

tax notes international



taxanalysts

U.S. ETI Repeal and Transition Relief

by Martin B. Tittle

Email: mbt@martintittle.com

Reprinted from *Tax Notes Int'l*, 6 October 2003, p. 43

TAX NOTES INTERNATIONAL

Copyright 2003, Tax Analysts

ISSN 1048-3306

Executive Editor: Cathy Phillips

Managing Editor: Maryam Enayat

Deputy Editor: Doug Smith

Online Magazine Editor: Paul M. Doster

Editor-in-Chief, International: Robert Goulder

Chief of Correspondents: Cordia Scott (cscott@tax.org)

Senior Editor: Deborah L. Aiken

Consulting Editor: Robert Manning

Publisher: Thomas F. Field

Correspondents

Africa: Zein Kebonang, Gaborone
Albania: Adriana Civici, Ministry of Finance, Tirana
Angola: Trevor Wood, Ernst & Young, Lisbon
Anguilla: Alex Richardson, Anguilla Offshore Finance Centre, Anguilla
Antigua: Donald B. Ward, PricewaterhouseCoopers Center, St. John's
Argentina: Cristian E. Rosso Alba, Hope, Duggan & Silva, Buenos Aires
Armenia: Suren Adamyan, Tax Inspectorate, Yerevan
Australia: Graeme S. Cooper, University of Melbourne, Parkville; Richard Krevier, Deakin University, Melbourne.
Austria: Markus Stefaner, Vienna University of Economics and Business Administration, Vienna
Bahamas: Hywel Jones, Canadian Imperial Bank of Commerce Trust Company (Bahamas) Ltd., Nassau
Bangladesh: M. Mushtaque Ahmed, Ernst & Young, Dhaka
Barbados: Patrick B. Toppin, Pannell Kerr Forster, Christ Church
Belgium: Werner Heyvaert, Nauta Dutilh, Brussels
Bermuda: Wendell Hollis, Mello, Hollis, Jones & Martin, Hamilton
Botswana: I.O. Sennanyana, Deputy Director, Tax Policy, Ministry of Finance & Development Planning, Gaborone
Brazil: David Roberto Ressa e Soares da Silva, Senior Tax Attorney, Farroco & Lobo Advogados — Associated with Squire, Sanders & Dempsey, São Paulo
British Virgin Islands: William L. Blum, Counsel to Grunert Stout Bruch & Moore, St. Thomas, U.S.V.I.
Bulgaria: Todor Tabakov, Sofia
Cameroon: Edwin N. Forelemu, International Tax Program, Harvard University, Cambridge
Canada: Brian J. Arnold, Goodmans, Toronto, Ontario; Jack Bernstein, Aird & Berlis, Toronto, Ontario
Caribbean: Bruce Zagaris, Berliner, Corcoran, and Rowe, Washington, D.C.
Cayman Islands: Timothy Ridley, Maples & Calder Asia, Hong Kong
Chile: Macarena Navarrete, Ernst & Young, Santiago
China (P.R.C.): David D. Liu, Sidley & Austin, Shanghai; Professor Jinyan Li, University of Western Ontario, London, Ontario; Lawrence Sussman, O'Melveny & Myers LLP, Beijing
Cook Islands: David R. McNair, Southpac Trust Limited, Rarotonga
Croatia: Hrvoje Zgombic, Ernst & Young — Tax & Finance Consulting Ltd., Zagreb
Cyprus: Theodoros Philippou, PricewaterhouseCoopers, Nicosia
Czech Republic: Michal Dlouhy, White & Case, Prague
Denmark: Thomas Froebert, Philip & Partners, Copenhagen
Dominican Republic: Dr. Fernando Ravelo Alvarez, Santo Domingo
Eastern Europe: Iurie Lungu, Graham & Levintsa, Chisinau
Egypt: Farouk Metwally, Ernst & Young, Cairo
Estonia: Helen Pahapill, Ministry of Finance, Tallinn
European Union: Joann Weiner, Brussels
Fiji: Bruce Sutton, KPMG Peat Marwick, Suva
Finland: Marjaana Helminen, University of Helsinki in the Faculty of Law, Helsinki
France: Marcellin N. Mbwa-Mboma, Baker & McKenzie, New York
Gambia: Samba Ebrima Saye, Income Tax Division, Banjul
Germany: Dr. Jörg-Dietrich Kramer, Federal Academy of Finance, Bonn; Rosemarie Portner, Meilicke Hoffmann & Partner, Bonn; Klaus Sieker, Flick Gocke Schaumburg, Frankfurt
Ghana: Seth Terkper, Chartered Accountant/Tax Expert, Accra
Gibraltar: Charles D. Serruya, Ernst & Young, Gibraltar
Greece: Alexandra Gavriellides, Athens
Guam: Stephen A. Cohen, Carlsmith Ball LLP, Hagatna
Guernsey: Neil Crocker, PricewaterhouseCoopers, St. Peter Port
Guyana: Lancelot A. Atherly, Georgetown
Hong Kong: Colin Farrell, PricewaterhouseCoopers, Hong Kong
Hungary: Dr. Daniel Deák, College of Finance & Accountancy, Budapest
Iceland: Indridi H. Thoriaksson, Reykjavik
India: Nishith M. Desai, Nishith Desai Associates, Mumbai Mumbai; Sanjay Sanghvi, Chartered Accountant, Mumbai
Indonesia: Freddy Karyadi, Karyadi & Co Law and Tax Office, Jakarta
Iran: Mohammad Tavakkol, Maliyat Journal, College of Economic Affairs, Tehran
Ireland: Kevin McLoughlin, Ernst & Young, San Jose
Isle of Man: Richard Vanderplank, Cains Advocates & Notaries, Douglas
Israel: Joel Lubell, Teva Pharmaceutical Industries, Ltd., Petach Tikva; Doron Herman, S. Friedman & Co. Advocates & Notaries, Tel-Aviv
Italy: Alessandro Adelchi Rossi and Luigi Perin, George R. Funaro & Co., P.C., New York; Gianluca Queiroli, Cambridge, Massachusetts
Japan: Gary Thomas, White & Case, Tokyo; Shimon Takagi, White & Case, Tokyo
Jersey: J. Paul Frith, Ernst & Young, St. Helier
Kazakhstan: Robert M. Ames and Erlan B. Dosymbekov, Andersen, Almaty
Kenya: Graham Glenday, Fellow, Harvard Institute for International Development, Cambridge, Massachusetts; and Ministry of Finance, Nairobi
Korea: Chang Hee Lee, Seoul National Univ. College of Law, Seoul, Korea
Kuwait: Abdullah Kh. Al-Ayoub, Kuwait
Kyrgyzstan: Ian Slater, Arthur Andersen, Almaty
Latin America: Ernst & Young LLP, Miami
Latvia: Andrejs Birums, Tax Policy Department, Ministry of Finance, Riga
Lebanon: Fuad S. Kwar, Beirut
Libya: Ibrahim Baruni, Ibrahim Baruni & Co., Tripoli
Liechtenstein: Reto H. Silvani, Coopers & Lybrand, Liechtenstein
Lithuania: Nora Vitkuniene, International Tax Division, Ministry of Finance, Vilnius
Malawi: Clement L. Mononga, Assistant Commissioner of Tax, Blantyre
Malaysia: Jayapalan Kasipillai, School of Accountancy, Universiti Utara
Malta: Dr. Antoine Fiot, Zammit Tabona Bonello & Co., and Lecturer in Taxation, Faculty of Law, University of Malta, Valletta
Mauritius: Ram L. Roy, PricewaterhouseCoopers, Port Louis
Mexico: Jaime Gonzalez-Bendiksen, Baker & McKenzie, Chihuahua; Ricardo Leon-Santacruz, Sanchez-DeVanny Eserverri, Monterrey
Middle East: Aziz Nishtar, Karachi, Pakistan
Monaco: Eamon McGregor, Moores Rowland Corporate Services, Monte Carlo
Mongolia: Baldangiin Ganhuleg, General Department of State Taxation, Ministry of Finance, Ulaanbaatar
Morocco: Mohamed Marzak, Agadir
Myanmar: Timothy J. Holzer, Baker & McKenzie, Singapore
Nauru: Peter H. MacSporran, Melbourne
Nepal: Prem Karki, Ministry of Forest and Soil Conservation, Katmandu
Netherlands: Eric van der Stoel, Allen & Overy, Amsterdam; Dick Hoffland, Freshfields, Amsterdam; Michaela Vrouwenvelder, Loyens & Loeff, New York; Jan Ter Wisch, Allen & Overy, Amsterdam
Netherlands Antilles: Dennis Cijntje, KPMG Meijburg & Co., Curaçao; Koen Lozie, Deurle
New Zealand: Adrian Sawyer, University of Canterbury, Christchurch
Nigeria: Elias Aderemi Sulu, Lagos
Northern Mariana Islands: John A. Manglona, Saipan
Norway: Frederik Zimmer, Department of Public and International Law, University of Oslo, Oslo
Oman: Fadli R. Talyarkhan, Ernst & Young, Muscat
Panama: Leroy Watson, Arias, Fabrega & Fabrega, Panama City
Papua New Guinea: Lutz K. Heim, Ernst & Young, Port Moresby
Philippines: Benedicta Du Baladad, Bureau of Internal Revenue, Manila
Poland: Dr. Janusz Fiszer, Warsaw University/White & Case, Warsaw
Portugal: Francisco de Sousa da Câmara, Morais Leitao & J. Galvão Teles, Lisbon
Qatar: Finbar Sexton, Ernst & Young, Doha
Romania: Sorin Adrian Anghel, Senior Finance Officer & Vice President, The Chase Manhattan Bank, Bucharest
Russia: Scott C. Antel, Ernst & Young, Moscow; Joel McDonald, Salans Hertzfeld & Heilbronn, Moscow
Saint Kitts-Nevis: Mario M. Novello, Nevis Services Limited, Red Bank
Saudi Arabia: Fauzi Awad, Saba, Abulkhair & Co., Dammam
Sierra Leone: Shakib N.K. Basma and Berthan Macaulay, Basma & Macaulay, Freetown
Singapore: Linda Ng, White & Case, Tokyo, Japan
Slovakia: Alzbeta Harvey, Principal, KPMG New York
South Africa: Peter Surtees, Deneys Reitz, Roggebaai
Spain: José M. Calderón, University of La Coruña, La Coruña
Sri Lanka: D.D.M. Waidyasekera, Mt. Lavinia
Sweden: Leif Mutén, Professor Emeritus, Stockholm School of Economics
Taiwan: Keye S. Wu, Baker & McKenzie, Taipei; Yu Ming-i, Ministry of Finance, Taipei
Tanzania: Awadhi Mushi, Dar-es-Salaam
Thailand: Edwin van der Bruggen, E.S.F. (Thailand) Limited, Bangkok
Trinidad & Tobago: Rolston Nelson, Port of Spain
Tunisia: Lassaad M. Bediri, Hamza, Bediri & Co., Legal and Tax Consultants, Tunis
Turkey: Mustafa Çamlıca, Arthur Andersen, Istanbul
Turks & Caicos Islands, British West Indies: Ariel Misick, Misick and Stanbrook, Grand Turk
Uganda: Frederick Ssekandi, Kampala
Ukraine: Victor Gladun, Taxware, a division of govONE Solutions, Salem, MA.
United Arab Emirates: Nicholas J. Love, Ernst & Young, Abu Dhabi
United Kingdom: Trevor Johnson, Trevor Johnson Associates, Wirral; Eileen O'Grady, barrister, London; Jefferson P. VanderWolk, Baker & McKenzie, London
United States: Richard Doernberg, Emory Univ. School of Law, Atlanta GA.; James Fuller, Fenwick & West, Palo Alto
U.S. Virgin Islands: Marjorie Rawls Roberts, Attorney at Law, St. Thomas, USVI
Uruguay: Dr. James A. Whitelaw, Whitelaw Attorneys, Uruguay
Uzbekistan: Ian P. Slater, Arthur Andersen, Almaty
Vanuatu: Bill L. Hawkes, KPMG, Port Vila
Venezuela: Ronald Evans, Baker & McKenzie, Caracas
Vietnam: Frederick Burke, Baker & McKenzie, Ho Chi Minh City
Western Samoa: Maiava V.R. Peteru, Kamu & Peteru, Apia
Yugoslavia: Danijel Pantic, Economic Institute, Belgrade
Zambia: W.Z. Mwanza, KPMG Peat Marwick, Lusaka
Zimbabwe: Prof. Ben Hlatshwayo, University of Zimbabwe, Harare

Viewpoints



U.S. ETI Repeal and Transition Relief

by Martin B. Tittle

Martin B. Tittle is a graduate of the University of Michigan Law School, specializing in cross-border taxation issues. He is grateful to Todd J. Weiler, Mike Castellano, Manny Rossman, Reuven S. Avi-Yonah, Gregory P. Lubkin, Gary Hufbauer, and Penny Schreiber for comments and suggestions. The views expressed and any errors that remain are his alone.

Copyright © Martin B. Tittle 2003

Businesses supporting the Thomas,¹ Crane-Rangel² and Grassley³ Extraterritorial Income Exclusion (ETI) repeal bills all want transition relief, that is, some extension or replication of ETI's benefits beyond the repeal date.⁴ The Coal-

ition for Fair International Taxation (C-FIT), a Thomas supporter that includes Dow Chemical, General Motors, and McDonalds, has called transition relief one of the "core elements [needed] to maintain the international competitiveness of U.S. businesses."⁵ The Thomas bill addresses this concern by offering two years of declining ETI benefits.⁶ The Coalition for U.S.-Based Employ-

⁵C-FIT, "C-FIT Release on 'Critical' International Tax Reform," 2003 WTD 132-31 2003-16214 (7 original pages) (July 10, 2003).

⁶See American Jobs Creation Act of 2003, *supra* note 1, sec. 4001(d). The Thomas bill is also intended to retain ETI's extension of FSC benefits for binding contracts. See FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (ETI) sec. 5(c), 114 Stat. 2423, 2433 (extending FSC benefits indefinitely for transactions pursuant to binding contracts "in effect on September 30, 2000, and at all times thereafter"); Gregory P. Lubkin, "FSC/ETI Repeal and the Battle over International Tax Reform: Chairman Thomas Throws Down the Gauntlet in H.R. 2896," 32 Tax Mgmt. Int'l J. 461, 464 (2003) ("the Thomas bill would retain the FSC transition rules in [ETI]"). Whether it succeeds in this respect is arguable. Chairman Thomas's 2002 ETI repeal bill clearly did not retain the FSC binding contract extension: it expressly repealed both sec. 5(c) of ETI and U.S. Internal Revenue Code (IRC) sec. 941, in which sec. 5(c) is codified as a note. See American Competitiveness and Corporate Accountability Act of 2002, H.R. 5095, 107th Cong. secs. 327(b)(1) (repealing ETI sec. 5(c)), 328(a) (repealing "[s]ubpart E of part III of subchapter N of chapter 1," which includes IRC sec. 941) (visited 25 Sept. 2003) <http://thomas.loc.gov>; Joint Committee on Taxation, *Technical Explanation of H.R. 5095 (the "American Competitiveness Act of 2002")* (JCX-78-02), 19 July 2002, at 91-92 (visited 26 Sept. 2003) <http://www.house.gov/jct/x-78-02.pdf>. The current Thomas bill

¹American Jobs Creation Act of 2003, H.R. 2896, 108th Cong. (visited 29 Aug. 2003) <http://thomas.loc.gov>.

²Job Protection Act of 2003, H.R. 1769, 108th Cong. (visited 29 Aug. 2003) <http://thomas.loc.gov>.

³Jumpstart Our Business Strength (JOBS) Act, S. 1637, 108th Cong. (visited 19 Sept. 2003) <http://finance.senate.gov/sitepages/legislation.htm>.

⁴For a brief summary of the WTO decisions underlying the current effort to repeal ETI, see part I of Martin B. Tittle, "U.S. Foreign Tax Credit for Value Added Taxes: Another Arrow in the ETI/E-VAT Quiver," 2003 WTD 101-16 Doc 2003-12877 (26 original pages) (27 May 2003). For a more detailed discussion, see Martin B. Tittle, "The FSC/ETI Controversy" (2003) (visited 29 Aug. 2003) http://www.martintittle.com/publications/FSC-ETI_details.pdf.

(Continued on next page)

ment (CUSBE), a Crane-Rangel supporter that includes Boeing, Caterpillar, and Microsoft, says “a reasonable transition period seems clearly warranted” given the decades that ETI and its predecessors have been part of the U.S. tax code.⁷ Crane and Rangel agree. Their bill offers five years of general transition relief and unlimited relief for existing, binding contracts.⁸ (For prior coverage, see *Tax Notes Int'l*, 29 Sept. 2003, p. 1109, 2003 WTD 184-2 or Doc 2003-20947 (1 original page).) The Grassley bill was introduced just as this article was being completed, so its supporters had yet to weigh in on this issue. (For related coverage, see story on p. 35.) However, in the ETI-repeal hearings held last July by the Senate Finance Committee, which Grassley chairs, four of the seven businesspeople who testified mentioned the importance of transition relief.⁹ Therefore, it is not surprising that the Grassley bill provides three years of general transition relief and, like the Crane-Rangel bill, unlimited relief for existing, binding contracts.¹⁰

Footnote 6 continued

omits H.R. 5095's repeal of ETI sec. 5(c) but retains the repeal of its codification in sec. 941. See American Jobs Creation Act of 2003, *supra* note 1, sec. 4001(b)(1) (repealing “[s]ubpart E of part III of subchapter N of chapter 1”). Although it is difficult to see how the FSC extension can technically survive repeal of subpart E, supporters of the Thomas bill have not expressed concern regarding the status of FSC binding contract relief. The Joint Taxation Committee's technical analysis of the Thomas bill is also silent on this issue, possibly indicating that the Committee does not think the bill makes a change to the FSC extension. See Joint Committee on Taxation, *Technical Explanation of H.R. 2896, the “American Jobs Creation Act of 2003”* (JCX-72-03), 13 Aug. 2003, at 145; cf. Joint Committee on Taxation, *Technical Explanation of H.R. 5095 (the “American Competitiveness Act of 2002”)*, *supra*, at 91-92 (explaining ETI's binding contract extension of FSC and saying “[t]he proposal would repeal the FSC transition rules”).

⁷E-mail from Hal Shapiro, CUSBE representative, to Martin B. Tittle (21 Aug. 2003) (on file with the author).

⁸See Job Protection Act of 2003, *supra* note 2, secs. 2(c)(2) (binding contract), 2(e) (general transition).

⁹See *An Examination of U.S. Tax Policy and Its Effect on the Domestic and International Competitiveness of U.S.-Based Operations, Hearing before the United States Senate Committee on Finance*, 108th Cong. (2003) (visited 24 Sept. 2003) <http://www.senate.gov/~finance/sitepages/hearing070803.htm> (testimony of James Berges, William Barrett, and Mark Russell); *An Examination of U.S. Tax Policy and Its Effect on the Domestic and International Competitiveness of U.S.-Owned Foreign Operations, Hearing before the United States Senate Committee on Finance*, 108th Cong. (2003) (visited 24 Sept. 2003) <http://www.senate.gov/~finance/sitepages/hearing071503.htm> (testimony of Charles J. Hahn).

¹⁰See Jumpstart Our Business Strength (JOBS) Act, *supra* note 3, secs. 101(c)(2) (binding contract), 101(e) (general transition). Joint Committee on Taxation, *Description of the Chairman's Mark of the “Jumpstart Our Business Strength (JOBS) Act”* (JCX-83-03), 26 Sept. 2003, at 3-4 (visited 26 Sept. 2003) <http://www.house.gov/jct/x-83-03.pdf>.

Despite the unanimity of support for transition relief, there is some debate over its compatibility with the World Trade Organization's (WTO) rules and its decisions in the FSC/ETI case. Less than a month after Crane and Rangel's bill was introduced last April, European Union spokesperson Arancha Gonzalez reportedly said that, according to the EU's lawyers, the Crane-Rangel transition provisions were not WTO-compliant.¹¹ In the months following, the European Union was publicly more reticent, with EU Trade Commissioner Pascal Lamy saying only that he expected whatever legislation the United States enacted would comply with WTO rules.¹²

The only transition period clearly available under WTO rules is the one provided by the WTO panel that decided the foreign sales corporation (FSC) dispute. When the panel declared FSC illegal on 8 October 1999, it gave the United States until 1 October 2000 to withdraw the FSC subsidies.¹³ When the ETI Act finally repealed FSC on 15 November 2000, however, it provided an extra 13½ months of transition for all FSC beneficiaries and unlimited future FSC benefits for transactions made under preexisting, binding contracts.¹⁴

In evaluating the U.S. argument in support of those transition provisions, the WTO Appellate Body noted first that, according to WTO rules, the panel deciding a dispute “shall specify in its recommendation the time-period within which the measure must be withdrawn.”¹⁵ It then said that there was “no legal basis for extending the time-period for the United States to withdraw fully the prohibited FSC subsidies.”¹⁶ Therefore, the transition provisions provided by ETI were WTO-illegal.

¹¹House Ways & Means Committee, “House of Representatives Ways & Means Committee Release on European Commission Response to Proposed FSC Fix,” 2003 WTD 90-20 or Doc 2003-11525 (91 original pages).

¹²Natalia Radziejewska, “EU Trade Commissioner Satisfied with U.S. FSC-ETI Repeal Progress,” *Tax Notes Int'l*, 23 June 2003, p. 1203, 2003 WTD 117-2, or Doc 2003-14711 (1 original page).

¹³WTO, Report of the Panel, *United States — Tax Treatment for “Foreign Sales Corporations.”* WT/DS108/R (8 Oct. 1999) para. 8.8 (visited 29 Aug. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/108R.doc>.

¹⁴See ETI, *supra* note 6, sec. 5(c).

¹⁵WTO, 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 (14 Jan. 2002) para. 226 (visited 29 Aug. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/108ABRW.doc> (quoting Article 4.7 of the WTO Agreement on Subsidies and Countervailing Measures (hereinafter SCM)).

¹⁶*Id.* para. 230.

Does that mean Ms. Gonzalez was right about the Crane-Rangel transition provisions? Probably. Both the Crane-Rangel bill and ETI contain two different types of transition relief. One is general transition relief, available to all companies that benefited from the program being repealed. The other is “binding contract” relief, available only for transactions controlled by contracts that predate the repeal. The Crane-Rangel and ETI binding contract rules are almost identical, so the fact that the latter is not WTO-compliant makes it highly likely that the former is noncompliant too.¹⁷

The Crane-Rangel and Grassley general transition rules differ from the parallel ETI provision. First, and least important, they both provide for a multi-year, declining transition benefit, where the ETI general transition rule was a simple extension of all FSC benefits for just over a year.¹⁸ Second, they are not extension of ETI, as the ETI rule was of FSC, but rather are separate subsidies that are based on whether a company qualified for FSC/ETI benefits in 2001¹⁹ or 2002.²⁰

The Crane camp defends the WTO-compliance of its general transition rule by saying that, unlike the ETI rule, it does not violate the WTO ban on subsidies that are “contingent on export performance.”²¹ According to a Crane white paper,²² 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.”²³ Because the general transition rule is not conditioned on fu-

ture exports, only on companies’ past export performance in 2001, it therefore does not violate the WTO rule.²⁴

At first glance, that defense looks promising. The white paper’s standard legal meaning of contingent 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.²⁵

The problem is the WTO Appellate Body already has 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.”²⁶ That definition contains no reference to a future uncertain event, as the definition in Black’s does, and therefore 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,²⁷ the process involved in raising that issue would likely

²⁴*Id.* paras. 12-14; see also Philip M. Crane, “EU Sanctions Would Hurt U.S. Businesses,” Roll Call, 4 Sept. 2003, Supp. at 12.

²⁵See, e.g., WTO, Report of the Appellate Body, *United States — Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R (2 Jan. 2002) para. 187 n.123 (visited 29 Aug. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/176ABR.doc>.

²⁶WTO, Report of the Appellate Body, *Canada — Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (2 Aug. 1999) para. 166 (visited 29 Aug. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/70ABR.doc>.

²⁷Mike Castellano, Trade and Tax Counsel for Crane-Rangel co-sponsor Sander Levin, points 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 (17 Sept. 2003) (on file with the author). He also notes 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, SCM article 3.1(a), 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 (20 Aug. 2001) para. 8.39 n.106 (visited 17 Sept. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/108RW-00.doc>. The fact that the Crane-Rangel and Grassley 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”

¹⁷See Job Protection Act of 2003, *supra* note 2, sec. 2(c)(2); ETI, *supra* note 6, sec. 5(c)(1)(B). The binding contract relief in Sen. Grassley’s bill is very similar to the Crane-Rangel provisions and therefore is probably equally noncompliant. See Jumpstart Our Business Strength (JOBS) Act, *supra* note 3, sec. 101(c)(2).

¹⁸See Job Protection Act of 2003, *supra* note 2, sec. 2(e); ETI, *supra* note 6, sec. 5(c)(1)(A).

¹⁹See Philip M. Crane, et al., “U.S. Job Protection Act Sponsors Explain Bill,” 2003 WTD 143-21 or Doc 2003-17322 (3 original pages) para. 12.

²⁰See Jumpstart Our Business Strength (JOBS) Act, *supra* note 4, sec. 101(e)(2). Use of 2002 as the base period could make a big difference because, as noted, ETI extended FSC benefits only through calendar year 2001. See ETI, *supra* note 6, sec. 5(c)(1)(A).

²¹See Philip M. Crane et al., *supra* note 19 para. 8.

²²*Id.* paras. 5-17. Congressman Sander M. Levin, D-Michigan, a co-sponsor of the Crane-Rangel bill, referred to that white paper as a “short document” in his testimony before the House Committee on Small Business on 10 September 2003, and requested unanimous consent that it be inserted into the record with his testimony. Sander M. Levin, “Levin Testifies at U.S. House Small Business Hearing on FSC/ETI Rules,” 2003 WTD 177-16 or Doc 2003-20199 (3 original pages).

²³See Philip M. Crane et al., *supra* note 19 para. 14.

(Footnote continued on next page)

not require the European Union to forgo application of its approved FSC/ETI sanctions.

Chairman Thomas has made no compliance arguments in support of his bill's proposed two-year transition period.²⁸ Therefore, it too would probably be judged noncompliant with WTO requirements.

If the Crane-Rangel, Thomas, and Grassley transition provisions are WTO-illegal, does that mean all is lost for the proponents of transition? Absolutely not. Under the "mutual agreement" procedure in article 3.6 of the WTO Dispute Settlement Understanding (DSU),²⁹ it is entirely within the power of the European Union and the United States to decide that, WTO-noncompliance notwithstanding, they want to resolve the matter by allowing some transition period. That is exactly what happened in 2001, when the United States held the winning hand in the *Bananas* dispute with the European Union: it agreed to allow the European Union, which was already two years past its original WTO deadline for compliance, an additional five-year transition period, during which the United States would not impose its WTO-authorized sanctions.³⁰

Footnote 29 continued

2001/2002. See Job Protection Act of 2003, *supra* note 2, sec. 2(e)(4)(B) (calendar year 2001); Jumpstart Our Business Strength (JOBS) Act, *supra* note 3, sec. 101(e)(4) (calendar year 2002); cf. 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*, *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]").

²⁸See, e.g., Bill Thomas, "U.S. Must Repeal ETI Provisions," Roll Call, 4 Sept. 2003, Supp. at 12 ("The [two-year] phase-out provides a 'soft landing' for current beneficiaries but does not invite retaliation against those industries and workers that are on the EU's retaliation list.").

²⁹DSU 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, 15 Apr. 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 29 Aug. 2003) http://www.wto.org/english/docs_e/legal_e/28-dsu.doc.

³⁰See WTO, *European Communities — Regime for the Importation, Sale and Distribution of Bananas, Notification of Mutually Agreed Solution*, WT/DS27/58 (2 July 2001) (visited 29 Aug. 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 (14 Nov. 2001) (visited 29 Aug. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/min01/16.doc>.

While the European Union has no legal obligation to reciprocate now that the shoe is on the other foot, the authors of the Crane white paper are right that "it would be difficult to justify" nonreciprocation.³¹ Whether reciprocation would necessarily support the five-year transition proposed in Crane-Rangel, however, is another matter. In May, EU Trade Commissioner Lamy stated that the United States already had almost three years for transition, dating back to fall 2000 when ETI was enacted.³² On 4 September, he said pointedly that a five-year transition period was "out of scope."³³ Last summer, when Sen. Orrin Hatch, R-Utah, questioned John Veroneau, general counsel for the United States Trade Representative, on the subject of an ETI transition period, Veroneau said "a one- or two-year phase-out is a normal tax legislative aspect. Beyond that, it becomes a little more cloudy, frankly, as to what would trigger retaliation and what would not."³⁴

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 1 January 1999,³⁵ and the agreement the European Union reached with the United States extended that deadline to 1 January 2006,³⁶ a period of seven years. The original deadline for the United States in the FSC case was 1 October 2000.³⁷ Therefore, a transition period parallel in scope with the extra, overall compliance time the European Union is now enjoying

³¹See Crane, et al., *supra* note 19, para. 11.

³²Charles Gnaedinger, et al., "U.S. Senate Taxwriters Voice Support for Crane-Rangel International Tax Plan," 2003 WTD 131-1 Doc 2003-16195 (5 original pages) (9 July 2003).

³³Chuck Gnaedinger and Patti Mohr, "In Trade Talks Wings, ETI Act Repeal Awaits Center Stage in U.S. Congress," 2003 WTD 172-3 or Doc 2003-19884 (3 original pages).

³⁴Senate Finance Committee, "Finance Committee Praises Crane-Rangel Bill, According to Unofficial Transcript of Hearing," 2003 WTD 134-21 or Doc 2003-16385 (97 original pages) paras. 118-121 (14 July 2003).

³⁵See 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 (7 Jan. 1998) para. 20 (visited 17 Sept. 2003) <http://docsonline.wto.org:80/DDFDocuments/t/WT/DS/27-15.wpf>.

³⁶See WTO, *European Communities — Regime for the Importation, Sale And Distribution of Bananas, Notification of Mutually Agreed Solution*, *supra* note 30.

³⁷See WTO, Report of the Panel, *United States — Tax Treatment for "Foreign Sales Corporations"*, *supra* note 13, para. 8.8.

would extend the U.S. FSC deadline to 1 October 1 2007, or about four years from the present.³⁸

Some observers focus on the fact that the *Bananas* agreement gave the European Union an additional five years to comply and argue that the United States 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.

Extending the Thomas and Grassley transition periods would be a simple matter, and shortening the parallel provision in Crane-Rangel by a year would not pose insurmountable difficulties. In the latter case, the bill’s authors could simply accelerate the phase-in of their corporate tax reduction. If, at the same time, they added some of Thomas’s revenue enhancers, such as the increase in Customs’ user fees in section 4002 of his bill,³⁹ they would gain additional flexibility.⁴⁰ They could expand their tax reduction, or they could broaden their bill by adding a capped foreign tax credit for value added taxes (VATs).⁴¹ Limited VAT credit, combined with the 50/50 source rule in U.S. Inter-

nal Revenue Code (IRC) section 863(b) and Treas. reg. section 1.863-3, would allow U.S. exporters in excess limit⁴² to benefit from, rather than be burdened by transactions in which they have direct VAT liability to foreign governments.⁴³ That group could include all U.S. businesses affected by the EU’s e-commerce VAT Directive,⁴⁴ as well as exporters of cutting-edge products that need to offer on-site trials to close sales.⁴⁵ If credit for VATs were financed by a revenue enhancement, it would not dilute the tax cut promised to domestic manufacturers.⁴⁶ In addition, it would make the Crane-Rangel bill more inclusive by giving a benefit to multinationals that are not in excess credit positions.⁴⁷

To sum up, although both sides in the ETI repeal debate want transition relief, the transition period granted in the original FSC decision expired almost three years ago. Therefore, any additional transition relief probably will involve the WTO’s “mutual agreement” procedure. The United States has a strong argument that the European Union should mirror the transition relief it received in the *Bananas* case, and although the EU would clearly prefer a shorter period, there is no logical reason it should not grant the U.S. the same overall accommodation that the U.S. granted to it two years ago. ♦

⁴²“Excess limit” means the taxpayer has not yet reached the limit of the foreign taxes she can credit against the U.S. tax on her foreign-source income. See I.R.C. sec. 904. The opposite, “excess credit,” means the taxpayer has more foreign tax credits than she can take in the current year.

⁴³See Martin B. Tittle, “Foreign Tax Credit for Value Added Taxes,” *supra* note 4, notes 121-125 and accompanying text.

⁴⁴See Council Directive 2002/38/EC of 7 May 2002, 2002 O.J. (L 128) 41; Martin B. Tittle, “U.S. Foreign Tax Credit for Value Added Taxes,” *supra* note 4, Part II.

⁴⁵See Martin B. Tittle, *Questions and Answers on ETI Repeal and VAT Creditability*, “Subject: VAT Creditability,” (6 July 2003) (visited 10 Sept. 2003) <http://www.martintittle.com/publications/Q&A.html>.

⁴⁶Congressman Crane recently reiterated that promise, saying “Congress must be steadfast in its commitment to returning all \$51 billion raised to the government upon repeal of FSC/ETI to the manufacturing sector of our economy.” Philip M. Crane, *supra* note 24.

⁴⁷See *supra* note 42.

³⁸The Grassley bill comes fairly close to this proposed deadline extension. Its general transition provision extends ETI benefits on a declining basis until 1 Jan. 2007. See Jumpstart Our Business Strength (JOBS) Act, *supra* note 3, sec. 101(e).

³⁹See American Jobs Creation Act of 2003, *supra* note 1.

⁴⁰An anonymous Crane aide has indicated the Congressman and his cosponsors are considering incorporating Thomas’s “non-ETI revenue raisers to enhance their ETI repeal package.” Warren Rojas, “August Doldrums Do Little to Cool U.S. Taxwriters’ ETI Animosity,” *Tax Notes Int’l*, 18 Aug. 2003, p. 617, 2003 WTD 154-1 or Doc 2003-18450 (2 original pages).

⁴¹See Martin B. Tittle, “U.S. Foreign Tax Credit for Value Added Taxes,” *supra* note 4.