WORLD TRADE ORGANIZATION

WT/DS108/AB/RW2
13 February 2006

(06-0580)

Original: English

UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

SECOND RECOURSE TO ARTICLE 21.5 OF THE DSU BY THE EUROPEAN COMMUNITIES

AB-2005-9

Report of the Appellate Body

CASES CITED IN THIS REPORT

Brazil – Aircraft (Article 21.5 – Canada)	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, DSR 2000:VIII, 4067
Canada – Aircraft (Article 21.5 – Brazil)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
EC – Bananas III	Appellate Body Report, *European Communities – Scheme for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
EC – Bed Linen (Article 21.5 – India)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
Mexico – Corn Syrup (Article 21.5 – US)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
US – Carbon Steel	Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R and Corr.1, adopted 19 December 2002, DSR 2002:IX, 3779
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619
US – FSC	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted 20 March 2000, as modified by Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1675
US – FSC (Article 21.5 – EC)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55
US – FSC (Article 21.5 – EC)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by Appellate Body Report, WT/DS108/AB/RW, DSR 2002:I, 119
US – FSC (Article 21.5 – EC II)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW2, 30 September 2005
US – FSC (Article 22.6 – US)	Decision by the Arbitrator, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS108/ARB, 30 August 2002, DSR 2002:VI, 2517
US – Softwood Lumber IV (Article 21.5 – Canada)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005

ABBREVIATIONS USED IN THIS REPORT

DSB	Dispute Settlement Body
DSU	*Understanding on Rules and Procedures Governing the Settlement of Disputes*
ETI	extraterritorial income
ETI Act	FSC Repeal and Extraterritorial Income Exclusion Act of 2000, United States Public Law 106-519, 114 Stat. 2423 (2000) (Exhibit EC-2 submitted by the European Communities to the Panel)
FSC	foreign sales corporations
GATT 1994	*General Agreement on Tariffs and Trade 1994*
IRC	United States Internal Revenue Code
Jobs Act	American Jobs Creation Act of 2004
First Article 21.5 panel	Panel in the first *US – FSC (Article 21.5 – EC)* proceedings
Panel	Panel in the current *US – FSC (Article 21.5 – EC II)* proceedings
Panel Report	Panel Report, *US – FSC (Article 21.5 – EC II)*
original panel	Panel in the original *US – FSC* proceedings
SCM Agreement	*Agreement on Subsidies and Countervailing Measures*
Section 5	Section 5(c)(1)(B) of the ETI Act
Working Procedures	*Working Procedures for Appellate Review*, WT/AB/W/5, 4 January 2005
WTO	World Trade Organization

WORLD TRADE ORGANIZATION
APPELLATE BODY

United States – Tax Treatment for "Foreign Sales Corporations"

Second Recourse to Article 21.5 of the DSU by the European Communities

United States, *Appellant/Appellee*
European Communities, *Appellant/Appellee*

Australia, *Third Participant*
Brazil, *Third Participant*
China, *Third Participant*

AB-2005-9

Present:

Abi-Saab, Presiding Member
Ganesan, Member
Janow, Member

I. Introduction

1. The United States appeals certain issues of law and legal interpretations developed in the Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations", Second Recourse to Article 21.5 of the DSU by the European Communities* (the "Panel Report").[1] The Panel was established to consider a complaint by the European Communities regarding the American Jobs Creation Act of 2004 (the "Jobs Act") and the United States' compliance with the recommendations and rulings of the Dispute Settlement Body (the "DSB") adopted on the basis of the Panel and Appellate Body Reports in *United States – Tax Treatment for "Foreign Sales Corporations"* ("*US – FSC*")[2] and *United States – Tax Treatment for "Foreign Sales Corporations", Recourse to Article 21.5 of the DSU by the European Communities* ("*US – FSC (Article 21.5 – EC)*").[3] Relevant aspects of the Jobs Act are described in paragraph 6 below, as well as in paragraphs 2.13 to 2.17 of the Panel Report.

2. The panel in *US – FSC* (the "original panel") concluded that the "FSC measure", consisting of Sections 921 to 927 of the United States Internal Revenue Code (the "IRC") and related measures establishing special tax treatment for foreign sales corporations ("FSC"), was inconsistent with the United States' obligations under the *Agreement on Subsidies and Countervailing Measures* (the "*SCM*

[1]WT/DS108/RW2, 30 September 2005.

[2]WT/DS108/R; WT/DS108/AB/R.

[3]WT/DS108/RW; WT/DS108/AB/RW.

Agreement") and the *Agreement on Agriculture*.[4] The Appellate Body upheld the original panel's finding that the FSC measure was inconsistent with the United States' obligations under the *SCM Agreement* and modified the original panel's findings under the *Agreement on Agriculture*.

3. On 20 March 2000, the DSB adopted the reports of the original panel and the Appellate Body. The DSB recommended that the United States bring the FSC measure into conformity with its obligations under the covered agreements and that the FSC subsidies found to be prohibited export subsidies within the meaning of the *SCM Agreement* be withdrawn without delay, pursuant to Article 4.7 of the *SCM Agreement*, namely, "at the latest with effect from 1 October 2000".[5] At its meeting held on 12 October 2000, the DSB agreed to a request made by the United States to modify the time period to comply with the recommendations and rulings of the DSB so as to expire on 1 November 2000.[6] The United States promulgated on 15 November 2000, the FSC Repeal and Extraterritorial Income ("ETI") Exclusion Act of 2000 (the "ETI Act")[7] in order to comply with the recommendations and rulings of the DSB.[8]

4. The European Communities considered that the ETI Act did not comply with the DSB recommendations and rulings in the original dispute, because the ETI Act was not consistent with the United States' obligations under the *SCM Agreement*, the *Agreement on Agriculture*, and the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"). As a result, the European Communities had recourse to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").[9] On 20 December 2000, the DSB referred the matter to a panel under Article 21.5 of the DSU.[10] The first Article 21.5 panel report was circulated to the Members of the World Trade Organization (the "WTO") on 20 August 2001.

5. The panel in the first Article 21.5 proceedings concluded that the ETI Act was inconsistent with the United States' obligations under the *SCM Agreement*, the *Agreement on Agriculture*, and the GATT 1994. In addition, it also held that, by making available indefinitely the FSC tax benefit for certain transactions by virtue of Section 5(c)(1)(B) ("Section 5") of the ETI Act, the United States

---

[4]Original Panel Report, *US – FSC*, para. 8.1. A detailed description of the FSC measure is contained in paragraphs 2.1-2.8 of the Original Panel Report, and in paragraphs 11-18 of the Original Appellate Body Report, in *US – FSC*.

[5]Original Panel Report, *US – FSC*, para. 8.8.

[6]WT/DSB/M/90, paras. 6-7. See also Panel Report, para. 1.1.

[7]United States Public Law 106-519, 114 Stat. 2423 (2000).

[8]Panel Report, *US – FSC (Article 21.5 – EC)*, para. 1.5. A detailed description of the ETI Act is contained in paragraphs 2.2-2.8 of the Panel Report, and in paragraphs 15-25 of the Appellate Body Report, in *US – FSC (Article 21.5 – EC)*.

[9]WT/DS108/16.

[10]WT/DS108/19.

"ha[d] not fully withdrawn the FSC subsidies found to be prohibited export subsidies [in the original proceedings] and ha[d] therefore failed to implement the recommendations and rulings of the DSB [in the original proceedings] made pursuant to Article 4.7 [of the] *SCM Agreement*."[11] The Appellate Body upheld those findings of the first Article 21.5 panel. The Appellate Body also recommended that the DSB "request the United States to bring the ETI measure ... into conformity with its obligations ... and ... to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."[12] On 29 January 2002, the DSB adopted the reports of the first Article 21.5 panel and the Appellate Body.[13]

6. On 22 October 2004, the United States, with a view to bringing its measures into conformity with its WTO obligations, enacted the Jobs Act, repealing the tax exclusion of the ETI Act.[14] The Jobs Act applies from 1 January 2005. Section 101 of the Jobs Act is entitled "Repeal of exclusion for extraterritorial income". Section 101(a) provides that "Section 114 [of the IRC] is hereby repealed." Section 101(b) is entitled "Conforming Amendments" and provides, in sub-paragraph (1): "Subpart E of Part III of subchapter N of chapter 1 (relating to qualifying foreign trade income) is hereby repealed." At the same time, Section 101(d) contains a "transition provision", pursuant to which the ETI tax scheme remains available, on a reduced basis, for certain transactions in the period between 1 January 2005 and 31 December 2006. Further, Section 101(f) contains a "grandfathering provision", pursuant to which the ETI tax scheme remains available *indefinitely* with respect to certain transactions.[15] Finally, Section 101 of the Jobs Act does not repeal or otherwise make reference to Section 5 of the ETI Act, which "grandfathered" indefinitely FSC subsidies with respect to certain transactions.[16] A more detailed description of the Jobs Act is contained in paragraphs 2.13 to 2.17 of the Panel Report.

---

[11]Panel Report, *US – FSC (Article 21.5 – EC)*, para. 9.1(e).

[12]Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 257.

[13]On 17 November 2000, the European Communities had requested authorization to take "appropriate countermeasures" and to suspend concessions pursuant to Article 4.10 of the *SCM Agreement* and Articles 22.2 and 22.7 of the DSU for an amount of US$ 4043 million per year. (WT/DS108/13) The United States objected to the appropriateness of the countermeasures proposed by the European Communities, as well as to the level of suspension of concessions proposed by the European Communities, and requested that the matter be referred to arbitration. The arbitrator, acting pursuant to Article 4.11 of the *SCM Agreement* and Article 22.6 of the DSU, determined that the countermeasures sought by the European Communities "would constitute appropriate countermeasures within the meaning of Article 4.10 of the *SCM Agreement*". (Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 8.1)

[14]Panel Report, para. 1.6.

[15]More specifically, to transactions made in the ordinary course of trade or business occurring pursuant to a binding contract between the taxpayer and an unrelated person, which contract was in effect on 17 September 2003 and at all times thereafter. (*Ibid.*, footnote 29 to para. 2.16)

[16]*Ibid.*, para. 2.17. These transactions are transactions pursuant to a binding contract between the FSC and an unrelated person, which contract was in effect on 30 September 2000. (*Ibid.*, para. 2.12)

7. The European Communities considered that the United States had failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, had failed to bring its scheme into conformity with its WTO obligations, and had therefore failed to implement the recommendations and rulings of the DSB of 20 March 2000 and 29 January 2002. The European Communities also considered that the United States continued to violate certain provisions of the *SCM Agreement*, the *Agreement on Agriculture*, and the GATT 1994. The European Communities therefore had recourse to Article 21.5 of the DSU for a second time.[17] On 20 December 2000, the DSB referred the matter to a panel under Article 21.5 of the DSU.[18] The Panel Report was circulated to WTO Members on 30 September 2005.

8. The Panel found that:

> The panel and Appellate Body findings in the first 21.5 compliance proceedings, as adopted by the DSB, established that the ETI scheme was in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994. Pursuant to Articles 101(d) and (f) of the Jobs Act, the ETI benefits remain available throughout 2005 and 2006 (albeit at reduced percentages), and indefinitely (in the case of certain transactions). The inconsistencies with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of GATT 1994 remain.
>
> We further note the indefinite grandfathering of the original FSC subsidies for certain transactions, through the continued operation of [S]ection 5[] of the ETI Act. As confirmed by the United States in response to Panel questioning, nothing in the legislative language of the Jobs Act modifies, implicitly or explicitly, these transition rules for the FSC subsidies.[19] (footnotes omitted)

9. The Panel concluded that:

> ... to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through the transition and grandfathering measures at issue, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.[20]

---

[17]Request for the Establishment of a Panel by the European Communities, WT/DS/108/29 (attached as Annex III to this Report).

[18]WT/DS108/30.

[19]Panel Report, para. 7.60-7.61.

[20]*Ibid.*, para. 8.1. See also para. 7.65.

10. The Panel also stated that:

> Since the original DSB recommendations and rulings in 2000 remain operative through the results of the compliance proceedings in 2002, we make no new recommendation.[21]

11. On 14 November 2005, the United States notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU, and filed a Notice of Appeal[22] pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").[23] On 21 November 2005, the United States filed an appellant's submission.[24] On 28 November 2005, the European Communities notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU, and filed a Notice of Other Appeal[25] pursuant to Article 23(1) of the *Working Procedures*. On 29 November 2005, the European Communities filed an other appellant's submission.[26] On 9 December 2005, the European Communities and the United States each filed an appellee's submission.[27] On the same day, Australia and Brazil each filed a third participant's submission[28] and China notified its intention to appear at the oral hearing as a third participant.[29] On 16 December 2005, the Director of the Appellate Body Secretariat informed the parties that Mr. John Lockhart was prevented from continuing to serve on the Division for serious personal reasons falling within Rule 12 of the *Working Procedures*. In accordance with Rule 13 of the *Working Procedures*, the Appellate Body selected Ms. Merit E. Janow to replace Mr. Lockhart. The oral hearing in this appeal was held on 9 January 2006.

---

[21]Panel Report, para. 8.2.

[22]WT/DS108/32 (attached as Annex I to this Report).

[23]WT/AB/WP/5, 4 January 2005.

[24]Pursuant to Rule 21(1) of the *Working Procedures*.

[25]WT/DS108/33 (attached as Annex II to this Report).

[26]Pursuant to Rule 23(3) of the *Working Procedures*.

[27]Pursuant to Rules 22 and 23(4) of the *Working Procedures*.

[28]Pursuant to Rule 24(1) of the *Working Procedures*.

[29]Pursuant to Rule 24(2) of the *Working Procedures*.

II. Arguments of the Participants and the Third Participants

A. *Claims of Error by the United States – Appellant*

1. Panel's Terms of Reference

12. The United States requests the Appellate Body to reverse the Panel's finding that, through the continued operation of Section 5 of the ETI Act, the "grandfathering" of the FSC tax exemption remained in effect, and that nothing in the Jobs Act modified this grandfathering provision. The United States argues that neither Section 5 of the ETI Act nor its continued operation was within the Panel's terms of reference and that, therefore, the Panel's findings in this regard are inconsistent with Articles 6.2 and 21.5 of the DSU.

13. According to the United States, Section 5 of the ETI Act was not within the Panel's terms of reference because it was not included in the European Communities' request for the establishment of a panel. The only provisions identified by the European Communities in that request as the subject of the dispute were Sections 101(d) and 101(f) of the Jobs Act. Those provisions are, respectively, the "transition provision" and the "grandfathering provision" for the ETI tax exclusion; those provisions do not relate to the FSC tax exemption. The United States emphasizes that the European Communities' panel request does not mention Section 5 of the ETI Act at all, "let alone a failure to withdraw [S]ection 5[]".[30]

14. The Panel, according to the United States, provided four reasons for its conclusion that the European Communities' panel request included Section 5 of the ETI Act. The first was that Section 101 of the Jobs Act "does not repeal [S]ection 5 of the ETI Act".[31] The United States points out that the panel request defines Section 101 of the Jobs Act, and its content, as the subject of the dispute; the panel request does not define as the subject of the dispute what Section 101 does *not* contain.

15. The second of the Panel's reasons, according to the United States, is that "elsewhere in the [European Communities'] panel request there are references to the ETI Act in its entirety, as well as to the prior panel and Appellate Body reports adopted in this dispute."[32] In the United States' view, these

[30]United States' appellant's submission, para. 46.

[31]*Ibid*., para. 50.

[32]*Ibid*., para. 51. (footnote omitted)

overly broad references are not "particularly informative as to the scope of the matter before the Panel".[33]

16. The third reason given by the Panel is that the European Communities' panel request referred to a failure to withdraw the prohibited subsidies and a failure to implement the recommendations and rulings of the DSB in the original and first Article 21.5 proceedings. However, according to the United States, "the mere reference to a failure to withdraw prohibited subsidies does not indicate whether the alleged failure pertains to the FSC tax exemption, the ETI tax exclusion, or both."[34]

17. The fourth reason given by the Panel, according to the United States, is that Article 6.2 does not require identification of specific aspects of a measure, and does not prescribe the manner for identifying a specific measure at issue. The United States asserts that—even assuming that this statement of the Panel is correct—"this does not mean that when a panel request expressly identifies the 'subject of the dispute'", and subsequently defines the subject of the dispute by referring to the specific provisions contained in a law, a panel may ignore the method actually used by the complainant to identify the measures at issue.[35]

18. The United States argues that, although the Panel paid "lip service" to the requirement that a panel request be read as a whole, in reality, it did not do so.[36] Instead, the Panel mechanically gave equal weight to every word or every section of the panel request. In the United States' view, the section of the European Communities' panel request entitled "The Subject of the Dispute" was, by virtue of its title, "more probative" than the other sections as to the measures covered by the panel request.[37] Moreover, the Panel also ignored the fact that Section 5 of the ETI Act was not mentioned anywhere in the panel request.

19. Finally, the United States takes issue with the Panel's conclusion that the United States was not prejudiced by a lack of clarity in the European Communities' panel request. Where, as in this case, a matter is not within a panel's terms of reference because it was not included in the panel request, there is no need for a responding Member to demonstrate that it has suffered prejudice.

---

[33]United States' appellant's submission, para. 51.

[34]*Ibid*., para. 52.

[35]*Ibid*., para. 53.

[36]*Ibid*., para. 54.

[37]*Ibid*.

2. Article 4.7 of the *SCM Agreement* and Article 21.5 of the DSU

20. The United States requests the Appellate Body to reverse the Panel's finding that the United States did not implement fully the DSB recommendations and rulings in the previous *US – FSC* and *US – FSC (Article 21.5 – EC)* disputes. The United States also requests the Appellate Body to reverse, in particular, the Panel's conclusion that the United Sates failed to comply with a recommendation adopted by the DSB under Article 4.7 of the *SCM Agreement* to withdraw prohibited subsidies. According to the United States, the Panel erred in making this conclusion because there was no DSB recommendation under Article 4.7 of the *SCM Agreement* to withdraw the ETI tax exclusion, while, in the case of the grandfathering provisions in Section 5 of the ETI Act, the Panel's terms of reference did not include as a measure this Section.

21. In the United States' view, the Panel "improperly equated the recommendation called for in Article 4.7 with an obligation on Members under the covered agreements".[38] The United States argues that the panel in the original *US – FSC* proceedings made a recommendation under Article 4.7 of the *SCM Agreement*, which recommendation pertained to the FSC tax exemption. The only reference to that provision in the first Article 21.5 proceedings was the Appellate Body's reference to the FSC tax exemption as "grandfathered" in the ETI Act. No recommendation was made with respect to the ETI Act itself under Article 4.7 of the *SCM Agreement*.

22. According to the United States, the Panel erroneously "create[d] an obligation to withdraw the ETI tax exclusion within the meaning of Article 4.7."[39] The Panel "essentially transform[ed] a DSB recommendation and ruling under Article 4.7 to withdraw the measures giving rise to the FSC tax exemption into a general obligation to withdraw prohibited subsidies."[40] Moreover, the Panel found that the "withdrawal recommendation" made in the original panel proceedings is the "operative" recommendation in respect of all future measures taken to comply with the recommendations and rulings of the DSB.[41]

23. The United States disagrees with these findings of the Panel for two reasons. First, in the United States' view, Article 4.7 of the *SCM Agreement* is directed to panels and not to WTO Members. Secondly, Article 4.7 does not refer to any "subsidy" but, rather, refers to "the measure in question ... found to be a prohibited subsidy".[42] Thus, the "measure" subject to the Article 4.7

[38]United States' appellant's submission, heading III.A.

[39]*Ibid*., para. 20.

[40]*Ibid*., para. 21.

[41]*Ibid*.

[42]*Ibid*., para. 24.

withdrawal recommendation is the measure considered by the original panel, and not "any future measure taken to comply that might be found to constitute a prohibited subsidy."[43] In the context of the present dispute, "the measure in question" that had to be withdrawn was the FSC tax exemption.[44] The Panel therefore erred in finding that the adopted recommendation of the original panel under Article 4.7 applies to measures other than the FSC tax exemption.

24. Another major error committed by the Panel, according to the United States, was to "mischaracteriz[e]" its task under Article 21.5.[45] The United States takes issue with the Panel's statement that its task under Article 21.5 was to determine whether a Member has "fixed the problem".[46] The United States argues that, under the terms of Article 21.5, a panel's task is simply to determine whether measures taken to comply exist or not, and, when such measures do exist, whether they comply with the rulings and recommendations of the DSB. By incorrectly characterizing its task under Article 21.5 as ensuring that a "problem" is "fixed", the Panel "appears to have conferred on itself the authority to ignore the precise text of Article 4.7 of the SCM Agreement and Article 21.5 [of the DSU], its terms of reference and the particular claims advanced by the complaining party".[47] In the United States' view, Article 4.7 does not direct a panel to recommend that a Member refrain from enacting any new provision that may provide a prohibited subsidy.[48]

25. According to the United States, the Panel moreover misinterpreted the findings and recommendations of the panel and the Appellate Body in the first Article 21.5 proceedings. The Panel stated that the first Article 21.5 panel "expressly indicated the view that the original Article 4.7 recommendation 'remain[ed] operative'."[49] However, the first Article 21.5 panel made this statement in response to a comment on the interim report in which the European Communities asserted that the panel should not make new recommendations. The United States argues that the only findings made by the first Article 21.5 panel under Article 4.7 of the *SCM Agreement* pertained exclusively to the FSC tax exemption and Section 5 of the ETI Act, which deals with that FSC tax exemption, but not with the ETI tax exclusion. For this reason, the United States disputes the view that the recommendation under Article 4.7 adopted by the DSB in the original *US – FSC* proceedings is

[43]United States' appellant's submission, para. 24. (footnote omitted)

[44]*Ibid*. (referring to Article 4.7 of the *SCM Agreement*).

[45]*Ibid*., para. 26.

[46]*Ibid*.

[47]*Ibid*., para. 29.

[48]*Ibid*. The United States stated at the oral hearing that the "systemic issue" as to whether an Article 21.5 panel has the authority to make a new recommendation under Article 4.7 of the *SCM Agreement*, in respect of the measure taken to comply before its consideration, need not be addressed in this dispute.

[49]United States' appellant's submission, para. 33 (referring to Panel Report, para. 7.56).

"operative" with respect to the ETI tax exclusion, "a tax exclusion provided by a legislation that did not even exist at the time of the 2000 DSB recommendation."[50]

26. The United States maintains that the first Article 21.5 proceedings resulted in two different sets of findings and recommendations. One set of findings pertained to Section 5 of the ETI Act and the transition provisions for the FSC tax exemption. With respect to this finding, there was a reference to the United States' failure to comply with previous recommendations and rulings made pursuant to Article 4.7 of the *SCM Agreement*. The other set of findings pertained to the ETI tax exclusion. Although there were findings of inconsistency of the ETI tax exclusion with the provisions of several covered agreements, there was no finding or recommendation with respect to Article 4.7 of the *SCM Agreement*.

27. The United States also argues that the Panel's interpretations of Article 4.7 of the *SCM Agreement* and Article 21.5 of the DSU were not necessary to avoid undermining the WTO dispute settlement system. The Panel erroneously believed that only an Article 4.7 recommendation could create an obligation for a Member to withdraw a measure found to be a prohibited subsidy. The United States accepts that when, as a result of proceedings under Article 21.5, the DSB makes a ruling that a measure taken to comply is inconsistent with a covered agreement, "the Member maintaining that measure must withdraw it or otherwise bring it into conformity with the relevant covered agreement."[51] Thus, the United States does not dispute that it was under an obligation "to remedy the[] inconsistencies [of the ETI Act] with its WTO ... obligations"; however, the United States disagrees that "this obligation flowed from Article 4.7 of the SCM Agreement or the recommendation made thereunder."[52]

B. *Arguments of the European Communities – Appellee*

1. Panel's Terms of Reference

28. The European Communities requests the Appellate Body to reject the United States' appeal against the Panel's finding concerning its terms of reference.

29. The European Communities argues, first, that the Panel was correct in considering the European Communities' panel request as a whole. The United States has not demonstrated why panels should be required, on the basis of Article 6.2, to look at the text of only one particular part of a panel request. Furthermore, reading Article 6.2 of the DSU in the context of proceedings under

[50]United States' appellant's submission, para. 34.

[51]*Ibid*., para. 40.

[52]*Ibid*., para. 41.

Article 21.5, the subject of the present proceedings "is primarily to review whether the 2004 Jobs Act finally achieved compliance with *inter alia* the 2000 DSB recommendations and rulings."[53] Seen in this way, section 2 of the European Communities' panel request described the relevant aspects of the Jobs Act. Furthermore, section 3 of the panel request is "inextricably linked"[54] to section 2 and contains a clear reference to the original recommendation under Article 4.7 of the *SCM Agreement* and to the findings made in the first Article 21.5 proceedings with respect to the ETI Act. These latter findings clearly include findings that the ETI Act partly keeps in force the FSC scheme through the "grandfathering" provision. Finally, the European Communities argues that the panel request explained why "pertinent aspects"[55] of the Jobs Act failed to implement the DSB recommendations, namely, because these provisions maintained "the tax exemptions already found to be WTO incompatible"[56]; these tax exemptions include the ETI as well as the FSC scheme.

30. Secondly, the European Communities argues that the Panel correctly reviewed whether the United States had suffered prejudice as a result of the alleged failure by the European Communities to identify Section 5 of the ETI Act correctly the measure at issue. The Panel did not impose a burden on the United States to demonstrate that the United States had suffered prejudice. Rather, the Panel noted that whether the responding party has suffered prejudice is a pertinent issue to be examined in deciding on an alleged violation of Article 6.2 of the DSU. Furthermore, the United States' arguments before the Panel also demonstrate that the United States was not prejudiced; the United States did not contest, but rather confirmed, that the Jobs Act did not, in substance, affect Section 5 of the ETI Act. Thus, the only defence put forward by the United States was "to acknowledge that there was nothing to defend."[57] This amounts to an admission that "in substance the Jobs Act did not affect Section 5[] of the ETI Act [and] demonstrates that there cannot have been any adverse effects on [the] defence opportunities of the United States."[58]

31. The European Communities also points out that (i) DSB rulings exist already to the effect that Section 5 of the ETI Acts does not achieve withdrawal of the FSC tax exemption pursuant to Article 4.7 of the *SCM Agreement*, resulting from the adoption of the first Article 21.5 panel and Appellate Body reports[59]; (ii) the United States has confirmed that the Jobs Act does not modify

[53]European Communities' appellee's submission, para. 64.

[54]*Ibid*., para. 66.

[55]*Ibid*., para. 70.

[56]*Ibid*., para. 71.

[57]*Ibid*., para. 77. (original underlining)

[58]*Ibid*., para. 78.

[59]This finding is contained in paragraph 9.1(e) of the Panel Report, and in paragraph 256(f) of the Appellate Body Report, in *US – FSC (Article 21.5 – EC)*.

Section 5 of the ETI Act; and (iii) the United States does not contest that the Jobs Act and the ETI Act constituted "measures taken to comply". The arguments of the United States—that the Panel should have found that only Sections 101(d) and 101(f) of the Jobs Act, and not also Section 5 of the ETI Act, were within its terms of reference—are therefore not well founded.

2. Article 4.7 of the *SCM Agreement* and Article 21.5 of the DSU

32. The European Communities considers that the United States' arguments with respect to Article 21.5 of the DSU and Article 4.7 of the *SCM Agreement* are without merit and should be dismissed. First, the recommendation made by the original panel under Article 4.7 of the *SCM Agreement* is relevant for the ETI Act, also with respect to the portion of the Act that introduced the ETI tax or "FSC replacement"[60] scheme. The Panel did not invent a new obligation and did not improperly equate a recommendation under Article 4.7 with an obligation to withdraw a prohibited subsidy. Rather, the United States incorrectly attempts to limit Article 21.5 proceedings to "original" panel proceedings. According to the European Communities, the focus of Article 21.5 proceedings "is to assess whether later measures taken to comply with earlier recommendations and rulings have in fact achieved compliance with such recommendations and rulings."[61] As a result, Article 4.7 of the *SCM Agreement* cannot be read in isolation.

33. Secondly, the European Communities argues that the Panel did not formulate an improper "fixing the problem"[62] standard. The Panel was correct in reviewing whether, *inter alia*, the violations found to exist in the original and in the first Article 21.5 proceedings had been eliminated. To the extent that the United States may be suggesting that Article 21.5 of the DSU "embodies a specific requirement to plead alternatively either the non-existence or the non-consistency of the measures allegedly taken to comply", the European Communities disagrees and submits that this is "certainly not the practice"[63] of requests for Article 21.5 panel establishment. Rather, these two elements are "two different ways of looking at the same issue".[64] With respect to the United States' argument that the Panel improperly blurred the distinction between the original measure (that is, the FSC scheme) and the measures taken to comply (that is, the ETI tax scheme and the Jobs Act), the European Communities argues that the Appellate Body's finding in *Canada – Aircraft (Article 21.5 – Brazil)*, cited by the United States, does not support the United States' argument that a measure taken to comply cannot be reviewed against the original recommendation. The European Communities refers

[60]European Communities' appellee's submission, para. 35.

[61]*Ibid*., para. 37.

[62]*Ibid*., para. 28.

[63]*Ibid*., para. 41.

[64]*Ibid*.

to the Appellate Body Report in *Brazil – Aircraft (Article 21.5 – Canada)* in support of its argument.[65]

34. Thirdly, according to the European Communities, the Panel did not misinterpret the findings and recommendations made in the first Article 21.5 proceedings. The European Communities disagrees with the United States that the original recommendation applies only to the FSC scheme and Section 5, but does not apply to the ETI tax scheme. Rather, according to the European Communities, the original Article 4.7 recommendation does apply to the entirety of the ETI Act, including Section 5 thereof. The "fundamental" reason for this is that the original recommendation represents the "very benchmark" against which the measure taken to comply must be reviewed in order to assess whether that measure has brought about compliance.[66] A new recommendation under Article 4.7 of the *SCM Agreement* was not necessary in the first Article 21.5 proceedings, because the main purpose of a recommendation under Article 4.7 is to define the time period within which the subsidy found to be in violation of Article 3.1 of the *SCM Agreement* must be withdrawn. The European Communities also notes that the United States admits that, even in the absence of a recommendation under Article 4.7 pertaining specifically to the ETI tax scheme, it was obliged to withdraw the ETI tax scheme in its entirety.

35. In this regard, the European Communities argues that the Appellate Body, in the first Article 21.5 proceedings, made its recommendation with respect to the "ETI measure", which included Section 5 of the ETI Act.[67] The Appellate Body also recalled that the "ETI measure" had been found to be inconsistent with United States' obligations under the three Agreements in question, and had recommended that the United States bring the "ETI measure" into conformity with those Agreements. The recommendation of the Appellate Body thus included the *SCM Agreement* and, in particular, Article 4.7 of that Agreement. As a result, according to the European Communities, if, at all, a new recommendation under Article 4.7 of the *SCM Agreement* were needed with respect to the ETI tax scheme, it is contained in that Appellate Body recommendation.

36. In addition, the European Communities points to its panel request in the first Article 21.5 proceedings and argues that the enquiry of the panel in those proceedings concerned the resolution of a disagreement whether the ETI Act as a whole achieved compliance with earlier recommendations

[65]European Communities' appellee's submission, para. 43 (referring to Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 82(a) and (b)).

[66]*Ibid*., para. 46.

[67]*Ibid*., para. 53 (referring to Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 257).

and rulings. No distinction was made between provisions creating a new subsidy regime and those "perpetuating"[68] FSC benefits.

37. Finally, the European Communities supports the concern of the Panel that, if a new Article 4.7 recommendation were necessary in every Article 21.5 proceeding, it might undermine the effective operation of the dispute settlement system, because it would involve setting new time-limits for compliance. The European Communities also draws attention to the inconsistencies in the United States' arguments that, on the one hand, no recommendation under Article 4.7 to withdraw the ETI tax exclusion had been made in the first Article 21.5 proceedings and that, on the other hand, Article 21.5 compliance panels have no authority to make such recommendations under Article 4.7.

C. *Claims of Error by the European Communities – Other Appellant*

38. In the event that the Appellate Body endorses any of the United States' claims on appeal, the European Communities requests the Appellate Body to rule on certain claims that the European Communities made before the Panel, which, according to the European Communities, the Panel decided only in part.

39. These claims were, first, that, by not entirely withdrawing FSC and ETI subsidies, the United States has failed to comply with the recommendations and rulings of the DSB as well as with Article 4.7 of the *SCM Agreement*. The European Communities submits that the Panel upheld this claim only "insofar as it found that the United States had failed to comply with the operative recommendations and rulings of the DSB."[69] However, the Panel did not expressly state whether a violation of Article 4.7 of the *SCM Agreement* had occurred, nor did it say that it was exercising judicial economy with regard to this claim of the European Communities.

40. Secondly, the European Communities argues that, by not entirely withdrawing FSC and ETI subsidies, the United States has failed to comply with the recommendations and rulings of the DSB and thereby its obligations under Articles 19.1 and 21.1 of the DSU. The Panel exercised judicial economy in respect of these claims. The European Communities argues that Article 19.1 of the DSU contains an implicit obligation on WTO Members similar to that in Article 4.7 of the *SCM Agreement*. Therefore, the European Communities considers that the United States is violating Article 19.1 and Article 21.1 of the DSU and requests the Appellate Body to make such a finding, in the event that it reverses any of the Panel's findings.

[68]European Communities' appellee's submission, para. 55.

[69]European Communities' other appellant's submission, para. 6.

41. In addition, in the event that the Appellate Body considers that the Panel erred in holding that "the original DSB recommendations and rulings in 2000 remain operative"[70], and that it did not therefore need to issue a new recommendation under Article 4.7 of the *SCM Agreement*, the European Communities requests the Appellate Body to make such a recommendation. The European Communities explains that the reason why it requested the first compliance panel *not* to make an Article 4.7 recommendation is that such a recommendation requires the fixing of a time period for withdrawal of the subsidy found to be prohibited. Compliance with WTO obligations should not be postponed through a "never-ending cycle"[71] of litigation and advancement of the time-limit for compliance. The European Communities furthermore argues that, in the event that the first and second Article 21.5 panels erred in *not* making a recommendation in the first and second compliance proceedings, the Appellate Body should complete the analysis and make such a recommendation.

42. The European Communities adds that recommendations under Article 4.7 of the *SCM Agreement* and Article 19.1 of the DSU—in the event they are considered necessary by the Appellate Body—must be made "irrespective of a specific request of the complaining party".[72] Accordingly, these recommendations may be made by the Appellate Body when the Appellate Body considers it necessary to complete the analysis in the absence of any such request. Such additional recommendations should not, however, imply setting a new time period for withdrawing the prohibited subsidies as that would undermine the effective operation of the dispute settlement system.

D. *Arguments of the United States – Appellee*

43. The United States requests the Appellate Body to reject the conditional claims of error raised by the European Communities. The United States argues that it could not have acted inconsistently with Articles 19.1 and 21.1 of the DSU: Article 19.1, first sentence, imposes an obligation on panels and the Appellate Body to make recommendations and does not impose obligations on WTO Members; Article 21.1 does not provide for any obligation. According to the United States, the European Communities confuses the role of recommendations with that of obligations of WTO Members. In the United States' view, any inconsistency is an inconsistency with the relevant provision of a covered agreement, not an inconsistency with Article 19.1 or Article 21.1.

44. Secondly, the United States submits that, as with Articles 19.1 and 21.1 of the DSU, Article 4.7 of the *SCM Agreement* does not impose obligations on WTO Members; rather,

[70]European Communities' other appellant's submission, para. 7 (referring to Panel Report, paras. 7.49 and 8.2).

[71]*Ibid*., para. 24 (referring to Panel Report, para. 7.46).

[72]*Ibid*., para. 27.

Article 4.7 is addressed to panels. According to the United States, the European Communities bases its arguments not on the text of Article 4.7, but, rather, on its own interpretation of statements made by the Appellate Body in *US – FSC (Article 21.5 – EC)*.[73] In the United States' view, it is Article 3.2 of the *SCM Agreement*, rather than Article 4.7 of the *SCM Agreement*, that prohibits the granting or maintenance of prohibited subsidies. Furthermore, the United States points out that neither the panel nor the Appellate Body in *US – FSC (Article 21.5 – EC)* found a violation of Article 4.7; rather, the panel found that the United States had "failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the SCM Agreement".[74]

45. Thirdly, the United States argues that the Appellate Body should reject the "contingency"[75] on which the European Communities' request for recommendations is premised. According to the United States, it is "impossible"[76] that the contingency defined by the European Communities—namely, should the Appellate Body find that the Panel erred in concluding that no new recommendations were necessary under Article 4.7 of the *SCM Agreement*—could arise. There "would be no basis for the Appellate Body to find that the Panel erred by not making new recommendations"[77], because neither the United States' Notice of Appeal, nor the European Communities' Notice of Other Appeal, contain a claim that the Panel erred in concluding that no new recommendations were necessary.

46. Fourthly, according to the United States, the European Communities failed to comply with Rule 21 of the *Working Procedures*, because the European Communities' other appellant's submission does not set out "a precise statement of the grounds for the appeal" or "a precise statement of the provisions of the covered agreement and other legal sources relied on"[78] as required by Rule 21. In particular, the United States' points to the statement in the European Communities' other appellant's submission that "[t]he detailed arguments supporting [the European Communities'] claims can be found in the [European Communities'] submissions before the Panel and are hereby incorporated by reference."[79] Although it "may perhaps be possible"[80] to comply with Rule 21 through incorporation by reference, the United States contends the European Communities has not complied with Rule 21 in

[73]United States' appellee's submission, para. 17 (referring to European Communities' other appellant's submission, para. 12, in turn quoting Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 229, which reads: "Article 4.7 of the *SCM Agreement* requires prohibited subsidies to be withdrawn 'without delay', and provides that a time-period for such withdrawal shall be specified by the panel.").

[74]*Ibid*., para. 20 (referring to Panel Report, *US – FSC (Article 21.5 – EC)*, para. 9.1(e)).

[75]*Ibid*., para. 22.

[76]*Ibid*.

[77]*Ibid*.

[78]*Ibid*., para. 25.

[79]*Ibid*. (referring to European Communities' other appellant's submission, para. 6).

[80]*Ibid*., para. 27.

this particular instance. This is because the European Communities' references are "vague" and because the European Communities' approach ignores the interests of third parties.[81] As a result, the United States asks the Appellate Body, pursuant to Rule 29 of the *Working Procedures*, to dismiss the relevant portions of the European Communities' conditional appeal.

E. *Arguments of the Third Participants*

1. Australia

47. With respect to the Panel's terms of reference, Australia submits that the grandfathering and exclusion provisions of Section 5 of the ETI Act constitute a measure already found to be inconsistent prior to the second Article 21.5 panel proceedings. The fact that Section 5 of the ETI Act is not explicitly cited in the panel request "does not serve to convert a WTO-inconsistent measure into a WTO-consistent measure."[82] Even if the Appellate Body were to reverse the Panel's ruing with regard to its terms of reference, the United States continues to be under a "continuing obligation"[83] to bring the measure at issue into conformity.

48. With respect to the United States' arguments regarding the ETI tax exclusion and the implementation of DSB recommendations and rulings, Australia agrees with the Panel's findings and argues that the United States is effectively seeking to appeal the adopted recommendations of the DSB in the first Article 21.5 proceedings. An Article 21.5 panel does not have a mandate to make recommendations under Article 4.7 of the *SCM Agreement*. The recommendations of the DSB in the original dispute have "continuing application"[84], given that the measures taken to comply continue to operate and these very same measures were found to be inconsistent with WTO law. In Australia's view, the United States' position would lead to a "legal absurdity"[85] concerning the legal effect of DSB recommendations. Moreover, the United States is under an obligation to remedy the inconsistencies, and a successful appeal by the United States "could not serve to convert a WTO-inconsistent measure into a measure conforming to WTO obligations."[86]

[81]The United States submits, specifically, that the European Communities refers to submissions, oral statements, and responses to Panel questions that were never served on the third parties. Although the opening statement of the European Communities was included as an annex to the Panel Report, the closing statement and responses to questions were not. Nor were these materials posted on the European Communities' website.

[82]Australia's third participant's submission, para. 9.

[83]*Ibid*.

[84]*Ibid*., para. 6.

[85]*Ibid*., para. 7.

[86]*Ibid*.

2. Brazil

49. With respect to the Panel's terms of reference, Brazil submits that the United States is, in effect, arguing that the European Communities attributed to one particular section of its panel request greater importance than to other sections, because that section was entitled "The Subject of the Dispute". In Brazil's view, the United States' appeal elevates "form over substance".[87] By asking, in the panel request, for a finding that the United States had failed to withdraw its prohibited subsidies and thus failed to implement the recommendations and rulings of the DSB, the European Communities satisfied the requirement of Article 6.2 of the DSU to present the problem clearly. The references to the ETI Act in its entirety and to previous panel and Appellate Body reports were sufficient to define the scope of the matter before the Panel. Moreover, the European Communities' first submission to the Panel made explicit reference to the fact that Section 5 of the ETI Act continued to be in force.

50. With respect to the United States' arguments regarding the ETI tax exclusion and the implementation of DSB recommendations and rulings, Brazil submits that the "fixing the problem" standard set forth by the Panel is "in line with a sound textual interpretation of Article 21.5 of the DSU".[88] Brazil also disagrees with the United States' argument that the "measure" subject to the Article 4.7 withdrawal recommendation is the measure considered by the original panel, and not any future measure taken to comply that might be found to constitute a prohibited subsidy. Rather, Brazil agrees with the Panel's finding that a Member's obligation to withdraw a prohibited subsidy is "a constant" and "remains until *full* implementation of DSB recommendations and rulings is achieved".[89] In addition, although the United States recognizes that it was under an obligation to remedy the inconsistencies found with respect to the ETI tax exclusion by the first compliance panel, it has not clarified how and when it would comply. Finally, Brazil "strongly cautions" against any interpretation by which the introduction of "new" inconsistencies[90], in the process of bringing a WTO-inconsistent measure into conformity with the covered agreements, would prolong disputes.

[87]Brazil's third participant's submission, para. 19.

[88]*Ibid*., para. 9.

[89]*Ibid*., para. 12 (referring to Panel Report, para. 7.31 (original emphasis)).

[90]*Ibid*., para. 17.

III. Issues Raised in This Appeal

51. The following two issues are raised in the appeal of the United States:

(a) whether the Panel erred in finding that Section 5(c)(1)(B) ("Section 5") of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the "ETI Act")[91], grandfathering prohibited foreign sales corporations ("FSC") subsidies, was within its terms of reference[92]; and

(b) whether the Panel erred in finding that, to the extent the United States maintains prohibited FSC and extraterritorial income ("ETI") subsidies through the transition and grandfathering measures at issue, "it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements."[93]

IV. Panel's Terms of Reference

52. We first address the issue raised by the United States that the Panel's conclusion that Section 5 of the ETI Act is within its terms of reference is inconsistent with Articles 6.2 and 7.1 of the DSU.[94]

53. The Panel defined the issue before it as an alleged failure on the part of the European Communities to identify the specific "measure at issue", namely, Section 5 of the ETI Act, grandfathering prohibited FSC subsidies, as required by Article 6.2.[95] The Panel stated that this measure would be within its terms of reference "to the extent that it is *adequately identified* in the [European Communities'] request for the establishment of the Panel".[96] The Panel took the view that the European Communities' panel request should be read "as a whole"[97], and noted that the text of the panel request "refers to the ETI Act in its entirety, and to the original DSB recommendations and rulings and the DSB adoption of the 2002 Article 21.5 panel and Appellate Body reports containing,

---

[91]United States Public Law 106-519, 114 Stat. 2423 (2000).

[92]Panel Report, para. 7.87.

[93]*Ibid.*, para. 7.65. See also para. 8.1.

[94]United States' appellant's submission, para. 57; United States' Notice of Appeal, WT/DS108/32 (attached as Annex I to this Report), para. 2.

[95]Panel Report, para. 7.72.

[96]*Ibid.*, para. 7.73. (original emphasis)

[97]*Ibid.*, para. 7.76. (footnote omitted)

inter alia, findings of inconsistency of [Section] 5 of the ETI Act."[98] The Panel further noted that the panel request identifies the "subject of the dispute" as Section 101 of the American Jobs Creation Act of 2004 (the "Jobs Act"), which provision "repeals the ETI [tax] scheme, except those transactions falling within the ETI transition and grandfathering provisions expressly cited, and the FSC grandfathering provisions in [S]ection 5 of the ETI Act."[99] The Panel stated:

> Thus, we reject the [United States'] argument that our terms of reference should be interpreted as excluding Section 5 of the ETI Act because this provision bears on the scope of effective repeal of the ETI Act: [S]ection 101 does not repeal the FSC grandfathering provisions in [S]ection 5 of the ETI Act.[100]

54. The Panel observed, moreover, that "[o]n a holistic basis, the text of the [European Communities'] Panel request cites the ETI Act, in its entirety, as well as both the 2000 and 2002 (Article 21.5) panel and Appellate Body reports, including recommendations and rulings adopted by the DSB" and that the panel request also refers to "a *failure* to withdraw prohibited subsidies and a *failure* to implement DSB recommendations and rulings from the original and first compliance proceedings."[101] The Panel declared that if the "*content* [of a specific measure] is adequately described in the Panel request, then the particular measure may be adequately identified."[102] The Panel concluded on this basis that:

> ... the textual references in the [European Communities'] Panel request embrace the ETI provisions grandfathering the original FSC [tax] scheme, as well as Panel and Appellate Body findings of inconsistency of Article 5 of the ETI Act, as adopted by the DSB. In our view, this clearly meets the requirements of Article 6.2 of the *DSU*.[103] (original italics)

55. After reaching this conclusion, the Panel assessed whether the United States "may be prejudiced by any apparent defects in the ... panel request".[104] The Panel recognized that defects in a panel request cannot be "cured"[105] in a subsequent submission, but noted that, nevertheless, a complainant's first written submission "may confirm the meaning of the words used in the panel

---

[98]Panel Report, para. 7.78.

[99]*Ibid.*, para. 7.80.

[100]*Ibid.*

[101]*Ibid.*, para. 7.82. (original emphasis)

[102]*Ibid.* (emphasis added)

[103]*Ibid.*

[104]*Ibid.*, para. 7.83.

[105]*Ibid.* (referring to Appellate Body Report, *EC – Bananas III*, para. 143).

request"[106]. The Panel took the view that the European Communities, in its first written submission, "clearly made the distinction" between the grandfathering of the FSC tax scheme and the grandfathering of the ETI subsidies by the ETI Act and the Jobs Act, and that this first written submission showed that the European Communities "wishe[d] to challenge both".[107] The Panel further noted that the original recommendations and rulings required withdrawal of the prohibited subsidies by 1 October 2000, and that "[t]he United States was well aware of its obligations since at least that point in time."[108] The Panel concluded that it did not believe that the United States had been prejudiced in its ability to defend itself.[109]

56. On appeal, the United States argues that section 2 of the European Communities' panel request defines, as the subject of the dispute, only "what [S]ection 101 *contains*"[110], and that this Section does not address Section 5 of the ETI Act at all. The fact that the European Communities' panel request refers "elsewhere" to the ETI Act in its entirety, as well as to the prior panel and Appellate Body reports adopted in this dispute, is not "particularly informative as to the scope of the matter before the Panel".[111] Similarly, a mere reference to a "failure to withdraw prohibited subsidies" does not indicate whether that alleged failure pertains to the FSC tax exemption, the ETI tax exclusion, or to both, because this dispute involves "two different measures"[112] found to be prohibited subsidies.

57. The United States further submits that the Panel erred in giving equal weight to "every word or every section of the panel request"[113]; rather, the Panel should have assigned "more probative"[114] value to section 2 of the panel request entitled "The Subject of the Dispute". Finally, the United States disagrees with the Panel's finding on the issue of prejudice; it submits that, where, as here, a matter is not within a panel's terms of reference because the measure at issue (Section 5 of the ETI Act) is not included in the panel request, there is no need for a responding Member to show prejudice.[115]

---

[106]Panel Report, para. 7.83 (referring to Appellate Body Reports, *US – Carbon Steel*, para. 127).

[107]*Ibid.*, para. 7.85.

[108]*Ibid.*, para. 7.86.

[109]*Ibid.*

[110]United States' appellant's submission, para. 50. (original emphasis)

[111]*Ibid.*, para. 51.

[112]*Ibid.*, para. 52.

[113]*Ibid.*, para. 54.

[114]*Ibid.*

[115]*Ibid.*, para. 56.

58. We begin our analysis with the text of Article 21.5 of the DSU, which provides, in its relevant part:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to *these dispute settlement procedures*, including wherever possible resort to the original panel. (emphasis added)

59. The Appellate Body has, to date, not been called upon to determine the precise scope of the phrase "these dispute settlement procedures" in Article 21.5 and how it relates to Article 6.2 of the DSU.[116] We do not consider it necessary, for purposes of resolving the present dispute, to determine the precise scope of this phrase. However, we are of the view that the phrase "these dispute settlement procedures" does encompass Article 6.2 of the DSU, and that Article 6.2 is generally applicable to panel requests under Article 21.5.[117] At the same time, given that Article 21.5 deals with compliance proceedings, Article 6.2 needs to be interpreted in the light of Article 21.5. In other words, the requirements of Article 6.2, as they apply to an original panel request, need to be adapted to a panel request under Article 21.5.

60. We note that the purpose of Article 21.5 is to resolve a disagreement between the parties "as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. Thus, an Article 21.5 panel may be called upon to examine either the "existence" of "measures taken to comply" with DSB recommendations and rulings, or, when such measures exist, the "consistency" of those measures with the covered agreements, or a combination of both, in situations where the measures taken to comply, through omissions or otherwise, may achieve only partial compliance.

61. It is important to note that the text of Article 21.5 expressly links the "measures taken to comply" with the recommendations and rulings of the DSB. Therefore, the "specific measures at issue" to be identified in Article 21.5 proceedings are measures that have a bearing on compliance with the recommendations and rulings of the DSB. This, in our view, indicates that the requirements of Article 6.2 of the DSU, as they apply to an Article 21.5 panel request, must be assessed in the light

---

[116]In *Mexico – Corn Syrup (Article 21.5 – US)*, the Appellate Body made certain findings assuming, *arguendo*, that Article 6.2 applied in the context of Article 21.5 proceedings. The Appellate Body did not make a finding whether Article 6.2 *actually applied* in the context of Article 21.5 proceedings and, if so, to what extent. (See Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, paras. 52-53 and 67)

[117]In response to questioning at the oral hearing, both participants explicitly agreed with the general applicability of Article 6.2 in Article 21.5 proceedings, although they had some differences on the specific details of the requirements of Article 6.2 in Article 21.5 proceedings.

of the recommendations and rulings of the DSB in the original panel proceedings that dealt with the same dispute.

62. Hence, in order to identify the "specific measures at issue" and to provide "a brief summary of the legal basis of the complaint" in a panel request under Article 21.5, the complaining party must identify, at a *minimum*, the following elements in its panel request. First, the complaining party must cite the recommendations and rulings that the DSB made in the original dispute as well as in any preceding Article 21.5 proceedings, which, according to the complaining party, have not yet been complied with. Secondly, the complaining party must either identify, with sufficient detail, the measures allegedly taken to comply with those recommendations and rulings, as well as any omissions or deficiencies therein[118], or state that *no* such measures have been taken by the implementing Member. Thirdly, the complaining party must provide a legal basis for its complaint, by specifying how the measures taken, or not taken, fail to remove the WTO-inconsistencies found in the previous proceedings, or whether they have brought about new WTO-inconsistencies. We note that this latter issue is not before us in this case.[119]

63. The participants agree that the case before us is not one of a *complete absence* of a "measure taken to comply". Indeed, the European Communities stated at the oral hearing that the present dispute concerned, in part, the existence of a measure taken to comply, namely, with respect to Section 5 of the ETI Act, as well as, in part, the consistency of a measure taken to comply, namely, Section 101 of the Jobs Act. Moreover, we note that the issue before us is not the failure to state a legal basis for the claims; rather, the issue before us is whether, with respect to Section 5 of the ETI Act, the European Communities adequately identified the "specific measure at issue".

64. Turning to the European Communities' panel request in this dispute, we note that the European Communities identified all the recommendations and rulings of the DSB in both the original and the first Article 21.5 proceedings.[120]

---

[118]Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 67.

[119]In this respect, we recall that the Appellate Body stated, in *EC – Bed Linen (Article 21.5 – India)*, that the measure taken to comply may be inconsistent with WTO law "in ways different from" the original measure. (Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 79) See also Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 40.

[120]The European Communities' panel request explicitly refers to the DSB recommendations and rulings in the original and first Article 21.5 disputes in section 1 ("The History of the Dispute"), in section 2 ("The Subject of the Dispute"), and in section 3 ("Request for the Establishment of a Panel"). (Request for the Establishment of a Panel by the European Communities, WT/DS/108/29 (attached as Annex III to this Report))

65. With respect to the "specific measures at issue", we note that the European Communities explicitly referred to Section 101 of the Jobs Act as a "measure taken to comply".[121] The United States does not contend that the European Communities has failed to identify adequately the Jobs Act, or Section 101(d) and (f) thereof, as a measure at issue.[122] Rather, the contention of the United States is that the European Communities' panel request is specifically and exclusively limited to Section 101 of the Jobs Act and that it does not extend to Section 5 of the ETI Act. The question before us, therefore, is whether the European Communities' panel request put the United States on sufficient notice that a challenge was being brought against the continued operation of Section 5 of the ETI Act.

66. In our view, the European Communities has satisfied this requirement because, in its panel request, the European Communities has explicitly referred to a "*fail[ure by the United States] to withdraw its prohibited subsidies* as required by Article 4.7 of the *SCM Agreement* [and the] fail[ure] to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002".[123] This language clearly indicates that the European Communities was referring to the *entirety* of the prohibited subsidies found to exist in the original and first Article 21.5 proceedings and covered by the DSB recommendations and rulings, which included Section 5 of the ETI Act. Given that the Jobs Act does not apply to the prohibited FSC subsidies—because the Jobs Act "neither repeals nor explicitly or implicitly affects the operation of [S]ection 5 of the ETI Act in any way"[124], a fact that the United States does not contest—the European Communities' panel request is to be read as including the continued operation of Section 5 of the ETI Act.

67. We recall, as the Panel has done, that the Appellate Body has previously stated that, "in considering the sufficiency of a panel request, submissions and statements made during the course of the panel proceedings, in particular the first written submission of the complaining party, may be consulted in order to confirm the meaning of the words used in the panel request".[125] We note that, in its first written submission to the Panel, the European Communities drew a clear distinction between "the grandfathering clause for FSC subsidies contained in [S]ection 5[] of the ETI Act"[126]

---

[121]In section 2 of the panel request ("The Subject of the Dispute"), the European Communities states: "Section 101 of the JOBS Act purports to repeal the ETI Act (Section 101(a))".

[122]The United States' appeal concerning the Panel's terms of reference is limited to Section 5 of the ETI Act. Furthermore, the United States submits: "Section 2 [of the European Communities' panel request] *clearly identifies* as the subject of the dispute [S]ections 101(d) and (f) of the [Jobs Act]". (United States' appellant's submission, para. 48) (emphasis added)

[123]Request for the Establishment of a Panel by the European Communities, section 3. (emphasis added)

[124]Panel Report, para. 7.68.

[125]Appellate Body Report, *US – Carbon Steel*, para. 127.

[126]European Communities' first written submission to the Panel, para. 58; Panel Report, p. A-14.

and "the transitional and grandfathering clauses in the Jobs Act"[127], and explicitly stated that it was challenging both of these elements.[128] We also agree with the Panel that the European Communities' panel request should be read as a whole and that the assessment of the panel request should not be confined to the content of its section 2 entitled "The Subject of the Dispute".

68. In the light of the above considerations, we conclude that the European Communities' panel request does identify the continued operation of Section 5 of the ETI Act sufficiently to put the United States on notice in this respect.[129] At the same time, we consider that it would have been preferable, and would have better fulfilled the requirements of Article 6.2 of the DSU, had the European Communities explicitly articulated its challenge to the continued operation of Section 5 of the ETI Act. The European Communities could have referred explicitly to the continued grandfathering of FSC subsidies when it was explicitly challenging the grandfathering of ETI subsidies under the Jobs Act. Nevertheless, looking at the European Communities' panel request as a whole, and in the specific circumstances of the present Article 21.5 dispute, we consider that the panel request of the European Communities satisfies the minimum requirements of Article 6.2, read in the light of Article 21.5 of the DSU.[130]

69. We therefore *uphold* the Panel's finding, in paragraph 7.87 of the Panel Report, that Section 5 of the ETI Act, grandfathering prohibited FSC subsidies, was within the Panel's terms of reference.

V. Article 4.7 of the *SCM Agreement* and Article 21.5 of the DSU

70. We now turn to the second issue raised on appeal by the United States. The United States appeals the Panel's finding that the United States "continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited [FSC and ETI] subsidies and to bring

[127]European Communities' first written submission to the Panel, para. 59; Panel Report, p. A-14.

[128]We wish to caution—as did the Panel in this case—that a panel examining a complaining party's first written submission for purposes of confirming the meaning of that party's panel request must bear in mind that a deficient panel request cannot be "cured" subsequently in the first submission. (Appellate Body Report, *EC – Bananas III*, para. 143 (referring to the requirement under Article 6.2 of the DSU to provide "a brief summary of the legal basis of the complaint"))

[129]We also note that the European Communities argues that the responding party in compliance proceedings may be expected to be aware of the measures that were covered by the DSB recommendations or rulings in the original or first Article 21.5 proceedings. (See also Panel Report, para. 7.86)

[130]Given our view that the European Communities satisfied the minimum requirement of Article 6.2, read in the light of Article 21.5, we do not consider it necessary to address the issue whether the United States may have been prejudiced by the alleged lack of clarity in the European Communities' panel request. In this respect, we note that the United States agreed, at the oral hearing, with the proposition that, once a measure is determined to properly fall within a panel's terms of reference, there is no need to demonstrate, in addition, the presence or absence of prejudice to the responding party.

its measures into conformity with its obligations under the relevant covered agreements."[131] More specifically, the United States challenges the Panel's finding that there was a failure on the part of the United States to withdraw the prohibited FSC and ETI subsides under Article 4.7 of the *SCM Agreement*.[132]

71. The United States' appeal that the Panel erroneously found non-compliance with the DSB's recommendations under Article 4.7 of the *SCM Agreement* rests on two separate grounds. With respect to the ETI subsidy, the United States argues that the Panel was in error "because there was no recommendation by the DSB under Article 4.7 with respect to the ETI tax exclusion."[133] As to the FSC subsidy, the Panel was in error because it "incorrectly found that [S]ection 5[] of the ... 'ETI Act' ... was within the Panel's terms of reference" and "[t]his error, in turn, resulted in the Panel erroneously making findings on a measure that was not within its terms of reference."[134] The United States does not dispute that, with respect to the FSC subsidy, there was a DSB recommendation under Article 4.7 that it be withdrawn, which made in the original and first Article 21.5 panel and Appellate Body proceedings.

72. In Section II above, we have upheld the finding of the Panel that Section 5 of the ETI Act was within the Panel's terms of reference. We therefore confine our analysis below to the United States' challenge with respect to the ETI subsidy, namely, that there was no recommendation of the DSB under Article 4.7 with respect to the ETI tax exclusion, and that a panel under Article 21.5 may not make a new recommendation pursuant to Article 4.7 of the *SCM Agreement*.

73. We note that the original panel recommended, pursuant to Article 4.7 of the *SCM Agreement*, that the United States withdraw the prohibited FSC subsidies by 1 October 2000.[135] The first Article 21.5 panel concluded that the United States, through the ETI Act, had failed to bring itself fully into conformity with its WTO obligations by not implementing the recommendations of the DSB made under Article 4.7 of the *SCM Agreement* to withdraw completely the prohibited FSC subsidies.[136] The Appellate Body upheld the findings of the original panel and recommended in the first Article 21.5 proceedings that the DSB request the United States to bring its ETI measure into

[131]Panel Report, para. 7.65; United States' Notice of Appeal, para. 1.

[132]United States' Notice of Appeal, para. 1.

[133]United States' appellant's submission, para. 3.

[134]*Ibid.*, para. 4.

[135]Original Panel Report, *US – FSC*, paras. 8.3 and 8.8. At its meeting held on 12 October 2000, the DSB agreed to modify the time period so that it expired on 1 November 2000. (Panel Report, para. 1.1)

[136]Panel Report, *US – FSC (Article 21.5 – EC)*, para. 8.170.

conformity with its WTO obligations as well as "to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."[137]

74. In these second Article 21.5 panel proceedings, the European Communities claims that Sections 101(d) and 101(f) of the Jobs Act are inconsistent with the WTO obligations of the United States because they continue to maintain the prohibited ETI subsidies.[138] In addition, the European Communities claims that the United States persists in failing to withdraw fully those prohibited FSC subsidies that are grandfathered through Section 5 of the ETI Act.[139] The United States "does not ... contest the substantive arguments of the European Communities"[140] with respect to the grandfathering and transition provisions related to the ETI and FSC subsidies. Nor does it contest the Panel's finding that the transition and grandfathering provisions relating to the ETI subsidy (as contained in Sections 101(d) and (f) of the Jobs Act) are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 3.3, 8, and 10.1 of the *Agreement on Agriculture*, and Article III:4 of the GATT 1994.[141]

75. The Panel concluded that:

> ... to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through these transitional and grandfathering measures, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.[142]

The Panel further concluded that it would not make a new recommendation under Article 4.7 "[s]ince the original DSB recommendations and rulings in 2000 remain operative through the results of the compliance proceedings in 2002".[143]

---

[137]Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 257.

[138]First, the "transition provision", which provides for a two-year continuation of a percentage of ETI benefits (80 per cent in 2005 and 60 per cent in 2006); and secondly, the "grandfathering provision", which exempts certain transactions indefinitely from the repeal of the ETI tax scheme.

[139]This grandfathering provision has not been repealed or modified by the Jobs Act. (Panel Report, para. 7.80)

[140]*Ibid.*, para. 7.11; United States' appellant's submission, para. 41.

[141]Panel Report, para. 7.60; United States' response to questioning at the oral hearing.

[142]Panel Report, paras. 7.65 and 8.1.

[143]*Ibid.*, para. 8.2. See also paras. 7.40-7.41 and 7.44.

76. The United States appeals these findings. According to the United States, there is no recommendation of the DSB under Article 4.7 of the *SCM Agreement* resulting from the first Article 21.5 proceedings (in 2002) with respect to the ETI tax exclusion.[144] The panel and the Appellate Body in the first Article 21.5 proceedings made such a recommendation only with respect to Section 5 of the ETI Act. The United States argues that the Panel erroneously transformed the original DSB recommendation under Article 4.7 to withdraw the FSC tax exemption into a general obligation to withdraw any future prohibited subsidies. The United States does not dispute that it was under an obligation to withdraw fully the WTO-inconsistent FSC subsidy; however, this obligation, in the United States' view, does not stem from Article 4.7 of the *SCM Agreement*, but, exclusively, from Article 3 of that Agreement. According to the United States, Article 4.7 of the *SCM Agreement*—like its generic counterpart, Article 19.1 of the DSU—does not impose obligations on Members.[145] Finally, the United States argues that the task of an Article 21.5 panel is not to determine whether a Member has "fixed the problem"[146], but, rather, to determine whether measures taken to comply exist or not, and, when such measures do exist, whether they comply with the rulings and recommendations of the DSB.

77. The United States points out that, when the original panel made its Article 4.7 recommendation to withdraw the prohibited FSC subsidies by October 2000, the ETI Act was not in existence. The Article 4.7 recommendation of the original panel obviously did not relate to, and therefore could not include, the ETI Act.[147] Subsequently, in 2002, although the first Article 21.5 panel found the ETI Act to provide prohibited subsidies, it did not make any Article 4.7 recommendation with respect to the ETI subsidies. Consequently, the recommendations adopted by the DSB did not include a recommendation pertaining to the withdrawal of the ETI subsidy under Article 4.7, and the United States was therefore under no obligation to withdraw the ETI tax exclusion by virtue of a recommendation under Article 4.7.

78. The European Communities responds that a new recommendation under Article 4.7 was not necessary in the first Article 21.5 proceedings, because the main purpose of a recommendation under Article 4.7 is to define the time period within which the subsidy found to be in violation of Article 3 of the *SCM Agreement* must be withdrawn. The original recommendation under Article 4.7 represents the "benchmark" against which the measure taken to comply must be reviewed in order to assess whether that measure has brought about compliance.[148] As a result, even in the absence of a

[144]United States' appellant's submission, para. 3.

[145]United States' statement at the oral hearing.

[146]United States' appellant's submission, para. 26.

[147]*Ibid.*, paras. 10-11.

[148]European Communities' appellee's submission, para. 46.

new Article 4.7 recommendation pertaining specifically to the ETI tax scheme, the United States was obliged to withdraw the ETI tax scheme in its entirety without delay. If a new Article 4.7 recommendation were necessary in every Article 21.5 proceeding, that would undermine the effective operation of the dispute settlement system, because it would involve extending the time-limits for compliance through successive Article 21.5 proceedings. The European Communities also argues that the Panel did not invent an improper "fixing the problem" standard, but, rather, correctly reviewed whether the violations of WTO law found in the original and first Article 21.5 proceedings had been eliminated.

79. The European Communities also draws attention to what it considers to be a contradiction in the arguments of the United States. On the one hand, the United States argues that the first Article 21.5 panel did not make a recommendation under Article 4.7 of the *SCM Agreement* with respect to the ETI tax exclusion; on the other hand, the United States argues that the second Article 21.5 Panel—the present Panel—was not entitled to make a new recommendation under Article 4.7 with respect to the ETI tax exclusion.[149] Finally, the European Communities submits that the recommendation of the Appellate Body in the first Article 21.5 proceedings relating to the withdrawal of the FSC subsidy pursuant to Article 4.7 of the *SCM Agreement*[150] implicitly covers also the withdrawal of the ETI subsidy under that provision.[151]

80. The United States' appeal thus raises the question whether a recommendation under Article 4.7 made in the original proceedings remains in effect until the implementing Member has fully complied with the DSB recommendations and rulings in the original proceedings as well as subsequent Article 21.5 proceedings.

81. We begin our analysis with the text of Article 4.7 of the *SCM Agreement*, which provides:

> If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time period within which the measure must be withdrawn.

82. It is clear from the text of Article 4.7 that, when a panel finds a measure at issue to be a prohibited subsidy, the panel is required to make a recommendation with two components: (i) that the subsidy be withdrawn "without delay"; and (ii) that the time period within which the subsidy must be

[149]European Communities' appellee's submission, para. 56.

[150]Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 257.

[151]European Communities' appellee's submission, para. 53.

withdrawn be specified by the Panel. When such a recommendation is adopted by the DSB, it must be, by virtue of Article 17.14 of the DSU, "unconditionally accepted by the parties to the dispute", and it thus becomes effective and binding on the parties. Pursuant to Article 4.10 of the *SCM Agreement*, if compliance with an Article 4.7 recommendation is not achieved within the time period specified, the DSB may authorize the imposition of appropriate countermeasures upon the subsidizing Member.

83. We are of the view that the obligation of the subsidizing Member to withdraw the prohibited subsidy "without delay", and within the time period specified, emanates from a finding of a violation of Article 3 of the *SCM Agreement* and a consequent Article 4.7 recommendation once adopted by the DSB. That recommendation under Article 4.7 remains in effect until the Member concerned has fulfilled its obligation by *fully* withdrawing the prohibited subsidy.[152] Where a Member withdraws a prohibited subsidy only in part, it has failed to comply *fully* with its WTO obligation and the Article 4.7 recommendation continues to be in effect with respect to the part of the subsidy that has not been withdrawn. Similarly, full *withdrawal* of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* cannot be achieved by a "measure taken to comply" that replaces the original subsidy with yet another subsidy found to be prohibited. In both instances, the Member cannot be said to have complied with the obligation to withdraw fully the prohibited subsidy.[153]

84. As a result, if, in an Article 21.5 proceeding, a panel finds that the measure taken to comply with the Article 4.7 recommendation made in the original proceedings does not achieve *full* withdrawal of the prohibited subsidy—either because it leaves the entirety or part of the original prohibited subsidy in place, or because it replaces that subsidy with another subsidy prohibited under the *SCM Agreement*—the implementing Member continues to be under the obligation to achieve full withdrawal of the subsidy. The obligation to comply with an Article 4.7 recommendation remains in effect, even if several proceedings under Article 21.5 become necessary, until the prohibited subsidy is fully withdrawn.

---

[152]As noted earlier, Article 17.14 of the DSU provides that Appellate Body reports, including panel findings upheld or modified by the Appellate Body, are to be unconditionally accepted by the parties to the dispute upon adoption by the DSB.

[153]We recall that the Appellate Body has previously held that Article 21.5 proceedings involve not *any* measure taken by a WTO Member, but rather "measures taken to comply with the recommendations and rulings". (Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 36) We also recall the findings of the Appellate Body and the criteria identified by the Appellate Body to determine when a measure has a "particularly close relationship to the declared 'measure taken to comply'". (Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 77) There are a number of dimensions that would have to be examined to determine whether a challenged subsidy falls within the scope of "measures taken to comply". We note that the issue of what constitutes "measures taken to comply" that can be examined in an Article 21.5 proceeding is not before us in this appeal.

85. These second Article 21.5 proceedings before us concern a situation where the measure taken to comply with the DSB recommendations from the original and first Article 21.5 proceedings—the Jobs Act—has in large part withdrawn the prohibited subsidies.[154] However, to the extent that the Jobs Act, by virtue of its transition and grandfathering provisions, does not fully withdraw the ETI subsidies found in the previous proceedings to be prohibited under the *SCM Agreement*, it was sufficient for the second Article 21.5 Panel to conclude that the original Article 4.7 recommendation adopted by the DSB has not been complied with entirely and remains in effect for the part that has not been implemented.

86. Even if, *arguendo*, an Article 21.5 panel made a new Article 4.7 recommendation to withdraw the prohibited subsidy "without delay", it would presumably also "specify ... the time period within which the measure must be withdrawn". If this were to result in an extension of the time period set for withdrawal of the subsidy found to be prohibited in the original proceedings, compliance proceedings could have the effect of extending implementation periods through new Article 4.7 recommendations in successive Article 21.5 proceedings. This could lead to a potentially "never-ending cycle"[155] of dispute settlement proceedings and inordinate delays in the implementation of recommendations and rulings of the DSB.

87. We agree with the Panel that the relevant recommendations adopted by the DSB in the original proceedings in 2000, and those in the first and these second Article 21.5 proceedings, form part of a continuum of events relating to compliance with the recommendations and rulings of the DSB in the original proceedings.[156] The purpose of the first compliance proceedings in 2002 was to determine whether the ETI Act, enacted by the United States to comply with the recommendations and rulings of the DSB in the original proceedings, did, in fact, bring about compliance pertaining to the FSC subsidies. However, the first Article 21.5 panel and Appellate Body reports adopted by the DSB in 2002, pertaining to the ETI subsidies, found that the United States had not fully withdrawn the FSC subsidies.[157] In these second Article 21.5 proceedings, the Panel found that the Jobs Act has not fully withdrawn the prohibited FSC and ETI subsidies. This shows that the United States has not implemented the totality of the findings and recommendations adopted by the DSB, has not met its obligation to withdraw fully the prohibited subsidies, and continues to be under an obligation to do so.

---

[154]We note that Section 101(a) of the Jobs Act repeals the ETI Act.

[155]Panel Report, para. 7.46.

[156]*Ibid.*, para. 7.86; Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 121.

[157]Panel Report, para. 7.52.

88. We now turn to the issue of whether an Article 21.5 panel has the authority to make a new recommendation pursuant to Article 4.7 of the *SCM Agreement*. At the oral hearing, the United States confirmed that, upon further reflection, it withdrew its appeal concerning this issue.[158] The United States further stated that it based its appeal on the other grounds it had advanced, namely, that there was no Article 4.7 recommendation of the DSB in this case with respect to the ETI tax exclusion and that, therefore, the United States was under no obligation to withdraw it by virtue of Article 4.7 of the *SCM Agreement*.[159]

89. In our view, whether the first Article 21.5 panel made or could make a new Article 4.7 recommendation is not dispositive of the question whether the original Article 4.7 recommendation continues to be in effect until full compliance is achieved.[160] Like the Panel, we see "no material significance in the purported lack of an explicit 'new' ... recommendation under Article 4.7 of the *SCM Agreement* in the first [Article 21.5] compliance proceeding."[161]

90. Finally, we address the United States' claim that the Panel "mischaracterized[d]" its task under Article 21.5 by stating that it was to determine whether a Member has "fixed the problem".[162] The United States argues that the task of an Article 21.5 panel is not to determine whether a Member has "fixed the problem", but, rather, to determine whether measures taken to comply exist or not, and, when such measures do exist, whether they do comply with the rulings and recommendations of the DSB. According to the United States, by following a "fixing the problem" standard, the Panel "appears to have conferred on itself the authority to ignore the precise text of Article 4.7 of the SCM Agreement and Article 21.5 [of the DSU], its terms of reference and the particular claims advanced by the complaining party".[163] The United States submits that Article 4.7 requires a panel to recommend withdrawal of the measure "found to be a prohibited subsidy"[164], but does not go further and direct a panel to recommend that a WTO Member refrain from enacting any new provisions that may provide a prohibited subsidy.

---

[158]United States' appellant's submission, footnote 36 to para. 38. The United States confirmed this in response to questioning at the oral hearing.

[159]The United States does not dispute that it is under an obligation to withdraw fully the ETI subsidy by virtue of Articles 3.1(a) and 3.2 of the *SCM Agreement*.

[160]We note that the United States "does not contest that it was under an obligation [deriving from Article 3 of the *SCM Agreement*] to remedy these inconsistencies with its WTO Agreement obligations", regardless of whether or not there is a specific Article 4.7 recommendation. (United States' appellant's submission, para. 41)

[161]Panel Report, para. 7.55. See also Panel Report, *US – FSC (Article 21.5 – EC)*, para. 9.1(e)); and Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 257.

[162]United States' appellant's submission, para. 26.

[163]*Ibid.*, para. 29.

[164]*Ibid.*

91. The European Communities responds that the task of an Article 21.5 panel "can be more fully described as examining whether the previously found violations have been removed and whether in doing so the implementing Member has fully respected its WTO obligations (and has not introduced any new violations)."[165] According to the European Communities, this is what the Panel meant by the term "fixing the problem ... both literally and logically".[166]

92. The Panel noted:

> Article 21.5 compliance proceedings form part of a continuum of events flowing from the various steps in dispute settlement proceedings, with the operative recommendations and rulings for the purposes of Article 21.5 compliance proceedings being those adopted by the DSB in the *original* proceedings. These remain operative through compliance panel proceedings under Article 21.5 of the *DSU* until the "problem" is entirely "fixed", in terms of *full* withdrawal of the prohibited subsidy.[167] (original italics; underlining added; footnote omitted)

93. In order to determine whether the Panel indeed "mischaracterized" its task under Article 21.5, as alleged by the United States, we consider, first, the task of a panel under Article 21.5, and secondly, we review the Panel's findings in this respect. The task of an Article 21.5 panel is to determine whether "measures taken to comply" implement the "recommendations and rulings" adopted by the DSB in the original proceedings.[168] In doing so, an Article 21.5 panel may examine either the "existence" of measures taken to comply with DSB recommendations and rulings, or, when such measures exist, the "consistency" of those measures with the covered agreements, or a combination of both in situations where the measures taken to comply, through omissions or other deficiencies, may achieve only partial compliance. As we noted earlier, the text of Article 21.5 expressly links the "measures taken to comply" and the recommendations and rulings of the DSB.[169] The determination of whether "measures taken to comply" challenged by the complaining party implement fully, or only in part, the DSB recommendations and rulings requires a panel to examine all of the previous DSB recommendations and rulings and the entire range of measures covered by them.[170] Hence, in compliance proceedings, an Article 21.5 panel may have to examine whether the

---

[165]European Communities' appellee's submission, para. 29.

[166]*Ibid.*

[167]Panel Report, para. 7.36.

[168]Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 40.

[169]See *supra*, para. 61.

[170]Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 68.

"measures taken to comply" implement fully, or only partially, the recommendations and rulings adopted by the DSB.

94. We now turn to examine how the Panel conducted its enquiry under Article 21.5 in this case. The Panel stated that Article 21.5 compliance proceedings "form part of a continuum of events flowing from the various steps in dispute settlement proceedings".[171] According to the Panel, the original recommendations and rulings of the DSB "remain operative through compliance panel proceedings under Article 21.5 of the *DSU* until the 'problem' is entirely 'fixed'"[172], that is, until the prohibited subsidy is fully withdrawn. Subsequently, the Panel stated that it would examine whether the measures taken by the United States to comply with the recommendations and rulings are consistent with the relevant covered agreements. The Panel, first, identified the "measures taken to comply" and the recommendations and rulings at issue; secondly, it set out its view concerning Article 4.7 of the *SCM Agreement* and the recommendations made thereunder by the original panel; and, finally, it addressed the existence or consistency of the identified "measures taken to comply".

95. The Panel could have used language more precise than "fixing the problem" in describing its task under Article 21.5. On reading the Panel's analysis as a whole, we consider that the Panel did adequately describe its task and, more importantly, did not exceed its authority under Article 21.5. The Panel examined whether the United States had removed fully the subsidies found in the original and first Article 21.5 proceedings to be prohibited as required by the recommendations and rulings adopted by the DSB.

96. For the reasons set out above, we *uphold* the Panel's finding, in paragraph 7.65 of the Panel Report, that "to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through [the] transitional and grandfathering measures, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements."

VI. European Communities' Conditional Appeals

97. The European Communities makes two conditional appeals with respect to "certain claims that [the European Communities] made before the Panel and which the Panel did not consider

[171]Panel Report, para. 7.36. (footnote omitted)

[172]*Ibid.* (original italics)

necessary to decide".[173] In the event that the Appellate Body should reverse "any of the Panel's findings", the European Communities requests the Appellate Body to find that:

> [b]y not entirely withdrawing FSC and ETI subsidies, the United States has failed to comply with its obligations under Article 4.7 of the *SCM Agreement*; [and that] [b]y not entirely withdrawing FSC and ETI subsidies and maintaining the less favourable treatment of imported as compared to domestic products, the United States has failed to comply with its obligations under Articles 19.1 and 21.1 of the *DSU*.[174] (original italics)

98. The European Communities confirmed at the oral hearing that these appeals are "conditional in nature" and that it is "only if the Appellate Body were to reverse in full or in part the Panel Report that it will need to consider these claims in order to complete the analysis and resolve the dispute."[175]

99. Having upheld both of the Panel's findings that are under appeal by the United States, the condition on which the European Communities' conditional appeal is predicated does not arise, and there is no need for us to examine these conditional appeals.

VII. Findings and Conclusions

100. For the reasons set forth in this Report, the Appellate Body:

(a) upholds the Panel's finding, in paragraph 7.87 of the Panel Report, that Section 5(c)(1)(B) of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, grandfathering prohibited FSC subsidies, was within its terms of reference[176]; and

(b) upholds the Panel's finding and conclusion, in paragraphs 7.65 and 8.1 of the Panel Report, that "to the extent that the United States, by enacting Section 101 of the American Jobs Creation Act of 2004, maintains prohibited FSC and ETI subsidies through [the] transitional and grandfathering measures, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements."

---

[173]European Communities' other appellant's submission, para. 3.

[174]*Ibid.*, para. 29.

[175]*Ibid.*, para. 4; European Communities' response to questioning at the oral hearing.

[176]Panel Report, para. 7.87.

Signed in the original in Geneva this 26th day of January 2006 by:

_____

Georges Abi-Saab
Presiding Member

_____ _____

A.V. Ganesan
Member

Merit E. Janow
Member

ANNEX I

WORLD TRADE ORGANIZATION

WT/DS108/32
16 November 2005

(05-5377)

Original: English

UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Second Recourse to Article 21.5 of the DSU by the European Communities

Notification of an Appeal by the United States
under Article 16.4 and Article 17 of the Understanding on Rules
and Procedures Governing the Settlement of Disputes (DSU),
and under Rule 20(1) of the *Working Procedures for Appellate Review*

The following notification, dated 14 November 2005, from the Delegation of the United States, is being circulated to Members.

_____

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the *Working Procedures for Appellate Review*, the United States hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the Report of the Panel on *United States – Tax Treatment for "Foreign Sales Corporations": Second Recourse to Article 21.5 of the DSU by the European Communities* (WT/DS108/RW2) ("Panel Report") and certain legal interpretations developed by the Panel in this dispute.

1. The United States seeks review of the Panel's conclusion that the United States continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements. This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations, including with respect to Articles 6.2 and 21.5 of the DSU and Article 4.7 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").[1] These erroneous findings and related legal interpretations include that there was a recommendation pursuant to Article 4.7 of the SCM Agreement with respect to the Extraterritorial Income Exclusion Act ("ETI Act") and that a panel established under Article 21.5 of the DSU may make a recommendation pursuant to Article 4.7 of the SCM Agreement.

2. The United States seeks review of the Panel's legal conclusion that section 5 of the ETI Act is within the Panel's terms of reference pursuant to Articles 6.2 and 7.1 of the DSU.[2] This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations.

_____

[1]See, for example, Panel Report, paragraphs 7.39, 7.41 - 7.44, 7.51 - 7.58, 7.62 - 7.65.

[2]See, for example, Panel Report, paragraphs 7.61, 7.68, 7.72 - 7.73, 7.76, 7.78 - 7.87.

ANNEX II

WORLD TRADE ORGANIZATION

WT/DS108/33
30 November 2005

(05-5652)

Original: English

UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Second Recourse to Article 21.5 of the DSU by the European Communities

Notification of an Other Appeal by the European Communities
under Article 16.4 and Article 17 of the Understanding on Rules
and Procedures Governing the Settlement of Disputes (DSU),
and under Rule 23(1) of the *Working Procedures for Appellate Review*

The following notification, dated 28 November 2005, from the Delegation of the European Commission, is being circulated to Members.

---

1. Pursuant to Article 16.4 and Article 17 of the DSU and to Rule 23.1 of the Working Procedures for Appellate Review, the European Communities submits its Notice of Other Appeal on certain issues of law in the Report of the Panel on *United States – Tax Treatment for "Foreign Sales Corporations": Second recourse to Article 21.5 of the DSU by the European Communities*[1] and certain legal interpretations developed by the Panel.

2. The European Communities agrees with the Panel's findings of continued violation and inconsistency and its conclusion that there is a continuing failure to implement DSB recommendations and rulings, as well as with the Panel's rejection of the US procedural defences. However, if the Appellate Body were to uphold any of the US claims on appeal, the European Communities considers that it would become necessary for the Appellate Body to consider certain other issues in order to resolve this dispute. For this reason, the European Communities requests the Appellate Body, in the event that it should reverse any of the Panel's findings, to consider the following claims:

(a) By not entirely withdrawing FSC and ETI subsidies, the United States has failed to comply with its obligations under Article 4.7 of the *SCM Agreement*;[2]

(b) By not entirely withdrawing FSC and ETI subsidies and maintaining the less favourable treatment of imported as compared to domestic products, the United States has failed to comply with its obligations under Articles 19.1 and 21.1 of the *DSU*.[3]

3. Furthermore, for the case the Appellate Body considered that the Panel was in error in concluding that no new recommendations under Article 4.7 of the *SCM Agreement* or Article 19.1 of the DSU are needed,[4] the European Communities respectfully requests the Appellate Body to correct the error and issue the necessary recommendations.

---

[1] WT/DS108/RW2, circulated on 30 September 2005.

[2] Which the Panel did not address in its Report (see WT/DS108/29, 14 January 2005).

[3] On which the Panel exercised judicial economy (see e.g. Panel Report, footnote 84).

[4] See e.g. Panel Report, paras. 7.37-7.46, 7.49, 7.52-7.58, 8.2.

4. The European Communities considers that if the Appellate Body were to find that the Panel had erred, this would mean that the Panel had not conducted its assessment of the matter in accordance with Article 11 of the DSU and had not contributed to an effective resolution of the dispute within the meaning of Article 3 of the DSU.

_____

ANNEX III

WORLD TRADE ORGANIZATION

WT/DS108/29
14 January 2005

(05-0183)

Original: English

UNITED STATES – TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Second Recourse to Article 21.5 of the DSU by the European Communities

Request for the Establishment of a Panel

The following communication, dated 13 January 2005, from the delegation of the European Communities to the Chairperson of the Dispute Settlement Body, is circulated pursuant to Article 21.5 of the DSU.

---

1. THE HISTORY OF THE DISPUTE

On 8 October 1999, the Panel in this dispute found that the United States of America's "Foreign Sales Corporations" scheme violated Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (the "*SCM Agreement*") and Article 3.3 of the Agreement on Agriculture [WT/DS108/R]. On 24 February 2000 the Appellate Body confirmed the findings of the Panel with respect to the violations of the *SCM Agreement* and modified the findings concerning the Agreement on Agriculture, concluding that the Foreign Sales Corporations scheme violated Articles 10.1 and 8 of the Agreement on Agriculture [WT/DS108/AB]. On 20 March 2000, the Dispute Settlement Body (the "DSB") adopted the Appellate Body report and the report of the Panel, as modified by the Appellate Body. The resulting DSB recommendations and rulings include the recommendation that the United States bring its measures found to be inconsistent with the *SCM Agreement* and the Agreement on Agriculture into conformity with the provisions of those agreements, and that the United States withdraw its export subsidies at the latest with effect from 1 October 2000.

On 12 October 2000, at a special session, the DSB agreed to the United States' request to allow it a time period expiring on 1 November 2000 to implement the DSB recommendations and rulings.

On 15 November 2000, the President of the United States signed into law the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, US Public law No 106-519 (the "ETI Act").

On 20 December 2000, the matter was referred back to the Panel under Article 21.5 of the DSU and on 29 January 2002 the DSB adopted the Panel [WT/DS108/RW] and Appellate Body [WT/DS108/AB/RW] reports declaring that the ETI Act violates Articles 3.1(a), 3.2 and 4.7 of the *SCM Agreement*, Articles 8, 10.1 and 3.3 of the Agreement on Agriculture and Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), so that the US had failed to fully withdraw its prohibited subsidy scheme and failed to implement DSB recommendations and rulings in this dispute.

On 22 October 2004, the United States enacted the "the American JOBS Creation Act of 2004" (the "JOBS Act"). In purported implementation of the above DSB recommendations and rulings

in case WT/DS108, the JOBS Act fails to properly implement them and is inconsistent with the same provisions of the *WTO Agreement* as its predecessor legislation.

2. THE SUBJECT OF THE DISPUTE

Section 101 of the JOBS Act purports to repeal the ETI Act (Section 101 (a)). However, at the same time, it effectively maintains part of the ETI Act tax exemptions for a transitional period up to the end of 2006 (Section 101 (d)). Furthermore, the repeal of the ETI Act does not apply to certain contracts, without any time limits (Section 101(f)).

In the light of the above, the European Communities considers that Section 101 of the JOBS Act contains provisions which will allow US exporters to continue benefiting from the tax exemptions already found to be WTO incompatible (a) in the years 2005 and 2006 with respect to all transactions, and (b) for an indefinite period with respect to certain contracts. Thus, the United States has failed to implement the DSB's recommendations and rulings by failing to withdraw without delay schemes found to be prohibited subsidies under the *SCM Agreement* and to bring its legislation into conformity with its obligations under the *SCM Agreement*, the Agreement on Agriculture and the GATT 1994.

3. REQUEST FOR THE ESTABLISHMENT OF A PANEL

On 5 November 2004, the European Communities requested consultations with the United States of America with a view to reaching a mutually satisfactory solution of the matter. The request was circulated in document WT/DS/108/27 dated 10 November 2004. Consultations were held on 11 January 2005 in Geneva. They have allowed a better understanding of the respective positions but have not led to a satisfactory resolution of the matter.

Therefore, there continues to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB between the United States and the European Communities, within the meaning of Article 21.5 of the DSU.

Accordingly, pursuant to Articles 6 and 21.5 of the DSU, Article 4 of the *SCM Agreement*, Article 19 of the Agreement on Agriculture and Article XXIII of the GATT 1994, the European Communities hereby requests the establishment of a Panel. In particular, the European Communities respectfully requests the Panel to find the following:

– that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*.

– that the United States continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994.

In accordance with Article 21.5 of the DSU, the European Communities requests that this matter be referred to the original Panel. It further requests that the Panel examines the matter above in accordance with the standard terms of reference set out in Article 7 of the DSU.

The European Communities asks that this request be placed on the agenda for the meeting of the Dispute Settlement Body to be held on 25 January 2005.