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WTO Rules U.S. in Violation of EU Trade Agreements; Appeals Filed

BY JULIE ELIZABETH MCGUIRE

Special to the Legal

In October 1999, a panel created by the Dispute Settlement Body of the World Trade Organization issued its final report concluding that the U.S. Foreign Sales Corporation tax regime creates illegal export subsidies. A FSC is a corporation given special tax treatment under the U.S. tax laws, and the purpose of the FSC provisions is to promote United States exports in a manner compatible with the agreements negotiated between the United States and its trading partners.

The European Union, which has opposed the FSC regime since its enactment in the mid-1980s, originally filed a complaint against the United States in November 1997. In July 1998, after consultations between the EU and the U.S. failed to resolve differences, the EU requested that the WTO's Dispute Settlement Body form a panel to rule on the issue. The WTO panel was formed in September 1998. In October 1999, the WTO's panel released its findings in a 298-page report.

The panel concluded that the U.S. FSC regime creates illegal export subsidies and should be abolished by October 1, 2000.

EU COMPLAINT

Specifically, the EU complaint alleged that the FSC regime violates certain export subsidy prohibitions of the WTO Agreement of Subsidies and Countervailing Measures by granting tax subsidies contingent upon export performance and tax subsidies contingent upon the use of domestic over imported goods; and the WTO Agreement on Agriculture by granting tax subsidies to agricultural goods in excess of the budgetary outlay and quantity commitment levels specified in negotiated schedules.

JULIE ELIZABETH MCGUIRE *is a shareholder in Hull McGuire. She is an attorney and CPA. The firm's practice areas are limited to international corporate planning and transactions, tax law, intellectual property, complex litigation, employment practices, federal legislation and natural resources law.*

Claims that the FSC regime also violated the GATT 1994 were included in the original complaint but were not pursued once the panel was formed.

Interestingly, the report notes that both Canada and Japan filed positions with the WTO panel supporting the EU position.

U.S. POSITION

The U.S. position has consistently been that the FSC regime is not an illegal export subsidy. In fact, the U.S. had taken great care to meet the requirements of its trade treaties when it first enacted the FSC legislation in the mid-1980s.

Previously, the Domestic International Sales Corporation tax regime, enacted by the U.S. in 1971, had been attacked as a violation of the GATT. In response to the GATT challenges, the U.S. all but eliminated the DISC regime, enacting the FSC legislation in an attempt to promote exports while complying closely with the treaty requirements.

The FSC regime was enacted to enable U.S. manufacturers — confronted with a harsh taxing scheme based on worldwide income — to compete with non-U.S. manufacturers who face less onerous taxing schemes, often territorial in scope. The FSC represents a partial adoption of the territorial approach to taxation, common in Europe, and intended to equalize the position of U.S. manufacturers in markets outside the United States — such as the EU, where the availability of VAT rebates along with territorial taxing schemes make non-U.S. goods cheaper than those manufactured in the U.S.

WTO RULING

The WTO panel ruled that the FSC regime does create illegal export subsidies and should be withdrawn by October 1, 2000.

In reaching that conclusion, the WTO first found that the FSC income exemptions violate the SCM agreement, which prohibits "subsidies" that are "contingent upon export performance." Noting

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