

United States Senate Committee on Finance  
October 1, 2003

Hearing

To Consider a Substitute to S. 1637, the  
Jumpstart Our Business Strength (JOBS) Act of 2003

Written Statement of  
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## *Introduction*

My name is Martin B. Tittle. I am a licensed attorney in the state of Michigan, and I am employed as a researcher at the University of Michigan Law School in Ann Arbor. One of my research topics for the past fifteen months has been the Foreign Sales Corporation and Extraterritorial Income Exclusion Act cases in the World Trade Organization (WTO) and the U.S. response to those cases. I recently authored an article titled “U.S. ETI Repeal and Transition Relief” which was published in *Tax Notes International* and *Worldwide Tax Daily*,<sup>1</sup> and my comments below are drawn in large part from that article. My statement is submitted on my own behalf and not on behalf of any government or private entity.

### *The General Transition Relief in the Jumpstart Our Business Strength (JOBS) Act of 2003 is Likely Not WTO-Compliant*

Section 101(e) of the Jumpstart Our Business Strength (JOBS) Act of 2003 (JOBS Act),<sup>2</sup> provides a general transition period for taxable years beginning before January 2007 during which “a current FSC/ETI beneficiary shall be allowed a deduction equal to the transition amount determined under this subsection.” After the Committee’s October 1 hearing on the JOBS Act, EU spokesperson Arancha Gonzalez was widely quoted in the press as saying, “We have already waited for three years to get the [FSC] legislation repealed, and therefore an extra three-year period couldn’t be acceptable to us.”<sup>3</sup>

Committee Chairman Charles E. Grassley responded, saying, “I’m surprised the European Union would threaten sanctions now. . . . The fact is the transition does not continue, in [Ms. Gonzalez’s] words, ‘a scheme that was declared illegal by the WTO.’ Unlike the ETI, there is absolutely no requirement in our bill to export a single item to benefit from the transition.”<sup>4</sup>

The *Seattle Times* expanded on this rationale in an October 3 story, saying “U.S. lawmakers and company representatives say that the transition in the current legislation is compatible with WTO rules because it is based on export figures from last year, and so won’t be an incentive or subsidy to future sales.”<sup>5</sup>

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<sup>1</sup> See Martin B. Tittle, “U.S. ETI Repeal and Transition Relief,” 32 *Tax Notes Int’l* 43, 2003 *Worldwide Tax Daily* 193-16 (Oct. 3, 2003); see also Martin B. Tittle, “Follow-Up Regarding Binding Contract Relief and the Thomas ETI Repeal Bill,” 32 *Tax Notes Int’l* 153 (Oct. 13, 2003), 2003 *Worldwide Tax Daily* 198-17 (Oct. 14, 2003).

<sup>2</sup> Jumpstart Our Business Strength (JOBS) Act, S. 1637, 108th Cong. (visited Oct. 14, 2003) <<http://thomas.loc.gov>>.

<sup>3</sup> See, e.g., Shailagh Murray and Matthew Newman, “Congress Seeks an End to Export-Tax Break,” *Wall St. J.*, Oct. 3, 2003.

<sup>4</sup> Charles E. Grassley, “Grassley ‘Surprised’ at EU Spokesperson’s Comments on U.S. ETI Repeal,” 2003 *Worldwide Tax Daily* 192-11 (Oct. 3, 2003).

<sup>5</sup> Jonathan Stearns, “E.U. Threatens \$4 Billion in Sanctions[;] Trade War Looms Over Repeal of Tax Credit,” *The Seattle Times*, Oct. 3, 2003, at C1.

Similar arguments have been made regarding the WTO compliance of the general transition provision in the Job Protection Act of 2003,<sup>6</sup> sometimes called the “Crane-Rangel” bill, and in fact, the general transition provisions in the JOBS Act and the Crane-Rangel bill are comparable in that “they are not extensions of [the FSC Repeal and Extraterritorial Income Exclusion Act of 2000<sup>7</sup> (ETI)], as the ETI [transition] rule was of FSC, but rather are separate subsidies that are based on whether a company qualified for FSC/ETI benefits in 2001 [in the case of the Crane-Rangel bill] or 2002 [in the case of the JOBS Act].”<sup>8</sup> Last July, in a “Dear Colleague” letter, Reps. Philip M. Crane, Charles B. Rangel, Sander M. Levin, and Donald A. Manzullo made the following argument in favor of the WTO-compliance of the general transition provision in the Crane-Rangel bill:

The general transition relief, like the effective rate reduction, is not export-contingent. WTO rules prohibit export-contingent subsidies, not subsidies to companies that have exported in the past. As footnote 4 to the WTO Subsidies Agreement states: “The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.”

The standard legal meaning of “contingent” is “possible, but not assured, doubtful or uncertain, conditioned upon the occurrence of some future event which is itself uncertain.” The general transition relief is not export-contingent; if the taxpayers receiving general transition relief have zero exports, they will nonetheless receive the full general transition relief. Under the transition provision, no manufacturer is required in any way to export anything to receive the transition benefits. There simply is no incentive whatever to export. In fact, the general transition relief is not contingent upon anything. It is guaranteed to recipients; receipt of these benefits is assured and is not conditioned upon any future uncertain event. A measure that applies regardless of export performance is not in any way “contingent,” “dependent,” or “conditional” upon export performance.<sup>9</sup>

This defense is congruent with Chairman Grassley’s statement that “there is absolutely no requirement in our bill to export a single item to benefit from the transition,” and at first glance, the argument it presents looks promising. The cited “standard legal meaning” of “contingent”

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<sup>6</sup> Job Protection Act of 2003, H.R. 1769, 108th Cong. (visited Aug. 29, 2003) <<http://thomas.loc.gov>>.

<sup>7</sup> FSC Repeal and Extraterritorial Income Exclusion Act of 2000, Pub. L. No. 106-519; 114 Stat. 2423 (codified at I.R.C. §§ 114, 941-943).

<sup>8</sup> Martin B. Tittle, “U.S. ETI Repeal and Transition Relief,” *supra* note 1, at 45 (footnotes omitted).

<sup>9</sup> Philip M. Crane *et al.*, “U.S. Job Protection Act Sponsors Explain Bill,” 2003 Worldwide Tax Daily 143-21 paras. 13-14 (July 25, 2003).

appears word for word in the Sixth Edition of Black's Law Dictionary, and there is no doubt that the WTO sometimes uses Black's as an authority to define terms in the WTO agreements.<sup>10</sup>

The problem is the WTO Appellate Body has already defined "contingent" as that word is used in the export subsidy prohibition, saying it just means "conditional" or "dependent for its existence on something else."<sup>11</sup> This definition contains no reference to a future uncertain event, as the definition in Black's does, and thus would allow the WTO to find that the new subsidy's dependence on past export performance violates WTO rules. While it is remotely possible the WTO could be persuaded to change its definition of "contingent,"<sup>12</sup> the process involved in

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<sup>10</sup> See, e.g., WTO, Report of the Appellate Body, *United States - Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R (Jan. 2, 2002) para. 187 n.123 (visited Aug. 29, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/176ABR.doc>>.

<sup>11</sup> WTO, Report of the Appellate Body, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Aug. 2, 1999) para. 166 (visited Aug. 29, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/70ABR.doc>>. This definition has been cited in other Appellate Body decisions, including WTO, Report of the Appellate Body, *Canada - Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R (May 31, 2000) para. 98 (visited Aug. 29, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/139ABR.doc>> and WTO, Report of the Appellate Body, *United States - Tax Treatment for "Foreign Sales Corporations" Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW (Jan. 14, 2002) para. 111 (visited Aug. 29, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/108ABRW.doc>>

<sup>12</sup> Mike Castellano, Trade and Tax Counsel for Crane-Rangel co-sponsor Sander Levin, has pointed out that the Appellate Body has never (to his recollection) addressed a subsidy based on prior export performance, and that this new issue could warrant an extension of the current definition of "contingent." E-mail from Mike Castellano to Martin B. Tittle (Sept. 17, 2003) (on file with the author). He has also noted that subsidies based on past export performance do not implicate the market distortion rationale that underlies the prohibition of subsidies based on current or future exports. *Id.* The WTO would probably not be persuaded by these arguments because their adoption in this case would effectively allow the U.S. to create additional, ETI-clone benefits after ETI had been declared illegal and pay out those extra benefits over time. That result would completely undermine the intent of the export subsidy proscription, article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (SCM), and therefore violate the rule that "an interpreter is not free to adopt a reading that would reduce whole clauses of a treaty to redundancy or inutility." WTO, Report of the Panel, *United States - Tax Treatment for "Foreign Sales Corporations" Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW (Aug. 20, 2001) para. 8.39 n.106 (visited Sept. 17, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/108RW-00.doc>>. The fact that both the Crane-Rangel and JOBS Act general transition rules are not a direct continuation of ETI would probably be viewed as highly formalistic because both rules are customized for each recipient based on the individual business's "aggregate FSC/ETI benefits for the . . . taxable year beginning in calendar year" 2001/2002. See Job Protection Act of 2003, *supra* note 6, sec. 2(e)(4)(B) (calendar year 2001); Jumpstart Our Business Strength (JOBS) Act, *supra* note 2, sec. 101(e)(4) (calendar year 2002); *cf.* WTO, Report of the Panel, *United States - Tax Treatment for*

raising that issue would likely not require the EU to forgo application of its approved FSC/ETI sanctions. If Chairman Grassley’s defense of the JOBS Act’s general transition provision does not exceed the bounds of the Crane-Rangel arguments, it too will likely not be persuasive.

### *The WTO “mutual agreement” procedure*

The strong possibility that the JOBS Act’s general transition provision is not WTO-compliant “on the merits” does not mean that it cannot prevail. On the contrary, under the “mutual agreement” procedure in article 3.6 of the WTO Dispute Settlement Understanding (DSU),<sup>13</sup> it is entirely within the power of the EU and the U.S. to decide that, WTO-noncompliance notwithstanding, they want to resolve this matter by allowing some transition period. That is exactly what happened in 2001 when the U.S. held the winning hand in the *Bananas* dispute with the EU: it agreed to allow the EU, which was already 2<sup>1/2</sup> years past its original WTO deadline for compliance, an additional 4<sup>1/2</sup>-year transition period during which the U.S. would not impose its WTO-authorized sanctions.<sup>14</sup> While the EU has no legal obligation to reciprocate now that the shoe is on the other foot, the “Dear Colleague” letter of Rep. Crane *et al.* is right that “it would be difficult to justify” nonreciprocation.<sup>15</sup>

A logical standard for the appropriate level of reciprocation would be the number of years between the original WTO deadline for compliance with the *Bananas* decision and the new deadline reached in the 2001 “mutual agreement.” The original deadline was January 1, 1999,<sup>16</sup>

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*“Foreign Sales Corporations” Recourse to Article 21.5 of the DSU by the European Communities, supra*, paras. 8.37-8.38 (criticizing the revised definition of gross income in ETI as “highly formalistic” and “difficult to reconcile with the text and context of Article 1.1(a)(1)(ii) in light of the object and purpose of the [SCM]”).

<sup>13</sup> DSU Article 3.6 reads, “Mutually agreed solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements shall be notified to the DSB [Dispute Settlement Body] and the relevant Councils and Committees, where any Member may raise any point relating thereto.” Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Uruguay Round of Multilateral Trade Negotiations[:] Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations Done at Marrakesh on 15 April 1994, vol. 31 (1994) (visited Aug. 29, 2003) <[http://www.wto.org/english/docs\\_e/legal\\_e/28-dsu.doc](http://www.wto.org/english/docs_e/legal_e/28-dsu.doc)>.

<sup>14</sup> See WTO, *European Communities – Regime for the Importation, Sale And Distribution of Bananas, Notification of Mutually Agreed Solution*, WT/DS27/58 (July 2, 2001) (visited Aug. 29, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/27-58.doc>>; WTO, *European Communities – Transitional Regime for the EC Autonomous Tariff Rate Quotas on Imports of Bananas*, WT/MIN(01)/16 (Nov. 14, 2001) (visited Aug. 29, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/min01/16.doc>>.

<sup>15</sup> See Philip M. Crane *et al.*, *supra* note 9, para. 11.

<sup>16</sup> See WTO, Award of the Arbitrator, *European Communities - Regime for the Importation, Sale and Distribution of Bananas [-] Arbitration under Article 21.3(c) of the [DSU]*, WT/DS27/15

and the agreement the EU reached with the U.S. extended that deadline to January 1, 2006,<sup>17</sup> a period of seven years. The original deadline for the U.S. in the *FSC* case was October 1, 2000.<sup>18</sup> Therefore, a transition period parallel in scope with the extra, overall compliance time the EU is now enjoying in *Bananas* would extend the U.S. *FSC* deadline to October 1, 2007, or about four years from the present.<sup>19</sup>

Some observers focus on the fact that the *Bananas* agreement gave the EU an additional five years to comply and argue that the U.S. should receive an identical extension in any *FSC* agreement. That standard, however, would effectively place a premium on the time that passed before the WTO “mutual agreement” procedure was invoked. Losing parties whose cases generated a longer pre-agreement period would be rewarded with greater overall transition relief, while those who, for whatever reason, reached agreement more quickly would be penalized. This potential timing element, and the bickering that could accompany it, are neutralized in advance if reciprocation is based simply on the actual, total extension of the original WTO deadline.

### *Conclusion*

Although the general transition provision in the JOBS Act is probably not WTO-complaint, it can and should be implemented under the WTO’s “mutual agreement” procedure. When the U.S. held the winning hand in the *Bananas* dispute with the EU, it waited 2½ years past the original WTO deadline for compliance, and then, in 2001, signed a voluntary agreement giving the EU an additional 4½-year transition period. If the EU did no more than respond in kind and give the U.S. equal time to comply with the deadline in the *FSC* case, the U.S. would be entitled to a transition period ending (at the earliest) October 1, 2007. That would be nine months longer than the January 2007 deadline for total compliance set in the JOBS Act.

Apparently, a seven-year transition period did not seem like too much to the EU when it was on the receiving end in *Bananas*. Therefore, it should agree to allow the U.S. a shorter period now that the shoe is on the other foot.

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(Jan. 7, 1998) para. 20 (visited Sept. 17, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/27-15.wpf>>.

<sup>17</sup> See WTO, *European Communities – Regime for the Importation, Sale And Distribution of Bananas, Notification of Mutually Agreed Solution*, *supra* note 14.

<sup>18</sup> See WTO, Report of the Panel, *United States – Tax Treatment for “Foreign Sales Corporations,”* WT/DS108/R (Oct. 8, 1999) para. 8.8 (visited Sept. 17, 2003) <<http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/108R.doc>>.

<sup>19</sup> The JOBS Act comes fairly close to this proposed deadline extension. Its general transition provision provides for benefits on a declining basis until Jan. 1, 2007. See Jumpstart Our Business Strength (JOBS) Act, *supra* note 2, sec. 101(e).