incentivize the purchase and use of products made in Brazil as inputs into the production process, thereby modifying the conditions of competition to the detriment of imported inputs.

III. INTERPRETATION AND APPLICATION OF ARTICLE III:5 OF THE GATT 1994

7. The European Union and Japan assert that the disputed programs violate Article III:5 of the GATT 1994. If the Panel determines that the programs at issue violate Articles III:2 and III:4, the United States does not see the value of addressing additional claims under Article III:5. That said, the United States notes that Article III:5 prohibits regulations that relate to the "use of products in specified amounts or proportions" and require "that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources." As discussed above, certain PPBs require the use of a specified proportion of inputs that themselves conform to a PPB. If the Panel finds that goods produced in accordance with a PPB are necessarily domestic products, and insofar as these programs condition preferential tax treatment on compliance with such PPBs, the disputed programs would appear to require the use of specified amounts or proportions of domestic products.

IV. INTERPRETATION AND APPLICATION OF ARTICLE XX(a) OF THE GATT 1994

8. Brazil asserts that PATVD is necessary to protect public morals because it provides access to culture, information, and education through digital television in Brazil, and is thus justified by the exception under paragraph (a) of Article XX of the GATT 1994.

9. In considering whether a GATT-inconsistent measure is provisionally justified under Article XX(a), a panel must determine whether a measure contributes to a covered objective and, if so, whether that contribution is such that the measure is "necessary" to achieving the objective. The analysis may also entail consideration of whether a complaining party has identified a reasonably available, less trade-restrictive alternative.

10. Objective. Without directly addressing whether the provision of information and education via digital television falls within the scope of a measure to protect public morals under Article XX(a), the United States notes that a certain degree of deference must be given to WTO Members with respect to determining what constitutes public morals and measures to protect same. As the *Colombia – Textiles* panel explained: "[T]he term 'public morals' denotes standards of right and wrong conduct maintained by or on behalf of a community or nation, and its content may vary in time and space, depending on the prevailing factors. Members have the right to determine the level of protection that they consider appropriate and some scope to define and apply for themselves the concept of 'public morals' in their respective territories, according to their own systems and scales of values."

11. Necessity. In this case, Brazil's stated objective with respect to protecting public morals is to ensure "proper and timely access of the Brazilian population to information and education" via digital television. However, Brazil fails to explain why digital TV transmitters must be developed and manufactured *in Brazil* in order to accomplish the objective of providing access to information and education via digital television. Making sure digital TV transmitters are available to Brazilians may be relevant to this objective, but there would not seem to be any reason why those transmitters must be developed or made in Brazil to provide such access. The public would have as much access to information and education if it were conveyed by imported transmitters as by domestic transmitters. Thus, there does not appear to be a genuine relationship between the provision of tax benefits to domestic producers of digital TV transmitters via PATVD and the goal of making digital television accessible in Brazil.

12. Less trade-restrictive alternative. As noted above, it is for the complainants to identify a reasonably available, less trade-restrictive alternative measure. As a general matter, there would appear to be a number of reasonably available alternative measures that would achieve the same end of ensuring access to digital television, while being less trade restrictive than the PATVD program. For example, Brazil could provide tax exemptions for sales of *all* digital TV transmitters that comply with Brazil's digital TV standards, regardless of whether they are imported or domestically produced. Alternatively, Brazil could eliminate tariffs on the importation of digital TV transmitters, or provide subsidies for producers of digital TV transmitters. Each of these measures would provide the Brazilian population with access to digital television, while avoiding the trade-restrictive impact of the PATVD program.

V. INTERPRETATION AND APPLICATION OF ARTICLES 1.1(a)(1)(ii) AND 1.1(b) OF THE SCM AGREEMENT

13. The European Union and Japan assert that the tax exemptions and suspensions provided by the disputed programs constitute subsidies "contingent...upon the use of domestic over imported goods," contrary to Article 3.1(b) of the SCM Agreement. In determining whether a subsidy exists, the Appellate Body has identified two distinct elements: (1) a financial

contribution by a government, which may be met if government revenue that is otherwise due is foregone or not collected; and (2) the financial contribution must confer a benefit.

14. Government revenue otherwise due is foregone or not collected. 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." The United States notes that insofar as the disputed programs *exempt* taxes that would otherwise have to be paid but for the program, a financial contribution has been provided: government revenue, otherwise due, is clearly foregone. In addition, to the extent the disputed programs *suspend* taxes that are later paid further down the production chain, a financial contribution has still been provided: at the moment in which government revenue would otherwise be due, it is foregone (albeit temporarily). Moreover, given the time-value of money, suspending the collection of a tax may also result in less revenue being raised.

15. A benefit is thereby conferred. As the Appellate Body explained in *Canada – Aircraft*, "there can be no 'benefit' to the recipient unless the 'financial contribution' makes the recipient 'better off' than it would otherwise have been, absent that contribution." Under the programs at issue, producers whose goods are tax-*exempt* are clearly better off than those who must pay taxes. A producer that does not have to pay a tax may be able to charge less, or earn a greater profit, for the same goods when compared with a producer whose goods are not tax-exempt. This is true even in the case of intermediate goods—while taxes might be charged later in the production chain, the intermediate producer still receives the benefit of an exemption on its own sales. Moreover, there is a benefit even in the case of tax *suspensions*. A producer whose payment of taxes is suspended is better off than one who must pay the taxes, but receives a credit that can be redeemed later. In particular, funds that would otherwise be tied up by the payment of taxes are instead available for use and reinvestment.

EXECUTIVE SUMMARY OF U.S. THIRD PARTY ORAL STATEMENT

I. INTERPRETATION AND APPLICATION OF ARTICLE III:2 OF THE GATT 1994

16. The complaining parties assert that the disputed programs result in imported ICT products being taxed in excess of domestic ICT products, in a manner inconsistent with the first sentence of Article III:2 of the GATT 1994.

17. Article III:2 provides that imported products shall not be subject to internal taxes "in excess of" those applied to like domestic products. The programs at issue in this dispute condition certain tax benefits on the sale of products that conform to a Brazilian Productive Process, or "PPB." PPBs require that a number of manufacturing steps take place in Brazil, including manufacturing of intermediate components and the assembly of various components into a final product. Based on the facts presented by the complaining parties, it would appear that complying with a PPB would necessarily result in a domestic product benefitting from a lower tax on its sale. An imported product could not meet the domestic manufacturing requirements of a PPB, and therefore could not receive the same tax benefits that are available to a domestic product that complies with a PPB.

18. The United States therefore agrees that insofar as the disputed programs result in a tax applied to products manufactured in Brazil in conformance with a PPB lower than the tax for like imported products, these programs would appear to tax imported products "in excess of" like domestic products.

II. INTERPRETATION AND APPLICATION OF ARTICLE III:4 OF THE GATT 1994

19. The complaining parties assert that the disputed programs provide tax benefits for domestic ICT products that are unavailable to imported ICT products and, in certain instances, incentivize the purchase and use of domestic inputs over imported inputs. The complaining parties allege that this situation results in imported products being accorded less favorable treatment than domestic products contrary to Article III:4.

20. Article III:4 provides that imported products "shall be accorded treatment no less favourable" than like domestic products with respect to "all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." Panels and the Appellate Body have interpreted the scope of Article III:4 to include "any laws or regulations which might adversely modify the conditions of competition between domestic and imported products." Under the disputed programs, products that are manufactured in Brazil in conformance with a PPB may be exempt from certain taxes when they are sold, whereas imported products would not receive such an exemption. Therefore, insofar as the programs at issue exempt domestic products from taxes that would otherwise be due upon sale, but do not provide the same exemption for like imported products, these programs would appear to "affect[] the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products" by adversely modifying the conditions of competition for imported products compared to like domestic products.

21. For the subset of PPBs that require the use of input products that themselves conform to another PPB, a different analysis applies. For example, the PPB for "Tablet PCs with a Touch Screen" requires that 90 percent of the "motherboards" used during production of "tablet PCs with a touch screen" comply with the PPB for printed circuit boards. To obtain tax benefits under the disputed programs, companies seeking to comply with these "nested" PPBs must therefore purchase and use the required amount of PPB-compliant input products. Input products produced in accordance with a PPB would be domestic products; imported input products cannot be produced in accordance with a PPB. Therefore, the requirement to use input products that conform to a PPB necessarily requires the use of domestic products. The United States therefore agrees that by providing tax benefits for products manufactured using input products meeting "nested" PPBs, the disputed programs incentivize the purchase and use of domestic products as inputs by downstream producers, thereby modifying the conditions of competition for those input products to the detriment of imports.

III. INTERPRETATION AND APPLICATION OF ARTICLE III:5 OF THE GATT 19944

22. The complaining parties also assert that the disputed programs are inconsistent with Article III:5, which prohibits regulations that relate to the "use of products in specified amounts or proportions" and "require[], directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources."

23. If the Panel determines that the disputed programs are inconsistent with Articles III:2 and III:4, there would not seem to be value in addressing additional claims under Article III:5. That said, "nested" PPBs specifically require the use of a specified amount or percentage of inputs that are domestic goods produced in accordance with a PPB. The United States therefore agrees that insofar as the disputed programs condition preferential tax treatment on compliance with such PPBs, the programs would appear to require the use of "specified amounts or proportions" of products "from domestic sources."

IV. INTERPRETATION AND APPLICATION OF ARTICLE 3.1(B) OF THE SCM AGREEMENT

24. The complaining parties assert that the tax exemptions and suspensions available under the disputed programs are contingent on "the use of domestic over imported goods" in part because PPBs may require the producer of the final product to produce certain components of that product domestically. As noted in Canada's third-party submission, interpreting Article 3.1(b) to cover situations in which subsidy recipients are required to produce goods domestically would be an improper expansion of the scope of that provision. The SCM Agreement does not prohibit Members from granting subsidies that are contingent on the recipient producing goods domestically. Rather, Article 3.1(b) is directed to conditioning a subsidy on "use" of a domestic over an imported good.

25. Moreover, GATT 1994 Article III:8(b), which the Appellate Body has noted provides relevant context for the interpretation of Article 3.1(b) of the SCM Agreement, expressly permits the payment of subsidies exclusively to domestic producers. By necessity, the derogation in Article III:8(b) extends to subsidies to the productive activities or manufacturing steps that make the recipient a domestic producer. To the extent that these encompass the production of what might be considered intermediate components, a Member remains free to define the domestic producers receiving subsidies as those recipients also producing those components.

26. The United States therefore disagrees with the complaining parties to the extent they claim that a requirement to engage in specified production steps leading to the production of a finished good in the territory of a Member is a subsidy contingent on "the use of domestic over imported goods."