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Dispute Settlement Body
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MINUTES OF THE MEETING

Held in the Centre William Rappard
on 20 December 2000

Chairman: Mr. S. Harbinson (Hong Kong, China)

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1. United States – Tax treatment for "Foreign Sales Corporations"

(a) Recourse to Article 21.5 of the DSU by the European Communities: Request for the establishment of a panel (WT/DS108/16)

1. The Chairman drew attention to the communication from the European Communities contained in document WT/DS108/16.

2. The representative of the European Communities expressed regret that the United States had decided not to address the concerns raised by the EC during the bilateral discussions on the draft laws prepared to replace the Foreign Sales Corporations (FSC) scheme. After long and detailed exchanges of views during which the EC had made clear that the US proposal was WTO-inconsistent, the EC was surprised that the United States had decided to adopt a new law that replicated the elements of the FSC scheme which had already been condemned by the WTO. That scheme maintained the same tax benefits to exporting companies, and aggravated the previous violations by increasing the level of subsidization and by adding further violations of the WTO Agreements. Moreover, it was only on 15 November 2000 that the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 had been signed into law: i.e. 15 days after the deadline agreed by the DSB for the United States to comply with its WTO obligations; i.e. by 1 November 2000. This delay would have entitled the EC to request immediate authorization to impose sanctions. On 17 November 2000, the EC had requested consultations with the United States under Article 21.5 of the DSU. These consultations, which had been held in Geneva on 4 December 2000, had been useful to clarify both sides' positions. However, they had not resulted in a solution. For this reason, the parties had jointly considered that the consultations had failed to settle the dispute in the sense of Article 4.7 of the DSU. Therefore, the EC was requesting the establishment of a panel pursuant to Article 21.5 of the DSU to examine the compatibility of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 with the WTO

Agreements. The EC attached importance to the resolution of this dispute in accordance with the DSU rules, and that was why it had agreed with the United States on the procedures to be followed in this case.

3. The representative of the United States said that the EC's request for a panel pursuant to Article 21.5 proceedings while not unexpected was nonetheless regrettable. While the United States did not agree with the findings of either the Panel or the Appellate Body in the original dispute, it had nevertheless engaged in an extraordinary effort to enact legislation which fixed the problems that the Panel and the Appellate Body had identified with the FSC legislation. The United States had done so notwithstanding the fact that the deadlines established by the Panel were extremely short (less than eight months from the date of the Appellate Body report) for legislative action; the legislation involved the complex subject of income taxation and it was a national election year in the United States. Moreover, in its legislation, the United States had sought to address issues of concern to the EC on which the Panel and the Appellate Body had not even made findings. The United States had also eliminated the so-called FSC administrative pricing rules to alleviate the EC's concerns about transfer pricing between related firms. The United States had eliminated the requirement to set up a foreign subsidiary in order to address the EC's concerns regarding so-called "tax havens". It had addressed both concerns of the EC even though neither had been substantiated. The US task might have been made easier if the EC had been willing to engage in a meaningful discussion as to what precise steps the United States could take to satisfy the EC's concerns. However, the US inquiries had been repeatedly rebuffed by the EC with the explanation: "we are not tax experts". Nevertheless, this self-proclaimed lack of expertise regarding income tax matters had not delayed the EC in its move to challenge the FSC replacement legislation. At the present meeting, he did not wish to provide detailed legal arguments as to why the FSC replacement legislation complied with the DSB's recommendations and rulings and was otherwise WTO-consistent. The United States had agreed with the EC on procedures for resolving these issues, and would present its arguments to the appropriate bodies in due course. It was sufficient to state that while EC officials had stated publicly that they were confident that the FSC replacement legislation would be found to be WTO-inconsistent, the United States was equally confident that its legislation would be found to be WTO-consistent.

4. However, there were some points on which the United States felt compelled to comment and he believed that those points should also be of concern to other Members. First, the EC has acknowledged that the exclusion of extraterritorial income provided by the FSC replacement legislation was not limited to US exporters, but also encompassed companies that manufactured and sold abroad. Second, the EC had acknowledged that exempting extraterritorial income from taxation - which was what the FSC replacement legislation did – was an appropriate and widely accepted tax practice that did not constitute a prohibited export subsidy. Finally, in the first round of this proceeding, the EC had conceded that the use of the internationally-accepted exemption method to avoid double taxation could result in exports being taxed more favorably than comparable domestic transactions. These points of agreement represented small progress, but progress nonetheless. Unfortunately, there remained areas of misunderstanding and disagreement that appeared to go to the heart of this dispute and had left the United States perplexed. Perhaps most importantly, in their various statements regarding the FSC replacement legislation, EC officials avoided the indisputable fact that the tax treatment of export transactions under the FSC replacement legislation was very similar to the tax treatment of export transactions under European regimes that employed the exemption method. This fundamental error caused many of the EC's objections to the FSC replacement legislation to be unfounded and, in any event, these objections would be equally applicable to certain European tax regimes.

5. Another area of misunderstanding concerned the term "extraterritorial income". The EC had asserted that the FSC replacement legislation "exempts income that is generated in the US while territorial systems only exempt income derived from activities carried out abroad". This assertion was not only incorrect, but also unsupported by any evidence. Rather, the FSC replacement legislation

excluded from US tax only "extraterritorial income", which was defined in the legislation as income generated outside the territory of the United States. Finally, with respect to what the EC had sometimes referred to as the "US content provisions" of the FSC replacement legislation, those provisions simply were not what the EC claimed they were, and the EC's charges appeared to reflect a fundamental misunderstanding of what these provisions implied and how they were intended to operate. In the US view, these provisions did not require the use of domestic over imported goods, and the EC had yet to provide any evidence that they had. The United States continued to be puzzled by the EC's charges, given how the tax regimes of its member States functioned. Nevertheless, it recognized the EC's right under the DSU and the procedural agreement to request a panel to consider its claims. In accordance with the procedural agreement, the United States would not object to the establishment of a panel at the present meeting.

6. The DSB took note of the statements and agreed, pursuant to Article 21.5 of the DSU, to refer to the original Panel the matter raised by the European Communities in document WT/DS108/16. The panel would have standard terms of reference.

7. The representatives of Australia, Canada, India and Japan reserved their third-party rights to participate in the Panel's proceedings.

2. Statement by Panama regarding the EC's proposal to modify its banana import regime

8. The representative of Panama, speaking under "Other Business", said that on 19 December 2000, the EC Council of Agriculture Ministers had adopted a new proposal in an attempt to solve the banana dispute and, at the same time, it had undertaken a political commitment to continue considering the option presented by the European Commission which included a first come, first served system. Panama rejected this political agreement and noted that the proposal provided the Commission with a broad spectrum of actions. It, therefore, urged the EC not to implement the option which was based on a first come, first served system but to adopt regulations to implement an option which was WTO-compatible. Such an outcome would provide Latin American producers with effective and fair access to the EC market.

9. The representative of Costa Rica said that his country also regretted that the EC had ignored the views expressed by seven Latin American banana exporting countries representing more than 70 per cent of the banana exports. On several occasions, the countries in question had rejected the regime based on a first come, first served system. He noted that the United States had also objected to that system. The EC had maintained that it had to protect its operators and producers as well as the ACP countries. He noted that Latin American countries were not receiving any preferences because in line with their comparative advantage they had become the most efficient producers of bananas in the world. The EC had adopted criteria that implied that comparative advantage was irrelevant since its decisions were based on political considerations. Trade in agricultural products was directly linked to sustainable development. However, this link had not been taken into consideration by the EC. In the past, the EC had defended policies in favour of sustainable development and had supported the coordination mechanism between the Bretton Woods institutions in order to ensure coherent development policies. However, these goals seemed to be in contradiction with the EC's statement on its agricultural policy, which worked against the interests of developing countries' agricultural development, in this case Latin American countries, and favoured another group of countries thus creating inequality among developing countries.

10. The representative of Guatemala said that her country supported the statements made by the previous speakers who had urged the EC to implement a WTO-compatible banana import regime. Guatemala was concerned that the EC was taking a decision on the proposal based on a first come, first served system which was incompatible with the interests of Latin American banana producing countries.

11. The representative of Honduras said that it was regrettable that more than three years after the WTO had condemned the EC's banana import regime, on 19 December 2000, the EC Council of Ministers of Agriculture had adopted the recommendation by the European Commission to implement a new banana import regime based on a first come, first served system. That decision would seriously affect the Honduran banana industry and would perpetuate the discrimination that had been maintained for many years. Honduras rejected any new banana import regime that included a first come, first served option. It urged the EC member States not to implement a regime that infringed the WTO Agreements because there were other legal and fair options which had not yet been taken into account. Furthermore, notwithstanding its feelings of frustration resulting from the EC's lack of compliance in this case, his country was fully prepared to explore legal and fair solutions. Honduras would closely follow the regulations issued on the basis of the decision of the Council of Ministers of Agriculture with a view to taking legal action in the WTO in order to restore its rights.

12. The representative of Ecuador said that his country had great interest in this matter and his authorities were now examining the decision taken by the EC Council of Ministers of Agriculture. Ecuador awaited further details as to how the European Commission would implement this recent Council decision, and reiterated its interest in maintaining a close dialogue with the European Commission in order to participate in the definition of those details, which were essential to making the new regime operational. He recalled that the questions related to the banana case which had been raised by Ecuador at the past three meetings of the DSB remained open since Ecuador still had doubts as to whether the proposed regime would be implemented in a fully WTO-consistent manner.

13. The representative of Colombia said that his delegation also wished to voice concerns about the recent decision of the EC that the new banana import regime would be implemented on the basis of a first come, first served system. Like Ecuador, Colombia wished to examine different aspects of that decision and would present its views thereon at a future DSB meeting.

14. The representative of Nicaragua said that his country was concerned about the measures adopted by the EC and supported the statements made by Colombia, Costa Rica, Guatemala, Honduras and Panama.

15. The representative of Mexico said that his authorities were examining the EC's proposal. Mexico wished to participate in any discussions to be carried out on this matter.

16. The representative of Mauritius said that her country was not a banana producer but had always wished to have a fair and constructive solution to this dispute, which would take into account the situation of the most vulnerable producers.

17. The representative of the European Communities said that his delegation had noted the statements made at the present meeting and would make a substantive response at the next regular DSB meeting.

18. The DSB took note of the statements.