WT/DS472/R/Add.1
WT/DS497/R/Add.1

30 August 2017

(17-4585)

Original: English

BRAZIL – CERTAIN MEASURES CONCERNING TAXATION AND CHARGES

REPORTS OF THE PANEL

Addendum

This *addendum* contains Annexes A to C to the Reports of the Panel to be found in documents WT/DS472/R, WT/DS497/R.

____

LIST OF ANNEXES

ANNEX A

WORKING PROCEDURES OF THE PANEL

Contents		Page
Annex A-1	Working Procedures of the Panel	A-2
Annex A-2	Additional Working Procedures of the Panel Concerning Business Confidential Information	A-7
Annex A-3	Joint working procedures of the Panels	A-8
Annex A-4	Additional Joint Working Procedures of the Panel Concerning Business Confidential Information	A-13

ANNEX B

ARGUMENTS OF THE PARTIES

EUROPEAN UNION

Contents		Page
Annex B-1	First part of the executive summary of the arguments of the European Union	B-2
Annex B-2	Second part of the executive summary of the arguments of the European Union	B-13

JAPAN

Contents		Page
Annex B-3	First part of the executive summary of the arguments of Japan	B-27
Annex B-4	Second part of the executive summary of the arguments of Japan	B-38

BRAZIL

Contents		Page
Annex B-5	First part of the executive summary of the arguments of Brazil	B-49
Annex B-6	Second part of the executive summary of the arguments of Brazil	B-60

ANNEX C

ARGUMENTS OF THE THIRD PARTIES

Contents		Page
Annex C-1	Executive summary of the arguments of Argentina	C-2
Annex C-2	Executive summary of the arguments of Australia	C-10
Annex C-3	Executive summary of the arguments of Canada	C-11
Annex C-4	Executive summary of the arguments of Korea	C-13
Annex C-5	Executive summary of the arguments of Ukraine	C-15
Annex C-6	Executive summary of the arguments of the United States	C-17

ANNEX A

WORKING PROCEDURES OF THE PANEL

Contents		Page
Annex A-1	Working Procedures of the Panel	A-2
Annex A-2	Additional Working Procedures of the Panel Concerning Business Confidential Information	A-7
Annex A-3	Joint working procedures of the Panels	A-8
Annex A-4	Additional Joint Working Procedures of the Panel Concerning Business Confidential Information	A-13

ANNEX A-1

WORKING PROCEDURES OF THE PANEL

Adopted on 28 April 2015

1.1. In its proceedings, the Panel shall follow the relevant provisions of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). In addition, the following Working Procedures shall apply.

General

1.2. The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU or in these Working Procedures shall preclude a party to the dispute (hereafter "party") from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted to the Panel by another Member which the submitting Member has designated as confidential. Where a party submits a confidential version of its written submissions to the Panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.

1.3. The Panel shall meet in closed session. The parties, and Members having notified their interest in the dispute to the Dispute Settlement Body in accordance with Article 10 of the DSU (hereafter "third parties"), shall be present at the meetings only when invited by the Panel to appear before it.

1.4. Each party and third party has the right to determine the composition of its own delegation when meeting with the Panel. Each party and third party shall have the responsibility for all members of its own delegation and shall ensure that each member of such delegation acts in accordance with the DSU and these Working Procedures, particularly with regard to the confidentiality of the proceedings.

Submissions

1.5. Before the first substantive meeting of the Panel with the parties, each party shall submit a written submission in which its presents the facts of the case and its arguments, in accordance with the timetable adopted by the Panel. Each party shall also submit to the Panel, prior to the second substantive meeting of the Panel, a written rebuttal, in accordance with the timetable adopted by the Panel.

1.6. A party shall submit any request for a preliminary ruling at the earliest possible opportunity and in any event no later than in its first written submission to the Panel. If the European Union requests such a ruling, Brazil shall submit its response to the request in its first written submission. If Brazil requests such a ruling, the European Union shall submit its response to the request prior to the first substantive meeting of the Panel, at a time to be determined by the Panel in light of the request. Exceptions to this procedure shall be granted upon a showing of good cause.

1.7. Each party shall submit all factual evidence to the Panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttal, answers to questions or comments on answers provided by the other party. Exceptions to this procedure shall be granted upon a showing of good cause. Where such exception has been granted, the Panel shall accord the other party a period of time for comment, as appropriate, on any new factual evidence submitted after the first substantive meeting.

1.8. Where the original language of exhibits is not a WTO working language, the submitting party or third party shall submit a translation of such exhibits or of their relevant parts into the WTO working language of the submission at the same time. The Panel may grant reasonable extensions of time for the translation of such exhibits upon a showing of good cause. Any objection as to the

accuracy of a translation should be raised promptly in writing, no later than the next filing or meeting (whichever occurs earlier) following the submission which contains the translation in question. Any objection shall be accompanied by a detailed explanation of the grounds of objection and an alternative translation. Should a party become aware of any inaccuracies in the translations of the exhibits submitted by that party, it shall inform the Panel and the other party promptly and provide a new translation.

1.9. In order to facilitate the work of the Panel, each party and third party is invited to make its submissions in accordance with the WTO Editorial Guide for Panel Submissions attached as Annex 1, to the extent that it is practical to do so.

1.10. To facilitate the maintenance of the record of the dispute and maximize the clarity of submissions, each party and third party shall sequentially number its exhibits throughout the course of the dispute. For example, exhibits submitted by the European Union could be numbered EU-1, EU-2, etc. If the last exhibit in connection with the first submission was numbered EU-5, the first exhibit of the next submission thus would be numbered EU-6.

Questions

1.11. The Panel may at any time pose questions to the parties and third parties, orally or in writing, including prior to each substantive meeting.

Substantive meetings

1.12. Each party shall provide to the Panel the list of members of its delegation in advance of each meeting with the Panel and no later than 5.00 p.m. (Geneva time) the previous working day.

1.13. The first substantive meeting of the Panel with the parties shall be conducted as follows:

a. The Panel shall invite the European Union to make an opening statement to present its case first. Subsequently, the Panel shall invite Brazil to present its point of view. Before each party takes the floor, it shall provide the Panel and other participants at the meeting with a provisional written version of its statement. In the event that interpretation is needed, each party shall provide additional copies for the interpreters, through the Panel Secretary. Each party shall make available to the Panel and the other party, the final version of its opening statement as well as its closing statement, if any, preferably at the end of the meeting, and in any event no later than 5.00 p.m. (Geneva time) on the first working day following the meeting.

b. After the conclusion of the statements, the Panel shall give each party the opportunity to ask each other questions or make comments, through the Panel. Each party shall then have an opportunity to answer these questions orally. Each party shall send in writing, within a timeframe to be determined by the Panel, any questions to the other party to which it wishes to receive a response in writing. Each party shall be invited to respond in writing to the other party's written questions within a deadline to be determined by the Panel.

c. The Panel may subsequently pose questions to the parties. Each party shall then have an opportunity to answer these questions orally. The Panel shall send in writing, within a timeframe to be determined by it, any questions to the parties to which it wishes to receive a response in writing. Each party shall be invited to respond in writing to such questions within a deadline to be determined by the Panel.

d. Once the questioning has concluded, the Panel shall afford each party an opportunity to present a brief closing statement, with the European Union presenting its statement first.

1.14. The second substantive meeting of the Panel with the parties shall be conducted as follows:

a. The Panel shall ask Brazil if it wishes to avail itself of the right to present its case first. If so, the Panel shall invite Brazil to present its opening statement, followed by the European Union. If Brazil chooses not to avail itself of that right, the Panel shall invite the European Union to present its opening statement first. Before each party takes the floor, it shall provide the Panel and other participants at the meeting with a provisional written version of its statement. In the event that interpretation is needed, each party shall provide additional copies for the interpreters, through the Panel Secretary. Each party shall make available to the Panel and the other party the final version of its opening statement as well as its closing statement, if any, preferably at the end of the meeting, and in any event no later than 5.00 p.m. (Geneva time) of the first working day following the meeting.

b. After the conclusion of the statements, the Panel shall give each party the opportunity to ask each other questions or make comments, through the Panel. Each party shall then have an opportunity to answer these questions orally. Each party shall send in writing, within a timeframe to be determined by the Panel, any questions to the other party to which it wishes to receive a response in writing. Each party shall be invited to respond in writing to the other party's written questions within a deadline to be determined by the Panel.

c. The Panel may subsequently pose questions to the parties. Each party shall then have an opportunity to answer these questions orally. The Panel shall send in writing, within a timeframe to be determined by it, any questions to the parties to which it wishes to receive a response in writing. Each party shall be invited to respond in writing to such questions within a deadline to be determined by the Panel.

d. Once the questioning has concluded, the Panel shall afford each party an opportunity to present a brief closing statement, with the party that presented its opening statement first, presenting its closing statement first.

Third parties

1.15. The Panel shall invite each third party to transmit to the Panel a written submission prior to the first substantive meeting of the Panel with the parties, in accordance with the timetable adopted by the Panel.

1.16. Each third party shall also be invited to present its views orally during a session of this first substantive meeting, set aside for that purpose. Each third party shall provide to the Panel the list of members of its delegation in advance of this session and no later than 5.00 p.m. (Geneva time) the previous working day.

1.17. The third-party session shall be conducted as follows:

a. All third parties may be present during the entirety of this session.

b. The Panel shall first hear the arguments of the third parties in alphabetical order. Third parties present at the third-party session and intending to present their views orally at that session, shall provide the Panel, the parties and other third-parties with provisional written versions of their statements before they take the floor. Third parties shall make available to the Panel, the parties and other third parties the final versions of their statements, preferably at the end of the session, and in any event no later than 5.00 p.m. (Geneva time) of the first working day following the session.

c. After the third parties have made their statements, the parties may be given the opportunity, through the Panel, to ask the third parties questions for clarification on any matter raised in the third parties' submissions or statements. Each party shall send in writing, within a timeframe to be determined by the Panel, any questions to a third party to which it wishes to receive a response in writing.

d. The Panel may subsequently pose questions to the third parties. Each third party shall then have an opportunity to answer these questions orally. The Panel shall send in writing, within a timeframe to be determined by it, any questions to the third parties to which it wishes to receive a response in writing. Each third party shall be invited to respond in writing to such questions within a deadline to be determined by the Panel.

Descriptive part

1.18. The description of the arguments of the parties and third parties in the descriptive part of the Panel report shall consist of executive summaries provided by the parties and third parties, which shall be annexed as addenda to the report. These executive summaries shall not in any way serve as a substitute for the submissions of the parties and third parties in the Panel's examination of the case.

1.19. Each party shall submit executive summaries of the facts and arguments as presented to the Panel in its written submissions and oral statements, in accordance with the timetable adopted by the Panel. These summaries may also include a summary of responses to questions. Each such executive summary shall not exceed 15 pages. The Panel will not summarize in the descriptive part of its report, or annex to its report, the parties' responses to questions.

1.20. Each third party shall submit an executive summary of its arguments as presented in its written submission and statement in accordance with the timetable adopted by the Panel. This summary may also include a summary of responses to questions, where relevant. The executive summary to be provided by each third party shall not exceed 6 pages.

Interim review

1.21. Following issuance of the interim report, each party may submit a written request to review precise aspects of the interim report. Either party may also request a further meeting with the Panel in accordance with the timetable adopted by the Panel. The right to request such a meeting shall be exercised no later than a date at least two working days following receipt by the panel of the parties' written requests (if any) for review. The exact date will be determined by the Panel and communicated to the parties in due course.

1.22. In the event that no further meeting with the Panel is requested, each party may submit written comments on the other party's written request for review, in accordance with the timetable adopted by the Panel. Such comments shall be limited to commenting on the other party's written request for review.

1.23. The interim report, as well as the final report prior to its official circulation, shall be kept strictly confidential and shall not be disclosed.

Service of documents

1.24. The following procedures regarding service of documents shall apply:

a. Each party and third party shall submit all documents to the Panel by filing them with the DS Registry (office No. 2047).

b. Each party and third party shall file 6 paper copies of all documents it submits to the Panel. Exhibits may be filed in 4 copies on CD-ROM or DVD and 4 paper copies. The DS Registrar shall stamp the documents with the date and time of the filing. The paper version shall constitute the official version for the purposes of the record of the dispute.

c. Each party and third party shall also provide an electronic copy of all documents it submits to the Panel at the same time as the paper versions, preferably in Microsoft Word format, either on a CD-ROM, a DVD or as an e-mail attachment. If the electronic copy is provided by e-mail, it should be addressed to DSRegistry@wto.org, with a copy to ****.****@wto.org and ****.****@wto.org. If a CD-ROM or DVD is provided, it shall be filed with the DS Registry.

d. Each party shall serve any document submitted to the Panel directly on the other party. Each party shall, in addition, serve on all third parties its written submissions in advance of the first substantive meeting with the Panel. Each third party shall serve any document submitted to the Panel directly on the parties and all other third parties. Each party and third party shall confirm, in writing, that copies have been served as required at the time it provides each document to the Panel.

e. Each party and third party shall file its documents with the DS Registry and serve copies on the other party (and third parties where appropriate) by 5.00 p.m. (Geneva time) on the due dates established by the Panel. A party or third party may submit its documents to another party or third party in electronic format only, subject to the recipient party or third party's prior written approval and provided that the Panel Secretary is notified.

f. The Panel shall provide the parties with an electronic version of the descriptive part, the interim report and the final report, as well as of other documents as appropriate. When the Panel transmits to the parties or third parties both paper and electronic versions of a document, the paper version shall constitute the official version for the purposes of the record of the dispute.

1.25. The Panel reserves the right to modify these procedures as necessary, after consultation with the parties.

ANNEX A-2

ADDITIONAL WORKING PROCEDURES OF THE PANEL CONCERNING BUSINESS CONFIDENTIAL INFORMATION

Adopted on 28 April 2015

1.1. Each party shall treat as confidential information submitted to the Panel by the other party which the submitting party has designated as business confidential information (BCI).

1.2. No person may have access to BCI other than a member of the Secretariat or the Panel, a person specifically authorized by the Secretariat or the Panel, and employees, agents, and advisors of the parties.

1.3. BCI obtained under these procedures may be used only for the purpose of providing information and argumentation in this dispute and for no other purpose.

1.4. The party submitting BCI shall mark the cover and/or first page of the document containing BCI, and each page of the document, to indicate the presence of such information. The specific information in question shall be placed between double brackets, as follows: [[xx,xxx.xx]]. The first page or cover of the document shall state "Contains business confidential information on pages xxxxxx", and each page of the document shall contain the notice "Contains Business Confidential Information" at the top of the page.

1.5. Where a party submits a document containing BCI to the Panel, the other party when referring to that BCI in its documents, including written submissions and oral statements, shall clearly identify all such information in those documents in accordance with the procedures laid down in paragraph 4.

1.6. The Panel will not disclose BCI, in its report or in any other way, to persons not authorized under these procedures to have access to BCI. The Panel may, however, make statements of conclusion drawn from such information. Before the Panel circulates its final report to the Members, the Panel will give each party an opportunity to review the report to ensure that it does not contain any information that the party has designated as BCI.

1.7. Submissions containing BCI will be included in the record forwarded to the Appellate Body in the event of an appeal of the Panel's Report.

ANNEX A-3

JOINT WORKING PROCEDURES OF THE PANELS

Adopted on 9 October 2015

1.1. Pursuant to Article 9.3 of the DSU, the timetables in DS472 and DS497 are harmonized. The Panels shall, to the greatest extent possible, conduct a single panel process, with a single record, resulting in separate reports contained in a single document, taking into account the rights of all Members concerned, and in such a manner that the rights that parties or third parties would otherwise have enjoyed are in no way impaired.

1.2. In its proceedings, the Panels shall follow the relevant provisions of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). In addition, the following Working Procedures shall apply.

General

1.3. The deliberations of the Panels and the documents submitted to it shall be kept confidential. Nothing in the DSU or in these Working Procedures shall preclude a party to a dispute (hereafter "party") from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted to the Panels by another Member which the submitting Member has designated as confidential. Where a party submits a confidential version of its written submissions to the Panels, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.

1.4. The Panels shall meet in closed session. The parties, and Members having notified their interest in either dispute to the Dispute Settlement Body in accordance with Article 10 of the DSU (hereafter "third parties"), shall be present at the meetings only when invited by the Panels to appear before them.

1.5. The parties and third parties shall treat business confidential information in accordance with the procedures set forth in the Additional Joint Working Procedures of the Panels Concerning Business Confidential Information, set out in Annex 1 to these Working Procedures.

1.6. Each party and third party has the right to determine the composition of its own delegation when meeting with the Panels. Each party and third party shall have the responsibility for all members of its own delegation and shall ensure that each member of such delegation acts in accordance with the DSU and these Working Procedures, particularly with regard to the confidentiality of the proceedings.

Submissions

1.7. Before the first substantive meeting of the Panels with the parties, each party shall submit a written submission in which it presents the facts of the case and its arguments, in accordance with the timetable adopted by the Panels. Each party shall also submit to the Panels, prior to the second substantive meeting of the Panels, a written rebuttal, in accordance with the timetable adopted by the Panels.

1.8. A party shall submit any request for a preliminary ruling at the earliest possible opportunity and in any event no later than in its first written submission to the Panels. If a party requests such a preliminary ruling, the other party shall submit its respective response to such request within a time limit specified by the Panels. Exceptions to this procedure will be granted upon a showing of good cause.

1.9. Each party shall submit all factual evidence to the Panels no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttal, answers

to questions or comments on answers provided by the opposing party or parties. Exceptions to this procedure shall be granted upon a showing of good cause. Where such exception has been granted, the Panels shall accord the opposing party or parties a period of time for comment, as appropriate, on any new factual evidence submitted after the first substantive meeting.

1.10. Where the original language of exhibits is not a WTO working language, the submitting party or third party shall submit a translation of such exhibits or of their relevant parts into the WTO working language of the submission at the same time. The Panels may grant reasonable extensions of time for the translation of such exhibits upon a showing of good cause. Any objection as to the accuracy of a translation should be raised promptly in writing, no later than the next filing or meeting (whichever occurs earlier) following the submission which contains the translation in question. Any objection shall be accompanied by a detailed explanation of the grounds of objection and an alternative translation. Should a party become aware of any inaccuracies in the translations of the exhibits submitted by that party, it shall inform the Panels and the other parties promptly and provide a new translation.

1.11. In order to facilitate the work of the Panels, each party and third party is invited to make its submissions in accordance with the WTO Editorial Guide for Panel Submissions (electronic copy provided), to the extent that it is practical to do so. To facilitate the maintenance of the record of the disputes and maximize the clarity of submissions, each party and third party shall sequentially number its exhibits throughout the course of the dispute. Exhibits submitted by the European Union could be numbered EU-1, EU-2, etc., exhibits submitted by Japan could be numbered JPN-1, JPN-2, etc., and exhibits submitted by Brazil could be numbered BRA-1, BRA-2, etc. If the last exhibit in connection with the first submission was numbered EU-5, the first exhibit of the next submission thus would be numbered EU-6. In order to avoid unnecessary duplication of exhibits, the complaining parties may file joint exhibits by numbering them accordingly, for example JE-1, JE-2, etc. The Parties and third parties in one dispute may refer to arguments and evidence already submitted in the other dispute without needing to repeat them in their entirety or provide an equivalent exhibit. The source of any such references shall be clearly identified.

Questions

1.12. The Panels may at any time pose questions to the parties and third parties, orally or in writing, including prior to each substantive meeting. The Panels shall ensure that a precise deadline is set forth for the submission of written responses and shall provide sufficient time for the parties and third parties to prepare their written responses.

Substantive meetings

1.13. Each party shall provide to the Panels the list of members of its delegation in advance of each meeting with the Panels and no later than 5.00 p.m. (Geneva time) the previous working day.

1.14. The first substantive meeting of the Panels with the parties shall be conducted as follows:

a. The Panel shall invite the European Union and Japan to make opening statements to present their cases first. Subsequently, the Panels shall invite Brazil to present its point of view. Before each party takes the floor, it shall provide the Panels and other participants at the meeting with a provisional written version of its statement. In the event that interpretation is needed, each party shall provide additional copies for the interpreters, through the Panels' Secretary. Each party shall make available to the Panels and the other parties, the final version of its opening statement as well as its closing statement, if any, preferably at the end of the meeting, and in any event no later than 5.00 p.m. (Geneva time) on the first working day following the meeting.

b. After the conclusion of the statements, the Panels shall give each party the opportunity to ask each other questions or make comments, through the Panels. Each party shall then have an opportunity to answer these questions orally. Each party shall send in writing, within a timeframe to be determined by the Panels, any questions to the other party or parties to which it wishes to receive a response in writing. Each party shall be

invited to respond in writing to the other party or parties' written questions within a deadline to be determined by the Panels.

c. The Panels may subsequently pose questions to the parties. Each party shall then have an opportunity to answer these questions orally. The Panels shall send in writing, within a timeframe to be determined by them, any questions to the parties to which they wish to receive a response in writing. Each party shall be invited to respond in writing to such questions within a deadline to be determined by the Panels.

d. Once the questioning has concluded, the Panels shall afford each party an opportunity to present a brief closing statement, with the European Union and Japan presenting their statements first.

1.15. The second substantive meeting of the Panels with the parties shall be conducted as follows:

a. The Panels shall ask Brazil if it wishes to avail itself of the right to present its case first. If so, the Panels shall invite Brazil to present its opening statement, followed by the European Union and Japan. If Brazil chooses not to avail itself of that right, the Panels shall invite the European Union and Japan to present their opening statements first. Before each party takes the floor, it shall provide the Panels and other participants at the meeting with a provisional written version of its statement. In the event that interpretation is needed, each party shall provide additional copies for the interpreters, through the Panels' Secretary. Each party shall make available to the Panels and the other parties the final version of its opening statement as well as its closing statement, if any, preferably at the end of the meeting, and in any event no later than 5.00 p.m. (Geneva time) of the first working day following the meeting.

b. After the conclusion of the statements, the Panels shall give each party the opportunity to ask each other questions or make comments, through the Panels. Each party shall then have an opportunity to answer these questions orally. Each party shall send in writing, within a timeframe to be determined by the Panels, any questions to another party or parties to which it wishes to receive a response in writing. Each party shall be invited to respond in writing to such written questions within a deadline to be determined by the Panels.

c. The Panels may subsequently pose questions to the parties. Each party shall then have an opportunity to answer these questions orally. The Panels shall send in writing, within a timeframe to be determined by them, any questions to the parties to which they wish to receive a response in writing. Each party shall be invited to respond in writing to such questions within a deadline to be determined by the Panels.

d. Once the questioning has concluded, the Panels shall afford each party an opportunity to present a brief closing statement, with the party that presented its opening statement first, presenting its closing statement first.

Third parties

1.16. The Panels shall invite each third party to transmit to the Panels a written submission prior to the first substantive meeting of the Panels with the parties, in accordance with the timetable adopted by the Panels.

1.17. All third parties shall also be invited to present their views orally during a session of this first substantive meeting, set aside for that purpose. All third parties shall provide to the Panels the list of members of their delegation in advance of this session and no later than 5.00 p.m. (Geneva time) the previous working day.

1.18. The written submissions and oral statements shall address only the issues raised in the disputes in which the relevant third parties have notified their interest to the DSB.

1.19. The third-party session shall be conducted as follows:

a. All third parties may be present during the entirety of this session.

b. The Panels shall first hear the arguments of the third parties in alphabetical order. Third parties present at the third-party session and intending to present their views orally at that session, shall provide the Panels, the parties and other third-parties with provisional written versions of their statements before they take the floor. Third parties shall make available to the Panels, the parties and other third parties the final versions of their statements, preferably at the end of the session, and in any event no later than 5.00 p.m. (Geneva time) of the first working day following the session.

c. After the third parties have made their statements, the parties may be given the opportunity, through the Panels, to ask the third parties questions for clarification on any matter raised in the third parties' submissions or statements. Each party shall send in writing, within a timeframe to be determined by the Panels, any questions to a third party to which it wishes to receive a response in writing.

d. The Panels may subsequently pose questions to the third parties. Each third party shall then have an opportunity to answer these questions orally. The Panels shall send in writing, within a timeframe to be determined by them, any questions to the third parties to which they wish to receive a response in writing. Each third party shall be invited to respond in writing to such questions within a deadline to be determined by the Panels.

Descriptive part

1.20. The description of the arguments of the parties and third parties in the descriptive part of the Panel reports shall consist of executive summaries provided by the parties and third parties, which shall be annexed as addenda to the reports. These executive summaries shall not in any way serve as a substitute for the submissions of the parties and third parties in the Panels' examination of the cases.

1.21. Each party shall submit executive summaries of the facts and arguments as presented to the Panels in its written submissions and oral statements, in accordance with the timetable adopted by the Panels. These summaries may also include a summary of responses to questions. Each such executive summary shall not exceed 15 pages. The Panels will not summarize in the descriptive part of its reports, or annex to its reports, the parties' responses to questions.

1.22. Each third party shall submit an executive summary of its arguments as presented in its written submission and statement in accordance with the timetable adopted by the Panels. This summary may also include a summary of responses to questions, where relevant. The executive summary to be provided by each third party shall not exceed 6 pages.

Interim review

1.23. Following issuance of the interim reports, each party may submit a written request to review precise aspects of the interim reports. Either party may also request a further meeting with the Panels in accordance with the timetable adopted by the Panels. The right to request such a meeting shall be exercised no later than a date at least two working days following receipt by the panels of the parties' written requests (if any) for review. The exact date will be determined by the Panels and communicated to the parties in due course.

1.24. In the event that no further meeting with the Panels is requested, each party may submit written comments on the other party or parties' written request for review, in accordance with the timetable adopted by the Panels. Such comments shall be limited to commenting on the other party or parties' written request for review.

1.25. The interim reports, as well as the final report prior to their official circulation, shall be kept strictly confidential and shall not be disclosed.

Service of documents

1.26. The following procedures regarding service of documents shall apply:

a. Each party and third party shall submit all documents to the Panels by filing them with the DS Registry (office No. 2047).

b. Each party and third party shall file 6 paper copies of all documents it submits to the Panels. Exhibits may be filed in 4 copies on CD-ROM or DVD and 4 paper copies. The DS Registrar shall stamp the documents with the date and time of the filing. The paper version shall constitute the official version for the purposes of the record of the disputes.

c. Each party and third party shall also provide an electronic copy of all documents it submits to the Panels at the same time as the paper versions, preferably in Microsoft Word format, either on a CD-ROM, a DVD or as an e-mail attachment. If the electronic copy is provided by e-mail, it should be addressed to DSRegistry@wto.org, with a copy to ****.****@wto.org, ****.****@wto.org and ****.****@wto.org. If a CD-ROM or DVD is provided, it shall be filed with the DS Registry.

d. Each party shall serve any document submitted to the Panels directly on the other party or parties. Each party shall, in addition, serve on all third parties (WT/DS472 and WT/DS497) its written submissions in advance of the first substantive meeting with the Panels. Each third party shall serve any document submitted to the Panels directly on the parties and all other third parties (WT/DS472 and WT/DS497). Each party and third party shall confirm, in writing, that copies have been served as required at the time it provides each document to the Panels.

e. Each party and third party shall file its documents with the DS Registry and serve copies on the other party or parties (and third parties where appropriate) by 5.00 p.m. (Geneva time) on the due dates established by the Panels. A party or third party may submit its documents to another party or third party in electronic format only, subject to the recipient party or third party's prior written approval and provided that the Panel Secretary is notified.

f. The Panels shall provide the parties with an electronic version of the descriptive part, the interim reports and the final reports, as well as of other documents as appropriate. When the Panels transmit to the parties or third parties both paper and electronic versions of a document, the paper version shall constitute the official version for the purposes of the record of the disputes.

1.27. The Panels reserve the right to modify these procedures as necessary, after consultation with the parties.

ANNEX A-4

ADDITIONAL JOINT WORKING PROCEDURES OF THE PANELS CONCERNING BUSINESS CONFIDENTIAL INFORMATION

Adopted on 9 October 2015

1.1. Each party shall treat as confidential information submitted to the Panels by the other party which the submitting party has designated as business confidential information (BCI).

1.2. No person may have access to BCI other than a member of the Secretariat or the Panels, a person specifically authorized by the Secretariat or the Panels, and employees, agents, and advisors of the parties.

1.3. BCI obtained under these procedures may be used only for the purpose of providing information and argumentation in this dispute and for no other purpose.

1.4. The party submitting BCI shall mark the cover and/or first page of the document containing BCI, and each page of the document, to indicate the presence of such information. The specific information in question shall be placed between double brackets, as follows: [[xx,xxx.xx]]. The first page or cover of the document shall state "Contains business confidential information on pages xxxxxx", and each page of the document shall contain the notice "Contains Business Confidential Information" at the top of the page.

1.5. Where a party submits a document containing BCI to the Panels, the other party when referring to that BCI in its documents, including written submissions and oral statements, shall clearly identify all such information in those documents in accordance with the procedures laid down in paragraph 4.

1.6. The Panels will not disclose BCI, in its report or in any other way, to persons not authorized under these procedures to have access to BCI. The Panels may, however, make statements of conclusion drawn from such information. Before the Panels circulate its final report to the Members, the Panels will give each party an opportunity to review the report to ensure that it does not contain any information that the party has designated as BCI.

1.7. Submissions containing BCI will be included in the record forwarded to the Appellate Body in the event of an appeal of the Panels' Report.

____

ANNEX B

ARGUMENTS OF THE PARTIES

EUROPEAN UNION

Contents		Page
Annex B-1	First part of the executive summary of the arguments of the European Union	B-2
Annex B-2	Second part of the executive summary of the arguments of the European Union	B-13

JAPAN

Contents		Page
Annex B-3	First part of the executive summary of the arguments of Japan	B-27
Annex B-4	Second part of the executive summary of the arguments of Japan	B-38

BRAZIL

Contents		Page
Annex B-5	First part of the executive summary of the arguments of Brazil	B-49
Annex B-6	Second part of the executive summary of the arguments of Brazil	B-60

ANNEX B-1

FIRST PART OF THE EXECUTIVE SUMMARY OF THE ARGUMENTS OF THE EUROPEAN UNION

1. INTRODUCTION

1. The European Union takes issue with seven fiscal incentive programmes providing for a reduction of indirect taxes on goods produced in Brazil, that result in the like products from other WTO Members being discriminated in a manner prohibited by the GATT 1994, the TRIMs Agreement as well as the SCM Agreement.

2. The present case concerns therefore Brazil's discriminatory application of the following internal federal taxes:

- IPI (*Imposto sobre Produtos Industrializados* – Tax on Industrialised Products),
- PIS/PASEP (*Programa de Integração Social* – Social Integration Programme / *Programa de Formação do Patrimônio do Servidor Público* – Civil Service Asset Formation Programme),
- COFINS (*Contribuição para o Financiamento da Seguridade Social* – Contribution to Social Security Financing),
- PIS/PASEP-Importação (Programa de Integração Social e de Formação do Patrimônio do Servidor Público incidente na Importação de Produtos Estrangeiros ou Serviços – Social Integration and Civil Service Asset Formation Programmes applicable to Imports of Foreign Goods or Services),
- COFINS-Importação (Contribuição para o Financiamento da Seguridade Social incidentes sobre a importação de bens e serviços – Contribution to Social Security Financing applicable to Imports of Goods or Services),
- CIDE (*Contribuição sobre Intervenção no Domínio Econômico* – Contribution of Intervention in the Economic Domain).

3. It is not disputed that those taxes are internal indirect taxes.

2. PROCEDURAL BACKGROUND

4. On 31 October 2014, the European Union requested the establishment of a panel pursuant to Article 6 of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article XXIII of the General Agreement on Tariffs and Trade, 1994 (GATT 1994), Articles 4.4 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement), and Article 8 of the Agreement on Trade-Related Investment Measures (TRIMs Agreement). On 26 March 2015, the WTO Director-General composed the Panel pursuant to Article 8.7 of the DSU.

5. Argentina, Australia, Canada, China, Colombia, India, Japan, Korea, Russia, South Africa, the Chinese Taipei, Turkey and the United States reserved their rights to participate in the Panel proceedings as third parties.

3. OVERVIEW OF THE LEGAL ISSUES IN THIS DISPUTE: LEGAL STANDARD

6. The most prominent feature in the Brazilian measures at issue is the tax discrimination against imported goods, particularly through the use of tax advantages tied to local content requirements. Furthermore, with respect to the INOVAR-AUTO programme (*Programa de Incentivo à Inovação Tecnológica e Adensamento da Cadeia Produtiva de Veículos Automotores)*, Brazil also discriminates between products originating from MERCOSUR and Mexico, on the one hand, and products originating from other WTO members, including the European Union, on the other hand.

Brazil also provides subsidies which are contingent upon either the use of domestic over imported products or export performance.

3.1. Discrimination between imported products and like domestic products: Article III:2, first sentence of the GATT 1994

7. As articulated by the relevant WTO case-law, the analysis of whether an internal tax or other internal charges are inconsistent with the first sentence of Article III:2 of the GATT 1994 requires a two-step test analysis: (i) whether imported and domestic products are like products; and (ii) whether the imported products are taxed "in excess of" the domestic products. With respect to the first condition, where a WTO Member draws an origin-based distinction in respect of internal taxes, a comparison of specific products is not required and, consequently, it is not necessary to examine the various likeness criteria. With respect to the second element, even the slightest difference in the tax burden between imported and domestic like products amounts to a breach of Article III:2, first sentence.

3.2. Discrimination between imported products from different third countries (Most-Favoured Nation)

8. Based on the text of Article I:1, the following elements must be demonstrated to establish a violation: (i) that the measure at issue falls within the scope of application of Article I:1; (ii) that the imported products at issue are "like" products within the meaning of Article I:1; (iii) that the measure at issue confers an "advantage, favour, privilege, or immunity" (hereafter, "advantage") on a product originating in the territory of any country; and (iv) that the advantage so accorded is not extended "immediately" and "unconditionally" to "like" products originating in the territory of all Members. In sum, Article I:1 prohibits imposing conditions that have a detrimental impact on the equality of competitive opportunities for like imported products from any Member.

3.3. Discrimination between imported products and like domestic products (National Treatment) through local content requirements: Articles III:4 and III:5 of the GATT 1994 and Articles 2.1 and 2.2, together with Paragraph 1(a) of the Annex of the TRIMs Agreement

9. According to the relevant WTO case-law, for a violation of Article III:4 to be established, three elements must be satisfied: (i) the imported and domestic products at issue are "like products"; (ii) the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and (iii) the imported products are accorded "less favourable" treatment than that accorded to like domestic products. In sum, imposing requirements on operators to achieve directly or indirectly a particular level of domestic content in order to obtain a benefit from the government runs contrary to Article III:4 of the GATT 1994, because it negatively affects the internal sale, offering for sale, purchase or use of like imported products. This conclusion is also supported both contextually as well as a matter of a more specific legal basis in the context of trade-related investment measures by Articles 2.1, 2.2 and the Annex of the TRIMS agreement.

10. According to the relevant GATT jurisprudence, in order to apply the obligation in the first sentence of Article III:5, it is required to determine (i) whether there is an "internal quantitative regulation relating to the mixture, processing or use of products in specific amounts or proportions"; and (ii) whether such regulation "requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources". This provision is also infringed if internal quantitative regulations are applied in a manner so as to afford protection to domestic production. In that respect, Article III:1 of the GATT 1994 serves as relevant context to understand under which circumstances a measure is applied primarily with a protectionist purpose.

11. Overall, paragraphs 4 and 5 of Article III of the GATT 1994 as well as paragraph 1(a) of the Annex to the TRIMs Agreement indicate that the use of local content requirement is inconsistent with the the basic principle of granting national treatment to imported products.

3.4. *PROHIBITED SUBSIDIES THROUGH FISCAL MEASURES*

12. The SCM Agreement regulates the use of fiscal measures as subsidies, and prohibits situations where those subsidies are contingent, solely or as one of several other conditions, upon (a) export performance, and (b) the use of domestic over imported products.

13. Firstly, when a government foregoes or does not collect revenue arising from indirect taxation that is otherwise due according to the organising principles and structure of its own system, a subsidy is deemed to exist in accordance with Article 1.1 of the SCM Agreement. Secondly, when obtaining the subsidy is subject to export performance, this amounts to a prohibited subsidy under Article 3.1(a) of the SCM Agreement. Thirdly, when the subsidy is contignet upon the use of domestic over imported products then it is prohibited subsidy pursuant to Article 3.1(b) of the SCM Agreement. Fourthly, prohibited subsidies are *per se* specific according to Article 2.3 of the SCM Agreement. Article 3.2 of the SCM Agreement provides that a Member shall neither grant nor maintain prohibited subsidies.

14. The European Union considers that the notion of "domestic" and "imported" in Article 3.1(b) of the SCM Agreement does not depend on the rules of origin of the Member concerned. Certainly, if the rules of origin of that Member confirm the domestic over imported nature of the goods at issue, those rules could be used *a fortiori* to confirm that the discrimination takes place also as understood by that Member.

15. The European Union submits that the terms "domestic over imported" in Article 3.1(b) of the SCM Agreement should be understood as juxtaposing two opposing concepts: one, of goods which are considered as national or domestic because they are obtained, substantially transformed, made in or brought into existence that country; and another of goods that are brought in or imported into the country. Since "domestic" is juxtaposed in this provision of the SCM Agreement to "imported" goods, this indicates that a product that has not been imported, but that is present in the market or came into existence in that market cannot be considered "imported" for the purposes of Article 3.1(b) of the SCM Agreement, and must logically be considered as "domestic".

4. MEASURES IN THE AUTOMOTIVE SECTOR

16. Under the INOVAR-AUTO programme, Brazil provides tax advantages with respect to the IPI. The tax advantages primarily consist in a reduction of the IPI tax burden on the sale of the products (motor vehicles) covered by the programme. The goal and operation of the INOVAR-AUTO programme can be summarily explained as "slowing import growth and developing local suppliers" as shown by statistical evidence.

4.1. *MEASURE AT ISSUE*

17. Since 2011, Brazil applies a special tax scheme for the automotive sector. The programme has been gradually modified and formally called INOVAR-AUTO programme in April 2012. This programme covers a number of 52 product codes, as per Annex I of Decree 7,819/2012.

18. The INOVAR-AUTO programme operates in two steps: as a first step, it increases the IPI tax rates for the covered products by 30 percentage points; as a second step, it offers a system of tax credits through which accredited companies may offset most of the IPI tax burden on motor vehicles, namely an amount of IPI tax corresponding to up to 30% of the taxable value of the vehicles. Furthermore, it offers a reduction of 30 percentage points in the IPI rates for motor vehicles originating in MERCOSUR and Mexico, under certain conditions. Accordingly, the practical effect of the INOVAR-AUTO programme for motor vehicles is to maintain the previous (i.e. pre2011) tax treatment only for domestic products and for products from preferential origins, while increasing the IPI by 30 percentage points for the like products from the rest of the World, including the European Union.

19. To benefit from the INOVAR-AUTO programme, companies need to be "accredited" *(habilitadas)* by means of an administrative decision (*Portaria*). There are three types of "accreditation" (*habilitação*): (i) for domestic manufacturers; (ii) for local distributors without manufacturing activities in Brazil; and (iii) for investors in domestic manufacturing capacity. In order to be "accredited", eligible operators must fulfil certain conditions which concern, depending

on the accreditation sought, in particular a minimum number of manufacturing activities in Brazil and/or minimum levels of expenditure in Brazil on research and development, engineering, basic industrial technology and capacity-building of actual and potential suppliers.

20. Under the INOVAR-AUTO programme, accredited companies can earn tax credits which can be used, under certain conditions, to offset the IPI otherwise due on the domestic sale of motor vehicles covered by the programme. The tax credits are linked to the level of expenditure in Brazil on certain items, including strategic inputs and tools, research and development, or capacity-building of suppliers. Expenditure in Brazil to purchase strategic inputs (automotive components) and tools is the item which translates into the largest tax credit and it is thus decisive as regards the actual tax burden on the sale of motor vehicles. As a result, the advantage of a lower tax burden on finished vehicles is contingent for the greatest part on the use of domestically sourced inputs.

21. Any excess tax credit can be used to offset up to 30 percentage points of the IPI due on the domestic commercialisation of imported vehicles, but only up to a maximum number of products (i.e. 4,800 vehicules/year per company). Tax credits are not used to offset the IPI tax at the border, which is generally due with limited exceptions. However, motor vehicles from a limited number of WTO Members benefit from a special reduction in IPI rates that apply both at the point of importation and in subsequent sales. Special provisions also apply to companies accredited as investors and companies producing certain vehicles by fitting vehicle bodies on a chassis.

22. A traceability system is put in place in order to ensure that manufacturers comply with the domestic content requirements under the INOVAR-AUTO programme. It involves independent reporting on the local content levels of automotive components and tools by relevant Brazilian manufacturers. This enables the Brazilian authorities to verify and cross-check the levels of local content reported by motor vehicle manufacturers. Further, a "deductible portion" is deducted from the expenditures on strategic inputs and tooling, so that the presumed IPI credits only arise if such strategic inputs and tooling contain a specific level of local content.

4.2. Legal Claims

23. The European Union submits that the INOVAR-AUTO programme, as embodied and developed in the relevant legal instruments and also as applied by the relevant Brazilian authorities, is inconsistent with Brazil's obligations under Articles III:2, I:1, III:4 and III:5 of the GATT 1994, Article 2.1 of the TRIMS Agreement, in conjunction with Article 2.2 and with paragraph 1(a) of the Agreement's Illustrative List, and with Articles 3.1(b) and 3.2 of the SCM Agreement.

24. By reserving to domestic companies the access to tax credits which may alleviate an amount of IPI tax of up to 30% of the IPI taxable base for the relevant products, the INOVAR-AUTO programme imposes a fiscal burden on imported products in excess of that imposed on the like domestic products and therefore violates Article III:2, first sentence of the GATT 1994.

25. By according motor vehicles, automotive components and tools originating from the EU less favourable treatment than that accorded to like domestic products, through the conditions for company accreditation, the content requirements contained in the manufacturing steps as well as through the calculation and use of the tax credits under the INOVAR-AUTO programme, Brazil violates Article III:4 of the GATT 1994.

26. The INOVAR-AUTO programme is inconsistent with Article III:5 of the GATT 1994, because the conditions regarding the minimum number of processing activities that producers of automotive products need to perform in Brazil in order to benefit from the IPI reductions, as well as the percentages relating to specific domestic input that are used for the calculation of the tax credits amount to internal quantitative regulations relating to the processing of products, which require a specified proportion of products to be sourced locally (Article III:5, first sentence); and, subsidiarily, because the conditions relating to the minimum processing activities that must be carried out in Brazil amount to an internal quantitative regulation that is applied so as to afford protection to domestic production (Article III:5, second sentence).

27. The INOVAR-AUTO programme is not a subsidy exclusively paid to domestic producers within the meaning of Article III:8(b) of the GATT 1994, as Brazil attempts to assert. Furthermore, the European Union disagrees with Brazil, which maintains that the requirements to perform certain manufacturing steps in Brazil, to invest in R&D and in engineering in Brazil in order to benefit from the tax advantages under the INOVAR-AUTO programme are stages of production and other requirements which are not relating to products, thus falling outside the scope of Article III.

28. Brazil's national treatment violations are not justified under Articles XX(b) and (g) of the GATT 1994 because energy efficiency and road safety are only elements of boosting competitiveness of the domestic auto industry and not aims in themselves. Furthermore, 30 out of the 52 covered product codes are exempted from the energy efficiency requirements. In any event, the discriminatory treatment under the INOVAR-AUTO programme makes no contribution to the protection of the alleged human life or health and exhaustible natural resources objectives, as those objectives do not require discriminating between domestic and imported products. There are several WTO-compatible alternative measures, making an equivalent (actually a more important) contribution to the objectives sought, while being less trade restrictive. Furthermore, the measure at issue was not taken in conjunction with domestic restrictions. Finally, the measure at issue does not fulfil the requirements of the *chapeau* of Article XX.

29. A violation of Article 2.1 of the TRIMs Agreement is established by demonstrating two elements: (i) the existence of an investment measure related to trade in goods (*i.e.*, a TRIM); and (ii) either (a) the inconsistency of that measure with Article III (or Article XI) of the GATT 1994, or (b) that the measure falls under paragraph (a) of the Annex. The European Union considers that the INOVAR-AUTO programme is a trade-related investment measure within the meaning of Article 1 of the TRIMS Agreement. Since the EU has already established that the INOVAR-AUTO programme is inconsistent with Articles III:2, III:4, and III:5 of the GATT 1994, it also violates Article 2.1 of the TRIMS Agreement. In addition, the requirement related to the purchase or use of inputs and manufacturing equipment, as well as laboratory equipement, of Brazilian origin in order to benefit from the IPI reduction falls squarely within the Illustrative List of the TRIMs Agreement and notably under paragraph 1(a) of the Annex to the TRIMs Agreement relating to measures that are inconsistent with Article III:4 of the GATT 1994. Therefore, the INOVAR-Auto programme is also inconsistent with Brazil's obligations pursuant to Article 2.2 of the TRIMs Agreement.

30. The INOVAR-AUTO programme is inconsistent with Brazil's obligations under the SCM Agreement. In particular, the INOVAR-AUTO programme provides advantages that are subsidies within the meaning of Article 1.1 of the SCM Agreement, and which are inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement because they are contingent upon the use of domestic over similar imported goods from other WTO Members, including the EU.

31. By failing to accord immediately and unconditionally the same advantages it accords to the products at issue originating in the other MERCOSUR members and Mexico to the like products from the European Union, Brazil acts inconsistently with Article I:1 of the GATT 1994.

32. The advantages accorded by Brazil to Argentina, Mexico and Uruguay are manifestly not justified under the Enabling Clause. There is no clear link between LAIA, ECAs, the INOVAR-AUTO programme and the relevant provisions of the Enabling Clause relied on by Brazil. The Montevideo Treaty and the subsequent ECAs concluded between Brazil and other LAIA members do not cover internal taxation. In addition, the specific conditions in paragraphs 2(b) and 2(c) of the Enabling Clause are not fulfilled.

5. MEASURES RELATING TO INFORMATION AND COMMUNICATION TECHNOLOGY, AUTOMATION AND RELATED GOOD

5.1. MEASURE AT ISSUE

33. Brazil has adopted and maintains legislation granting advantages in relation to taxes, duties, contributions and charges, which are contingent upon domestic production and technological development of information and communication technology, automation and related goods (ICT) in Brazil. The set of advantages primarily consist in tax exemptions or reductions applied in connection with taxes levied on the sale of the relevant goods or on the revenue generated

through those sales. These advantages apply in relation to products manufactured in Brazil by companies accredited under each programme.

34. This system of advantages is embodied in and applied through a comprehensive set of inter-related measures: (1) the Informatics Programme; (2) the "Programme of Incentives for the Semiconductors Sector" (PADIS, *Programa de Incentivos ao Setor de Semicondutores*); (3) the "Programme of Support to the Technological Developments of the Industry of Digital TV Equipment" (PATVD, *Programa de Apoio ao Desenvolvimento Tecnológico da Indústria de Equipamentos para TV Digital*); and (4) the "Programme for Digital Inclusion" (*Inclusão Digital*).

5.1.1. Informatics programme

35. In order to benefit from the tax advantages under the Informatics programme, an ICT producer needs to be "accredited" (*habilitadas*) by means of an administrative decision (*Portaria*) granted jointly by the Ministry for Development, Industry and Trade and the Ministry of Science and Technology. In order to be accredited, an ICT producer must invest in R&D in Brazil in the ICT sector (reaching a minimum investment target expressed as a percentage of its domestic turnover in the product it is accredited for, minus the acquisition cost of the products incentivised under the Informatics or PADIS programme) and it must produce that product in Brazil in accordance with the terms of the "Basic Productive Process" (PPB, *Processo Productivo Basico*).

36. PPBs determine the minimum manufacturing steps that need to be carried out in Braizil for a product to be considered as effectively "industrialised" in Brazil. They identify products that, according to Brazil itself, are produced in Brazil and are truly Brazilian products. They are issued by inter-ministerial decision (*Portaria*) at the initiative of the company seeking the tax advantages. PPBs aim at maximising domestic added value by requiring that certain production steps take place in Brazil and that certain input, parts or components are sourced in Brazil (either produced by the accredited company itself or by other companies in Brazil, including sometimes in accordance with their respective PPBs).

37. In addition, PPB compliant products that are "developed" in Brazil benefit from greater tax advantages. Products are considered "developed" in Brazil when they meet the specifications, rules and standards laid down in Brazilian law and when the related specifications, projects and developments are carried out by residents in Brazil, and in Brazilian facilities, as mandated by *Portaria* 950/2006. In order to benefit from this characterisation, such status needs to be recognised ("*reconhecimento*") by means of an administrative decision by the Ministry of Science, Technology and Innovation.

38. Products manufactured by companies accredited under the Informatics programme benefit from an IPI rate reduction or exemption when they are put on the Brazilian market. The tax incentive is expressed as a percentage reduction of the IPI rate applicable to all like products (identified on the basis of the NCM nomenclature) and tends to decrease over time. The percentage reduction tends to be higher in less prosperous Brazilian regions. A suspension/exemption from the IPI tax otherwise due is also granted to accredited companies on the purchase of raw materials, intermediate goods and packaging material used in the production of the product they are accredited for.

5.1.2. PADIS and PATVD programmes

39. Both PADIS and PATVD programmes essentially reflect the structure and architecture of the Informatics programme but they apply to a smaller set of products. In addition they grant a larger pallet of tax advantages.

40. PADIS grants exemptions from several indirect taxes and duties applicabe on a set of goods classified by the Brazilian legislation as "final products", provided the producer of those products performs in Brazil certain development and production steps (including design, creation, development, manufacturing, cutting, encapsulation and testing). Those products are (i) semiconductors; (ii) displays; and (iii) strategic inputs and equipment, produced in accordance with PPB, for the production of semiconductors or displays. Under PATVD similar exemptions are granted to companies that develop and manufacture in Brazil Digital TV trasmitters, either in

accordance with the relevant PPB or in compliance with *Portaria* 5,906/2006, that defines when a a product is to be considered as developed in Brazil.

41. In order to benefit from the programmes, companies must be "accreditated" by the relevant Ministries. To be accredited, they must invest in R&D in Brazil a minimum percentage of their gross revenue from sales of the final products.

42. Accredited companies do not pay any IPI, PIS/PASEP, COFINS, PIS/PASEP-*Importação,* COFINS-*Importação,* and CIDE (as well as ordinary customs duties in the context of the PADIS programme) on the purchase or imports of machinery, tools, instruments, and equipment, as well as of software and inputs, for the production of the final products mentioned above or the Digital TV trasmitters. In addition, those same final products and Digital TV trasmitters produced by the accredited companies are exempted from PIS/PASEP, COFINS and IPI when they are put on the Brazilian market.

5.1.3. Digital Inclusion programme

43. Pursuant to the Digital Inclusion programme, Brazil exempts retail sales of a number of consumer electronics (such as laptops, input and output units, routers, smartphones and other hardware) from payment of PIS/PASEP and COFINS, provided that such products are produced in Brazil in accordance with their respective PPBs. The Digital Inclusion programme incentivises the sales of products that fall within the scope of the Informatics programme.

5.2. Legal claims

44. The set of tax reduction/exemption/suspensionmentioned above, as embodied and developed in the Informatics, PADIS, PATVD and Digital Inclusion programmes and also as applied by the relevant Brazilian authorities, are inconsistent with Brazil's obligations under the WTO agreement as follows.

45. As a preliminary point the EU underlines that the benefits arising from compliance with the relevant programmes consists precisely in a decrease of the fiscal charge that is applicable to each individual product produced by the accredited company when that product is put on the Brazilian market. Moreover, the text of Article III as well as the relevant case-law confirms that Article III applies to products, including pre-market or production requirements when they affect the equality of competitive conditions for imported products in the market.

46. Furthermore, the EU submits that those programmes create a distinction for tax purposes between imported and domestic products based on factors such as as the place of production of the products, the origin of the parts or components, the place of the technical development of the products and the obligations assumed by the producer in relation to R&D investments in Brazil. This is clearly an origin based distinction because imported products do not comply with those requirements. Therefore, for the purpose of Article III:2 and Article III:4 it is sufficient to observe that there could be and indeed there are imported products that are like the incentivised domestic ones.

47. Finally a product that is produced, manufactured or assembled in Brazil, regardless of the origin of its components, is necessarily a domestic product. Conversely, a product that is imported in Brazil is certainly not a domestic product. It follows that when a product is produced, manufactured or assembled in Brazil, for assessing if a product is domestic it is irrelevant to estimate the value of the imported components in proportion to the total value of that product.

48. With regard to Article III:2, the EU recalls only domestic products (products produced or manufactured in Brazil) can benefit from the Informatics, PADIS, PATVD and Digital Inclusion programmes. Therefore, those programmes impose an indirect tax burden on imported products in excess of that imposed on like domestic products. The prohibition of discrimination between imported and domestic like products enshrined in Article III:2 makes neither a distinction among intermediate and final products, nor does it allow to compare the tax burden imposed on imported intermediate products when they are put on the Brazilian market, with the tax burden imposed on domestic intermediate products later in time, when the final product that incorporates the intermediate product is put on the Brazilian market.

49. The conditions for accreditation under those programmes taken together result in less favourable treatment granted to imported intermediate and final products than that accorded to like domestic intermediate and final products contrary to Article III:4. In any event, the imposition, under the terms of the corresponding PPBs, of an obligation to use local inputs in the production of ICT products, as a condition to benefit from the exemptions or reductions, also affords less favourable treatment to imported intermediate products than that accorded to like domestic intermediate products. The less favourable treatment for like imported products arises at least at three levels.

50. First, imported products are subject to a higher indirect tax burden. The fact that in certain circumsances (identical rates for intermediate and final product) the tax burden imposed on a domestic intermediate product when the final product incorporating it is sold on the Brazilian market may be nominally the same as the tax burden generally imposed on the imported like intermediate product when it is put on the Brazilian market, does not mean that there is identical treatment between domestic and imported intermediate products. Indeed, this observation takes into account neither the time value of money, nor the fact that the payment of indirect taxes on the purchase of intermediate products constitutes a costs that the producer must recoup by increasing the price of its products. Moroever, it does not consider the effects resulting from the combined application of different programmes.

51. Second, there is an incentive for companies accredited under PADIS and the Informatics programme to purchase intermediate products incentivised by those two programmes, so as to reduce the amount of resources that they must invest in R&D in Brazil.

52. Third, other companies are incentivised to purchase products that are exempted from IPI, PIS/PASEP and COFINS because in that way they do not have to claim a compensation or reimbursement of a tax credit and undergo the paperwork and delaies to obtain either.

53. Furthermore, the EU submits that those programmes are incompatible with Article III:5 first sentence because the conditions imposed under the terms of the corresponding PPBs regarding the minimum number of processing activities that producers of ICT, automation and related products need to perform in Brazil in order to benefit from the exemptions or reductions amount to an internal quantitative regulation relating to the processing of products, which requires a specified proportion of the final product to be sourced locally. In an event the conditions relating to the minimum number of processing activities to be carried out in Brazil amount to an internal quantitative regulation that is applied so as to afford protection to domestic production contrary to Article III:5 second sentence.

54. The four challenged programmes by requiring, under the terms of the PPBs, the purchase or use of inputs and manufacturing equipment of Brazilian origin or from Brazilian sources in order to benefit from the exemptions or reductions, squarely fall under the list of examples under paragraph 1(a) of the Annex to the TRIMs Agreement of measures that are inconsistent with Article III: 4 of the GATT 1994 and are therefore contrary to Article 2.1 of the TRIMS Agreement. It is undisputed that those programmes are investment measures. Moreover, they are also necessarily trade-related because requirements to use domestic products as a condition to obtain tax advantages, by definition, always favour the use of domestic products over imported products, and therefore affect trade in goods. e.

55. Article III:8(b) does not provide a valid defence agains those claims raised by the EU as that provisions only applies to the payment of subsidies which involve the "expenditure of revenue by a government", and not to subsidies in the form of exemption or reduction of internal taxes. Second, Article III:8(b) exempts payments to domestic producers from the national treatment obligation, but only to the extent that those payments do not discriminate between domestic and imported goods.

56. Those programmes are also inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement. The government foregoes revenue that was otherwise due when it grants a tax exemption or reduction on the products sold by accredited companies and also when it grants a tax exemption or suspension (as well as ordinary customs duties exemptions) on the products purchased or imported by those companies (e.g. machinery, tools, instruments, and equipment, as well as of software and inputs). The fact that some of those tax incentives apply on intermediate products

does not change that conclusion, for the reasons mentioned in paragraph 50 above, which apply *mutatis mutandis*. By definition, the foregoing of certain taxes that would otherwise be due clearly confers a benefit. Given that the tax benefits at issue are contingent upon the use of domestic over imported inputs they constitute prohibited subsidies.

57. The PATVD programme is not justified under Article XX(a) of the GATT 1994 because it does not aim to protect Brazil's public morals but merely aims at pursuing an industrial policy objective of Brazil. In any event, it makes no contribution to the protection of the alleged public morals objective, as that objective does not require discriminating between domestic and imported products. An equivalent (actually a more important) contribution could have been achieved by WTO-consistent, less trade restrictive means. Finally, the measure at issue does not fulfil the requirements of the *chapeau* of Article XX.

6. MEASURES PROVIDING TAX ADVANTAGES TO EXPORTERS

58. Brazil has put in place certain programmes that confer benefits to "predominantly exporting companies" in the form of a suspension, and ultimately an exemption, of taxes otherwise due in relation to their supplies.

6.1. THE RECAP PROGRAMME

59. Brazil has introduced a "Special Regime for the Purchase of Capital Goods for Exporting Enterprises" (RECAP, *Regime Especial de Aquisição de Bens de Capital para Empresas Exportadoras*). Under this programme, Brazil suspends (and ultimately exempts) the application of PIS/PASEP, COFINS, PIS/PASEP *Importação* and COFINS *Importação* with regard to purchases by legal persons that are "predominantly exporting companies", that is, companies that exported at least 50 percent of their gross turnover over the preceding year and commit to maintain at least that export level for a period of two calendar years.[1]

60. In order to benefit from the RECAP programme, "predominantly exporting companies" must be accredited.

61. PIS/PASEP, COFINS, PIS/PASEP-*Importação* and COFINS-*Importação* are suspended as regards the domestic purchase or importation by accredited companies of machinery, tools, instruments and other equipment (i.e. capital goods). The suspension is not limited to the equipment, or the proportion thereof, that is to be used in the production of goods for export (which can be exempted from indirect taxes), but it applies generally (i.e. also as regards the capital goods, or the proportion thereof, used in the production of goods to be sold domestically). The suspension becomes a zero rate (thus, an exemption) when certain conditions are met, namely the verification of the respect during the relevant time period of the required export threshold. If an accredited company does not incorporate the capital goods to its fixed assets or if it sells the goods before the conversion of the suspension into a zero rate, it can be required to pay the suspended contributions as well as interests and penalties. If the export threshold is not achieved, only interest and penalties are due, proportionally to the difference between the exports actually made and the export threshold.

6.2. THE SCHEME OF EXPORT CONTINGENT SUBSIDIES FOR THE PURCHASE OF RAW MATERIALS, INTERMEDIATE GOODS AND PACKAGING MATERIALS

62. Brazil suspends (and ultimately exempts) the application of IPI, PIS/PASEP, PIS/PASEP *Importação*, COFINS and COFINS *Importação* with regard to raw materials, intermediate goods and packaging materials to accredited or registered legal persons that are "predominantly exporting companies", that is, producers that exported at least 50 percent of their gross turnover over the preceding year. These benefits are therefore conditional on those companies achieving or exceeding a certain export target, expressed as a percentage of the companies' turnover. The benefits apply in relation to purchases of by the beneficiaries of the scheme. The suspension is not limited to the inputs to be used in the production of goods for export (which can be exempted from

[1] In addition, the RECAP programme is also available to those companies that, even if their export activities did not reach 50 percent of their gross turnover over the course of the preceding year, commit to match or exceed this threshold for the following three years.

indirect taxes), but it applies also as regards inputs processed or otherwise used in the production of goods for the domestic market.

63. The tax suspension expires and the tax become definitively non-due upon exportation or sale on the domestic market of the final goods incorporating the raw materials, intermediate goods and packaging materials. In other cases, however, the taxes and contributions become payable, together with interests and penalties.

6.3. Legal claims

64. The RECAP programme and the scheme of export contingent subsidies for the purchase of raw materials, intermediate goods and packaging materials are prohibited subsidies programmes. The government foregoes revenue when it grants a tax suspension/exemption on the products purchased or imported by those companies, contray to the general rule under Brazilian law according to which the purchase of those products entails the payment of the mentioned taxes and the accrual of a tax credit that can be compensated with other tax liabilities or reimbursed as the case may be.

65. Brazil has not demonstrated the existence of a general rule according to which all tax credit accumulating companies would be exempted to pay indirect taxes on their purchases. By definition, the foregoing of certain taxes that would otherwise be due clearly confers a benefit. Given that those subsidies are are contingent upon export performance they are prohibited subsidies inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.

7. Conclusions and request for relief

66. The European Union requests the Panel to find that the measures at issue are inconsistent with the the GATT 1994, the TRIMs Agreement and the SCM Agreement.

67. The INOVAR-AUTO programme, as embodied and developed in the mentioned instruments and also as applied by the relevant Brazilian authorities is inconsistent with Brazil's obligations under the GATT 1994, the SCM Agreement and the TRIMs Agreement. The national treatment violations are not justified under Articles XX(b) and (g) of the GATT 1994 and the MFN violations are not justified under the Enabling Clause.

68. In particular, the INOVAR-AUTO programme is inconsistent with:

- Article III:2 of the GATT 1994 because motor vehicles of the EU imported into Brazil are subject to a IPI tax burden in excess of that borne by like domestic products;
- Article III:4 of the GATT 1994 because motor vehicles, automotive components and tools of the EU imported into Brazil are accorded less favourable treatment than that accorded to like products of Brazilian origin;
- Article III:5 of the GATT 1994 because conditions imposed on manufacturing activities amount to an internal regulation relating to the processing of products and an internal regulation that is applied so as to afford protection to domestic products;
- Article 2.1 of the TRIMS Agreement, in conjunction with Article 2.2 and with paragraph 1(a) of the Agreement's Illustrative List because the programme is a trade-related investment measure inconsistent with Article III:4 of the GATT 1994; and
- Articles 3.1(b) and 3.2 of the SCM Agreement because the programme provides tax advantages that are subsidies within the meaning of Article 1.1 SCM Agreement and contingent upon the use of domestic over similar imported goods;

- Article I:1 of the GATT 1994 because the EU products at issue are not accorded immediately and unconditionally any advantage granted to like products originating in certain other countries.

69. The set of advantages contingent upon domestic production and technological development of ICT goods in Brazil, as embodied and developed in the Informatics, PADIS, PATVD and Digital Inclusion programmes and also as applied by the relevant Brazilian authorities, are inconsistent with Brazil's obligations under the GATT 1994, the SCM Agreement and the TRIMs Agreement. The national treatment violations (PATVD) are not justified under Article XX(a) of the GATT 1994.

70. The Informatics, PADIS, PATVD and Digital Inclusion programmes, as embodied and developed in the mentioned instruments and as applied by the relevant Brazilian authorities, are inconsisten with:

- The first sentence of Article III:2 of the GATT 1994 because imported ICT goods (Informatics)/ semiconductors, displays, and strategic inputs and equipment (PADIS)/ digital TV transmitters (PATVD)/consumer electronics (Digital Inclusion) are taxed in excess of like domestic products;

- Article III:4 of the GATT 1994 because Brazil grants a less favourable treatment to producers of imported goods as regards to the conditions for accreditation in order to benefit from tax exemptions;

- Article III:4 of the GATT 1994 because Brazil grants a less favourable treatment to imported inputs by requiring to use local inputs in order to benefit from tax exemptions;

- Article III:5 first sentence of the GATT 1994 because Brazil imposes conditions which amount to an internal quantitative regulation relating to the processing or use of products which requires a proportion of the products to be supplied from domestic sources ; in the alternative with Article III:5 second sentence because Brazil applies internal quantitative regulations relating to the minimum processing activities that must be carried out in Brazil so as to afford protection to domestic production;

- Article 2.1 of the TRIMS Agreement, in conjunction with Article 2.2 and with paragraph 1(a) of the Agreement's Illustrative List because the requirement to purchase or use inputs of Brazilian sources is a trade-related investment measure; and

- Articles 3.1(b) and 3.2 of the SCM Agreement, in conjunction with 1.1 of the SCM Agreement because Brazil provides advantages that are subsidies within the meaning of Article 1.1 SCM Agreement and contingent upon the use of domestic over similar imported goods.

71. The RECAP programme, as embodied and developed in the mentioned instruments and also as applied by the relevant Brazilian authorities, is inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement because the RECAP programme provides for subsidies contingent upon export performance.

72. The scheme of export contingent subsidies for the purchase of raw materials, intermediate goods and packaging materials, as embodied and developed in the mentioned instruments and also as applied by the relevant Brazilian authorities, is inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement because the scheme provides for subsidies contingent upon export performance.

ANNEX B-2

SECOND PART OF THE INTEGRATED EXECUTIVE SUMMARY OF THE ARGUMENTS OF THE EUROPEAN UNION

1. GENERAL ISSUES

1. In this section the EU addresses horizontal arguments raised by Brazil, demonstrating that they are without merit.

1.1.1. Article III of the GATT 1994 applies to the INOVAR-AUTO and the ICT-related programmes

2. The obligations contained in Articles III:2, III:4 and III:5 of the GATT 1994 fully apply to the INOVAR-AUTO and the ICT-related programmes.

3. The EU disagrees with Brazil that the programmes at issue escape the disciplines of Article III. The text of Article III as well as the relevant case-law confirms that Article III applies to products (including through pre-market or production requirements) when they affect the equality of competitive conditions for imported products in the market. Article III:1 refers explicitly to "regulations requiring the mixture processing or use of products" and Article III:5 contains similar language. Moreover, the illustrative list of TRIMs that are inconsistent with Article III:4 contained in the Annex to the TRIMs Agreement refers explicitly to measures which require the purchase or use of products of domestic origin or from any domestic source specified in terms of a proportion of volume or value of a company local production. Thus, by its plain terms, Article III *also* covers measures that concerns the production or processing of products.

4. In order to establish whether measures is are caught by Article III of the GATT 1994, it should be demonstrated that how those measures alter the competitive conditions between domestic and like imported products in the market of the Member in question. Brazil's approach that the programmes are addressed to "producers" as opposed to products and that they concern "pre-market" stages is formalistic and it would open a loophole in the non-discrimination obligations, allowing Members to introduce measures which alter the conditions of competition to the detriment of imports, just because "formally" they are addressed to producers. Moreover, the terms "pre-market" do not appear in the covered agreements.

5. Moreover, the case-law shows that measures affecting the equality of competitive conditions between domestic and imported products cannot be limited to measures directly regulating products or imposing market requirements. That the case-law demonstrates that any measure affecting the equality of competitive conditions between domestic and imported products is covered by Article III.

6. The programmes at issue modify the conditions of competition between products produced in Brazil in accordance with the requirements under those programmes and imported like products. The benefit arising from compliance with those requirements consists in a decrease of the fiscal charge that is applicable to each individual product produced by the accredited company when that product is put on the Brazilian market.

7. The programmes at issue draw an origin-based distinction granting fiscal advantages only to products produced in Brazil and/or incorporating a certain level of Brazilian input products. Pursuant to the programmes at issue, if in producing a given product a company decides to take certain development or production steps outside Brazil, the resulting product can never benefit from the advantageous tax treatment. Likewise, by providing tax benefits for products when certain manufacturing steps are carried out in Brazil or parts and components of those products are produced in Brazil, the programmes incentivise the purchase and use of products made in Brazil as inputs into the production process.

8. The EU disagrees Brazil that Article III:8(b) applies in the present case. First, as clarified by the 1992 GATT Panel Report in *United States – Measures Affecting Alcoholic and Malt Beverages* and the Appellate Body Report in *Canada – Periodicals*, Article III:8(b) applies only to the payment of subsidies which involve the "expenditure of revenue by a government". In this case, the programmes at issue do not involve the expenditure of revenue by Brazil, but rather the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. Second, the panel in *Indonesia – Autos* found that Article III:8(b) exempts payments to domestic producers from the national treatment obligation, but only to the extent that those payments do not discriminate between domestic and imported goods. Since the programmes at issue discriminate between imported and domestic products they do not fall within the scope of Article III:8(b). Third, the EU recalls that when there is tax discrimination between imported and domestic product, there is no need to show any impact of such different taxation on the market to demonstrate a violation of Article III:2 of the GATT 1994. The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a "trade effects test" nor is it qualified by a *de minimis* standard so even the smallest amount of "excess" is too much. Likewise, also a violation of Article III:4 does not require an analysis of the actual effects of the measure on trade, but essentially an analysis of the design, architecture, revealing structure and expected operation of the measure. Finally, Brazil wrongly argues that the subsidies in question are paid to producers to compensate for the costs of complying with the challenged programmes. Brazil does not demonstrate that those programmes impose additional costs that the accredited companies would not have to incur in any case, it does not demonstrate the proportionality between the alleged costs and the advantages, and falls into contradiction when it asserts that those programmes give no advantage to the producers of intermediate products which are nevertheless subject to the same alleged additional costs as those imposed on producers of finished products. Moreover, a similar off-setting argument has been already rejected in *EC and certain Member States – Large Civil Aircraft* because it would unduly restrict the scope of the SCM Agreement. Finally, the programmes at issue rely on a reduction of indirect taxation as the tool to improve the competitive condition of domestic *products* when they are put in the market.

1.1.2. Brazil fails to justify certain national treatment violations under Article XX of the GATT 1994

9. The EU highlights the manifest disconnect between the measures at issue and the attempted justifications in the present case. Brazil failed to establish that the discriminatory features of the INOVAR-AUTO and the PATVD programmes can be justified under Article XX of the GATT 1994. This will be further discussed below.

1.1.3. The programmes at issue confer a subsidy within the meaning of Article 1.1 of the SCM Agreement

10. The EU disagrees with Brazil that, with respect to inputs, suspensions and exemptions of non-cumulative valued added taxes along the production chain do not constitute a subsidy within the meaning of Article 1.1 of the SCM Agreement

11. *First*, Brazil has failed to show that the suspension/exemption of otherwise revenue collected at the time of the purchases by accredited companies is the "prevailing domestic standard" established by the tax rules in Brazil. Brazil is not consistent with the alleged general rule. The suspension of IPI for certain goods does not imply the suspension of other similar contributions imposed on the same transactions, such as PIS/PASEP and COFINS. Even within the IPI tax, a quick glance at the TIPI shows that Brazil is not consistent. Brazilian legislation show on the other hand that the "prevailing domestic standard" is the opposite of the one advocated by Brazil: companies pay indirect taxes on their purchases of input and accrue a tax credit even when the products they produce is subject to low or not taxation.

12. *Second*, there is revenue foregone or not collected in the sense of Article 1.1(a)(1)(ii) of the SCM Agreement. It cannot be denied that the same nominal amount of money has a different value over time. Moreover, the time-value of money assumes particular relevance in times of high inflation. Currently, Brazil's inflation rate is around 10% a year. Accordingly, the suspension or exemption of indirect taxes on the purchase of inputs is a significant advantage for a company in terms of improved cash flow/working capital and, thus, it represents a cost for the government. The arguments developed by Brazil to deny that cash flow effect, merely tend to minimise that effect because companies in general compensate their tax credits in the month following the

accrual of the credits. By the same token the simulations provided by Brazil in Exhibit BRA-109 are misleading and do not disprove the existence of a cash flow effect inherent to the suspension or exemption of indirect taxes on the purchase of input products. In any case, low taxation of intermediate products also means lower production costs for final products, which in turns translate in a smaller tax basis for indirect taxes on final products. As a consequence there is an advantage for the producers of intermediate products that benefit of a low indirect tax rate on their output and a loss of revenue for the State all along the production chain.

13. *Finally*, the EU fails to see how the programmes at issue do not confer a benefit in the sense of Article 1.1(b) of the SCM Agreement. As already recalled the panel in *EC and certain Member States – Large Civil Aircraft* rejected the argument that Brazil tries to make about the offsetting of costs and benefit of the challenges programmes. In any event, Brazil's argument must fail also because it lacks in facts.

14. Brazil shows how complying with the R&D investment requirement under the Informatics programme provides an advantage to accredited companies. Indeed, that thanks to the Informatics programme many companies have set up their own research institute in Brazil in order to optimize the resources invested in R&D. ICT producers in Brazil benefit from those R&D investments, not only indirectly through a development of the general technological environment but also directly because they can invest in R&D activities in-house or set up their own research institute in which they can invest they own resources.

1.1.4. The programmes at issue are prohibited subsidies

15. Brazil fails to rebut the EU's argument with respect to the INOVAR-AUTO and the ICT-related programmes as subsidies contingent upon the use of domestic over imported products in the sense of Article 3.1(b) of the SCM Agreement. It is uncontested that in this case imported products (including both inputs and final products) cannot benefit from the advantages granted through the programmes. Brazil wrongly argues that a mere requirement to attach the imported wheels to the imported structure using the imported fasteners would not make the resulting bicycle "domestic" for the purpose of Article 3.1(b) of the SCM Agreement as the percentage of value-added in the territory would be virtually zero. Brazil conveniently switches to an example which does not show the need to use domestic bicycles part over imported parts. The point is not whether the resulting bicycle is "domestic" or not. Rather, what matters is whether in order to make such an incentivised bicycle, the programme required the use of domestic over imported parts either directly or indirectly. Brazil further does not seriously dispute that the programmes for predominantly exporting companies (i.e. RECAP and the programme of fiscal incentives with respect to raw materials, intermediate goods and packaging materials) are contingent upon export performance in the sense of Article 3.1(a) of the SCM Agreement. Brazil merely attempts to justify the chosen export thresholds in order to benefit from the programmes. Whether the export threshold is set on the basis of the level of credit accumulation by certain companies or because of any other reason, this does not put into question the fact that the subsidies are granted only if certain export conditions are met.

1.1.5. Brazil's argument about the lack of trade effects of the measures is inapposite

16. The EU fails to see the relevance of Brazil's argument. As noted by the Appellate Body, a panel is not required to focus its examination primarily on numerical or statistical data regarding the effects of the measure in practice. The programmes at issue are designed to promote the development of the domestic industry in Brazil. Whether Brazil's programmes have achieved total or partial import substitution is irrelevant. As a matter of fact, Brazil has not shown any figures indicating what level of imports would have been reached but for the incentivising programmes.

1.1.6. Final remarks

17. As noted in the EU's responses to the Panel's questions to the Parties, the EU disagrees with Brazil that the changes made by Law 13,137/2015 as well as *Portaria* 257/2014 are outside the Panel's terms of reference. Furthermore, since Brazil acknowledges that the PIS/PASEP-*Importação* and the COFINS-*Importação* amount to indirect taxes, and absent any further reaction by Brazil during the first meeting with the Panel, the EU considers it unnecessary to further

develop its alternative claim under Article II:1(b) of the GATT 1994 in the context of the ICT-related programmes.

2. MEASURES IN THE AUTOMOTIVE SECTOR: THE INOVAR-AUTO PROGRAMME

2.1.1. Factual arguments related to vehicle energy efficiency

18. The EU points out three inconsistencies with respect to Brazil's allegations regarding its vehicle energy efficiency policy. *First*, Brazil links energy efficiency exclusively to domestic products and local content requirements, while discriminating like imported products. The products at issue from the EU are capable of achieving similar vehicle energy efficiency. Attempting to justify the discriminatory aspects of the INOVAR-AUTO programme under the guise of environmental protection (and road safety) lacks any scientific substantiation. *Second*, energy efficiency (and road safety) concerns seem relevant to Brazil in the context of the INOVAR-AUTO programme but only insofar as they boost the competitiveness of the domestic auto industry and not as aims in themselves. The aim of the programme is definitely the protection and development of the domestic industry, as it results very clearly from the explanatory memorandum which Brazil itself quotes in its first written submission. However, after the EU demonstrated how the explanatory memorandum to the INOVAR-AUTO programme in fact contradicted Brazil's assertions, Brazil tried to dismiss the importance of the explanatory memoranda in general. *Third*, Brazil has failed to offer a plausible explanation about why 30 out of the 52 product codes covered by the INOVAR-AUTO programme are exempted from the energy efficiency requirements.

2.1.2. The INOVAR-AUTO programme is inconsistent with Brazil's national treatment obligations

3.3.2.1. The INOVAR-AUTO programme draws origin-based distinctions between like imported and domestic products

19. The INOVAR-AUTO programme draws origin-based distinctions (both explicitly, and by its design and structure) between domestic and imported motor vehicles with respect to all three steps necessary for benefiting from the IPI tax reduction through the use of IPI tax credits: (i) the conditions for accreditation to participate in the INOVAR-AUTO programme; (ii) the manner in which IPI tax credits are calculated; and (iii) the conditions for using such credits.

20. *First*, INOVAR-AUTO's accreditation conditions draw origin-based distinctions between foreign and domestic manufacturers, including newcomers. Because the accreditation conditions require manufacturing activities in Brazil, as well as certain domestic spending in R&D and/or engineering, foreign manufacturers are put in a less favorable situation than domestic manufacturers and newcomers. The three modes of accreditation under Article 2 of Decree 7,819/2012 draw explicit origin-based distinctions between domestic and imported motor vehicles.

21. *Second*, the INOVAR-AUTO programme draws discriminatory distinctions between imported and domestic like products through the manner in which IPI tax credits are calculated and accrued. In particular, the INOVAR-AUTO programme sets conditions for earning IPI tax credits that distinguish between foreign and domestic motor vehicles, both in terms of the ability to earn credits and with regard to the overall amount of IPI credits to be earned. These distinctions clearly put imported goods at a competitive disadvantage.

22. Two basic categories of expenditures that can result in the accrual of IPI tax credits must occur "in the Country" to result in the accrual of IPI tax credits. In order to ensure that strategic inputs and tools actually originate "in the Country", Brazil designed a *calculation system* where the "deductible portion" ensures that the value of the IPI credit resulting from expenditures on strategic inputs and tools is reduced to the extent that such goods incorporate content manufactured outside Brazil. This local content requirement is monitored through a traceability system, so as to ensure that only satisfying levels of domestic content incorporated into the products at issue attract tax credits. As a result, the combined effect of the "in the Country" requirement and the local content requirement through the "deductible portion" (and traceability system) draw origin-based distinctions between imported and domestic like products by its very

design, structure and operation. Brazil fails to discuss the EU's arguments with regard to the deductible portion and the traceability system.

23. *Lastly*, the INOVAR-AUTO programme draws origin-based distinctions with respect to the *use* of the IPI credits. Decree 7,819/2012 explicitly provides that IPI credits must be used on domestic vehicles first, and only if such credits remain unused, they may be used on imported vehicles. These conditions constitute additional origin-based distinctions, confirming that domestic and imported motor vehicles subject to the INOVAR-AUTO programme are "like" products within the meaning of Articles III:2 and III:4 of the GATT 1994. Brazil does not address the EU's arguments with regard to the origin-based distinctions with respect to the *use* of the IPI credits. Accordingly, the EU considers that Brazil concedes this point.

3.3.2.2. The INOVAR-AUTO programme contains local content requirements and is not a subsidy to domestic producers under Article III:8(b) of the GATT 1994

24. The EU disagrees that the clear local content requirements embodied in the INOVAR-AUTO programme are only "pre-market requirements" and production stages which do not affect the products at issue. Requirements like a minimum number of manufacturing steps to be performed in Brazil cannot be characterised as merely production stages, especially as such requirements are coupled with rules on a deductible part and a traceability system which seek to ensure that only products incorporating a certain level of domestic content may benefit of the programme.

25. The EU explained that the provisions of Article III:8(b) of the GATT 1994 cover only *payments* to domestic producers *stricto sensu*, and cannot be broadly construed so as to include government *revenue* that is *otherwise due* which is *foregone* or not collected. As clarified by previous case-law, Article III:8(b) applies *only* to the payment of subsidies which involve the "expenditure of revenue by a government", and not to subsidies in the form of exemption or reduction of internal taxes, like in the present case.

3.3.2.3. The INOVAR-AUTO programme is inconsistent with Articles III:2, III:4 and III:5 of the GATT 1994

26. Brazil failed to rebut the EU's *prima facie* case with regard to the national treatment violations. The INOVAR-AUTO programme is inconsistent with Article III:2 of the GATT 1994. All different sets of conditions (accreditation, calculation of tax credits and their use) confirm an origin-based distinction between domestic and imported goods. In addition, the INOVAR-AUTO programme is inconsistent with Article III:4 of the GATT 1994, with respect to motor vehicles, as well as automotive components and tools originating in the EU and imported into Brazil, which are accorded less favourable treatment than that accorded to like products of Brazilian origin. The less favourable treatment results from the conditions for accreditation to the programme, as well as from the rules on the calculation and use of the presumed IPI tax credits. Finally, certain requirements of the INOVAR-AUTO programme more specifically violate the provisions of Article III:5 of the GATT 1994, because they refer to conditions relating to the minimum number of manufacturing steps, together with the calculation of the tax credits, which manufacturers of motor vehicles need to perform in Brazil, which amount to an internal quantitative regulation relating to the processing of products, as such conditions require a specified proportion of the final product from domestic sources.

2.1.3. The discriminatory aspects of the INOVAR-AUTO programme are not justified under Articles XX(b) and (g) of the GATT 1994

2.1.3.1 Article XX(b) of the GATT 1994

27. The INOVAR-AUTO programme cannot be justified under Article XX(b).

28. *First*, Brazil has not shown that the discriminatory aspects of the INOVAR-AUTO programme, including the local content requirements, have been adopted or enforced to protect human, animal or plant life or health. The Explanatory Memorandum of the Provisional Measure 563/2012, which then was turned into Decree 7,819/2012, demonstrates that energy efficiency and vehicle safety were rather seen as elements of boosting competitiveness of the domestic auto industry and not

as aims in themselves. There is a manifest disconnection between the objectives allegedly pursued by Brazil and the discriminatory elements in the programme.

29. *Second*, the discriminatory aspects of the INOVAR-AUTO programme are clearly not necessary to protect human, animal or plant life or health. Furthermore, there is an apparent contradiction between the overall alleged objective of energy efficiency of the INOVAR-AUTO programme and the fact that the energy efficiency requirement does not apply to accredited companies that only produce or market in Brazil the types of vehicles listed in Annex IV of Decree 7,819/2012. These exemptions concern 30 product codes out of the 52 codes covered by the INOVAR-AUTO programme. Thus, the contribution made by the INOVAR-AUTO programme to the protection of the alleged objectives is *not* a *material* contribution.

30. *Third*, there are other alternatives reasonably available to Brazil, capable of making an equivalent contribution to the objectives allegedly pursued. Such reasonably available alternatives could be: (i) that Brazil provides tax exemptions for sales of all the products at issue which comply with Brazil's energy efficiency and road safety standards, regardless of whether they are imported or domestically produced; and (ii) the elimination or the substantial reduction of customs duties on the products at issue which comply with Brazil's energy efficiency and road safety requirements.

31. *Finally*, the measure at issue does not comply with the conditions of the *chapeau* of Article XX of the GATT 1994. The INOVAR-AUTO programme unjustifiably discriminates between countries where the same conditions prevail and the incentives accorded to domestic producers result in a disguised restriction on international trade. There is no link between the discriminatory treatment and the alleged energy efficiency and road safety objectives of the INOVAR-AUTO programme. Like products at issue from the EU meet at least similar levels of energy efficiency and road safety, as Brazil itself indirectly admits when it takes as a reference point relevant European standards. The discrimination between domestic and imported products is arbitrary and unjustifiable, and amounts to a disguised restriction on international trade.

2.1.3.2 Article XX(g) of the GATT 1994

32. The INOVAR-AUTO programme cannot be justified under Article XX(g). *First*, Brazil has not shown that the discriminatory aspects of the INOVAR-AUTO programme have been adopted or enforced for the conservation of exhaustible natural resources. *Second*, the discriminatory aspects of the INOVAR-AUTO programme clearly do not "relate to" the conservation of exhaustible natural resources. Brazil has not demonstrated that there is "a close and genuine relationship of ends and means" between the measure at issue and the conservation of exhaustible natural resources. *Third*, the measure at issue is not even-handed, as it is not made effective in conjunction with restrictions on domestic production or consumption. The EU has already explained that energy efficiency requirements are not applied in practice for 30 product codes out of the 52 codes covered by the INOVAR-AUTO programme. *Finally*, the measure at issue does not comply with the conditions of the *chapeau* of Article XX of the GATT 1994. The INOVAR-AUTO programme unjustifiably discriminates between countries where the same conditions prevail and the incentives accorded to domestic producers (and others, such as distributors of domestic products) result in a disguised restriction on international trade.

2.1.4. TRIMs claims

33. The EU notes that Brazil agrees that the INOVAR-AUTO programme is an investment measure. Furthermore, the programme is a trade-related investment measure and its specific requirements clearly fall under the list of examples in paragraph 1(a) of the Annex to the TRIMs Agreement. As already explained, requirements such as those related to the purchase or use of inputs and manufacturing equipment, as well as laboratory equipment, of Brazilian origin, in order to benefit from the IPI reductions cannot be characterised as pre-market requirements.

2.1.5. SCM claims

34. The EU clearly disagrees with Brazil's assertion according to which the INOVAR-AUTO programme is not a subsidy contingent upon the use of domestic over imported goods. Brazil's alleges that domestic transactions cannot be considered a "use" in the sense of Article 3 of the SCM Agreement. The EU recalls that tax credits do not simply accrue from expenditures on

strategic inputs and tools, as Brazil maintains, but the rules on calculation make sure that only goods produced with a sufficient proportion of domestic content may attract IPI tax credits. Finally, Brazil invokes trade data which demonstrates an increase rather than a decrease of imports of inputs after the establishment of the INOVAR-AUTO programme. The EU recalls that there is abundant case-law clarifying that an inconsistency with certain provisions such as Articles III:2, III:4 and I:1 of the GATT 1994 is not contingent upon the actual trade effects of a measure. A similar reasoning applies with regard to an inconsistency with Articles 3.1(b) and 3.2 of the SCM Agreement.

2.1.6. The advantages accorded to Argentina, Mexico and Uruguay violate Brazil's MFN obligations and are not justified under the Enabling Clause

35. Brazil does not rebut the EU's claim under Article I:1 of the GATT 1994. Instead, Brazil concedes its MFN violation and relies directly on the Enabling Clause. However, Brazil's measures at issue are *manifestly* not within the purview of the Enabling Clause.

36. *First*, there is no clear link between LAIA, ECAs, the INOVAR-AUTO programme and the relevant provisions of the Enabling Clause. Brazil has never notified the INOVAR-AUTO programme as required by paragraph 4 of the Enabling Clause or by the specific provisions of the transparency mechanisms for RTAs (with respect to paragraph 2(c)) and for PTAs (with respect to paragraph 2(b)). The Treaty of Montevideo (TM 80) and the subsequent LAIA notifications directly or indirectly refer to paragraph 2(c), while Brazil raised as a defence in the present case only paragraph 2(b) of the Enabling Clause. In the event of a finding that Brazil's failure to notify the relevant arrangement under paragraph 4 of the Enabling Clause precludes Brazil from relying on the Enabling Clause, the EU still requests the Panel to make findings with respect to the non-fulfilment by the measures at issue of the conditions in paragraphs 2(b) and (c) of the Enabling Clause. This would be particularly relevant in the event of an appeal, as well as for implementation purposes.

37. *Second*, both the "umbrella treaty" of Montevideo establishing LAIA and the subsequent ECAs do not cover internal taxation. The mentioned treaties refer to the elimination of tariffs (customs duties) among the members in certain circumstances.

38. *Third*, Paragraph 2(b) allows developing countries to deviate from the MFN obligation with respect to non-tariff measures, but only in the qualifying context of instruments multilaterally negotiated under the auspices of the GATT. The ECAs and LAIA are obviously not "multilateral instruments negotiated under the auspices of the GATT", but rather regional instruments. In addition, even if one were to accept Brazil's argument and read the provision as "under the auspices of the WTO", there is no multilateral agreement with respect to internal taxation to fulfil this condition. Similarly, the provision cannot be interpreted as the GATT 194 being the agreement negotiated under its own auspices. Finally, Japan has explained that for the purposes of paragraph 2(b) "non-tariff measures" do not cover internal taxation. Thus, the present case does not qualify under paragraph 2(b) of the Enabling Clause.

39. *Fourth*, at this stage of development of the WTO law, paragraph 2(c) does not allow developing countries to deviate from the MFN obligation with respect to non-tariff measures. "May" should be understood as a faculty and not as an obligation. Prescription of the relevant criteria is a pre-condition. There are other similar examples when certain provisions required subsequent action by the Membership in order to become applicable. In the present case, internal taxation measures are clearly not tariff measures and thus cannot be subject to preferential arrangements under paragraph 2(c) of the Enabling Clause.

40. The treatment accorded by Articles 21 and 22 of Decree 7,819/2012 is not conditioned upon the conclusion of subsequent ECAs. Brazil did not invoke the Enabling Clause with regard to the products at issue from Paraguay and Venezuela.

41. Although very similar to Article XXIV:4 of the GATT 1994, the language of the paragraph 3(a) contains two main textual differences: (i) it is mandatory ("shall"), as opposed to "should be" and thus cannot be considered merely "purposive"; (ii) it refers not only to "not to raise barriers to trade" but also to "not create undue difficulties for the trade". The relevant condition in paragraph 3(a) may be read as "not to raise barriers to or create unjustified burdens on other Members". In

other words, the arrangements falling within the scope of paragraphs 2(b) and 2(c) of the Enabling Clause should be crafted in a *reasonable* way.

42. Paragraph 3(b) sets trade creation as a priority under the Enabling Clause in the case of, for instance, a PTA not only within the members to the PTA, but also on an MFN basis, in such a way that the former process does not constitute an impediment to the latter. This provision is relevant not only with respect to the reduction or elimination of tariffs, but also with respect to the reduction or elimination of other restrictions to trade.

3. MEASURES RELATING TO ICT, AUTOMATION AND RELATED GOODS

3.1. INFORMATICS PROGRAMME

3.1.1. Factual issues

43. *First*, Brazil maintains that PPBs do not establish a "minimum percentage of components that must be produced locally". However, an examination of the first model PPB or of the current three general PPBs mentioned by Brazil confirms the description given by the EU in its first written submission. PPBs contain local content requirements expressed in terms of processing operation or production steps to be carried out in Brazil and often also in terms of local sourcing or specific quotas of Brazilian intermediate products that must be used by the accredited company.

44. *Second*, to the extent that PPBs require that the input, parts and components incorporated in the product are produced locally, they impose the use of domestic products instead of imported ones. A quick glance to *Portarias* confirms that they contain local content requirements expressed in terms of components or intermediate products that must be manufactured by the accredited company or a third party in Brazil.

45. *Third*, Brazil argues that in order for a product to be "domestic" for the purposes of Article 3.1(b) of the SCM Agreement a substantial percentage of value of the product must have been added in the territory of the concerned country. However, Brazil fails to provide any objective criteria that would allow to establish when a product is domestic and when it is not and it is unable to show on which treaty language his position is founded.

46. *Lastly*, Brazil asserts that in about ¼ of the PPBs in force compliance with certain processing steps can be replaced with additional investments in R&D. However, the possibility of replacing some processing steps with additional R&D investment is limited as it concerns clearly a minority of the PPBs, and specific processing steps, but not all of the steps which make a product complying with PPB one that is effectively produced in Brazil and that is therefore domestic.

3.1.2. Legal Claims

3.1.2.1 Pre-market requirements altering the competitive relation between imported and domestic products fall within Article III of the GATT

47. What Brazil has called "pre-market requirements" are in reality requirements that make sure that the accredited company can sell the incentivised products with tax advantages, thereby affecting the competitive position of imported and domestic "like products" in the Brazilian marketplace. Thus, the benefit arising from complying with the requirements of the Informatics programme (or any of the other programmes) *does relate to products* when they are put on the Brazilian markets. In any event, the text of Article III as well as the relevant case-law confirms that Article III applies to products (including through pre-market or production requirements) when they affect the equality of competitive conditions for imported products in the market.

48. The EU recalls the Appellate Body Report in *Thailand – Cigarettes* falling within the purview of Articles III:2 *and* III:4, which is particularly relevant in the present disputes for several reasons. First, like the present case, it concerned an indirect value added tax. The Appellate Body underlined that some legal requirements applicable to the sellers of imported cigarettes had an impact on the amount of tax applicable on the sale of imported cigarettes, while the sale of domestic cigarettes was exempted. Despite those requirements applied to the sellers and not to

the cigarettes directly, they could fall within the purview of Articles III:2 and III:4 because they resulted in different level of taxation. Second, the Appellate Body also ruled that the fact that seller of imported cigarettes could claim back the VAT paid on their purchase at a later stage through a tax credit mechanism did not save the measure from Article III:2 of the GATT 1994. This seems to be sufficient to reject Brazil's argument that there is not difference between the situation of a company paying IPI on the input and claiming back the credit at a later stage and the situation of a company having the IPI suspended on the purchase of its input.

3.1.2.2 Article III:2

49. The Informatics programme draws an origin-based distinction between domestic and imported products. Requiring certain production steps to be carried out in Brazil in order for a product to benefit from a tax incentive is necessarily non-origin-neutral, because like imported products that have not undergone the same production steps in Brazil are by definition excluded from the incentive. The same reasoning applies *a fortiori* when the PPB requires not only that certain production steps take place in Brazil, but also that the product incorporates inputs manufactured in Brazil or sourced in Brazil. The position of the EU is perfectly consistent with the case-law and notably with the Report of the panel in *Indonesia – Autos* which shows that origin based distinctions can come in the form of local content requirements. Moreover, the EU maintains that the obligation contained in Article III:2 of the GATT 1994 does not differentiate between inputs and finished products. The question of whether the incentivised product is a product that can be used as input in other more complex products is clearly irrelevant, as Article III:2 applies to all types of products and each individual transaction.

3.1.2.3 Article III:4

50. Brazil's narrow reading of the term "affect" in Article III:4 goes against consistent case-law, which recognises that the term "affecting" gives this provision a broad scope of application, thereby including any measure capable of *influencing* a manufacturer's choice between the imported product and the like domestic product. There is no need to demonstrate that such choice is mandated or that such effects have actually been produced. The tax incentives provided for by the Informatics programme applies only to products produced in Brazil in accordance with a PPB. The position of those products in the Brazilian market is therefore improved vis-à-vis like imported products which do not benefit from the same tax reductions or exemption.

51. Brazil maintains that Brazilian companies purchase a high proportion of imported input and this should prove that there is not violation of Article III:4. However, Brazil does not demonstrate that figures provided in Exhibits BRA-32 and 34 are correct, let alone that it has done anything to check their reliability. In any case, the high percentage of imported input used by accredited companies would demonstrate that the local content requirements contained in the PPBs so far have not been particularly effective in promoting local production of input for ICT products and that Brazilian producers still need to import most of those inputs. .

52. The EU emphasizes that the less favourable treatment of imported products arises at three levels at least. First, the mechanism for the calculation of the amount of resources that must be invested in compulsory R&D in the context of the Informatics and the PADIS programme, provides for a deduction of the sums paid when purchasing incentivised products and thereby incentives the purchase those products to the detriment of like imported products. Second, whenever a product benefits from an exemption or suspension of an indirect tax, a lower administrative burden for the purchaser of that product arises compared to the purchase of a product subject to the tax. Unlike the purchaser of the incentivised product, the purchaser of the latter products has to compensate or ask for the reimbursement of a tax credit. That creates an incentive to buy domestic products incentivised under the programme, and in particular with respect to intermediate products, which are purchased by other producers. Brazil has explicitly confirmed that the mechanism for the calculation of the amount of resources to be invested in R&D pursuant to PADIS and the Informatics Programme provide for a deduction of the acquisition costs of incentivised products. It has also confirmed that the procedure for the compensation or reimbursement of tax credits is burdensome and time consuming. Third, imported products are treated less favourably because they are subject to a higher indirect tax burden when put on the Brazilian market, in comparison with like domestic products incentivised by the Informatics programme. The reduction of the tax burden applied on incentivised products is the consequence explicitly provided for complying with the challenge programmes.

3.1.2.4 Article III:5

53. Brazil argues that the production step requirements laid down in the Informatics programme by means of the PPBs fall outside the scope of Article III:5 on the basis of two panel reports in *EEC-Animal feed proteins* and *Canada-FIRA*. However, these reports do not confirm the narrow reading of Article III:5 proposed by Brazil. Even though the panel in *EEC-Animal feed proteins* followed a rather narrow interpretation of Article III:5 first sentence, it adopted a rather broad reading to Article III:5 second sentence. Likewise, the panel report in *Canada-FIRA* cannot be considered conclusive for the definition of the scope of Article III:5.

54. With regard to the first sentence of Article III:5, it is clear that the claim of the EU under Article III:5, first sentence is twofold. The EU claims that PPBs contain requirements relating to both (a) the minimum number of processing steps the producers of ICT products need to carry out in Brazil and (b) the proportion of local inputs that producers need to use to manufacture ICT products in Brazil. However, Brazil basically tries to rebut the part of sub-claim(a), but makes no argument with regard to sub-claim (b). With regard to sub-claim (a), the EU confirms its arguments contained its first written submission.

55. With regard to the second sentence of Article III:5, the EU has argued that the minimum processing steps that must be carried out in Brazil constitute internal quantitative regulation that is applied so as to afford protection to domestic production. Unlike the first sentence, the second sentence of Article III:5 refers to quantitative regulations but it does not say that those regulations must require any specified amounts or proportion of any product, which is the subject of the regulation to be supplied from domestic sources. It is clear that a regulation for the purpose of the second sentence of Article III:5 can be considered 'quantitative' when it limits the quantities of imported product so as to afford protection to domestic production.

56. The only argument that Brazil develops as regards the second sentence of Article III:5 is based on paragraph 5 of the Ad Article to Article III:5, but Brazil does not demonstrate that the conditions required by that provision are met.

3.1.2.5 TRIMs Agreement

57. The EU recalls that it has demonstrated in its first written submission that many PPBs contain local content requirements expressed in terms of minimum percentage of local parts or components (sometimes produced in accordance with their own PPBs) that the accredited company must source in Brazil (purchase or manufacture itself) in the production of ICT products, in order to comply with the Informatics programme and that the domestic content requirements included in the Informatics programme are undoubtedly "related to trade in goods", as they affect ICT products marketed in Brazil.

3.1.2.6 Article 3(1)(b) of the SCM Agreement

58. The EU maintains that the Informatics programme, insofar as requires the use of domestic over imported products as explained before, is inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement. The EU contends that if the resulting final product can only be subsidised when a given intermediate product is sourced locally or made in Brazil by the recipient, then the subsidy must be considered as contingent upon the use of domestic over imported products.

59. Further, Brazil reading of paragraph 130 of the Appellate Body in *Canada – Autos* is not correct. The Appellate Body rejected the Panel's reasoning that under no circumstances any value added requirement can result in a finding of contingency "in law" upon the use of domestic over imported product. At the same time, the Appellate Body recognised that Article 3.1(b) of the *SCM Agreement* also extends to subsidies contingent "in fact" upon the use of domestic over imported goods. Unfortunately, the Appellate Body could not complete the analysis neither on the contingency in law nor on the contingency in fact. A subsequent Appellate Body in *US – FSC (Article 21.5)* casts light on how contingency on the use of domestic over imported good "whether solely or as one of several other conditions" should be interpreted in the context of Article 3.1(a) of the SCM Agreement. The EU submits that *mutatis mutandis* the same logic should apply in the context of Article 3.1(b) of the SCM Agreement.

60. Brazil also argues that several products produced according to a PPB are not domestic within the meaning of Article 3.1(b) of the SCM Agreement and that in order for a product to be "domestic" for the purposes of Article 3.1(b) of the SCM Agreement a substantial percentage of value must have been added in the territory of the concerned country and that when the value of imported input is more that 90% of the product, than the product should not be domestic. However, this position finds no support in the text, structure or objective of Article 3.1(b) of the SCM Agreement, nor has Brazil ever pointed to any case law that could support this reading

3.2. PADIS PROGRAMME

61. The EU maintains that the PADIS programme is inconsistent with the GATT 1994, the TRIMs Agreement and the SCM Agreement. The discussion of claims against the Informatics programme applies *mutatis mutandis* to the parallel legal claim raised against the PADIS programmes. Despite the PADIS programme does not contemplate the adoption of *Portarias* setting out PPBs for the incetivised products, the production steps requirements laid out in the legal instruments defining the PADIS programme are designed in such a way so as to incentivise the use of domestic over like imported goods.

3.3. PATVD PROGRAMME

62. For essentially the same reasons developed with regard to the Informatics programme, the EU asserts that the PATVD programme is inconsistent with the GATT 1994, the TRIMs Agreement and the SCM Agreement. For the sake of conciseness, the EU does not repeat those reasons, but focuses on Brazil's legal defence under Article XX(a) of the GATT 1994.

3.3.1. EU's rebuttal of Brazil's Article XX(a) defence

63. The PATVD programme cannot be justified under Article XX(a) of the GATT 1994, because it does not aim to protect Brazil’s public morals but merely aims at pursuing an industrial policy objective of Brazil.

64. *First*, the public moral objective advanced by Brazil is just a general social and economic development objective which characterise nearly any governmental action and thus it does not constitute a public moral standard, otherwise any governmental action which is taken in the public interest could be justified under Article XX(a).

65. *Second*, in any event, the PATVD programme does not pass the necessity test. It does not make a *material* contribution to the protection of the alleged public morals objective. Notably, the discriminatory aspects of the PATVD are not necessary to achieve that objective and rather they run counter it. In addition, an equivalent contribution could have been achieved by WTO-consistent, less trade restrictive means.

66. *Finally*, the measure at issue does not fulfil the requirements of the *chapeau* of Article XX. The PATVD programme constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail and a disguised restriction on international trade. The domestic content requirements in PATVD discriminate between Brazil and other countries, and this discrimination runs counter to the purported objective of PATVD.

3.4. DIGITAL INCLUSION PROGRAMME

67. For essentially the same reasons developed with regard to the Informatics programme, the EU maintains that the Digital Inclusion programme is inconsistent with the GATT 1994, the TRIMs Agreement and the SCM Agreement.Brazil has clarified that the tax advantages provided for by the Digital Inclusion programme are not only available to the sellers of those products at the retail level, but also to the producers (already benefitting from the Informatics programme) that may sell consumers electronics directly to companies or governmental entities.

4. MEASURES PROVIDING TAX ADVANTAGES TO PREDOMINANTLY EXPORTING COMPANIES

4.1. CLAIMS RELATING TO THE RECAP PROGRAMME

68. The EU asserts that Brazil has failed to rebut the EU's claim that the RECAP programme amounts to a prohibited subsidy under Article 3.1(a) of the SCM Agreement and that Brazil, thus, acts contrary to Article 3.2 of the SCM Agreement.

4.1.1. The RECAP programme provides subsidies in accordance with the definition under Article 1.1 of the SCM Agreement

69. The EU considers that the RECAP programme provides a financial contribution to the accredited companies in the form of revenue otherwise foregone or not collected in the sense of Article 1.1(a)(1)(ii) of the SCM Agreement.

70. *First*, there is no general rule of taxation by which "predominantly credit accumulating companies" are exempted from paying PIS/PASEP, COFINS, PIS/PASEP-*Importação* and COFINS-*Importação* contributions in Brazil. Brazil has equally failed to demonstrate that this rule is part of its organising principles. Specifically with respect to the RECAP programme, Brazil has not adduced evidence showing why the 50% export threshold is appropriate with respect to RECAP companies.

71. *Second*, the EU disagrees with Brazil that tax authorities cannot make a horizontal rule for predominantly credit accumulating companies. Brazil wrongly focuses on the difficulties in predicting *ex ante* which sectors would be in a credit accumulation situation. The EU considers that Brazil could device a general rule to prevent tax credit accumulation with respect to companies (as opposed to sectors) whereby companies accumulating a particular amount of tax credits in the preceding or preceding years could benefit from a suspension of taxes. The ultimate exemption could be subject to the company actually having more tax credits than debits in a given year.

72. *Third*, in the view of the EU, Brazil alleges the existence of a general rule to avoid credit accumulation but exempts the sales of products by RECAP accredited companies in the Brazilian market. While the EU understands the logic of exempting taxes on capital goods of exporting companies (which are not subject to taxes when exporting their products), the EU fails to understand the logic of also exempting from the payment of those contributions when the RECAP company sells 49% of its production in Brazil.

73. *Fourth*, the appropriate normative benchmark in this case should be the tax treatment of comparable income of comparably situated taxpayers, i.e. the purchase of capital goods by non-accredited companies under the RECAP programme.

74. *Fifth*, when the government suspends/exempts the collection of PIS/PASEP, COFINS, PIS/PASEP-*Importação* and COFINS-*Importação* contributions on those transactions made by a RECAP accredited company, it foregoes or does not collect revenue otherwise due. The suspension and exemption of taxes otherwise due increases the cash flow of the accredited company, which does not need to anticipate the amounts to the tax authorities.

75. *Sixth*, the EU disagrees that pursuant to Article 1, XII of Law 11,774/08, the totality of PIS/COFINS tax credits generated by the purchase of capital goods may be offset immediately. There would always be a risk that the tax authorities would collect less revenue.

76. *Finally*, the EU observes that Brazil does not contest the fact that, under the normative benchmark, when purchasing certain capital goods non-accredited companies are subject to an additional 1% in the case of COFINS-*Importaçao* that does not generate any right to a tax credit. Brazil does not deny that the RECAP beneficiary never pays the COFINS-*Importação* amounts due on the import transaction, including the additional 1%; and later on, with regard to the revenue from domestic sales, a lower COFINS rate applies, without any additional percentages. This means that the additional 1% is definitely lost to the government with respect to RECAP companies.

77. With respect to benefit in accordance to Article 1(1)(b) of the SCM Agreement, even if the RECAP programme were to be considered merely as a tax deferral (*quod non*), the programme would be improving the cash flow conditions of the accredited companies, which do not need to

advance the money when it was due in comparison to the prevailing normative benchmark. This in itself would provide a benefit to the accredited companies pursuant to the RECAP programme.

78. The EU also fails to see how the tax suspension and exemption pursuant to the RECAP programme could increase the price of inputs. Whether the seller to a RECAP company will decide to increase its price is pure speculation. Rather, the reality would indicate the opposite. According to the RECAP programme, the invoices to the RECAP entity must specify that the transaction is made subject to the PIS/PASEP and COFINS suspension. Thus, it should be expected that the price of the capital good is equal or less than the price charged by the same producers to other non-accredited companies.

79. Finally, the EU disagrees that the RECAP programme merely equalises the conditions of competition by making all companies in the Brazilian market not credit accumulators. The RECAP programme provides an advantage in the form of better cash flow for the accredited companies when compared to what the rule would be absent the programme. This was clearly spelled out in the Explanatory Memorandum.

4.1.2. The RECAP programme provides subsidies which are contingent upon export performance

80. The EU disagrees with Brazil that the criteria for the accreditation under the programme (i.e. the 50% export requirement) do not constitute export contingency, but an objective threshold above which tax credits are accumulated. In addition to the fact that Brazil has failed to show on which basis it sets the 50% export requirement generally, the text of Article 13 of Law 11,196/2005 explicitly states that, in order to obtain the RECAP benefits, the company in question must commit to a certain level of export performance. The reasons behind requiring such an export commitment are irrelevant to determine whether the subsidy is contingent upon export performance in the sense of Article 3.1(a) of the SCM Agreement.

4.2. CLAIMS RELATING TO THE SCHEME OF EXPORT CONTINGENT SUBSIDIES FOR THE PURCHASE OF RAW MATERIALS, INTERMEDIATE GOODS AND PACKAGING MATERIALS

81. The EU maintains that the scheme at issue amounts to a prohibited subsidy under Article 3.1(a) of the SCM Agreement. Since the reasons alleged by Brazil with respect to the RECAP and PEC programmes are identical, the EU incorporates in this section, *mutatis mutandi*, the claims under the RECAP programme. However, the EU makes some specific comments below.

4.2.1. The PEC programme provides subsidies in accordance with the definition under Article 1.1 of the SCM Agreement

82. The EU considers that the PEC programme provides a financial contribution to the accredited companies in the form of foregoing or not collecting revenue otherwise due in the sense of Article 1.1(a)(1)(ii) of the SCM Agreement.

83. *First*, Brazil makes an artificial distinction between companies that do not tend to accumulate credits and, hence, "operate normally in the credit-debit system", on the one hand, and "credit accumulating companies", such as a PEC, on the other hand, "which are not similarly situated with regard to their tax burden". Brazil wrongly assumes that companies whose gross profit predominantly originates from products subject to taxation "can expect to offset regularly the totality of their credits in the next month of production", whereas companies whose gross profits originate predominantly from products subject to low taxation or exempted, such as a PEC, structurally and increasingly accumulate credits tied up with the tax authority. Whether a company can offset its tax credits in the next month of production depends on multiple factors such as its organization, profitability, economic activity, etc. In fact, for many companies, it may take more than a month between the purchase of inputs and the making/selling of the final product incorporating those inputs.

84. *Second*, Brazil also wrongly argues that in the case of predominantly exporting companies most taxes on inputs are not due as in principle they are incorporated into exempted final products, and thus would have to be reimbursed. The logic of Brazil's taxation system in a non-cumulative regime is that it decides to impose a cost of the companies purchasing the inputs (and

having to advance taxes on the inputs) even if those amounts are compensated (with no legal interest) later on. In other words, the "cost of money" is with the companies, not with the government. Thus, Brazil's argument is incorrect and entirely circular.

85. *Third*, Brazil wrongly argues that the PEC programme, as well as the other "special regimes" identified by Brazil in its first written submission, are an expression of a general rule of taxation and the proper tax regulation for certain types of companies and for a certain type of product. The common features of special regimes are not tackling the phenomenon of credit accumulation. Rather, they target very specific sectors in an effort to boost their performance such as promoting exports of technology and IT services (REPES), boosting the competitiveness of the domestic aeronautic industry and substitute imports (RETAERO), achieving independency of defense (RETID), and incentivising the use of computers in schools (REICOMP).

86. *Fourth*, the EU also disagrees with Brazil's perception that the EU's reasoning would impose an excessive burden on predominantly credit-accumulating companies and would ultimately lead to an additional cost for the government, which would have to pay interest on the amounts reimbursed to these companies. As explained before, Brazil could well tackle the phenomenon of credit accumulation by foreseen a general rule which ensures that the tax credits/tax debits are even out quickly.

87. *Fifth*, Brazil wrongly asserts that the PEC programme is an effective means to apply the destination principle reflected in footnote 1 of the SCM Agreement, which further demonstrates that there is no revenue foregone otherwise due. However, the EU does not take issue with the fact that under the PEC (or RECAP) programme exported products are not subject to indirect taxation; rather, the EU considers that the same exemption with respect to products sold locally amounts to a subsidy. Brazil then further makes incorrect economic assumptions to show that a predominantly exporting company would bear an additional burden of the credits that could not be offset.

88. *Finally*, Brazil wrongly argues that is no revenue foregone if the good is destined to the domestic market, since the full weight of the tax liabilities apply without any credits with which to offset them. The EU has shown in its first written submission that, even if the same nominal amount is collected by the government, it does so at different moments, thereby improving the cash flow of the beneficiaries at the expense of the financial loss for the government when compared to the general regimes.

89. With the same reasons stated in the context of the RECAP programme, the EU disagrees with Brazil's arguments regarding Article 1(1)(b) of the SCM Agreement.

4.2.2. The PEC programme provides subsidies which are contingent upon export performance

90. With the same reasons stated in the context of the RECAP programme, the EU disagrees with Brazil that the criteria for the accreditation under the PEC programme (i.e. the 50% export requirement) do not constitute export contingency, but an objective threshold above which tax credits are accumulated.

5. CONCLUSIONS

91. In view of the foregoing, as well as the previous submissions made before in these proceedings, the EU requests the Panel to find that the measures at issue are inconsistent with the GATT 1994, the TRIMs Agreement and the SCM Agreement and to recommend that Brazil brings itself into compliance with its obligations under the covered agreements.

ANNEX B-3

FIRST PART OF THE EXECUTIVE SUMMARY OF THE ARGUMENTS OF JAPAN

I. EXECUTIVE SUMMARY OF JAPAN'S FIRST WRITTEN SUBMISSION

1. This dispute is about a range of Brazilian tax policies that are structured and designed to tilt the competitive landscape in favor of domestic products through differential taxation, differential treatment, preferential subsidies, and other forms of discrimination on the basis of national origin. In particular, the measures at issue concern the tax incentive programmes for the automotive sector, the information and communication technology (ICT) sector, and exporting companies.

2. As for the automotive sector, INOVAR-AUTO reduces the tax burden associated with the IPI,[1] a generally applicable value-added tax (VAT), due on motor vehicles depending on criteria such as their origins and the levels of local content. For information and communications technology (ICT) products, under a suite of measures (i.e. the Informatics Programme, PADIS,[2] PATVD,[3] and the Digital Inclusion Programme), Brazil reduces or eliminates various taxes on goods including the IPI, PIS/PASEP, COFINS, PIS/PASEP-Importação and COFINS-Importação contributions,[4] if such goods are produced domestically and/or contain a specific level of local content. For goods for export – including capital goods, raw materials, intermediate goods, and packaging – RECAP[5] and PEC[6] suspend and/or eliminate applicable IPI, PIS/PASEP, COFINS, PIS/PASEP-Importação and COFINS-Importação taxes. All of these measures accord preferences to domestic products through tax reductions and exemptions and related requirements.

3. As discussed in greater detail below, these measures are inconsistent with core WTO obligations: Articles I:1, III:2, III:4, and III:5 of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Articles 3.1(a) and (b) and 3.2 of the SCM Agreement.

4. This dispute is not about Brazil's ability to adopt policies to promote development, support domestic research and development (R&D), and/or develop human capital. Japan fully appreciates that all WTO Members, including Brazil, have the prerogative to pursue such objectives, provided that they are WTO-consistent. As such, what Japan is challenging is not Brazil's policy itself, but Brazil's choice of measures for that policy. Japan also stresses that it is the overall structure and design of the measures at issue in this dispute which tend to shed the most light on the WTO-inconsistencies at issue, rather than the sometimes arcane details of Brazil's tax policies.

A. Overview of Brazil's Taxation System and Industrial Policy

5. Brazil is known for its complex tax schemes. In particular, as relevant in this dispute, Brazil imposes a number of indirect taxes on importation and domestic sale of goods. Among such indirect taxes are (i) the IPI, which is similar to a VAT and taxable upon importation and domestic sale of industrialized goods; (ii) social contributions known as PIS/PASEP and COFINS, and (iii) the import-focused variants of (ii), i.e. PIS/PASEP-Importação and COFINS-Importação. All of these are federal taxes. In addition, one of the taxes imposed at the sub-federal level is the value-added tax on goods and services known as Imposto sobre Circulação de Mercadoria e Serviços (ICMS). These various indirect taxes result in a significant increase in the prices of domestic and imported goods faced by consumers in the marketplace. Furthermore, imported goods incur additional costs including import duties (Impostos sobre a Importação, or II) and customs clearance fees. The

---

[1] I.e. Tax on Industrialized Products (*Imposto sobre Produtos Industrializados*).

[2] I.e. the Programme of Incentives for the Semiconductors Sector (*Programa de Incentivos ao Setor de Semicondutores*).

[3] I.e. the Programme of Support to the Technological Development of the Industry of Digital Equipment (*Programa de Apoio ao Desenvolvimento Tecnológico da Indústria de Equipamentos para TV Digital*).

[4] I.e. the *Programa de Integração Social* (Social Integration Programme), *Programa de Formação do Patrimônio do Servidor Público* (i.e. Civil Service Asset Formation Programme) and *Contribuição para o Financiamento da Seguridade Social* (Contribution to Social Security Financing).

[5] I.e. the Special Regime for the Purchase of Capital Goods for Exporting Enterprises (*Regime Especial de Aquisição de Bens de Capital para Empresas Exportadoras*).

[6] I.e. the Regime for Preponderantly Exporting Companies.

measures at issue in this dispute primarily concern the selective reduction of, and/or exemption from, the IPI, PIS/PASEP, COFINS, PIS/PASEP-Importação and COFINS-Importação.

6. The IPI tax is an indirect tax applied to all "industrialized" products, i.e. those products that have been modified through a production process. The IPI operates as a VAT on manufactured products. Specifically, at each stage of the production process of a good, the manufacturer's IPI liability will be equal to the difference between the sales price to the downstream producer or consumer, and the purchase price of the inputs (including if the inputs are imported). In this sense, the IPI is described as "non-cumulative" – i.e. the tax base is the value added by each individual manufacturer, rather than the cumulative value added by all producers.

7. The PIS and PASEP are taxes levied monthly on the gross revenue of businesses, and described as "social contributions". The PIS/PASEP contributions are collected to finance public funds for insurance for unemployment, child benefit and allowance for low paid workers. The COFINS is a tax for social security financing applied to the monthly invoicing. As individual sales of goods add to businesses' gross revenue, the PIS/PASEP and COFINS, like the IPI, operate as indirect taxes on sales of goods. The PIS/PASEP and COFINS are due either under a cumulative regime or a non-cumulative regime. The cumulative regime applies for certain types of companies (e.g. financial institutions and companies that elect the presumed profit regime for income tax purposes), as well as certain types of revenues (e.g. income from the sale of newspapers, telecommunication services, public transportation, education services, and civil construction). Otherwise the non-cumulative regime applies. The cumulative and non-cumulative regimes each have their own specific assessment rates.

8. PIS/PASEP-Importação and COFINS-Importação are the import-focused variants of PIS/PASEP and COFINS (and thus they exist in both cumulative and non-cumulative varieties). As such, PIS/PASEP-Importação and COFINS-Importação qualify as "internal taxes or other internal charges" within the meaning of Article III:2. These contributions are levied upon individual import transactions of goods and services. The taxable base is the customs value.

9. The non-cumulative taxes described above – i.e. the IPI, the non-cumulative version of PIS/PASEP and COFINS, and PIS/PASEP-Importação and COFINS-Importação – operate through a system of tax credits. When a manufacturer purchases or imports an input, it pays the applicable non-cumulative tax to the Brazilian government on the basis of the value of the input, and receives a credit of equal value. When the manufacturer then sells its finished product to a downstream producer or consumer, the manufacturer accrues a liability based on the value of the finished product. The net amount of tax due is the liability arising from the sale of the finished product, minus the credit arising from the purchase of the inputs.

B. Legal Standards

10. Japan's claims in this dispute are based on several provisions in the covered Agreements: Article III:2 of the GATT 1994; Article III:4 of the GATT 1994; Article III:5 of the GATT 1994; Article 2.1 of the TRIMS Agreement, separately and in conjunction with Article 2.2 and paragraph 1(a) of the Agreement's Illustrative List; Articles 3.1(b) and 3.2 of the SCM Agreement; and Article I:1 of the GATT 1994. The common thread among all of these claims is discrimination that is inherent in all of the challenged Brazilian measures by according preferences to domestic products through tax reductions, exemptions, and related requirements.

C. INOVAR-AUTO Is Inconsistent with Brazil's WTO-Legal Obligations

11. INOVAR-AUTO is a tax incentive programme in the automotive sector introduced in 2012 as part of a broader *Brasil Maior* industrial policy. Brazil argues that INOVAR-AUTO was introduced in order to achieve a variety of policy objectives including qualitative improvement of vehicles, technological and safety innovation and energy efficiency. In reality, however, INOVAR-AUTO incorporates, both explicitly and by its structure and design, and irrespective of Brazil's subjective intent, a number of origin-based distinctions between imported and domestic products – including both motor vehicles as well as the parts and components that go into them, and the equipment used in automotive manufacturing. In essence, INOVAR-AUTO is a mix of preferential tax policies for motor vehicles, as well as local content requirements that reach all the way to so-called Tier 3 auto inputs, or lower-level auto parts, components, and sub-components.

12. Japan challenges the specific features of INOVAR-AUTO, a tax incentive programme which imposes a generally applicable 30 percentage point increase in the IPI tax rates for motor vehicles, while also allowing for the possibility of a reduction or exemption from this 30-point increase. There are two ways to achieve a reduction/exemption of the IPI due on motor vehicles: (i) offsetting the IPI with the use of "presumed" IPI tax credits, and (ii) IPI tax rate reduction without the use of such credits.

13. In order to be eligible for item (i) above, companies must become accredited. They can do this by satisfying a particular combination of the following criteria: perform a certain minimum number of manufacturing activities, directly or through third parties, within Brazil for at least 80% of vehicles that are produced; spend a certain minimum percentage of gross revenues on R&D in Brazil; spend a certain minimum percentage of gross revenues in Brazil on engineering, basic industrial technology and the capability of corresponding suppliers; and/or have a certain number of models of vehicles certified by INMETRO, Brazil's vehicular tagging programme. Current manufacturers of domestic motor vehicles in Brazil, as well as companies that have committed to establish or expand manufacturing operations in Brazil, are required to satisfy different and less onerous combinations of these criteria than companies that manufacture motor vehicles outside Brazil and companies that market imported motor vehicles in Brazil.

14. Once the accreditation requirements are fulfilled, a company may earn "presumed" IPI tax credits, which can be used to offset an amount of IPI tax corresponding to up to 30% of the taxable base (the sales price) in domestic transactions. The accrual of "presumed" IPI tax credits is linked to the level of expenditure made "in the Country" (*no País*) on certain items, including strategic inputs (*insumos estratégicos*) and tooling (*ferramentaria*). This "in the Country" requirement is construed to mean that both the buyer and the seller are located in Brazil. Therefore, expenditures on imported strategic inputs and tooling cannot accrue IPI tax credits, because the seller (exporter) is not located in Brazil. In addition, under Implementing Order 257/2014, IPI tax credits arising from expenditures on strategic inputs and tooling are reduced if they do not contain specified levels of local content.

15. INOVAR-AUTO also provides for item (ii) above – i.e. IPI tax reductions without the use of IPI tax credits available under certain circumstances. Under INOVAR-AUTO, motor vehicles produced in other Mercosur countries and/or Mexico, if imported by companies accredited under Article 2, item I or item III of Decree 7,819 (i.e. domestic manufacturers or investors), receive an automatic 30 percentage point reduction in the applicable IPI rate, effectively eliminating the higher IPI rate introduced by INOVAR-AUTO for motor vehicles in general. In addition to the tax reduction explained above, motor vehicles imported from Uruguay (which is also a Mercosur member) are subject to even more favorable treatment by extending the automatic IPI rate reduction to motor vehicles from Uruguay, regardless of accreditation. Moreover, motor vehicles from any member state, including one outside the Mercosur/Mexico group, may also be able to benefit from a 30 percentage point IPI tax rate reduction, if imported by an accredited company.

16. In light of the features described above, INOVAR-AUTO discriminates on the basis of origin with respect to both motor vehicles as well as automotive components and manufacturing equipment. Thus, regardless of the stated objectives of INOVAR-AUTO, or the Brazilian government's subjective intent, INOVAR-AUTO distorts the equality of competitive conditions between imported and domestic products, and promotes precisely the type of protection to domestic production as mentioned by the Appellate Body. Through a complex web of requirements, INOVAR-AUTO protects the domestic motor vehicle and automotive components industry, by making it more difficult for production, importation, purchase and/or use of foreign motor vehicles and automotive components to result in reduction in the IPI imposed on vehicles. Indeed, this is precisely how the measure is structured and designed to operate.

17. The protectionist aspects of INOVAR-AUTO are inconsistent with WTO rules in several different ways:

(i) As internal taxes on imported motor vehicles in excess of those applied to like domestic products, in violation of the first sentence of Article III:2 of the GATT 1994;

(ii) As internal taxes applied so as to afford protection to domestic production, in violation of the second sentence of Article III:2 of the GATT 1994;

(iii) As less favourable treatment for imported motor vehicles and automotive parts than like domestic products, in violation of Article III:4 of the GATT 1994;

(iv) As an internal quantitative regulation relating to the mixture, processing or use of automotive components in specified amounts or proportions, which requires that specified amounts or proportion be supplied from domestic sources, and which is applied so as to afford protection to domestic production, in violation of Article III:5 of the GATT 1994;

(v) As a trade-related investment measure that is inconsistent with the above-listed provisions of the GATT 1994, in violation of Article 2.1 of the TRIMs Agreement, separately and in conjunction with Article 2.2 and paragraph 1(a) of the Agreement's Illustrative List;

(vi) As a tax subsidy to domestic motor vehicle producers to use domestic over imported automotive components, in violation of Articles 3.1(b) and 3.2 of the SCM Agreement; and

(vii) As a measure that denies motor vehicles originating in most WTO Members the same advantages as those granted to motor vehicles originating in Mercosur and Mexico (which are Brazil's close trading partners), in violation of Article I:1 of the GATT 1994.

D. The ICT Measures are Inconsistent with Brazil's WTO-Legal Obligations

18. Four ICT-related programmes are being challenged in this dispute: the Informatics Programme, PADIS (the Support Programme for the Technological Development of the Semiconductor Industry), PATVD (the Support Programme for the Technological Development of the Digital TV Equipment Industry), and the Digital Inclusion Programme (collectively, the "ICT Measures").

19. Brazil's ICT policies have their roots in one of the measures subject to this dispute: the tax reduction programme under the Informatics Law, or the *Informatics Programme*. The *Informatics Programme* reduces or eliminates the applicable IPI tax due on domestic ICT products on certain conditions. Specifically, to claim benefits arising under the Informatics Programme, companies that manufacture covered products must obtain a product-specific accreditation (*habilitação*) from the Brazilian government, which involves demonstrating that they produce the relevant product in Brazil in accordance with the terms of the particular product-specific *Processo Produtivo Básico* ("basic production process"), or PPB. In turn, PPBs identify particular intermediate manufacturing steps that must take place in Brazil in order for companies to be accredited. Since 1991, the Informatics Law has been amended and expanded so that it now affects a large number of product categories even beyond core ICT equipment.

20. *PADIS* is a tax incentive programme for semiconductor electronic devices, information displays, and supplies and dedicated equipment for those products. PADIS eliminates, *inter alia*, the IPI, PIS/PASEP, COFINS payments otherwise due on the gross revenue from sales of those products. As with the Informatics Programme, in order to benefit under PADIS, companies must obtain product-specific accreditations from the Brazilian government. Accreditation requires the performance of certain manufacturing steps in Brazil, which are specified either in Brazilian laws and regulations (i.e. in the case of semiconductor electronic devices and displays), or else in PPBs (i.e. in the case of supplies and dedicated equipment).

21. *PATVD* is a tax incentive programme for the digital TV equipment industry, the basic structure of which is very similar to that of PADIS. PATVD eliminates, *inter alia*, the IPI, PIS/PASEP and COFINS otherwise due on the gross revenue from sales of radio frequency signal transmitting equipment for digital televisions. As with PADIS, companies must obtain product-specific accreditations from the Brazilian government in order to benefit from PATVD. This requires that

companies produce covered products in accordance with the requirements of the relevant PPB, or meet alternative criteria.

22. The *Digital Inclusion Programme* eliminates the PIS/PASEP and COFINS contributions otherwise due on the gross revenue from sales of certain consumer electronic products, such as computers, routers, smartphones and other hardware. The products covered by the Digital Inclusion Programme are also covered by the Informatics Programme, and thus the two complement each other: the Informatics Programme reduces or eliminates the applicable IPI, while the Digital Inclusion Programme eliminates the applicable PIS/PASEP and COFINS.

23. Thus, the ICT Measures at issue in this dispute have several similar features that make them problematic from a WTO perspective: they involve product-specific exemptions from generally applicable taxes due on products; and they all make the exemptions conditional on the performance of certain intermediate manufacturing processes in Brazil (which are specified either in PPBs or other legal instruments). As such, imported products cannot benefit from tax exemptions/reductions under these programmes, resulting in origin-based distinctions between imported and domestic products. In addition, these programmes, either explicitly or through the manufacturing steps requirements, require the use of domestic over imported inputs.

24. Accordingly, the Informatics Programme, PADIS, PATVD, and the Digital Inclusion Programme, and each of the legal instruments through which they are established and administered – both individually and collectively – in light of their structure and design, are inconsistent with Brazil's obligations under the following provisions of the GATT 1994, the TRIMs Agreement and the SCM Agreement:

(i) Article III:2 of the GATT 1994, because imported ICT, automation and related products are subject, directly or indirectly, to internal tax burdens in excess of those applied, directly or indirectly, to like domestic products; and because imported ICT, automation and related products and directly competitive or substitutable products that are domestically produced are taxed in a manner that affords protection to domestic production.

(ii) Article III:4 of the GATT 1994, because the conditions and requirements to benefit from tax advantages under the respective programmes result in less favourable treatment for imported products than that accorded to like domestic products; and because the requirement to use local inputs and equipment in the production of ICT, automation and related products results in less favourable treatment for imported inputs and equipment than that accorded to like domestic products.

(iii) Article III:5 of the GATT 1994, because the criteria and/or requirements to benefit from tax advantages under the respective programmes, including (*inter alia*) the requirement to perform certain manufacturing steps in Brazil, the requirement to use specific kinds of inputs and/or the minimum levels of local content or national value added, amount to internal quantitative regulations relating to the mixture, processing or use of products in specified amounts or proportions, which require that a specified amount or proportion of the final product be supplied from domestic sources; and because the said criteria and/or requirements also amount to internal quantitative regulations that are applied so as to afford protection to domestic production.

(iv) Article 2.1 of the TRIMs Agreement, separately and in conjunction with Article 2.2 and paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement, because the programme and related legal instruments are TRIMs that are inconsistent with Article III of the GATT 1994; and because they require the purchase or use of products of domestic origin or from domestic sources in order to obtain tax advantages.

(v) Articles 3.1(b) and 3.2 of the SCM Agreement, because the programmes and related legal instruments are and/or confer subsidies within the meaning of

Article 1.1 of the SCM Agreement that are contingent upon the use of domestic over imported products.

E. RECAP and PEC Are Export Subsidies

25. In recent years, Brazil has established two programmes that confer benefits to "predominantly exporting companies" in the form of a suspension, and ultimately an exemption, of taxes otherwise due in relation to their inputs and capital goods.

26. First, under the RECAP programme (established by Law 11,196/2005), companies that are accredited as "predominantly exporting companies" are entitled to purchase (i.e. purchase domestically or import) capital goods (machinery, tools or other equipment) free of PIS/PASEP, COFINS, PIS/PASEP-*Importação* or COFINS-*Importação* (i.e. these taxes are suspended and, generally, eventually exempted) – whereas in the absence of RECAP, the companies would generally be responsible for paying each of those taxes immediately. "Predominantly exporting companies" is defined to mean that the companies meet certain levels of export performance – currently, 50% of gross turnover.

27. Second, under PEC (established by Law 10,637/2002 and Law 10,865/2004), companies that are accredited as "predominantly exporting companies" are entitled to acquire (i.e. purchase domestically or import) raw materials, intermediate goods and packaging materials without having to pay IPI, PIS/PASEP, COFINS, PIS/PASEP-*Importação* or COFINS-*Importação* (i.e.these taxes are suspended and, generally, eventually exempted) – whereas in the absence of PEC, the companies would generally be responsible for paying each of those taxes immediately. In the absence of PEC, the company would generally be responsible for paying each of those taxes immediately. As with RECAP, "Predominantly exporting companies" is defined to mean that the companies meet certain levels of export performance – currently, 50% of gross turnover.

28. Thus, both schemes have a similar design and structure, including because they provide certain tax-related advantages to companies accredited as "predominantly exporting companies". However, RECAP and PEC provide tax-related advantages with respect to different products: RECAP pertains to new capital goods, and PEC pertains to raw materials, intermediate goods and packaging materials. In addition, another difference between the two schemes is that PEC suspends IPI for covered products, whereas RECAP does not cover IPI.

29. In addition, neither RECAP nor PEC requires that the specific goods eligible for suspensions/exemptions be consumed in the production of exported products. Rather, these programmes grant suspensions/exemptions for goods irrespective of whether they are exported or destined for the domestic market – provided that the companies that purchase the relevant goods are accredited, which (as noted above) requires that they be deemed "predominantly exporting companies", and provided that other applicable requirements are met..

30. Accordingly, both RECAP and PEC are subsidies contingent on export performance within the meaning of the SCM Agreement, and thus are inconsistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement.

F. Conclusion

31. The measures challenged in this dispute discriminate against Japanese and other foreign motor vehicles, automotive components and equipment, and ICT products. They also confer prohibited export subsidies. They place Japanese and other foreign products at a significant and cross-cutting competitive disadvantage in the marketplace. In addition, INOVAR-AUTO in particular denies Japanese products the MFN treatment to which they are entitled.

32. Accordingly, Japan requests that the Panel find that INOVAR-AUTO, the ICT Measures, and RECAP and PEC are inconsistent with the provisions of the covered agreements listed above and in Japan's panel request.

II. EXECUTIVE SUMMARY OF JAPAN'S OPENING STATEMENT AT THE FIRST MEETING OF THE PANEL

A. Introduction

33. This dispute involves three categories of measures. The first is INOVAR-AUTO, which provides a tax reduction for motor vehicles manufactured in Brazil with the use of strategic inputs and tooling of domestic origin, whereas imported motor vehicles are not eligible for the reduction except under very limited circumstances. In addition, INOVAR-AUTO completely exempts imported motor vehicles from the 30 percentage point IPI tax rate if the vehicles originate in other MERCOSUR countries or Mexico.

34. The second set of measures are the ICT Measures. The ICT Measures are similar to INOVAR-AUTO in the sense that they reduce or exempt applicable IPI taxes and/or other internal taxes otherwise due on the sale of covered products, provided that these products are manufactured in Brazil with a sufficient number of manufacturing steps also performed in Brazil, and provided that they incorporate domestic inputs, in accordance with PPBs and other legal instruments.

35. The third set of measures consists of RECAP and PEC, two programmes that confer benefits to "predominantly exporting companies" in the form of a suspension, and ultimately an exemption, of internal taxes otherwise due in relation to their inputs and capital goods. These programmes explicitly condition the benefits upon export performance, because "predominantly exporting companies" is currently defined as companies that export at least 50% of gross turnover.

36. Japan would like to note that in its first written submission, Brazil essentially does not dispute the basic facts described by Japan. In particular, Brazil appears to accept the accuracy of Japan's description of the objective features and operation of the measures, including the benefits that they confer, the conditions for receiving the benefits, and the identification of the legal instruments containing this information. As such, the core issue in this dispute appears to be whether or not, based on the undisputed facts, the challenged measures violate the WTO Agreement in the ways identified in Japan's panel request and first written submission, including through origin-based discrimination, contingency upon the use of domestic over imported inputs (or local content requirements), and contingency upon export performance.

37. Japan will address four specific legal issues that should inform the Panel's examination of all the measures at issue in this dispute.

B. Brazil's Characterization of the Challenged Measures' Policy Objectives is Without Merit

38. Brazil characterizes INOVAR-AUTO, the ICT Measures, RECAP and PEC as all being intended for legitimate policy objectives such as innovation, the promotion of research and development, safety, protection of the environment and tax administration, and states that "[t]here is no masked intent behind them." However, Brazil's characterization is unavailing for a number of reasons.

39. First, Japan fully agrees that WTO Members have the right to pursue a range of policy goals including those referred to by Brazil. Japan also recognizes governments' discretion to adopt industrial measures in order to achieve such policy goals. However, Members are at the same time obliged to pursue their policy objectives in a manner consistent with their obligations under the WTO rules, which the Members themselves undertook. In other words, a WTO-inconsistent measure cannot simply be excused because it was intended for a legitimate purpose. Rather, as prior WTO jurisprudence has made abundantly clear, what matters are the objective features of the relevant measures, including the text of any relevant legal instruments, as well as the "design, the architecture, and the revealing structure of a measure".

40. Second, Brazil's characterizations of the measures' purposes in most instances are no more than mere allegations of Brazil's subjective intent which lack any evidentiary support. In fact, the policy objectives identified by Brazil are contradicted by, or otherwise cannot explain, the objective features and operation of the measures that Japan is taking issue with in this dispute.

41. Starting with INOVAR-AUTO, Brazil characterizes INOVAR-AUTO as a "specific tax regime for the automotive sector in Brazil aiming at supporting technological development, innovation, safety, environmental protection, energy efficiency and improvement of the quality of cars, trucks, buses and auto parts". Brazil also asserts that the tax reduction is granted to offset the costs companies incur in order to satisfy various requirements under INOVAR-AUTO, including the R&D investment requirement. On these bases, Brazil submits that INOVAR-AUTO "as a whole" does not violate WTO national treatment obligations.

42. Brazil's description of INOVAR-AUTO's policy objectives is misplaced, because Japan is not challenging INOVAR-AUTO on the basis that each aspect of the measure is WTO-inconsistent. Nor does Japan contend that INOVAR-AUTO's sole purpose is to distort trade. Rather, Japan challenges INOVAR-AUTO because it has certain specific features that are WTO-inconsistent, i.e. the differential treatment of imported and domestic products with regard to accreditation, as well as the calculation and use of IPI tax credits, and origin-based preferences for motor vehicles originating in other MERCOSUR countries and Mexico.

43. This discriminatory treatment cannot be explained or justified by any of the objectives alleged by Brazil. Whereas Brazil submits that INOVAR-AUTO is intended to achieve legitimate policy goals, it provides no explanation as to specifically how each type of discriminatory treatment between imported and domestic products under INOVAR-AUTO serves these objectives. For example, the up-to-30 percentage point reduction in IPI taxes on motor vehicles available under INOVAR-AUTO accrues through expenditures in Brazil on "strategic inputs and tooling" – i.e. domestic motor vehicle components parts and manufacturing equipment. However, the definitions of these terms lack any reference to energy efficiency or vehicle safety,[7] while they contain certain criteria relating to the origins of these products. As such, there is no basis on which to characterize this aspect of INOVAR-AUTO as serving the objectives alleged by Brazil, such as energy efficiency and vehicle safety.

44. In fact, Brazil even appears to admit that this aspect of INOVAR-AUTO is not directly related to the policy goals it asserts. Specifically, Brazil does not dispute the differential treatment of domestic and imported strategic inputs and tooling with respect to calculation and use of presumed IPI credits, but argues that "this potential difference is . . . justified under paragraphs (b) and (g) of Article XX" because it "ensure[s] the effective supply and development of a domestic auto parts industry able to provide environmentally friendly and energy efficient auto parts . . .". Essentially, Brazil's argument is that environmental goals require a strong domestic industry, so any measure that strengthens the domestic industry is justified – even if it is plainly discriminatory. Obviously this falls short of the means-end connection required under items (b) and (g) of Article XX. Moreover, Brazil has a range of reasonably available alternatives which would be less trade-restrictive than INOVAR-AUTO. INOVAR-AUTO also fails to meet the requirements of the chapeau of Article XX. Accordingly, even if Brazil had established that INOVAR-AUTO is provisionally justified under Article XX – which it has not done – Brazil's Article XX defences would still fail.

45. With respect to the ICT Measures, Brazil argues that the Informatics Programme is designed to "promote industrialization, technological innovation and the development of a skilled workforce." With respect to PADIS, Brazil asserts that the purpose is to "ensure a minimum productive capacity of semiconductor consistent with the protection of basic strategic interests[]". With respect to PATVD, Brazil asserts that it "guarantee[s] access to culture, education and information through digital television in Brazil". Brazil also invokes defence under Article XX(a) in this regard. In addition, Brazil asserts that the Digital Inclusion Programme is "aimed at increasing the access of the Brazilian population to computers and information technology products". Brazil also raises an "offsetting" argument, stating that the benefits under the ICT Measures are designed to subsidise investments made in R&D and the production chain.

46. Brazil again fails to address the core issue. As explained in Japan's first written submission, a key aspect of all four ICT Measures is their incorporation of domestic production requirements with respect to both final and intermediate products, via PPBs and other legal instruments. These requirements necessarily result in different tax rates for domestic and imported ICT products. However, the policy objectives identified by Brazil cannot explain these differences, leaving a number of questions unanswered. Brazil's "offsetting" argument is meritless because there is no

[7] Implementing Order 257/2014, Exhibit JE-158, Articles 1 and 2.

evidence of any quantitative correspondence between the actual amount of investments made to meet the requirements of the ICT Measures and the amount of tax subsidies conferred.

47. Moreover, with respect to PATVD in particular (i.e. the only ICT Measure for which Brazil has invoked Article XX): there is a range of less trade-restrictive measures that are reasonably available to achieve the programme's stated objectives. PATVD also falls short of the means-end connection required under item (a) of Article XX, let alone the requirement of the chapeau. Accordingly, even if Brazil had established that PATVD is provisionally justified under Article XX – which it has not done – Brazil's Article XX defense would still fail.

48. Turning to RECAP and PEC, which are tax programmes for "predominantly exporting companies", Brazil asserts that these measures are intended to address a problem of tax credit accumulation, and not subsidies contingent upon export performance. In particular, Brazil contends that predominantly exporting companies "tend" to accumulate tax credits, and recovering these tax credits requires "submitting a great number of tax reimbursement requests" which imposes an administrative burden on Brazil's tax authorities.

49. However, contrary to what Brazil contends, RECAP and PEC reward export performance itself, rather than the accumulation of IPI credits. The relevant legal texts could not be more straightforward in this regard: for example, a category of beneficiaries of RECAP is defined as "a legal person that (a) had gross revenue from export sales that is 50% or greater of total gross revenue from sales of goods and services . . . and (b) commits to maintain this 50% or greater export percentage . . .". Similarly, the beneficiaries of PEC are defined as "persons whose gross revenue derived from exports . . . exceeded 50% of their total gross revenue from the sales of goods and services . . ." or "a legal person . . . when its gross revenues from export . . . was equal to or greater than 50% of its to total gross revenue from the sale of goods and services . . .". Furthermore, the advantages under RECAP and PEC do not depend on the actual credit/debit balance of the company in the sense that but for those measures, beneficiary companies always or necessarily would have accumulated tax credits. Finally, Brazil's contention regarding the measures' purpose, even in terms of its subjective intent, is also undermined by evidence.

C. Irrelevance of Market Data

50. On the basis of market data, Brazil argues that the "in excess of" and "less favourable treatment" requirements of Japan's Article III claims are not met. In particular, with respect to INOVAR-AUTO, Brazil asserts that INOVAR-AUTO" has imposed no adverse effects on the competitive opportunities for imported products". Rather, according to Brazil, after the introduction of INOVAR-AUTO "the deficit in Brazil's balance of trade concerning the sector has continuously increased."

51. As an initial matter, it is not clear how Brazil has obtained the alleged "market data", because Brazil does not specify their sources. More importantly, in Japan's view, Brazil's arguments are legally irrelevant to the matter before the Panel. As the Appellate Body has explained, an analysis under Article III of the GATT 1994 should be "grounded in close scrutiny" of the "fundamental thrust and effect of the measure itself", and "need not be based on the actual effects of the contested measure in the marketplace." Moreover, the Appellate Body in *Japan – Alcoholic Beverages II* and *Korea – Alcoholic Beverages* further stated that "it is irrelevant [to Article III inconsistency] that the 'trade effects' of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent."

52. In addition, and in any event, Brazil's "market data" do not even establish the empirical proposition that they purport to show – i.e. that the challenged measures have not put imports at a disadvantage. Brazil does not address the counterfactual level of imports in the absence of the challenged measures.

D. The Scope of Article III of the GATT 1994

53. As for the third legal issue, Brazil argues that INOVAR-AUTO and the ICT Measures fall outside the scope of Article III, because they relate to production, or "pre-market" stages, and not to products. In particular, Brazil argues that INOVAR-AUTO's accreditation requirements, including

the minimum production step requirement, do not result in any inconsistency with Article III because they are supposedly "pre-market requirements that do not affect products".

54. These arguments rely on a false dichotomy between measures that affect goods at the so-called "pre-market" stage, i.e. those that pertain to production and intermediate goods, and, on the other hand, those that affect downstream goods directly. In fact, there is no reference whatsoever in the texts of Article III, including paragraphs 2, 4 and 5, to the alleged distinctions between "pre-market" and "post-market" stages. Nor have any WTO panels or the Appellate Body ever relied on such distinctions. On the contrary, the text of Article III clearly indicates that the scope of this Article is broad enough to cover both "pre-market" and "post-market" stages, as well as any other stages. This is evident with respect to Article III:2, first sentence, which covers excess taxation to which imported products are subject, directly or indirectly.

55. Similarly, Article III:4 covers "all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." As the Appellate Body has stated, the word "affecting" has a "'broad scope of application'". Thus, any measure that affects the internal sale, offering for sale, purchase, transportation, distribution or use of products, in any manner whatsoever "may fall within the scope of Article III:4. In addition, Article III:5 prohibits certain types of "internal quantitative regulation relating to the mixture, processing or use of products", which evidently covers measures that affect "pre-market" stages.

56. Turning to Article III:8(b) of the GATT 1994, which Brazil also invokes, this provision cannot be construed to justify origin-based discrimination that has been found to be inconsistent with other provisions of Article III, including paragraphs 2, 4 and 5. As explained by the panel in *Indonesia – Autos*, "the purpose of Article III:8(b) is to confirm that subsidies to producers do not violate Article III, so long as they do not have any component that introduces discrimination between imported and domestic products".

57. In addition, the tax advantages under INOVAR-AUTO and the ICT Measures do not constitute "the payment of subsidies exclusively to domestic producers[]" as set forth in Article III:8(b). In *Canada – Periodicals*, the Appellate Body found that the phrase "the payment of subsidies" only covers those subsidies that "involve[] the expenditure of revenue by a government[]", as opposed to e.g. revenue foregone that is otherwise due. As such, subsidies in the form of tax reductions or exemptions, as is the case with INOVAR-AUTO and the ICT Measures, cannot be justified under Article III:8(b).

E. Inapplicability of the Enabling Clause

58. The fourth issue is the applicability of the Enabling Clause. In its first written submission, Japan established that INOVAR-AUTO is inconsistent with Article I:1 of the GATT 1994 because it provides "advantage[s]" to motor vehicles originating in other MERCOSUR members and Mexico, which are not available to motor vehicles originating elsewhere. Brazil does not deny that INOVAR-AUTO favours motor vehicles from other MERCOSUR countries and Mexico, but instead argues that such discrimination is permitted under paragraph 2(b) of the Enabling Clause.

59. However, Brazil's argument fails. First, the Enabling Clause sets forth special treatment for developing Members by granting exceptions to the MFN principle, which is one of the pillars of the WTO Agreement. In particular, paragraph 4 of the Enabling Clause explicitly requires the Member taking an action under the Enabling Clause to notify, *ex ante*, other Members and furnish them with all relevant information, and to afford adequate opportunity for prompt consultations at the request of any interested Member. Second, while Brazil argues that the differential treatment under INOVAR-AUTO falls within "non-tariff measures" set out in paragraph 2(b) of the Enabling Clause, paragraph 2(b) does not endorse exceptions to the MFN principle with respect to "non-tariff measures" themselves, as Brazil appears to understand. Instead, paragraph 2(b) pertains to differential and more favourable treatment with respect to "*the provisions of the General Agreement concerning* non-tariff measures *governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT*".[8] However, Brazil does not even assert, much less establish, that INOVAR-AUTO provides for an exception with respect to "the provisions of the General Agreement . . . governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT". In addition, while Brazil briefly refers to paragraph 2(c) of the

[8] Emphasis added.

Enabling Clause, it fails to put forward any argument to substantiate its defence. Third, the term "non-tariff measures" should not be interpreted as including *anything* that does not relate to tariffs; rather, "non-tariff measures" should be construed to refer specifically to non-tariff *trade* measures, such as direct import/export restrictions, and not to behind-the-border measures, such as internal tax reductions.

F. Conclusion

60. The common denominator of all the measures in this dispute is discrimination. Brazil's measures upset the competitive balance between imported and domestic products, to the detriment of the former. Japan has explained and documented these instances of discrimination in painstaking detail, and Brazil does not dispute the basic facts. Rather, Brazil in its first written submission attempts to persuade the Panel that the measures are all intended for legitimate policy objectives. Brazil also invokes Article XX defenses in this regard with respect to some of the measures. However, none of the goals stated by Brazil can explain the specific features of the measures that Japan is challenging. In sum, Brazil fails to rebut the *prima facie* case put forward by the complainants.

ANNEX B-4

SECOND PART OF THE EXECUTIVE SUMMARY OF THE ARGUMENTS OF JAPAN

I. EXECUTIVE SUMMARY OF JAPAN'S SECOND WRITTEN SUBMISSION

1. Japan's first written submission performed a detailed factual and legal analysis of the measures at issue in this dispute, which was based on an examination of their structure, design, and operation. Based on this analysis, Japan concluded that each of the measures at issue in this dispute is inconsistent with the provisions of the covered agreements cited in Japan's panel request.

2. In response, Brazil acknowledges that "the overall factual explanations made by the complainants are correct[]". Thus, there is no disagreement between the parties with respect to the core facts at issue. However, Brazil disputes the legal basis for Japan's arguments, by drawing upon legal theories that are inconsistent with the text of the covered agreements, and inconsistent with findings in prior panel and Appellate Body reports.

3. In reality, Brazil's arguments represent attempts to weaken the interpretation of key WTO rules, which if accepted would open the door to circumvention by other WTO Members. Accordingly, it is important both for Japan's interests in this case and systemically, that Brazil's legal theories be rejected.

A. Cross-Cutting Issues

1. Brazil Does Not Dispute the Key Discriminatory Features Underlying the Measures at Issue

4. *INOVAR-AUTO* operates against the background of an IPI tax on motor vehicles that was raised by 30 percentage points in 2011. INOVAR-AUTO enables domestic companies to benefit from an up-to-30 percentage point reduction of IPI on motor vehicles under certain conditions. There are two ways to achieve such a reduction: (i) offsetting the IPI with the use of "presumed" IPI tax credits, and (ii) IPI tax rate reduction without the use of such credits. Brazil does not dispute the specific features of INOVAR-AUTO as described by Japan.

5. *The ICT Measures* at issue in this dispute (i.e. the Informatics Programme, PADIS, PATVD, and the Digital Inclusion Programme) all have similar features: they involve product-specific reductions/exemptions from generally applicable taxes due on products (i.e. IPI, PIS/PASEP and COFINS, and PIS/PASEP-*Importação* and COFINS-*Importação*); and they all make the reductions/exemptions conditional on the performance of certain intermediate manufacturing processes in Brazil, which are specified either in PPBs or other legal instruments. Unless specifically exempted, all the production steps in PPBs or other relevant legal instruments must take place in Brazil. In addition, given the nature of the particular production steps covered by PPBs or other relevant legal instruments, the requirement to perform certain manufacturing steps in Brazil is tantamount to requiring the incorporation of domestic content into the finished product. Furthermore, certain PPBs contain numerical thresholds indicating a required level of local content. Brazil does not dispute the specific features of the ICT Measures as described by Japan.

6. *RECAP and PEC* grant tax suspensions and/or exemptions to companies accredited as "predominantly exporting companies", which requires that they meet certain levels of export performance – currently, 50% of gross turnover (for both programmes). Accredited companies qualify for tax benefits for purchases (including imports) of certain products: for RECAP, the benefits accrue on purchase/import of capital equipment; for PEC, the benefits accrue on the purchase/import of raw materials, intermediate goods and packaging materials. The benefits take the form of a suspension of applicable taxes (in the case of RECAP, PIS/PASEP and COFINS, and PIS/PASEP-*Importação* and COFINS-*Importação*; in the case of PEC, all of these taxes as well as IPI). Suspension leads to exemption from having to pay the relevant taxes under certain conditions. Brazil seems to have no disagreement with Japan as regards the specific requirements

and operation of RECAP and PEC as a factual matter. Rather, Brazil only disputes the legal question of the appropriate normative benchmark for determining whether a financial contribution exists.

2. Despite Brazil's Continued Protestations, Its "Policy Objective" Arguments Still Do Not Constitute a Valid Defence

7. Japan's oral statement at the first substantive meeting with the Panel discussed Brazil's arguments that the challenged measures are intended for legitimate policy objectives such as innovation, the promotion of research and development, safety, protection of the environment, and tax administration. Japan explained that such arguments are mere assertions that are not supported by objective features establishing the discriminatory nature of the measures, such as their design, structure, and operation, and thus do not constitute valid defence.

8. Nonetheless, and without doing anything more to fix the flaws in its arguments, Brazil continues to argue – or in some instances just suggest – that it *intended* to pursue legitimate policy objectives such as innovation, R&D, safety, environment through the challenged programmes. Brazil's arguments are no more than mere assertions because it fails to explain how those purported policy objectives are embodied or manifested in the specific requirements or operation of the challenged measures. Brazil's description of the purported policy objectives appear to be *ex post* rationalizations and are often misleading as to the true structure and design of the challenged measures.

3. The Mere Fact That an Alleged Tax Subsidy Is Provided to Domestic Producers Does Not Necessarily Warrant a Determination of WTO-Consistency

9. Throughout the proceedings, Brazil has asserted that the tax advantages under INOVAR-AUTO and the ICT measures are subsidies "directed to domestic producers, not domestic products[]", and therefore, according to Brazil, they fall outside the scope of Article III of the GATT 1994 and other relevant provisions. In particular, Brazil contends that requirements to carry out certain manufacturing steps domestically (including production of intermediate goods) do not constitute a form of discrimination (e.g. local content requirements or preferential treatment for final goods) inconsistent with Articles III:2, III:4 and III:5 of the GATT 1994, Article 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement, and that they do not run afoul of the subsidy prohibition reflected in Articles 3.1(b) and 3.2 of the SCM Agreement.

10. However, the mere fact that a subsidy is granted to domestic producers and/or contingent on the domestic performance of certain production processes does not shield it from a finding that it is WTO-inconsistent. Rather, such a subsidy can nonetheless fall within the scope of the above-listed provisions if it meets the specific conditions mentioned in these provisions.

11. In this regard, it should be noted that it is always individual persons or legal entities that receive subsidies, because a product cannot itself receive money. As such, whenever a government wishes to favour a particular product by means of a subsidy, the recipient of such a subsidy is always individual persons or legal entities, such as producers, marketers, or consumers of the targeted product. Accordingly, if merely being directed towards particular producers or pertaining to production processes cured any WTO-inconsistency, then circumvention of WTO disciplines would be trivially easy. Members could simply provide a grant, for example, in the amount of a certain percentage (or even the entirety) of the price of the targeted product in the form of a subsidy to domestic producers of such a product. Under Brazil's theory, such a measure would automatically be WTO-consistent. In other words, the legal theory that Brazil's defence relies upon grants Members unlimited discretion to manipulate the competitive landscape among products, and indeed would eviscerate core WTO disciplines on non-discrimination.

12. Furthermore, there is nothing in the text or context of the relevant legal provisions – i.e. Articles III:2, III:4, III:5 and III:8(b) of the GATT 1994, Article 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement, and Article 3.1(b) and 3.2 of the SCM Agreement – suggesting that subsidies to domestic producers are necessarily WTO-consistent in all cases, regardless of the discriminatory elements that they contain. Rather, all of these provisions can

cover subsidies to domestic producers or subsidies contingent on domestic performance of certain production processes, so long as such subsidies involve discrimination between products.

B. INOVAR-AUTO

1. Brazil Fails to Rebut Japan's Demonstration That INOVAR-AUTO Is Inconsistent with Article III:2 of the GATT 1994

13. In its first written submission, Japan explained that through the increase in the IPI rate applicable to motor vehicles by 30 percentage points and possible reduction of the increased IPI, INOVAR-AUTO imposes internal taxes on imported motor vehicles that are in excess of IPI imposed on domestic motor vehicles inconsistent with the first sentence of Article III:2 of the GATT 1994. This discriminatory taxation occurs as a result of origin-based distinctions with respect to all the three prerequisites that must be satisfied in order to benefit from the tax reduction.

14. In particular, first, Japan explained that the accreditation requirements for INOVAR-AUTO are more onerous for manufacturers of domestic motor vehicles than for foreign manufacturers of imported motor vehicles. In response, **Brazil argues that the distinct requirements for manufacturers of domestic and imported motor vehicles, though different, are not necessarily more onerous for imported motor vehicles.** However, this argument misses the point. Decree 7,819/2012 sets out three categories of requirements related to accreditation in addition to the production steps requirement. Domestic manufacturers of motor vehicles only need to meet two of these three requirements, whereas importers of foreign motor vehicles must meet all three. Moreover, domestic motor vehicle manufacturers are more likely to meet any of these three requirements as a result of their domestic production activity and other business operations. Thus, the requirements as a whole are discriminatory against imported motor vehicles.

15. Second, Japan explained that accruing presumed IPI tax credits is easier for manufacturers of domestic motor vehicles than for manufacturers of imported motor vehicles, because the former are more likely to make the required types of expenditures "in the Country" that result in the accrual of such tax credits (i.e. expenditures on strategic inputs, tooling, and other categories of expenditures). In response, Brazil acknowledges that strategic inputs and tooling must originate in Brazil in order to result in the accrual of IPI tax credits. In addition, Brazil does not disagree with Japan's observation that domestic manufacturers are more likely to satisfy all of the expenditure requirements, because the expenditures must be made "in the Country". Indeed, Brazil's only argument regarding the accrual of tax credits is to assert that "the credits may be acquired by both the importers and the producers, without the actual need of incorporating the inputs into production." However, Brazil's assertion that importers can theoretically acquire presumed IPI credits on the same condition as domestic manufacturers is in fact at odds with the definitions of the terms "strategic inputs" and "tooling" under INOVAR-AUTO.

16. Third, Japan explained that Article 14 § 2(ii) of Decree 7,819/2012 (as amended) provides explicitly that IPI credits must be used on domestic vehicles before they are used on imported vehicles, and they can only be used on a limited number of imported vehicles (i.e. no more than 4,800 vehicles per year). In response, Brazil acknowledges that Japan is correct, stating: "Brazil does not deny that INOVAR-AUTO, through the method of calculation and use of presumed IPI credits, may favour certain domestic strategic inputs and machinery . . . ." . On this basis alone, it is possible to find that INOVAR-AUTO is inconsistent with Articles III:2 and III:4 of the GATT 1994.

17. Fourth, Japan explained that INOVAR-AUTO is inconsistent with the second sentence of Article III:2, because it involves the application of the IPI tax in a manner so as to afford production to domestic manufacturers of motor vehicles. Brazil fails to provide any response, except to assert: "as INOVAR-AUTO conforms to the requirements of Article III:2, first sentence, it also conforms to second sentence, as the products at issue are similarly taxed." Japan rejects the premise of this argument – i.e. INOVAR-AUTO is not consistent with the first sentence of Article III:2. Moreover, Brazil misinterprets the relationship between the first and second sentences of Article III:2. In fact, it is possible for a measure to be inconsistent with the second sentence, without being inconsistent with the first.

2. Brazil Fails to Rebut Japan's Demonstration That INOVAR-AUTO Is Inconsistent with Article III:4 of the GATT 1994

18. Japan established in its first written submission that INOVAR-AUTO discriminates against imported motor vehicles, with respect to (i) accreditation, (ii) the accrual of presumed IPI tax credits, and (iii) the use of such credits. These forms of discrimination are relevant to Japan's claims under both Article III:2 as well as Article III:4, as they constitute "less favourable treatment" for imported motor vehicles. In addition, Japan also established that INOVAR-AUTO accords less favourable treatment to foreign motor vehicle components and equipment (i.e. what Brazil's legal instruments, such as Decree 7,819/2012, refer to as strategic inputs and tooling, respectively). In particular, to (i) become accredited and (ii) accrue presumed IPI tax credits, companies must make expenditures on domestic strategic inputs or tooling. Furthermore, due to the "deductible portion", such expenditures are more valuable if the purchased Tier 1 components and equipment have a greater level of domestic Tier 2 and Tier 3 content. Thus, the less favourable treatment extends across all Tier 1, Tier 2 and Tier 3 components and manufacturing equipment.

19. Brazil acknowledges that INOVAR-AUTO results in less favourable treatment for imported motor vehicle components and manufacturing equipment. In particular, Brazil states: "Brazil does not deny that INOVAR-AUTO, through the method of calculation and use of presumed IPI credits, may favour certain domestic strategic inputs and machinery". Thus, there is no question that INOVAR-AUTO is inconsistent with Article III:4 in this regard.

20. However, as far as discrimination with respect to motor vehicles is concerned, Brazil argues that accreditation "do[es] not relate to Article III:4 as the provision deals with products in the marketplace." This is a version of Brazil's "pre-market" argument that Japan previously rebutted. Any measure that affects the internal sale, offering for sale, purchase, transportation, distribution or use of products, in any manner whatsoever may fall within the scope of Article III:4.

21. Furthermore, Brazil is factually incorrect that the accreditation requirements only affect products at the pre-market stage. Rather, the accreditation requirements affect companies' eligibility for an up-to-30 percentage point reduction in IPI taxes on motor vehicles, and thus they have a direct effect on motor vehicles. Moreover, they have a direct effect on certain motor vehicle components. Thus, there is no factual or legal support for Brazil's objection to Japan's claims under Article III:4.

3. Brazil Fails to Rebut Japan's Demonstration That INOVAR-AUTO Is Inconsistent with Article III:5 of the GATT 1994

22. Japan explained that INOVAR-AUTO is inconsistent with both the first and second sentences of Article III:5. With respect to the first sentence: both the minimum production steps requirement associated with accreditation, as well as the local content requirement associated with the accrual of IPI tax credits, mean that INOVAR-AUTO is an "internal quantitative regulation[] relating to the mixture, processing or use of products in specified amounts or proportions[]". Through both types of requirements, INOVAR-AUTO "requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources."

23. In response, Brazil argues that "production-step requirements set out in the INOVAR-AUTO do not establish an obligation to source goods domestically, contrary to what Japan has asserted; they only require that certain stages of production be performed in Brazil." This is an instance of Brazil's false dichotomy between production processes and products. What Brazil fails to acknowledge is that the requirement to perform a certain production process in-country can be tantamount to a requirement to use the output of that production process in a downstream application. Accordingly, INOVAR-AUTO does, in fact, require that certain goods be sourced domestically, contrary to Brazil's argument.

24. Brazil also argues that INOVAR-AUTO's local content requirement related to strategic inputs and tooling falls outside the scope of Article III:5, because it is supposedly "more closely associated to purchase obligations" than to "mixture, processing or use". However, Brazil is incorrect to assume that these two categories are mutually exclusive. The fact that INOVAR-AUTO

requires expenditures on domestic goods (i.e. in order to achieve an up-to-30 percentage point reduction in IPI taxes due on motor vehicles) should not prevent a finding of inconsistency with Article III:5.

4. Brazil Fails to Establish that INOVAR-AUTO Can Be Justified Under Article XX of the GATT 1994

a. INOVAR-AUTO Is Not Provisionally Justified Under Article XX(b) of the GATT 1994

25. Brazil has failed to establish that there is a genuine relationship between the objective of protecting human, animal or plant life or health, and the discriminatory elements of INOVAR-AUTO. In fact, Brazil's first written submission contains only one paragraph that purports to explain how INOVAR-AUTO contributes to these objectives. The paragraph asserts that INOVAR-AUTO contributes to energy efficiency, vehicle safety, and reduced CO2 emissions, but contains no explanation for these assertions. Further, the factual background section of Brazil's first submission contains isolated pieces of information that could potentially figure in Brazil's Article XX defence, such as discussion of broader programmes to achieve these goals as well as the accreditation requirements related to reducing emissions. However, Brazil fails to even explain whether Brazil considers these facts relevant to its Article XX defence, and if so, why. Furthermore, there are several possible alternatives to INOVAR-AUTO. Brazil had many options available to it in crafting a measure to promote energy efficiency or other purported objectives of INOVAR-AUTO. It was unnecessary to resort to a measure that is so plainly discriminatory on so many levels. Brazil thus fails to justify INOVAR-AUTO under Article XX(b) of the GATT 1994.

b. INOVAR-AUTO Is Not Provisionally Justified Under Article XX(g) of the GATT 1994

26. Brazil argues that INOVAR-AUTO's design and structure supposedly demonstrate a clear link with the conservation of petroleum and its derivatives, including gasoline. In this regard, Brazil references several features of INOVAR-AUTO, such as its energy efficiency targets, as well as incentives for expenditures on R&D and engineering in Brazil. On this basis, Brazil asserts that INOVAR-AUTO "as a whole" is justified under Article XX(g) of the GATT 1994.

27. However, Brazil's argument is misplaced because Japan is not challenging INOVAR-AUTO's requirements regarding energy efficiency targets or R&D spending in the first place. Rather, Japan is taking issue with specific features of INOVAR-AUTO that are discriminatory – e.g. the accreditation requirements; the method of accrual of presumed IPI credits for strategic inputs and tooling, which are the only way to accrue a presumed IPI credit worth up to 30 percentage points of the IPI tax due; and the conditions to use such presumed IPI credits. Brazil must explain how those specific features of INOVAR-AUTO are supposedly related to the objective of conserving petroleum and its derivatives, such that there is a "close and genuine relationship" between the end and means. Brazil fails to provide any explanation whatsoever in this regard, and its argument is without merit.

c. INOVAR-AUTO Does Not Satisfy the Requirements of the Chapeau of Article XX of the GATT 1994

28. The chapeau of Article XX of the GATT 1994 requires that the subject measure is "not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade". The burden of proof rests on the defending party, i.e. Brazil.

29. However, Brazil fails to establish a *prima facie* case. Brazil attempts to demonstrate that INOVAR-AUTO is not "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail", for three reasons: Brazil considers that the "conditions for accreditation are reasonable[]"; Brazil considers that "IPI reductions and credits are based on reasonable criteria[]"; and Brazil considers that "the requirement that investments be made in Brazil is consistent with the objectives of INOVAR-AUTO[]". However, all of these allegations amount to nothing more than mere repetition of Brazil's arguments related to Article III of the GATT 1994 (i.e. that the requirements of INOVAR-AUTO are

supposedly not discriminatory and are consistent with its purported policy objectives). In other words, Brazil's argument is flawed in precisely the same way that the Appellate Body warned against in *US – Gasoline*: it logically refers to the same standards by which a violation of the substantive rule should be determined to have occurred. Thus, Brazil falls short of establishing that INOVAR-AUTO is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination. In addition, contrary to Brazil's contention that INOVAR-AUTO meets the requirements of the chapeau, the fact that the discrimination under the measure at issue has no connection to the purported policy objectives by definition means that those requirements have not been met.

30. Brazil's failure to show that INOVAR-AUTO is not applied in a manner that constitutes arbitrary or unjustifiable discrimination between countries where the same conditions prevail, is itself evidence that INOVAR-AUTO is also applied in a manner that constitutes a disguised restriction on international trade. Furthermore, considering the objectives advocated in Article 1 of Decree 7,819, INOVAR-AUTO is a restriction "taken under the guise of a measure formally within the terms of an exception listed in Article XX". Thus, INOVAR-AUTO fails to meet the requirements of the chapeau of Article XX.

5. Brazil Fails to Rebut Japan's Demonstration That INOVAR-AUTO Is Inconsistent with Article 2 and Paragraph 1(a) of the Illustrative List of the TRIMs Agreement

31. In its first written submission, Japan explained that INOVAR-AUTO is inconsistent with Articles 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement. The inconsistency with Article 2.1 stems from INOVAR-AUTO's inconsistency with Article III of the GATT 1994. In addition, INOVAR-AUTO falls under paragraph 1(a) of the Illustrative List, due to its two local content requirements (i.e. those associated with the accreditation requirements and the accrual of presumed IPI tax credits). Further, as the panel in *Indonesia – Autos* has clarified, measures that "have investment objectives and investment features and which refer to investment programmes", and that are "aimed at encouraging the development of a local manufacturing capability . . . fall within any reasonable interpretation of the term 'investment measures'". INOVAR-AUTO is such a measure, as even Brazil acknowledges that one of its objectives is "'to strengthen the national automotive industry.'"

32. In response, Brazil does not deny that INOVAR-AUTO falls under paragraph 1(a) of the Illustrative List. In addition, Brazil acknowledges that INOVAR-AUTO is an investment measure. However, Brazil asserts that INOVAR-AUTO is not trade-related because "the requirements under [] INOVAR-AUTO are related to production, not to trade in goods[]". Yet Brazil fails to explain why it believes that production-related measures cannot also be trade-related. Indeed, as just noted, Brazil does not disagree with Japan that INOVAR-AUTO falls under paragraph 1(a) of the Illustrative List, which describes a local content requirement.

33. Moreover, Brazil does not even attempt to justify its assumption that measures relating to production cannot, in principle, also relate to trade. Indeed, the opposite is obviously true, as is clear for example from the text of paragraph 1(a) of the Illustrative List. Accordingly, there is no basis for Brazil's assumption that INOVAR-AUTO's relation to production somehow implies that it does not also affect trade.

6. Brazil Fails to Rebut Japan's Demonstration that INOVAR-AUTO Is Inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement

34. In its first written submission, Japan explained that INOVAR-AUTO confers subsidies related to the satisfaction of two types of local content requirements: a minimum manufacturing steps requirement that encourages the use of domestically manufactured automotive components including engines, gearboxes, transmissions, and steering and suspension system, as well as domestic equipment, as a condition for accreditation; and a requirement to make expenditures on domestic strategic inputs and tooling in order to accrue presumed IPI tax credits that reduce IPI taxes on motor vehicles by a maximum of 30 percentage points. Both local content requirements constitute contingencies on the use of domestic over imported goods, and accordingly INOVAR-AUTO is inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement.

35. In response, Brazil does not deny that INOVAR-AUTO confers subsidies within the meaning of Article 1 of the SCM Agreement. In addition, Brazil does not deny that INOVAR-AUTO contains an element of contingency. Rather, Brazil argues only that INOVAR-AUTO does not require the "use" of domestic goods within the meaning of Article 3.1(b). Brazil's argument seems to be that companies could potentially satisfy the local content requirements of INOVAR-AUTO by purchasing automotive components or manufacturing equipment and then reselling them to other companies. However, Brazil provides no support for this argument – and in particular, Brazil does not assert that brokers or resellers can accrue presumed IPI tax reductions under INOVAR-AUTO through expenditures on strategic inputs and tooling on behalf of third parties. In fact, Decree 7,819/2012 contradicts Brazil’s argument.

36. Furthermore, the definitions of "strategic inputs" and "tooling" indicate that for purposes of generating presumed IPI tax credits, strategic inputs must be "used in the manufacture and physically incorporated into the [covered] vehicles", and tooling must be used in that manufacturing process. This implies that accredited companies cannot claim credits with respect to inputs and tooling that they want to resell rather than use in their own manufacturing process. Thus, to the extent that Brazil is arguing that brokers and resellers do not "use" automotive components and manufacturing equipment within the meaning of Article 3.1(b), this argument is irrelevant.

7. Brazil Fails to Rebut Japan's Demonstration That INOVAR-AUTO Is Inconsistent with Article I:1 of the GATT 1994

37. In its first written submission, Japan explained that INOVAR-AUTO provides two types of "advantages" to products originating in other Mercosur members and Mexico:

- A 30 percentage point reduction of IPI tax rates to accredited domestic manufacturers and investors which import in Brazil motor vehicles of the same brand originating in other Mercosur members and Mexico (under Article 21 of Decree 7,819/2012); and

- A 30 percentage point reduction of IPI tax rates to motor vehicles imported from Uruguay without the pre-condition that the importing company is accredited (under Art. 22(i) of Decree 7,819/2012).

38. In response, Brazil does not attempt to rebut Japan's demonstration that INOVAR-AUTO is inconsistent with Article I:1, nor does Brazil deny that INOVAR-AUTO favours motor vehicles from other MERCOSUR countries and Mexico. Brazil also does not invoke the Article XX defence in respect of Japan's claims under Article I:1 of the GATT 1994. Rather, Brazil argues that INOVAR-AUTO falls under the Enabling Clause. Japan previously explained that Brazil's attempted defence under the Enabling Clause fails, because Paragraph 2(b) of the Enabling Clause does not apply. Thus far Brazil has not responded to Japan's arguments regarding the Enabling Clause. Accordingly, all the previous arguments still stand and indicate that Brazil's Enabling Clause defence fails.

C. ICT Measures

39. Japan's first written submission established that the ICT Measures discriminate with respect to both final and intermediate products, and they confer subsidies contingent on the use of domestic inputs. Accordingly, the ICT Measures are inconsistent with Brazil's obligations under Articles III:2, III:4, and III:5 of the GATT 1994, Article 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement, and Articles 3.1(b) and 3.2 of the SCM Agreement.

40. Brazil makes three factual arguments to support its contention that the ICT Measures are supposedly WTO-consistent: (i) the ICT Measures supposedly do not discriminate on the basis of national origin; (ii) in the case of intermediate goods produced by accredited companies, the indirect tax suspensions or exemptions applied under the ICT measures supposedly do not generate a difference in the effective tax burden due between imported and domestic products; and (iii) the ICT measures supposedly subsidize domestic producers rather than domestic products. Each of these three arguments fails.

1. Brazil Fails to Establish that the ICT Measures Do Not Discriminate Against Imported Final and Intermediate Products

41. The ICT Measures discriminate against both foreign ICT, automation and related products (i.e. collectively "ICT products"), as well as the inputs to such products. In particular, only products produced in Brazil – i.e. domestic goods – are eligible to benefit from the ICT Measures. In addition, only goods produced in accordance with PPBs (or other types of legal instruments containing requirements similar to those in PPBs – which Japan will refer to collectively as PPBs) are eligible to benefit from the ICT Measures, and PPBs require that the specified production steps be performed in Brazil. This means that an imported product that has not undergone any production step in Brazil cannot benefit from the ICT Measures. Further, PPBs contain the requirement that some form of integration or final assembly must take place in Brazil, and this integration/final assembly must incorporate other parts or components that are also required to be integrated/assembled in Brazil. Certain PPBs also contain additional requirements which indicate a specific percentage of a particular input that must be manufactured in accordance with a PPB. As a result, the production steps requirements under PPBs are tantamount to requiring the incorporation of domestic content into the finished product. Accordingly, the ICT Measures are inconsistent with Articles III:2, III:4, and III:5 of the GATT 1994; Article 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement; and Articles 3.1(b) and 3.2 of the SCM Agreement.

2. Brazil Fails to Establish that the ICT Measures Are "Neutral" with Respect to "Intermediate" Products

42. With respect to intermediate products, Brazil argues that the Informatics Programme and PADIS are supposedly "neutral in financial terms", because "the amounts not collected would otherwise offset the tax debit due at the next step of the productive chain." On this basis, Brazil asserts that the Informatics Programme (insofar as it applies to intermediate goods) and PADIS are consistent with Articles III:2, III:4, and III:5 of the GATT 1994, as well as Article 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement, and are not subsidies within the meaning of Article 1 of the SCM Agreement.

43. However, Brazil's argument fails for four reasons. *First*, Brazil's distinction between intermediate and final goods has no basis in the text of the provisions invoked by Japan. Rather, these provisions refer to "products" or "goods", without distinguishing between intermediate and final goods. *Second*, practically, it is often difficult to distinguish products that are "final" from those that are "intermediate". The same product may be considered either final or intermediate depending on the specific context. *Third*, Brazil's argument ignores the time value of money, i.e. the cost that companies face in the absence of the ICT measures to pay up-front taxes on intermediate products and wait until a subsequent point in time to use the received credits that offset the up-front payments. In particular, with respect to those products that Brazil characterizes as intermediate (as well as those that Brazil characterizes as final), companies accredited under the ICT Measures do not have to pay up-front taxes that are covered under the relevant programme. By contrast, outside the context of these programs, companies must pay the covered taxes upon purchase or importation, and then be reimbursed subsequently upon sale of the downstream product. Thus, in effect, the ICT Measures result in a deferral of tax collection, which has a significant effect on the economic situation of taxpayers. *Fourth*, Brazil's argument is not valid with respect to manufacturers of intermediate products which participate in the cumulative regime of PIS/PASEP and COFINS.

3. The Fact that the Subsidies Benefit Domestic Producers Should Not Shield the ICT Measures from WTO-Legal Scrutiny

44. Brazil argues that the ICT Measures provide "subsidies to domestic producers" and do not discriminate between products, supposedly falling outside the scope of Article III of the GATT 1994, Article 2 and paragraph 1(a) of the Illustrative List of the TRIMs Agreement and Articles 3.1(b) and 3.2 of the SCM Agreement. However, this argument is premised on the incorrect factual assumption that whenever a subsidy is provided to domestic producers, such a subsidy can never discriminate between products. Accordingly, Brazil's argument in this regard fails. In other words, the fact that the subsidies conferred through the ICT Measures benefit domestic producers, should not shield them from WTO-legal scrutiny.

D. RECAP and PEC

45. Japan established in its first written submission that both programmes provide financial contributions in the form of suspensions and exemptions from the relevant indirect taxes covered by each programme, which constitutes a financial contribution in the form of revenue foregone that is otherwise due, thereby conferring a benefit. Thus, both programmes provide subsidies within the meaning of Article 1 of the SCM Agreement. Moreover, Japan explained that the subsidies under RECAP and PEC are granted on the condition that recipient companies are deemed "predominantly exporting", i.e. exports account for at least 50% of their sales. Accordingly, the subsidies are contingent on export performance within the meaning of Article 3.1(a) of the SCM Agreement.

46. In response, Brazil accepts the factual underpinning for Japan's arguments. For example, Brazil acknowledges that the suspension of the taxes covered by RECAP and PEC leads to exemption from having to pay the relevant taxes under certain conditions. Brazil also does not disagree with Japan's understanding of the "predominantly exporting company" condition.

47. Indeed, there is only one legally relevant issue regarding RECAP and PEC where Brazil disagrees with Japan: the proper normative benchmark for assessing whether a financial contribution exists. In particular, Brazil argues that the benchmark should be credit-accumulating companies rather than companies in general, which are subject to the IPI, PIS/PASEP, COFINS, PIS/PASEP-*Importação*, and COFINS-*Importação*. On this basis, Brazil argues that no subsidy and no export contingency exist.

48. However, as Japan discussed in response to Panel question No. 41, Brazil's proposed benchmark is invalid. The benchmark identified by Brazil for both programmes – i.e. the class of companies that is "predominantly credit-accumulating" – is unduly narrow. The correct benchmark should include all domestic companies that pay the taxes suspended and/or exempted by these programmes, i.e. the IPI, PIS/PASEP, COFINS, PIS/PASEP-*Importação* and COFINS-*Importação*.

E. Conclusion

49. The measures at issue in this dispute discriminate against Japanese and other foreign motor vehicles, automotive components and equipment, and ICT products. They also confer prohibited export subsidies. They place Japanese and other foreign products at a significant and cross-cutting competitive disadvantage in the marketplace. In addition, INOVAR-AUTO in particular denies Japanese products the MFN treatment to which they are entitled.

50. Brazil has attempted to show that the measures at issue are somehow nonetheless WTO-consistent. However, the legal theories underpinning Brazil's arguments have no merit. In fact, they are extreme, have not been embraced by prior panel or Appellate Body reports, and if accepted would erode the WTO-legal disciplines being invoked in this dispute. Accordingly – and given the absence of any significant factual disagreement between the parties – the claims in Japan's request for the establishment of a Panel continue to be valid, and Japan requests that the Panel make findings accordingly.

II. EXECUTIVE SUMMARY OF JAPAN'S OPENING STATEMENT AT THE SECOND MEETING OF THE PANEL

51. One constant throughout this dispute has been the theme of discrimination. INOVAR-AUTO and the ICT Measures tilt the competitive landscape in favour of domestic products by subjecting them to lower rates of taxation, and by imposing local content requirements. RECAP and PEC distort trade by providing subsidies to companies deemed "predominantly exporting". The underlying facts, which the parties agree on in nearly all relevant respects, have been another constant. Indeed, as the proceedings have progressed, the scope of any remaining disputed issues has gradually narrowed, so that today, only seven categories of issues seem to remain.

52. First, Brazil attempts to defend INOVAR-AUTO and the ICT Measures by advocating for a legal principle that no panel or Appellate Body report has embraced: that subsidies granted to domestic producers are automatically WTO-consistent as long as they are related to a production process. This argument is contradicted by the text and context of the specific provisions of the WTO Agreement at issue, including Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement. While Brazil bases its defence on Article III:8(b) of the GATT 1994, Article III:8(b) does not cover the kinds of tax subsidies granted under INOVAR-AUTO or the ICT Measures.

53. Second, and closely related, according to Brazil, the terms "domestic" and "national" in Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement should be interpreted to ensure that subsidies received by domestic producers are *ipso facto* WTO-consistent, regardless of whether such subsidies amount to discrimination between domestic and imported products. However, this argument is circular and has no basis in the text of the covered agreements. Instead of Brazil's preferred approach, the term "domestic" should be interpreted in accordance with its ordinary meaning in its context, pursuant to Article 31 of the Vienna Convention on the Law of Treaties.

54. Third, Brazil argues that the benefits available under INOVAR-AUTO and the ICT Measures offset the costs associated with complying with the programmes' requirements and furthering the programmes' purported policy objectives. In reality, Brazil has failed to demonstrate that INOVAR-AUTO and the ICT Measures are structured and designed in such a manner that the recipient companies will allocate the benefits they have received to the achievement of the purported policy objectives. Rather, they are structured and designed to allow the recipient companies to use the benefits to simply lower their prices in competition with imported products.

55. Fourth, Brazil continues to argue that the tax suspensions and exemptions under the ICT Measures are "neutral" with respect to intermediate products. However, as a factual matter, there is no longer a real disagreement as to whether the ICT measures are neutral, because Brazil now acknowledges that participation in the ICT Measures results in a cash flow-related gain that can amount to 1.16% of taxes due. Nothing in the text of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, or Article 3.1(b) of the SCM Agreement suggests that a Member may favour domestic over imported goods as long as the amount of the benefit does not exceed 1.16% of the taxes due.

56. Fifth, Brazil argues that the less trade-restrictive alternative measures to INOVAR-AUTO and PATVD proposed by Japan are not reasonably available, because they would not spur the creation of a domestic industry. However, there is no genuine relationship between creating a domestic industry and the objectives listed in the subparagraphs of Article XX. Brazil's argument is tantamount to the invention of a new category of exception under Article XX for measures necessary for the creation of a domestic industry, which is not a valid basis to reject a proposed alternative measure.

57. Sixth, Brazil continues to argue that INOVAR-AUTO's inconsistency with Article I:1 should be excused because of the Enabling Clause. However, Brazil's Enabling Clause argument fails, because Brazil has not adhered to the Enabling Clause's procedural requirements; the GATT 1994 is not itself an "instruments multilaterally negotiated under the auspices of the GATT" within the meaning of paragraph 2(b) of the Enabling Clause; and INOVAR-AUTO is not a "non-tariff measure[]" within the meaning of paragraph 2(b) of the Enabling Clause.

58. Seventh, Brazil continues to argue that RECAP and PEC are intended to prevent the structural accumulation of tax credits, and therefore do not confer subsidies contingent on export performance. However, this argument is nothing more than a distraction. In reality, the determination of a subsidy in this case can be based on a straightforward comparison between the tax treatment of companies under generally applicable rules of taxation, and the tax treatment of companies under RECAP and PEC. Likewise, the finding of export-contingency is easy to reach, given that Brazil itself acknowledges that RECAP and PEC contain, in its words, a "50% export requirement" in order to receive benefits under the programmes.

59. If there were a motto for this dispute, it could be the more things change in this dispute, the more they stay the same. It is still the case that INOVAR-AUTO and the ICT Measures incentivize origin-based discrimination through local production requirements and local content requirements. And it is still the case that INOVAR-AUTO incentivizes discrimination through an IPI tax reduction for motor vehicles originating in other Mercosur countries and Mexico. RECAP and PEC confer subsidies contingent on export performance. Japan has stressed these points from the beginning, and they have not changed.

60. What has changed are Brazil's attempts to complicate the legal analysis of these measures. The seven arguments that Japan discussed at the second substantive meeting are all that remain of these attempts. As Japan has demonstrated, each of them is still meritless and should not distract the Panel from the core elements of discrimination which are at the very heart of this dispute.

III. EXECUTIVE SUMMARY OF JAPAN'S CLOSING STATEMENT AT THE SECOND MEETING OF THE PANEL

61. Throughout these proceedings, and in particular through the second substantive meeting, the scope of essential disagreements between the complainants and the respondent has been gradually narrowing down, and at the end of this substantive meeting, there seems to be only one fundamental disagreement remaining between the parties. This fundamental disagreement consists in whether or not Brazil has the right to its industrial policies in the form of what it characterizes as "production subsidies".

62. Japan does not deny that Members have their own rights to industrial policies, and that they are entitled to adopt certain measures in order to create or foster their industries. However, such rights are not limitless – of course, Members are required to comply with their obligations under the WTO Agreement. While Brazil appears to believe that any production subsidy must be permitted under the WTO Agreement, there is no provision in the WTO Agreement which suggests that so-called production subsidies should *a priori* be justified. Rather, production subsides in the form of a requirement that certain specified components or goods must be sourced domestically will violate Brazil's obligations under Article III of the GATT 1994, Article 2 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement.

63. In sum, Japan suggests that the Panel decide on the consistency or inconsistency of the challenged measures not on the basis of the general notion of "production subsidies", which actually does not exist in the WTO Agreement, but rather on the basis of the proper interpretation of the specific provisions of WTO Agreement which are at issue in this case.

ANNEX B-5

FIRST PART OF THE EXECUTIVE SUMMARY OF THE ARGUMENTS OF BRAZIL

A. INTRODUCTION

1. The promotion of sustainable and inclusive development remains a challenge for many developing countries, including Brazil. Addressing and overcoming these difficulties is essential in order to ensure that all WTO members are able to achieve the Organization's objectives of raising standards of living, ensuring full employment and expanding the production of and the trade in goods and services. Over the years, Brazil has adopted different measures to address the distinct aspects of its developmental needs. Among these measures, there are a number of policies related to industrial and technological development, including those challenged in the present dispute.

2. Each of the questioned measures has been specifically designed in light of Brazil's WTO commitment to promote technological development, job creation, innovation, and production investments in their specific fields, in view of Brazil's developmental needs and constraints. The programmes' goals and operation are transparent and established in law. Their complexity, when present, stems from the complexity of the problems they address.

3. In Brazil's understanding, WTO rules cannot be read as preventing Members from pursuing their legitimate policy objectives through the means they deem most appropriate, including through non-discriminatory and transparent fiscal measures, as long as the instruments adopted for that purpose are in conformity with WTO rules. In the present case, the challenged programmes do not discriminate on the basis of origin: they do not constitute local content requirements, import-substitution subsidies or prohibited export subsidies, and they are not applied to afford protection to domestic production. In many circumstances the programmes do not even involve tax burden reductions

4. The measures relating to ICT, automation and related sectors challenged by the European Union and Japan aim at promoting R&D investments and require the performance of production-steps in order to foster industrial capacity and skilled labour. In the case of PADIS, the production in Brazil of at least a minimal amount of semiconductors is necessary for the development of a skilled workforce in a critical industry and to respond to demands for specific uses, including government-related uses that the market structure of the sector worldwide severely constrains. PATVD became necessary in light of Brazil's decision to adopt a unique digital television standard. When the standard was adopted, it was not certain that foreign suppliers would develop and manufacture compatible digital television transmitters. Brazil then decided to facilitate to the maximum extent possible the development of the technological and industrial capacity necessary to ensure that Brazilians have access to culture and information under the new technological paradigm. Finally, the Digital Inclusion Programme is meant to provide access to all social segments in Brazilian society to the benefits of the information age.

5. INOVAR-AUTO establishes a regulatory framework, through a system of environmental and R&D requirements and non-trade distorting economic incentives, directed at improving the quality and the efficiency of cars circulating in Brazil so as to contribute to the achievement of Brazil's sustainable development goals.

6. Finally, the PEC and RECAP programmes are measures adopted to address the problem of tax credit accumulation in the export sector, which is a feature of the Brazilian tax system. They do not provide a financial contribution, as the taxes not collected were not due in the first place, and they do not confer a benefit, as the participants are not "better off" in comparison with similarly situated taxpayers. Although these programmes are designed to address the situation of predominantly exporting companies, they are not an export-contingent subsidy program within the meaning of the SCM Agreement.

7. Before commenting on each of the challenged measures, Brazil will address four horizontal issues relevant to this dispute.

B. LEGAL ARGUMENT

The complainants have not established a *prima facie* case nor satisfied the requirements for a *de jure* claim

8. Brazil considers important to observe that neither of the complainants has made a *de facto* claim or brought to the record sufficient evidence to support their allegations that the programmes are WTO inconsistent. A *de jure* claim will establish an inconsistency with a WTO obligation on the basis of the design, structure and application of a measure. In other words, a violation of a WTO commitment will stem from the measure itself. A *de jure* discrimination or contingency is one discerned from the text and structure of the challenged measure, which is not what we have here presently. Brazil believes that to preserve the proper balance of rights and obligations reflected in the Covered Agreements, compliance with this legal standard must not be assessed conceptually, as the claimants have purported to do.

9. As for the evidentiary burden of a *de facto* claim, a measure that, on its face, is not inconsistent with WTO rules could be indeed considered to be a *de facto* violation if the "total configuration of the facts" leads to that conclusion. In the evaluation of the "total configuration of the facts" under scrutiny, two main issues are taken into consideration: the effects and the purpose of the measure[1], understood to be the actual effects of the measure; and an objective analysis of the justification of the measure, respectively.

10. This kind of evidence was not submitted in the present dispute. The complainants could have attempted to present information regarding actual effects of the challenged measures in practice to demonstrate this point. Conceivably, the complainants could also have argued that the challenged measures are inconsistent with the Covered Agreements by providing sufficient evidence establishing that, while they do not discriminate *de jure* based on origin, a *de facto* violation exists. This was not done in the present dispute.

11. Therefore, it is legitimate to conclude that the complainants have not met their burden of proof in making a *prima facie* case. They simply did not produce "[…] evidence sufficient to raise a presumption that what is claimed is true […]"[2] regarding any of the programmes.

Local production and R&D requirements are not WTO-inconsistent "local content" requirements

12. Brazil considers that not every measure relating to the *locus* of the economic and productive activities involves necessarily requirements related to the source of inputs and products used in the production process, which could be properly characterized as a "local content requirement". Specifically, measures designed to promote local production (or pre-production operations, such as investment in R&D and product design) that foresee certain productive steps to take place in a given territory are categorically different from those requiring the use of domestic inputs, and must not be used interchangeably.

13. In the case of the measures related to the ICT sector, companies contemplated and accredited in those regimes must commit to the performance of a minimum set of operations in Brazil.[3] These are not concerned with products, but geared towards maximizing production steps made in Brazil in order to promote industrialization through the addition of national value in terms of innovation, technological and industrial development and skilled labour force, without any prejudice to treatment accorded to imported products. Non-discriminatory value-added requirements through processing operations are fully consistent with WTO law. These requirements do not relate to products at all, but to production steps that do not mandate the use of inputs from domestic source since they actually make no reference to the source of inputs.

14. Such alleged "local content requirements" identified by the complainants in five of the seven programmes challenged were raised in connection with different WTO rules, which address the

---

[1] Panel Report, *Canada – Pharmaceutical Patents,* para. 7.101.
[2] Appellate Body Report, *US – Shirts and Blouses*, p. 14.
[3] Namely, *Processo Produtivo Básico*, or PPB

issue of discrimination between domestic and imported products, in varying language[4]. However, none of these rules deal with requirements related to production, localisation of production or to investments in R&D and innovation, which is what is at stake here. The challenged programmes, once again, do not discriminate against imported products and are not contingent upon the use of domestic over imported products. The tax system applicable to the measures analysed addresses pre-market operations since it is conceived to offset costs related to fulfilling each of the programmes specific requirements, adding the needed carrots to the sticks for each of the programme. Brazil does not dispute that a measure that addresses pre-market operation could, conceivably, affect the conditions of competition between imported and domestic products at the market. Brazil does contend however that this is not the rule and should not be presumed.

15. The nature of the requirements contained in the language of the five programmes challenged is starkly distinct from the scope of the afore-mentioned WTO rules. The first and clearest element of Article III is that the all obligations set out in its various paragraphs apply to products, not to production or research and development. Moreover, as Article III.8(b) clearly excludes payments to producers from the scope of the obligations contained in Article III, such exemption confirms that a measure aimed at producers that does not affect products does not fall within the scope of the obligations of Article III.

16. Production requirements may create, through the development of greater manufacturing capabilities and technological skills, a more dynamic economic environment. Productivity growth, greater manufacturing capabilities and local development are in fact one of the main expected results of the challenged measures. Yet, none of this is done with a discriminatory bias towards imported products. On the contrary, as Brazil has demonstrated productivity growth generated by the Programmes translated into more imports, as a large majority of inputs in the production of goods covered by these programmes is imported. The complainants, on the other hand, have failed to submit evidence that any discriminatory impact within the meaning of the relevant WTO rules have occurred.

17. As for the claims under the SCM Agreement, Brazil would like to emphasize once again that there is a clear distinction between production and products in the Agreement that translates in a clear difference between actionable and prohibited subsidies. The relevant provision[5] prohibits a subsidy "contingent upon the use of domestic over imported goods", without prohibiting production requirements. A Member therefore is not prohibited from conditioning the granting of a subsidy to a production requirement or other localization requirements, such as the level of employment or investments in R&D and innovation, so long as such requirements do not establish any condition related to the origin of the products used in the production process.

18. As the Appellate Body has clarified, even a measure containing, among others, a requirement to use domestic over imported goods would not be a prohibited subsidy if the subsidy could be received by complying with other requirements[6].

Indirect tax reductions are not per se WTO-inconsistent advantages or subsidies

19. Another horizontal aspect of the complainants' narrative is that the tax regime under the programmes has the purpose and effect of either increasing the level of effective border protection in Brazil to the detriment of imported products or, in the case of RECAP and PEC, favouring exports. This notion is misconceived as it disregards the fact that participation in these taxation schemes is tied to mandatory requirements such as investments in R&D, performance of production steps or accumulation of tax credits that result in additional *costs* to the accredited companies.

20. Fiscal instruments, such as indirect tax breaks, are considered one of the main tools used by governments all over the world for pursuing public policy objectives. Indirect taxation in particular is increasingly being used, including in many developed countries, to pursue public objectives that generate positive, economic and social effects for society, such as encouraging savings,

[4] According to the complainants, the provisions relevant to assess this question are: GATT Articles III:2, III:4 and III:5, TRIMS Article 2.1, in conjunction with Article 2.2 and paragraph 1(a) of the Agreement's Illustrative List, and Articles 3.1(b) and 3.2 of the SCM Agreement
[5] Article 3.1(b) of the SCM Agreement
[6] Appellate Body Report, *Canada – Autos*, para. 130.

employment, and strategic economic activities. This kind of tax expenditure have actually become an effective substitute to direct spending in many countries as they allow for the financing of public policies, operating as shortcut to direct payments in time of growing budgetary constraints.

21. In the case of Brazil, indirect tax breaks have been central in pursuing long term goals of promoting strategic investments in R&D, innovation and skilled labour. As it is recognized worldwide, investments in these areas are crucial to promote sustainable economic growth. However, due to the high risks involved, this kind of investment is difficult to fund without proper government intervention. Brazil shares the view that a WTO Member cannot use its tax regulations to afford protection to domestic products at the expense of imported like products or to promote exports. Although the seven programmes challenged in this dispute contemplate reductions of indirect tax rates, the assumption that such tax breaks would necessarily constitute a discriminatory treatment or a subsidy, amounting to less favourable treatment towards imported products, is flawed.

22. In a system of indirect, non-cumulative taxation (as the one in Brazil), the effective tax burden on the overall production chain and, more specifically, on each stage of the productive chain, is not affected by the specific rates charged on each of these stages, because of the off-setting mechanisms whereby credit-and debits accumulated at each step compensate each other. Such mechanism ensures the neutrality of the taxation process throughout the production chain, without any revenue being foregone (considering that the overall tax burden remains the same).

23. In addition, in some instances a tax rate reduction simply reflects a tax administration measure, as it is the case with regard to two of the challenged programmes – PEC and RECAP. Here, the measure is necessary due to distortions generated by the predominantly exporting character of some companies in relation to indirect non-cumulative taxation. Companies that derive most of their revenue from exports would end up accumulating tax credits, because, in reality, the government would be collecting taxes from them that were not due in the first place. The complicated solution to this situation would be for the company to file a reimbursement request. The logical solution Brazil adopted is to suspend the collection of taxes that, ultimately, would not be due, thus simplifying the tax accounting system and increasing its efficiency. This same kind of logic is applied throughout the Brazilian tax system involving many other kinds of companies operating in markets where the last-stage tax liability is very low and it is not therefor related to the export character of their activities.

24. In "*US – Large Civil Aircraft* (Second Complaint)", the Appellate Body put forth a three-step analysis for identifying whether revenue that is otherwise due is foregone: (1) identifying the tax treatment that applies to the income of the alleged recipients; (2) identifying the appropriate benchmark, i. e., the tax treatment of comparable income of comparably situated taxpayers; and (3) comparing the reasons for the challenged tax treatment with the benchmark tax treatment it has identified after scrutinizing a Member's tax regime[7].We cannot, as the complainants purport to do, compare companies that do not tend to accumulate tax credits with companies which do, as they are not similarly situated taxpayers. Whereas companies that do not tend to accumulate tax credits are able to use their credits and thus recover the funds immediately, companies that do accumulate (and are faced with a much higher tax burden) will have a significantly increasing amount of money, rightfully theirs, tied up with the tax authorities, without being able to recover.

Definition of "domestic" under Article 3.1(b) of the SCM Agreement

25. Brazil would like to call attention to the fact that in the present dispute there are three distinct concepts that should not be used interchangeably: (i) product produced according to a PPB; (ii) domestic product, within the meaning of Article 3.1(b) of the SCM Agreement; (iii) and product originated in Brazil according to the relevant rule of origin. There may be cases where these three concepts apply equally to a same product. There are many cases, however, where these concepts do not overlap. Specifically, several products produced according to a PPB are not domestic within the meaning of Article 3.1(b) of the SCM Agreement.

26. The key legal matter in this connection is the proper understanding of the term "domestic" in Article 3.1(b) of the SCM Agreement, which is not defined in the Covered Agreements. The complainants seem to propose a sweeping theory that "domestic product" is any product that

[7] *US – Large Civil Aircraft (second complaint), para. 812.*

"comes into existence within the territory of the country concerned"[8]. According to the complainants' definition, a good would be a "domestic product" for the purposes of Article 3.1(b) of the SCM Agreement, even if the percentage of value added in the territory of the concerned country is virtually zero. Brazil disagrees.

27. To Brazil, the discipline contained in Article 3.1(b) requires a definition of "domestic" that makes economic sense. It should not be confused either with the WTO-law definition of "origin" relevant to the Agreement on Rules of Origin or with the Brazilian municipal law definition of "product produced in Brazil according to a PPB".

28. While it may be impossible to determine in the abstract the exact percentage of value added in the country concerned that is required to characterize a product as "domestic" in all cases, there certainly are cases that can be safely excluded – or included – in this definition. A product that has most of its value from imported inputs is certainly not domestic within the meaning of Article 3.1(b) of the SCM.

C. THE PROGRAMMES

The Informatics Programme

29. The Informatics Law was established as part of Brazil's long term strategy, refined over the years, of promoting "technological and productivity density[9]" and fostering know-how in the Brazilian IT sector. From its inception, the goal of the Informatics Law was to progressively promote the development of technology-based industries to expand the country's scientific infrastructure and to leverage high-skilled human resources.

30. In order to fulfill these objectives, the Informatics Law gives tax incentives to companies that develop or produce IT and automation products[10] and services, invest in activities of IT research and development (R&D)[11] and follow the respective PPB in the industrialization of the pertinent IT and automation products.[12]

31. As a result of this new model, the Brazilian electronic sector, which comprises the segments of informatics, industrial automation, electric and electronic components, telecommunications, energy infrastructure and domestic utilities became more dynamic on account of the creation and progressive development of a high-skilled workforce[13] and increased productivity in the sector, which in turn had a positive impact on imports of ITC inputs. Subject to the fulfillment of the qualifying criteria mentioned above, Brazilian producers are entitled to the tax regime conceived to offset the costs related to fulfilling the program requirements.

32. The Informatics Law does not draw a distinction between domestic and imported products. The programme provides tax reductions to domestic producers in order to offset R&D investment and production-step requirements in order to foment technology and workforce skills development of the ICT sector in Brazil. The tax reductions under the Programme are not based on the origin of the good and the requirements to benefit from the tax regime are related to production and pre-market activities which do not affect products. These requirements do not affect the sale, offering for sale, purchase, transportation, distribution or use, nor do they constitute internal quantitative regulations requiring the use of products in specified amounts or proportions.

33. The Informatics Law provides, in this sense, subsidies to domestic producers within the meaning of Article III:8(b). Regarding intermediate products, the tax reductions cannot even be

[8] EU Oral Statement, paragraph 50.
[9] Japan – FWS, para 283.
[10] A list of the IT and automation products with corresponding NCM codes is found in Annex I of Decree No. 5.906/2006 (as amended) and a list describing the products that are not considered IT and automation products for purposes of the Informatics Law is found under Annex II of the same decree Art. 16A of Law No. 8.248/1991 (Exhibit EU-1) and items V through VII of Decree No. 5.906/2006 (Exhibit EU-7).
[11] Art. 4 of Law No. 8.248/1991, as amended (Exhibit EU-1).
[12] §1°C of Art. 4 of Law No. 8.248/1991 (Exhibit EU-1) and Art. 1 of Law No. 8.248/1991 (Exhibit EU-1).
[13] Between 2005 and 2014, the number of people working in the sector increased from 133 to 174 thousand. Specifically regarding companies accredited under the Informatics Law (Exhibit BRA-24), the job increase is significantly higher. From 2006 to 2013, job creation almost tripled from 55,388 to 134,295 jobs. Higher level IT and automation jobs more than doubled in this period, from 13,802 to 31,983 jobs, and positions strictly related to R&D doubled from 4,108 to 8,122 jobs. See also Exhibit BRA-107.

legally characterized as subsidies, since they do not constitute a financial contribution within the meaning of the SCM Agreement.

34. Therefore, the programme is outside the scope of Article III of the GATT 1994, as it does not discriminate with regard to tax or regulatory treatment nor does it establish mandatory quantitative requirements. In addition, the Informatics Law is not a trade-related investment inconsistent with Article III of the GATT and is not a subsidy prohibited under Article 3.1(b) of the SCM Agreement.

PADIS

35. PADIS was established by means of Law No. 11.484, of 31 May 2007, regulated by Decree No. 6.233, of 11 October 2007 (as amended) and subsequent ordinances. As stated above, the PADIS is part of Brazil's PITCE and was created to promote the development of the semiconductor industry in Brazil. PADIS was not created in order to promote import substitution of semiconductors or to try to distort the condition of competition in the semiconductor markets. The very specific features of the semiconductor industry make such approach simply unrealistic. The resources to attempt such a feat or to compete with the few major front end producers at the top of the semiconductor chain would be basically prohibitive.

36. As matter of fact, the implementation and effect of PADIS have not prevented the growth of semiconductor imports into Brazil. From 2011 to 2014, imports grew from USD 100 million to almost USD 378 million, attesting to the non-protectionist intent of the programme.

37. The programme applies to companies that invest in R&D and perform in Brazil certain development and production activities related to semiconductors and displays. PADIS is, therefore, related to a mix of different development, production and service provision activities, and do not relate to products *per se*. PADIS also establishes R&D investment requirements of 5% of the beneficiary's gross revenue in the local market after the deduction of taxes levied on the sales of semiconductors and displays.

38. In light of the costs and high risks associated with the development and production of semiconductors and in order to ensure the fulfillment of the Program's goals, companies accredited under PADIS are entitled to a tax regime involving exemption of their IRPJ, CIDE and customs duties on their instruments, inputs and software destined to their covered activities. In addition, certain PIS/COFINS and IPI rates were reduced to zero. In particular, the programme provides subsidies to domestic producers through IRPJ reductions in order to offset R&D investment and production-step requirements. The tax exemption is based on a direct tax, and therefore not based on goods, and the requirements are related to development and production, pre-market activities which do not affect products. As for the zero rates of IPI and PIS/COFINS on semiconductors, as they are necessarily intermediate goods, the exemption is neutral in terms of revenue collection.

39. PADIS, therefore, is outside the scope of Article III of the GATT 1994. The programme provides subsidies to domestic producers within the meaning of Article III:8(b), through a tax exemption upon a direct tax, aimed at compensating producers for the requirements they have to fulfill. These requirements, in turn, do not affect the sale, offering for sale, purchase, transportation, distribution or use, nor do they constitute internal quantitative regulations requiring the use of products in specified amounts or proportions. Furthermore, PADIS is not a trade-related investment inconsistent with the TRIMS Agreement and is not a subsidy prohibited within the meaning of Article 3.1(b) of the SCM Agreement.

PATVD

40. The Brazilian Government decided on the adoption of a specific and unique standard, based upon the Japanese model[14] but adapted to the Brazilian needs and realities. The implementation of the Brazilian Digital Television System (*Sistema Brasileiro de Televisão Digital - SBTVD*) occurred

[14] The Japanese Standard for Digital Television (ISDB) operates mainly with High Definition Digital TV (HDTV) transmission, but is also capable of operating with Standard Digital TV (SDTV) technology. Set-top-boxes may convert digital signals (HDTV and SDTV) into NTSC and S-VHS signals or tune HDTV and SDTV signals and send them to video devices similar to what happens with the American standard. The Japanese standard also implemented mobile transmissions and reception.

by means of Decree No. 4.901, of 26 November 2003 From the very beginning, the implementation of digital television in Brazil was aimed at stimulating broadcasting, content producers and software industry, in addition to developing sector research.

41. The Brazilian system is unique in many ways. Compared to the already existing standards (Japanese, European and American), the SBTVD-T adds technological innovations, especially regarding video codification H.264 and the middleware developed in Brazil. The SBTVD-T preserved the characteristics of the Brazilian TV, open and free for all, but introduced the possibility of being received by portable and mobile receivers, in addition to allowing the interactivity of the viewers with the program. In order to qualify to PATVD, producers must commit to invest in R&D and perform activities of development and manufacture of digital television (TV) radiofrequency (RF) transmitting equipment, as classified in NCM 8525.50.20,[15] pursuant to the corresponding PPB[16] or, alternatively, meet the criteria for products developed in Brazil[17], as set forth by MCTI Ordinance 950/2006.[18].

42. The required R&D investment under the PATVD is a minimum of 2.5% of the beneficiary's gross revenue in Brazil after the deduction of the taxes levied on the sales of digital TV RF transmitting equipment and of the cost of acquisition of inputs. Once accredited, producers are entitled to the reduction to zero of the rates of PIS/COFINS, IPI on the purchases of certain inputs and on their sales.

43. PATVD is a programme aimed at fomenting and ensuring the proper transition of analog to digital television in Brazil with the new system. The programme provides subsidies to domestic producers through IPI reductions on transmitters in order to offset R&D investment and production-step requirements. The tax reductions are not based on the origin of the good and the requirements are related to development and production, pre-market activities which do not affect products.

44. The programme is outside the scope of Article III of the GATT 1994. PATVD provides subsidies to domestic producers within the meaning of Article III:8(b), the tax reductions are not based upon origin of the goods and are aimed at compensating producers for the requirements of the programme. These requirements, in turn, do not affect the sale, offering for sale, purchase, transportation, distribution or use, nor do they constitute internal quantitative regulations requiring the use of products in specified amounts or proportions. Furthermore, PATVD is not a trade-related investment measure inconsistent with Article III of the GATT and is not a prohibited subsidy within the meaning of Article 3.1(b) of the SCM Agreement. If the panel were to find that PATVD violates Article III of the GATT, it is justified under Article XX(a) of the GATT 1994 as a measure necessary to the protection of public morals.

45. *Arguendo*, if the Panel finds that PATVD is not a "payment of subsidies exclusively to domestic producers" under the provisions of Article III:8(b) of the GATT 1994 and that the program is inconsistent with any of the provisions of the GATT 1994 invoked by Japan, Brazil submits that any such inconsistency would be justified under Article XX(a) of the GATT, as PATVD is part of Brazil's comprehensive effort to protect its public morals.

46. Brazil elected digital television as one of the most efficient ways to promote social inclusion, enable a universal network of distance learning, encourage R&D and foster the expansion of Brazilian technologies, so as to guarantee access to information at costs compatible with viewers' income. Brazil's Digital Television System is to remain open and free for the entire population and will introduce the possibility of being received by portable and mobile receivers, as well as allowing program interactivity.

---

[15] Article 13 of Law No. 11.484/2007.

[16] PPB for digital TV transmitting equipment was established by means of Interministerial Ordinance MDIC/MCTI No. 62, of 31 March 2014. Exhibit EU-89.

[17] A list describing the digital TV transmitting equipment, with respective NCM code, is found under Annex I of Decree No. 6.234/2007. Decree No. 6.234/2007 also provides similar lists for machines, devices, instruments and equipment (Annex II), inputs (Annex III) and software (Annex IV) used in the manufacture of digital TV transmitting equipment. PATVD encompasses only one PPB (Ordinance 62/2014).

[18] §1° of Art. 13 of Law No. 11.484/2007. As explained under the Informatics Law, for a product to be considered as developed in Brazil the activities of design and development of the product and of its specifications must have taken place in Brazil.

47. Brazil's PATVD program is "necessary" within the meaning of Article XX(a) because (1) the interests it protects (public morals) are important to the highest degree, (2) it makes a significant contribution to the protection of public morals, (3) it does not restrict trade unjustifiably, and (4) there is no reasonably available measure that would secure the same level of protection and that is less trade restrictive. The manner in which Brazil applies PATVD constitutes neither (a) a means of "arbitrary or unjustifiable discrimination" between countries where the same conditions prevail, nor (b) a "disguised restriction on international trade."

Digital Inclusion Programme

48. The Digital Inclusion Programme (*Programa de Inclusão Digital*) is part of this broad effort to further digital inclusion in Brazil. The Programme was established by means of Law No. 11.196, of 21 November 2005, known as *Lei do Bem* (Good Law) and regulated by Decree No. 5.602, of 6 December 2005 (as amended).[19]

49. Pursuant to Article 28 of Federal Law 11,196 and to Article 1 of the aforementioned Decree, the program aimed at increasing the access of the Brazilian population to low cost computers and information technology products by exempting PIS/COFINS levied on the gross revenue of retail sales of certain products[20] and providing additional subsides to domestic producers accredited under the Informatics Law, in order to secure the development and production in Brazil of low cost IT products.

50. The above mentioned additional subsidies to domestic producers accredited under the Informatics Law are provided through IPI reductions on certain low-cost final products in order to offset costs related to the compliance with their respective production-step requirements. The tax reductions are not based on the origin of the good and the requirements are related to development and production, pre-market activities which do not affect products.

51. Therefore, the programme is outside the scope of Article III of the GATT 1994. The Digital Inclusion Programme provides subsidies to domestic producers within the meaning of Article III:8(b), as the tax reductions are not based upon origin of the goods and are aimed at compensating producers from the requirements of the programme. Furthermore, the Digital Inclusion Programme is not a trade-related investment inconsistent with the TRIMs Agreement and is not a subsidy prohibited under Article 3.1(b) of the SCM Agreement.

INOVAR-AUTO

52. Over the past years, the Brazilian Government has endeavored to promote a comprehensive qualitative improvement of the vehicles produced and sold in its domestic market, encompassing technological and safety aspects of the products, and an overhaul of their energy efficiency and gas-emissions levels. This paradigm-shift was conceived in order to benefit Brazilian consumers as they will be able to enjoy a market with better, safer and more environmentally friendly vehicles.

53. In light of these objectives, the Brazilian Government envisaged, among other measures, a specific tax regime for the automotive sector in Brazil aiming at supporting technological development, innovation, safety, environmental protection, energy efficiency and improvement of the quality of cars, trucks, buses and auto parts.

54. For these purposes, on April 2012, Brazil issued Provisional Measure No. 563 (MP 563/2012), creating the Program of Incentive to the Technological Enhancement and Densification of the Automobile Production Chain (*Programa de Incentivo à Inovação Tecnológica e Adensamento da Cadeia Produtiva de Veículos Automotores* – INOVAR-AUTO). MP 563/2012 was implemented by Decree No. 7.716 in April 2012 and was converted into Law No. 12.715 in September 2012. INOVAR-AUTO is governed by Articles 40 to 44 of Law 12.715 and creates a so-called "presumed IPI credit" scheme[21].

---

[19] Item II of article 30 of Law No. 11.196, of November 21, 2005.

[20] Art. 28 of Law No. 11.196/2005 and Art. 1 of Decree 5.602/2005.

[21] Brazil notes that the "presumed IPI credits" provided under INOVAR-AUTO are not value-added tax credits related to tax obligations on inputs or capital goods paid at previous steps along the production chain. As explained in this section, despite their denomination, the INOVAR-AUTO presumed credits are subsidies paid to accredited producers.

55. INOVAR-AUTO is the latest of a sequence of governmental measures aimed at improving the quality of cars circulating in Brazil. Most of this effort was directed at the promotion of cleaner, more efficient vehicles through the reduction of CO_2 emissions. INOVAR-AUTO is not only part of this effort, but the synthesis of a process to adapt emission reduction goals to the Brazilian automobile sector.

56. The guiding principle of INOVAR-AUTO is to promote the sustainable development of the automotive market, both through requirements which bring the vehicles produced and sold in Brazil to international standards and through the necessary corresponding incentives to make the changes effective and capable of being met.

57. The energy efficiency goals of INOVAR-AUTO are made clear by its "compulsory habilitation goals". Companies that voluntarily exceed the "compulsory habilitation goal" are granted an additional IPI reduction of 1% or of 2%. The commitment to achieve minimum levels of energy efficiency is a key aspect of INOVAR-AUTO. Companies which do not meet the compulsory goal are subject to progressive fines proportional to the energy consumption in excess of the target[22].

58. More importantly, if all qualified companies in the INOVAR-AUTO programme achieve the goal of 1.68 MJ/km (equivalent to the IPI bonus of 2 percentage points) by 2017, the energy efficiency of the vehicles marketed in Brazil will be close to the energy efficiency of the European vehicles.

59. Promoting energy efficiency is but one of the goals of the Programme. As already mentioned, INOVAR-AUTO ultimately aims to promote comprehensive qualitative improvement of the vehicles sold in Brazil and of the automotive sector as a whole. Therefore, in order to benefit from the Programme, companies are subject to a process of accreditation by which they commit to comply with several requirements established in light of the goals.

60. The programme encompasses in a non-discriminatory manner manufactures, distributers and newcomers to the Brazilian market. Automobile manufacturers must perform a number of manufacturing steps in Brazil[23] set out in Annex III of Decree 7819/2012, according to the type of vehicle produced. They also must choose to perform two of the following three obligations: (i) to make expenditures in Brazil on research and development[24] based on a percentage of their total gross revenue from the sale of goods and services excluding taxes[25]; (ii) to make expenditures in Brazil on engineering, basic industrial technology and supplier capacity-building based on a percentage of their total gross revenue from the sale of goods and services excluding taxes[26]; or (iii) to join the Brazilian Programme of Vehicle Labeling[27] – *Programa Brasileiro de Etiquetagem Veicular* (PBEV), a labeling programme to classify the fuel-efficiency of light vehicles and inform consumers on their products.

61. In order to attain INOVAR-AUTO's objectives, distributers also have equivalent obligations. However, since they do not manufacture goods in Brazil, the productive step requirement cannot apply to them. They must, therefore, fulfill the other three (i, ii and iii) previously mentioned conditions.

62. Companies with an investment project for a new plant (new-comers) have a temporary accreditation, as they will become manufacturers once they conclude their project and start producing vehicles. They must present an investment plan, with all of the technical characteristics of their products, for each unit they intend to establish. Once they start their manufacturing activities, the requirements for manufacturers apply, based on the year previous to their accreditation.

[22] As determined in Article 43 of Law 12.715 (as amended).
[23] Article 40, paragraph 5 of Law 12.715.
[24] The expenditures may be done directly, through contract with a third party or with a university, learning institution, enterprise or inventor under the *Lei de Inovação Científica*, Law 10.973/2004. The expenditures can also be made to the National Fund for the Scientific and Technologic Development – *Fundo Nacional de Desenvolvimento Científico e Tecnológico* - FNDCT. These expenditures, in turn, may be used to generate presumed IPI credits.
[25] Id.
[26] Id.
[27] For heavy vehicles, since there is no requirement for compulsory reduction goals, the corresponding requirement for labeling is also removed.

63. Once companies have been accredited, they are eligible to receive presumed IPI credits against their contribution to the programme's goals. Both importers and producers may benefit from this provision. The presumed credit is calculated based upon certain expenditures.

64. Vehicles imported under the framework of the Economic Complementation Agreements 14 and 55 by accredited companies that manufacture vehicles in Brazil or new-comers have a 30 p.p. IPI reduction. The specific rules for trade with each of the countries are the relevant agreements and their additional protocols and must be followed in order to benefit for the reductions.

65. INOVAR-AUTO is outside the scope of Articles III:2, III:4 and III:5, as it is a subsidy paid exclusively to domestic producers according to Article III:8(b) of the GATT 1994. Second, even if the programme were to be found inconsistent with one or more than one of these provisions, INOVAR-AUTO is a measure justified under Article XX(b) and XX(g) of the GATT 1994.

66. Brazil would like to underscore that the conditions for accreditation under the INOVAR-AUTO and the general requirements that must be fulfilled in order to benefit from the regime are not, as a whole, inconsistent with WTO national treatment obligations. Also, the requirements to perform certain manufacture steps in Brazil and to invest in R&D and or engineering in Brazil, in order to benefit from the tax regime established in the INOVAR-AUTO, are not local content.

67. If the Panel were to understand that INOVAR-AUTO violates in some aspect one or more paragraphs of Article III of the GATT 1994, Brazil submits that the measure is justified under Articles XX(b) and (g) of GATT 1994, as it is necessary to protect human life and health and relates to the conservation of exhaustible natural resources. INOVAR-AUTO is necessary to ensure the circulation of environmentally friendly and safe cars, as well as the provision of their parts in Brazil, and is related to the preservation of gasoline and petroleum by fomenting energy efficiency. The manner in which Brazil applies PATVD constitutes neither (a) a means of "arbitrary or unjustifiable discrimination" between countries where the same conditions prevail, nor (b) a "disguised restriction on international trade."

68. Brazil further argues that the tax treatment given to Mexico, Argentina and Uruguay fall under the purview of the Enabling Clause as "non-tariff measures" under the LAIA Agreement.

69. Finally, INOVAR-AUTO does not constitute a trade related investment measure inconsistent with the TRIMs Agreement. Also, the programme is not contingent on the use of domestic products within the meaning of Article 3.1(b) of the SCM Agreement.

Programs addressing tax credit Accumulation – PEC and RECAP

70. Brazil has a system of value-added taxation along the production chain. In the normal course of business, companies have more debits than credits and offset them with adequate regularity. There is no cash flow problem, as the credits gained are completely used to offset against debits on a monthly basis without any meaningful administrative or legal constraints deriving from the system.

71. In many sectors, however, products are subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits as the tax debits due are lower than the credits acquired in the previous steps of production. Credits which would otherwise be normally offset are accumulated. As a result, these "predominantly credit-accumulating companies" structurally accumulate tax credits in their normal course of business. Avoiding this situation is crucial for the Brazilian authorities.

72. The term "PEC" is being used in this dispute to make reference to a set of rules that provide the suspension of IPI, PIS and COFINS on sales of inputs to companies that tend to accumulate tax credits, and the suspension of IPI, PIS-importation and COFINS-importation on imports of inputs made by such companies. The core legal provisions addressed under the "programme" include basically art. 29, of Law No. 10.637/2002 (which provides for the suspension of IPI), and art. 40, of Law No. 10.865/2004 (which provides for the suspension of PIS, COFINS, PIS-importation and COFINS-importation.

73. The Special Regime for Acquisition of Capital Goods by Exporting Companies - RECAP – (*Regime Especial de Aquisição de Bens de Capital para Empresas Exportadoras*) is another regime aimed at preventing the accumulation of credits in companies which structurally tend to have more credits than debits[28]. Created by Law 11,196 of 2005, RECAP suspends the PIS/Pasep and COFINS contributions and PIS/Pasep-Importação and COFINS-Importação[29] for predominantly exporting companies[30] in the acquisition of capital goods[31].

74. PEC and RECAP are not inconsistent with the SCM Agreement, as it is a tax administration measure which does not provide a *financial contribution* and does not confer a *benefit*. Furthermore, even if the Panel understands that there is a subsidy, it is not contingent upon export performance as it establishes an objective criterion which is part of a larger framework addressing the issue of tax credit accumulation.

75. The Brazilian tax system provides for a method of tax administration to avoid the accumulation of tax credits by companies, such as the predominantly exporting companies, related to taxes that were never due. By granting tax suspensions or exemptions in the acquisition of inputs by companies whose majority of revenue comes from final products and are subject to low taxation, or are exempt from these taxes, such as is the case of predominantly exporting companies, the government is not foregoing any revenue. It simply avoids that these companies accrue tax credits that would have to be later reimbursed by the government.

76. The complainants incorrectly compare companies that tend to chronically accumulate credits to companies which do not tend to accumulate credits. The premise of the comparison is wrong as the wrong benchmark is used.

77. The measure essentially equalizes the conditions of competition by making all companies in the Brazilian market not credit accumulators. It does not put any Brazilian company in a "better off" situation regarding the internal or the international market. In sum, a benefit for the companies under PEC cannot be presumed solely from the legal text of the programme.

78. The progressive reductions accrue from the fiscal reality rather than from a concentrated effort towards exporting. The programme is not contingent in law upon export performance. The criteria for accreditation are an objective assessment of the level of tax credit accumulation of companies in Brazil.

D. CONCLUSION

79. In light of the arguments above, Brazil respectfully requests that all of the measures challenged by the complainants be found consistent with the relevant WTO provisions and that each of their claims be dismissed.

---

[28] Given the high cost of capital goods, such as new machinery, apparatuses, instruments and equipment, the PIS/PASEP and COFINS due on their acquisition gives rise to large amounts of tax credits that predominantly exporting companies have difficulties to offset or compensate, considering that export sales are exempted from indirect taxes.

[29] It is important to note that IPI does not generate credits, as capital goods are final goods for these companies, and would not otherwise generate tax credits. In the case of capital goods, thus, only PIS/Pasep and COFINS and PIS/Pasep-*Importação* and COFINS-*Importação* obligations generate correspondent tax credits to be used by the purchaser in its obligations.

[30] Pursuant to Article 13 of Law 11,196/2005, predominantly exporting companies are companies whose gross profit from exports during the preceding calendar year was equal to or greater than 50 percent or who commit to export at least 50 percent of their gross turnover for a period of two years. The required threshold had initially been set at 80%. Yet, the tax authorities saw that tax credit accumulation continued to occur. Therefore it was later reduced to 70% (or to 60% for companies manufacturing certain products) by Law 11,774 of 2008 (transposing Provisional Measure 428 of 2008), then finally to 50% by Law 12,715 of 2012 (transposing Provisional Measure 563 of 2012).

[31] For IPI obligations, capital goods are considered final goods, therefore, do not generate credits.

ANNEX B-6

SECOND PART OF THE EXECUTIVE SUMMARY OF THE ARGUMENTS OF BRAZIL

I. INTRODUCTION

1. Throughout these proceedings, Brazil has established that the measures challenged by the European Union and Japan are not only consistent with the Covered Agreements, but are designed, structured and applied in a way to promote some of the main objectives of the WTO. The Informatics Programme, PADIS, PATVD and the Digital Inclusion Programme do not result in discrimination against imports as prohibited by the GATT 1994, the TRIMS Agreement and the SCM Agreement. Likewise, INOVAR-AUTO is a WTO-consistent subsidy programme on the production of vehicles in Brazil that is also justified under paragraphs (b) and (g) of Article XX of the GATT 1994. Finally, PEC and RECAP are tax administration measures that do not constitute a financial contribution, or provide a benefit within the meaning of the SCM Agreement, that are tied to the accumulation of tax credits, rather than export performance, and, therefore these measures are not export subsidies as argued by the complainants.

II. HORIZONTAL LEGAL ISSUES

2. In order to demonstrate the consistency of the measures at issue, Brazil considers important to address certain systemic legal issues it believes should guide the analysis of the panel and the interpretation of the provisions raised by the complainants. Firstly, Brazil will address the term "domestic" in light of the provisions relevant to the dispute at hand. Secondly, it will further elaborate on the payment of subsidies to domestic producers by means of indirect taxation. Finally, Brazil will reiterate its views on the legal standard that should be apply in the analysis of the dispute.

The term "domestic" in Article 3.1(b) of the SCM Agreement and in Article III of the GATT 1994

3. In Brazil´s view, the proper interpretation of the term "domestic" in the relevant Covered Agreements is critical to the Panel's assessment of the consistency of the challenged measures with Brazil's WTO obligations. The complainants have proposed a sweeping theory that a "domestic product" is any product that "comes into existence within the territory of the country concerned"[1] or "that has not been imported"[2] and, as a consequence, any subsidy related to the *locus* of the productive activity or designed to promote local production would result in a subsidy contingent on the use of domestic products inconsistent with WTO rules. Under this assumption, the complainants have characterized the production step and the R&D requirements under five of the seven challenged programs as a *de jure* violation of both Article III of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

4. The sweeping notions raised by the complainants find no ground in WTO rules[3]. While the meaning of "imported" may be much easier to grasp and define (something brought from abroad; that crosses the border, etc.); the term "domestic" for purposes of the SCM Agreement and the GATT 1994 is not. Brazil understands that a superficial interpretation of the term "domestic" as "anything that is not imported" may reduce and distort the very concept and spirit of these Agreements For Brazil it follows from the structure and logic of the legal text that the proper interpretation of what is domestic for the purposes of the disciplines contained in Article 3.1(b) of the SCM Agreement and Article III of the GATT 1994 cannot be determined in abstract. It has to

[1] EU - Oral Statement, para. 50. The complainants also seem to understand the term "domestic" as strictly juxtaposed to "imported".[1] While the meaning of "imported" may be much easier to tangibly grasp and define (something brought from abroad; that crosses the border, etc.); the term "domestic" for purposes of the SCM Agreement and the GATT 1994 is not. Brazil understands that a superficial interpretation of the term "domestic" as "anything that is not imported" may reduce and distort the very concept and spirit of these Agreements.

[2] EU- First Integrated Executive Summary para 15

[3] Brazil's First Closing Statement, para. 5.

be established on a case-by-case basis, in light of the object and scope of those provisions and in the context of the total configuration of the facts of each situation.

5. Brazil understands that the term domestic cannot be interpreted in a manner that would prevent members to confer subsidies to producers contingent upon the performance of production steps of goods in their territory, including those that are meant to be integrated into a local production chain. Indeed, as WTO Agreements do not prohibit a Member from conditioning a subsidy to a production requirement or other localization requirements, such as the level of employment or investments in R&D, it would be incongruous to interpret the term "domestic product" as encompassing domestic production requirements.

6. It must follow therefore that the term "domestic product" has to have an economic sense. In this connection, the definition of a domestic product is a factual question that must be determined by looking at the characteristics of the specific product/sector. While it may not be possible to determine precisely the exact percentage of value added required to characterize, in each case, a product as domestic, the economic dimension must be taken into account. It is not merely because a product is made or brought into existence within the territory of a Member[4] that the product is necessarily or automatically a "domestic product" within the meaning of the relevant provisions, as the European Union contended.

7. Brazil has provided arguments and examples regarding the absurd conclusions that these notions would create, such as the situation of a product with only 1% of its value added in a Member's territory and that would have to be considered a domestic product. Should this notion prevail, a Member's ability to grant subsidies to its producers and to foster the integration of a production chain in its territory would be severely curtailed, effectively rendering moot Article III:8(b) of the GATT.

The legal standard for subsidies paid to domestic producers through indirect tax reductions

8. Brazil submits that the Covered Agreements cannot be read as precluding a Member from using indirect tax reductions to finance its public spending, including the granting of subsidies to domestic producers, as long as the tax incentive does not introduce discrimination between foreign and domestic *products*.

9. As explained at length, the relevant legal issue in assessing the impact of a subsidy granted to domestic producer is not whether it was granted through a specific means, but rather whether the subsidy entails an illegitimate trade distortive advantage. Therefore, the possibility of a Member granting a subsidy to its domestic producer through indirect tax reductions, an instrument increasingly used by governments – especially those of developing countries – as an effective substitute of direct payments, cannot be presumptively excluded. There is an intrinsic rationality in saving the government from the task of collecting taxes and then using the money derived from those taxes to pay back the same persons. Assuming *ex ante* that indirect tax reductions cannot legitimately qualify as a subsidy to domestic producers within the meaning of Article III:8(b) would deprive Members of an important tool to pursue its developmental goals and policies.

10. Indirect tax reductions, as any other type of subsidy, may have, of course, adverse effects in the marketplace, but this has to be assessed on a case-by-case basis. The complainants, however, seem to believe that "by definition" a subsidy granted through indirect tax reductions is WTO-inconsistent since it would necessarily discriminate against imported products and adversely affect the conditions of competition on the marketplace. As Brazil has demonstrated, this assumption is flawed.

The legal standard for *de jure* and *de facto* the present dispute

11. It is not disputed that the complainants made their claims as *de jure* claims. They have clearly submitted that the Panel should analyze the challenged programmes at their face value, according to their structure and design, as evidenced by their legal text. Brazil understands that,

[4] European Union Responses to the Panel para 41

for the complainants, the programmes discriminate between domestic and imported products and are contingent upon the use of domestic over imported products or contingent upon export performance by their very nature as they have not put forth evidence to substantiate their claims that these measures are inconsistent with WTO rules *de facto*.

12. Based upon the legal standard applied to assess both *de jure* and *de facto* cases, Brazil submits that the complainants clearly have not been able to establish a *prima facie* case with regard to their *de jure* claims and have not argued, much less proven that the measures at issue violate *de facto* the relevant provisions.

13. While not having to do so, Brazil brought extensive evidence that breaks any presumption of a *de jure* violation or contingency in the challenged programmes. Brazil particularly demonstrated the overwhelming amount of imports in the composition of the products made by companies accredited to the programmes and that the costs associated with the programme may more than offset the benefits intermediate and for final products. The complainants have not brought evidence proving otherwise. This was not done by accident. The evidence simply is not there. The challenged programmes have not restricted trade or discriminated against imported products. The numbers, as Brazil extensively pointed out, do not add up.

14. The ICT programmes and INOVAR-AUTO tax reductions are production subsidies designed to foment technology and workforce capacity in strategic sectors of the Brazilian economy. The measures were structured, on the one hand, by establishing R&D investment and production-step requirements with which accredited companies must comply and, on the other hand, by providing tax incentives to ensure they are able to meet the objectives of the programme The programmes are structured so as the required costs/ investments and the tax incentives offset each other during the production process. The tax incentives are clearly a production subsidy that do not affect the conditions of competition in the market place From a legal standpoint, this practice is wholly consistent with the covered agreement, as WTO rules do not prevent members to grant subsidies through fiscal incentives conditioned upon production requirements or other localization requirements such as the level of employment or investments in R&D and innovation, so long the requirements do not establish, in law or in fact, any condition related to the origin of the products used in the production process or result in discrimination against imported products

15. As for PEC and RECAP, the tax suspensions the complainants unduly read as subsidy, are simply a tax administration measure, necessary to avoid structural tax credit accumulation for certain types of companies. Here again, no *de jure* violation can be read or implied in the legal texts that established the two measures.

16. As demonstrated, it is clear from the design and structure of each of the challenged programmes, that the programmes at issue are wholly consistent with the provisions of the GATT and the SCM Agreement. With regard to TRIMs, Brazil understands that this agreement is intrinsically tied to Article III of the GATT. Accordingly, the arguments made under GATT throughout this proceeding are equally applicable to TRIMS.

III. MEASURES RELATING TO THE ICT, AUTOMATION AND RELATED SECTORS

The Informatics Programme is consistent with the Covered Agreements

17. The complainants contend that the measures at issue were designed, structured and applied not to accomplish the objectives set out in the programs, but rather to develop the domestic industry to the detriment of imported products.[5] There is absolutely no truth in this assertion.

18. The ICT Programs do not aim to replace imports for domestic products, but to promote the development of the Brazilian ICT sector and its integration in global supply chains, which actually has a positive impact on imports. Brazil has provided plenty of data demonstrating that that imports of ICT products have increased significantly between 2005 and 2014.[6] The European Union's attempt to dismiss this evidence by stating that the "ICT sector grew in the same period"[7]

[5] EU Oral Statement – Para. 105; Japan Oral Statement – Paras. 6, 8.
[6] Paras. 112, 115 and 116 of Brazil's FWS.
[7] Para. 105 of the EU's Oral Statement.

simply does not hold. Brazil has, in fact, provided data showing how its ICT exports have remained constant throughout time and how imports of ICT products have significantly increased, due to the impact of the Informatics Law.[8] Moreover, Brazil has shown how jobs in the Brazilian Electronic sector have increased and more so those in accredited companies, especially higher level jobs and jobs related to R&D.[9]

19. The Informatics Programme is a subsidy paid to domestic producers within the meaning of Article III:8(b) of the GATT 1994 to offset R&D and production step requirements with which they must comply. The indirect tax reductions for the production of final products are wholly absorbed by the costs associated with the compliance with the programme's requirement and do not result in a taxation of imported products "in excess of" domestic products in the sense of Article III:2; the requirements do not affect the internal sale, offering for sale, purchase, transportation, distribution or use of imported products and do not confer less favourable treatment to those products, in the sense of Article III:4, and the requirements are not quantitative regulations relating to the mixture processing or use of products "quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions" and do not require directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources, in the sense of Article III:5 of the GATT.

20. With regard to intermediate products, Brazil demonstrated that due to the overall functioning of the Brazilian tax system, there is no effective difference in taxation as the suspension or exemption of indirect value-added taxes in the middle of the production chain does not affect the tax burden of the final product. Brazil argues *mutatis mutandis* for intermediate products in the Informatics Law the arguments put forth under PADIS in this submission.

21. Furthermore, the Informatics Programme does not constitute a trade related investment measure in violation of Article III:4 of the GATT, thus, does not violate Article 2.1 of the TRIMs Agreement and is not a subsidy contingent upon the use of domestic over imported products, under Article 3.1(b) of the SCM Agreement.

PADIS is consistent with the Covered Agreements

22. Like the Informatics Programme, the PADIS Programme is a subsidy paid to domestic producers in order to offset R&D and production step requirements with which they must comply. In this case, however, the benefits are related to reduction of direct taxes and customs duties accredited companies must pay. They do not stem from reductions on indirect taxes, as alleged by the complainants, as all of the relevant products are intermediate products and, as such, does not result in a taxation of imported products "in excess of" domestic products in the sense of Article III:2.

23. Brazil understands that, despite all the evidence in contrary, the complainants insist that PADIS would impose a higher tax burden on imported products related to indirect taxation adversely affecting the conditions of competition of imported products. As Brazil has demonstrated throughout this proceeding the PADIS program aims at fostering knowledge, innovation and the development of the Brazilian sector of semiconductors and displays by promoting investments in R&D. Its objective is to promote development and assembly of semiconductors and displays in Brazil in a holistic manner without any discrimination towards the origin of inputs used in the process. To be eligible to benefit from the tax exemption granted under PADIS, companies must invest in R&D and perform certain activities related to the development and assembly of semiconductors and displays in Brazil.[10]PADIS was not conceived for and is not aimed at replacing imported by domestic products or undermining market competition. In order to illustrate that, Brazil prepared Exhibit BRA-109 and explained during the first substantive meeting with the Panel that the exemptions of indirect taxes granted under PADIS do not have any impact on the total tax burden of the production chain. In other words, the total tax paid throughout the production chain is the same with or without the exemptions granted under PADIS[11]

---

[8] Paras. 112-114 of Brazil's FWS.
[9] Paras. 112-116 of Brazil's FWS.
[10] Para. 317-323 of Brazil's FWS.
[11] Para. 185 of Brazil's FWS

24. Furthermore, as it was the case under the Informatics Programme the requirements under PADIS do not affect the internal sale, offering for sale, purchase, transportation, distribution or use of imported products and do not confer less favourable treatment to those products, in the sense of Article III:4, and the requirements are not quantitative regulations relating to the mixture processing or use of products "quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions" and do not require directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources, in the sense of Article III:5 of the GATT.

25. The PADIS Programme does not constitute either a trade related investment measure in violation of Article 2.1 of the TRIMs Agreement and is not a subsidy contingent upon the use of domestic over imported products, under Article 3.1(b) of the SCM Agreement.

26. The complainants take issue with an alleged cash flow that, in their views, would necessarily follow an exemption of taxation on intermediate products due to the amount of time that runs between the acquisition of the intermediate product and the sale of the product that incorporates that intermediate product, The complainant

27. Since the credits accrued from the purchase of inputs do not have to be necessarily compensated with debits of the same tax, they do not have necessarily to wait for the sale of the final product to be used. Such credits may be compensated even before the debit from the sale of the final product is generated.

28. The complainants fail to account that, in the case at hand, PADIS imposes certain requirements for companies to be eligible to receive the tax incentives under the program, such as carrying out investments of at least 5% of the beneficiary's gross revenue in R&D and the performance of specific development and/or manufacturing steps, which require that investments be made. The investments in R&D and in the development and/or manufacture of intermediate products is a major investment incurred by companies, which offsets any possible financial contribution that may derive from a company not bearing the "cost of money" of the payment of the relevant indirect tax in that stage of production. Accordingly, the alleged financial contribution received under PADIS does not have an impact on the competitive position of goods on the market.

Brazil has demonstrated that the PATVD is consistent with the Covered Agreements

29. Brazil has demonstrated throughout these proceedings that, as a subsidy paid to domestic producers in order to offset investments in R&D and in the compliance of production step requirements, the tax reductions under the PATVD Programme are fully consistent with WTO rules. These indirect tax reductions under the programme are wholly absorbed by the costs associated with the compliance with the programme and do not result in a taxation of imported products "in excess of" domestic products in the sense of Article III:2; the requirements do not affect the internal sale, offering for sale, purchase, transportation, distribution or use of imported products and do not confer less favourable treatment to those products, in the sense of Article III:4, and the requirements are not quantitative regulations relating to the mixture processing or use of products "quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions" and do not require directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources, in the sense of Article III:5 of the GATT.

30. PATVD does not constitute a trade related investment measure in violation of Article III:4 of the GATT, thus, does not violate Article 2.1 of the TRIMs Agreement and is not a subsidy contingent upon the use of domestic over imported products, under Article 3.1(b) of the SCM Agreement.

31. Brazil has stated also that, if the panel understands that the PATVD programme violates the GATT, it is justified as a measure necessary to protect public morals under Article XX(a) of the GATT. In its second submission Brazil will explore and counter the complainants' arguments related to this latter aspect and their suggestions for less trade restrictive measures below.

Brazil has demonstrated that the Digital Inclusion Programme is consistent with the Covered Agreements

32. As Brazil has explained, the Digital Inclusion Programme is a subsidy paid to domestic producers accredited under the Informatics Programme, in order to foment the production in Brazil of certain low cost ICT consumer products. The programme is fully consistent with Brazil´s WTO obligations. The indirect tax reductions are wholly absorbed by the costs associated with the compliance with the programme and do not result in a taxation of imported products "in excess of" domestic products in the sense of Article III:2; the requirements do not affect the internal sale, offering for sale, purchase, transportation, distribution or use of imported products and do not confer less favourable treatment to those products, in the sense of Article III:4, and the requirements are not quantitative regulations relating to the mixture processing or use of products "quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions" and do not require directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources, in the sense of Article III:5 of the GATT. The Digital Inclusion Programme does not constitute a trade related investment measure that violates Article 2.1 of the TRIMs Agreement and is not a subsidy contingent upon the use of domestic over imported products, under Article 3.1(b) of the SCM Agreement.

IV. MEASURES IN THE AUTOMOTIVE SECTOR

Brazil has demonstrated that INOVAR-AUTO is consistent with the Covered Agreements

33. The INOVAR-AUTO Programme is a subsidy paid to domestic producers and importers who undertake certain obligations to produce and commercialize safer, more environmentally friendly vehicles in Brazil, and make certain expenditures in Brazil. Accredited companies that fulfill the programme's requirements are entitled to benefit from presumed IPI credits that can be used to offset tax debits on both imported and domestic vehicles. Since the requirements are all pre-market operations, they do not affect the internal sale, offering for sale, purchase, transportation, distribution or use of imported products and do not confer less favourable treatment to those products, in the sense of Article III:4. They do not result in a taxation of imported products "in excess of" domestic products in the sense of Article III:2. The Programme also does not establish any quantitative regulations relating to the mixture processing or use of products "quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions" and do not require directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources, in the sense of Article III:5 of the GATT.

34. INOVAR-AUTO does not constitute either a trade related investment measure in violation of Article 2.1 of the TRIMs Agreement or a subsidy contingent upon the use of domestic over imported products, under Article 3.1(b) of the SCM Agreement.

35. Brazil submitted also that in any event the tax treatment conferred under the Program would be justified under Article XX(b) and XX(g) of the GATT as necessary measures to protect human life and health and relating to the conservation of exhaustible natural resources, and that the tax treatment given to certain LAIA countries is justified under the Enabling clause. Brazil will further explore these two issues below.

Brazil has established that INOVAR-AUTO is necessary to protect human life and health and is thus justified by Article XX(b) and XX (g) of GATT

36. Brazil has demonstrated that the tax treatment under INOVAR-AUTO is "necessary" to protect human life or health and that, contrary to what the complainants argued, there is a clear link between the challenged aspects of the programme and the requirements of paragraph (b) of Article XX. This contention is wrong.

37. The INOVAR-AUTO is a shift in paradigm with regard to environmental policy in the automotive sector. As Brazil explained at length the prior traditional approaches to foster the sustainable development of the automotive sector in Brazil had run on their course. In order to

require automobile industry to be more efficient, it becomes imperative to grant specific incentives to promote energy efficiency ant thus, protect human life and health and the environment. INOVAR- AUTO is aimed at providing, in and open and effective manner, the conditions for the automotive industry in Brazil, as well as its mains strategic suppliers, to comply with global environmental and security standards, while also providing incentives for importer to commercialize energy efficient automobiles in Brazil

38. The fuel efficiency standards, together with the investments and production steps requirements, on the one hand, and the benefit structure, on the other, are beyond doubt a measure necessary to promote the quality and the efficiency of the vehicles circulation in Brazil, and to reinforce the strategy of petroleum conservation in the country. INOVAR-AUTO´s particular contribution, with its carrot-and stick structure, allows for the overall efficiency improvement of the automotive sector in Brazil. Because both domestic manufactures and importers have to comply with the same energy conservation/efficiency requirements established in the programme, there is a clear "even handedness" in its application.

39. As a matter of fact, INOVAR-AUTO is structured in an open non-discriminatory manner, allowing for the participation of both producers and importers and accommodating different situations within its framework in order to avoid any distorting effects on trade. The presumed credits on various expenditures made in Brazil were conceived and are calculated to offset the costs incurred by the accredited companies in their different capacities in fulfilling the programmes requirements. Both the requirements and the type of expenditures foreseen in INOVAR-AUTO against which presumed credits are accrued were established in order to maximize their contribution to the programmes objectives.

40. It is also noteworthy that in their submissions, the complainants have failed to identify an alternative measure to INOVAR-AUTO that would allow Brazil to achieve its chosen level of protection.

The treatment given to certain LAIA countries falls under the purview of the Enabling Clause

41. Another important feature of INOVAR-AUTO is its clear contribution to the longstanding efforts of Latin American countries to foster regional integration under the auspices of LAIA, and, as such, the programme falls squarely within the bounds of the Enabling Clause. The complainants have not been able to prove otherwise.

42. Indeed, the tax treatment afforded to Argentina, Mexico and Uruguay within the framework of INOVAR-AUTO is incontestably justified under the Enabling Clause. First, the measure is clearly inscribed in the implementation process of the Economic Complementation Agreements negotiated under the umbrella of the Treaty of Montevideo-1980 (TM-80) that established the LAIA, in order to further the process of economic integration in Latin America. The fact that INOVAR- AUTO, as Japan has pointed out, is an internal measure does not change this feature, as the Treaty of Montevideo itself explicitly encourages its Members to progressively eliminate or reduce all trade barriers, non-tariff measures among them, using all instruments capable of consolidating and expanding markets at a regional level, including through unilateral measures[12].

43. Secondly, in Brazil's view, there is no doubt that the non-tariff measures at issue fall under the purview of paragraphs 2(b) and 2(c) of the Enabling Clause. The complainants themselves did not put forth any credible arguments contradicting this claim. Japan used the "Illustrative List of Non-Tariff Measures" in the document Non-Tariff Measures Affecting Trade of Developing Countries[13] to argue that internal taxes were not listed as non-tariff measures. That document, however, as Brazil demonstrated does list internal taxes as non-tariff measures.

44. The European Union[14], in its turn, gave an interpretation of Article 2(c) which clearly goes against the text and the spirit of the provision, essentially rendering it moot, as developing countries would not be able to deviate from MFN obligations with respect to non-tariff measures.

[12] Articles 3 and 9 of the TM-80
[13] JE – 232.
[14] EU – SWS, para. 204.

An absurd reading of the provision, counter to not only the LAIA, which has been harmoniously coexisting with the GATT and the WTO systems since its inception, but to other integration processes among developing countries.

45. Thirdly, contrary to what has been conveyed by the complainants, all the ECAs negotiated under the auspices of LAIA were dutifully and timely notified to the WTO, fully complying with paragraph 4 of the Enabling Clause. Brazil is ready to provide more details on this issue in answering the questions posed by the Panel, if necessary, but it worth recalling that, for many years now, regional and partial agreements that affect the implementation or the operation of an RTA already in force are notified under Section D ("Further notifications and reporting") of the 2006 Transparency Mechanism . In the case of agreements negotiated under the auspices of LAIA, it has been the practice that the Organization itself notifies the WTO on behalf of its members, so all WTO Members were dully notified of the existence and scope of all the arrangements falling under paragraph 2 of the Enabling Clause negotiated within the framework of the Treaty of Montevideo.

46. In sum, Brazil has amply demonstrated that the tax treatment accorded to LAIA's Member falls within the purview of the Enabling clause and complies with the totality of its requirements and that the complainants' objections had no ground. The complainants, therefore, are not discharged of their burden to demonstrate that that INOVAR-AUTO violates Article I of GATT.

V. MEASURES DESIGNED TO PREVENT CREDIT ACCUMULATION

PEC and RECAP are consistent with the covered agreements

47. Contrary to what the complainants have argued that PEC and RECAP are not subsidies at all. This can be easily concluded by properly assessing the manner by which the value added at each step of production gets properly taxed in Brazil without double counting through the use of tax credits and debits. A central tenet of this system is that tax debits are higher than tax credits, so that the revenue due is properly collected by the tax authorities and there are no money belonging to taxpayers tied up in the Revenue service.

For companies that mainly sell products with average rates of indirect taxes and mainly to the domestic market, the tenet holds in the normal course of business. However, for companies that mainly sell products with low or no taxation, including by the destination principle, exports, and tax credits accrued in previous steps of production will occlude and not properly flow if there is no outside intervention. Taxes must be suspended along the production chain so that the principle of debits being greater than credits holds. PEC and RECAP were conceived to tackle this situation. They do not qualify as financial contribution nor constitute a benefit in the sense of the SCM Agreement and, as there is no revenue foregone otherwise due, there is no subsidy in the sense of Article 1.1(a)(1)(ii) of the SCM Agreement.

48. The complainants nevertheless insist that there is an advantage in the form of a tax deferral with the suspension of IPI and PIS/COFINS along the production chain. This could not be further from the truth.

The different types of tax administration do not amount to a tax deferral constituting a subsidy within the meaning of the SCM Agreement

49. It appears that the complainants[15] consider that there is a delay in the moment of tax collection which amounts to a tax deferral, constituting revenue foregone and a benefit within the meaning of the SCM Agreement. Their understanding glosses over the functioning of VAT taxes and would amount to impose an absurd and undue burden on credit accumulating companies.

50. Non-credit-accumulating companies are able, as Brazil demonstrated, to offset the totality of their tax credits on their monthly payments of IPI and PIS/COFINS. Credit-accumulating companies, on the other hand, will tend to accumulate credits indefinitely, the government does not suspend indefinitely or even for a long period of time, Brazil simply equates credit-accumulating companies to what non-credit accumulating companies already practice.

[15] EU – SWS, para. 56.; Japan – SWS, para. 143.

51. Tax credits in Brazil are immediately available to be used by the buyer and, considering the general principle that tax debits must be higher than credits, these credits tend to be used immediately. Therefore, tax suspensions alone merely change the taxpayer from the seller to the buyer, without necessarily altering the time of the payment of the taxes.

52. The seller is the one who pays the taxes and there is no legal requirement for the seller to reduce its price because of a tax suspension. Thus, a reduction in the seller's price depends on a negotiation between the seller and the buyer, which hardly results in a price reduction equivalent to the total amount of the suspended taxes. The result of this negotiation depends, among other factors, on the price elasticity of the concerned product. If the price reduction is lower than the amount of suspended taxes, the buyer may have a loss.

53. Moreover depending on the payment terms negotiated between the seller and the buyer, the tax suspension may result in a worse "cash flow" scenario for buyer. This is a consequence of the fact that the buyer is entitled to the tax credits immediately after buying the products. However, it will only disburse the cash to pay for such credits when it actually pays the supplier. Therefore, considering, for example, a case in which the supplier grants 90 days for the recipient company to pay for the inputs, the tax suspension will worsen the buyer's cash flow because it will not be able to use the tax credits freely for 90 days before paying for them.

54. The potential benefit that could be identified at the moment of the suspension would have to be compared with the long standing operations of the company in order to determine whether, at a present value, there is really a benefit, *i.e.*, whether the company supposedly benefited with the tax suspension is indeed in a better off position in relation to the companies to which the tax suspension does not apply.

The exportation threshold was designed to prevent tax credit accumulation

55. As for the questions regarding the threshold of 50% for both programmes. Brazil has put forth evidence to that regard, by means of a study made by the Federal Revenue Service, which demonstrates where companies tend to structurally accumulate credits.

56. As will be further discussed in the questions submitted by the Panel, the table presented by Brazil was elaborated by the Federal Revenue Service. The table is the result of the analysis of the 2013/2014 Tax Return of Legal Entities by the Secretaria da Receita Federal do Brazil. The aggregate value was calculated by taking the difference between total gross revenue of companies minus the value of acquisition of inputs.

57. There is a direct relationship between PIS/COFINS and exports. As a company increases its exports, its PIS/COFINS debit decreases. After group 11 is reached (minimum of 45% export and maximum of 50%), there is no PIS/COFINS debit, there is only tax credit. The more a company exports the more credit it has and the table demonstrates that. As stated before, the predominantly exporting companies (45% or more of export revenue) are the credit accumulating companies.

58. Brazil finds that the complainants' arguments regarding this point are rather confusing. They appear to argue, on the one hand, that the problem with the programme is to suspend indirect taxes for sales made in the domestic market, as suspensions for exports are clearly covered by the SCM Agreement. On the other, they state that the mere fact that a company that exports 49% of its revenue would have an incentive to increase it to 50% would prove the export contingency inconsistent with the SCM Agreement.

59. The rational conclusion from the complainants' arguments, therefore, would be that Brazil has a production subsidy disguised as an export subsidy, because once the threshold is met, the contingency is to sell in the domestic market. Brazil, as absurd as it sounds, would give a prohibited subsidy which functioned, for all effects and purposes as a domestic sales contingent subsidy. This not only does not make sense. It is not true.

Brazil has demonstrated that RECAP is consistent with the Covered Agreements

60. The suspension of taxes on purchases of capital goods by companies that tend to accumulate credits (among which are the predominantly exporting companies) is consistent with the SCM Agreement, since it does not characterize a financial contribution from the government or confers a benefit to such companies within the meaning of the SCM Agreement. Furthermore, such suspension is not contingent upon export performance but rather upon the accumulation of tax credits.

61. As the nature of RECAP is similar to that of PEC, the arguments submitted in section 6.2 apply *mutatis mutandis* to RECAP and are incorporated by Brazil.

VI. CONCLUSION

62. In light of the above, Brazil respectfully requests that all of the measures challenged by the complainants be found consistent with the WTO provisions raised and that each of their claims be dismissed.

____

ANNEX C

ARGUMENTS OF THE THIRD PARTIES

Contents		Page
Annex C-1	Executive summary of the arguments of Argentina	C-2
Annex C-2	Executive summary of the arguments of Australia	C-10
Annex C-3	Executive summary of the arguments of Canada	C-11
Annex C-4	Executive summary of the arguments of Korea	C-13
Annex C-5	Executive summary of the arguments of Ukraine	C-15
Annex C-6	Executive summary of the arguments of the United States	C-17

ANNEX C-1

EXECUTIVE SUMMARY OF THE ARGUMENTS OF ARGENTINA

I. EUROPEAN UNION'S CLAIMS REGARDING THE INCONSISTENCE OF The INOVAR-AUTO programme with ARTÍCLES III.2 AND I.1 AND OF THE GATT 1994.

In its First Written Submission, the EU submits that the **INOVAR-AUTO programme is inconsistent with Article III.2 of the GATT 1994,** since pursuant to it, motor vehicles of the EU imported into Brazil, are subject to a tax burden regarding the Tax on Industrialized Products (hereinafter IPI) in excess of that borne by like domestic products. More specifically, the EU submits that the INOVAR-Auto programme violates Article III.2 GATT 1994.

On the other hand the EU also submits that **the INOVAR-AUTO programme is inconsistent with Article I:1 of the GATT 1994,** because motor vehicles originating in the EU are not accorded immediately and unconditionally any advantage, favour, privilege or immunity granted to like products originating in other MERCOSUR members and Mexico.[1]

Indeed, according to the EU, under the INOVAR-AUTO programme the products at issue originating in the other MERCOSUR members, benefit from reduced IPI rates, in particular the rates prevailing before the establishment of the INOVAR-AUTO programme.

Under EU's views the practical effect of the INOVAR-AUTO programme for motor vehicles is to maintain the previous to 2011 tax treatment, only for domestic products and for products from preferential origins, while increasing the IPI by 30 percentage points for the like products from the rest of the World, including the imports of the like product originating in the EU.

II. THE RESPONSIBILITY OF RAISING THE ENABLING CLAUSE

In its First Written Submission the UE argues that pursuant to Article 21 of Decree 7,819/2012 companies accredited under the INOVAR-AUTO-programme either as domestic manufacturers or as newcomers, are able to import into Brazil, and subsequently sell, motor vehicles originating in the other MERCOSUR members at reduced IPI rates, against article I.1 of GATT 1994.[2] However, the EU further states that Decree 7,819/2012 does not mention by name the countries benefiting of a better treatment, but makes reference to a series of Decrees which concern Brazil's bilateral agreements, between Brazil and Argentina,[3] and Brazil and Uruguay.[4] In particular, and regarding Argentina, the EU mentions the Legislative Decree 350 of 21 November 1991 (Treaty of Asuncion),[5] and the Decree 6,500 of 2 July 2008 (Economic Complementation Agreement N|°14 between the Republic of Argentina and the Federative Republic of Brazil (here in after ECA N° 14).[6]

In response, Brazil contends that the tax treatment for vehicles of Latin-American Integration Association (here in after LAIA) is a measure created to meet Brazil's commitments undertaken as a Member of such regional integration association and therefore it is justified under the provisions of the TM 80, that was duly notified according to the Enabling Clause.[7]

In view of the foregoing, and having in mind the EU reference to the provisions of the Treaty of Asuncion and the ECA N° 14 as the legal context based on which Brazil would had granted benefits to certain MERCOSUR 'members states, Argentina considers the Appellate Body's Report in EC – Tariff Preferences informative. Indeed, in this dispute, and after highlighting the special status of the Enabling Clause in the WTO system and the particular implications that is has for WTO dispute settlement, and, as well as, after qualifying it as an exception to the Most-Favored Nation Clause

[1] European Union's First Written Submission. paras. 348 - 365.
[2] European Union's First Written Sumbission. para 295.
[3] European Union's First Written Submission Article 21 of Decree 7,819/2012.. (EXHIBIT EU -132)
[4] European Union's First Written Submission 22 of Decree 7,819/2012. (EXHIBIT EU -132)
[5] European Union's First Written Submission. para 296. (EXHIBIT EU **-** 163).
[6] European Union's First Written Submission (EXHIBIT EU - 165)
[7] Brazil's First Written Submission. para. 742**.**

(here in after MFN Clause) embodied in Article I.1 of the GATT 1994, the Appellate Body subsequently found regarding the legal responsibility for raising the Enabling Clause that: "(…) *it is insufficient in WTO dispute settlement for a complying to allege inconsistency with Article I:1 of the GATT 1994 if the complying seeks also to argue that the measure is not justified under the Enabling Clause. (…)*.[8]

In that dispute, the Appellate Body also interpreted that: "In the light of the extensive requirements set forth in the Enabling Clause, we are of the view that, when a complaining party considers that a preference scheme of another Member does not meet one or more of those requirements, the specific provisions of the Enabling Clause with which the scheme allegedly falls afoul, form critical components of the "legal basis of the complaint" and, therefore, of the "matter" in dispute.[9]Accordingly, a complaining party cannot, in good faith, ignore those provisions and must, in its request for the establishment of a panel, identify them and thereby "notify the parties and third parties of the nature of its case"[10]. For the failure of such a complaining party to raise the relevant provisions of the Enabling Clause would place an unwarranted burden on the responding party. This due process consideration applies equally to the elaboration of a complaining party's case in its written submissions, which must "explicitly" articulate a claim so that the panel and all parties to a dispute "understand that a specific claim has been made, [are] aware of its dimensions, and have an adequate opportunity to address and respond to it".[11]

In this context, and taking into account that not only the TM 80 but also the Treaty of Asuncion were duly notified to WTO under the umbrella of the Enabling Clause, Argentina fails to see which are those requirements that the INOVAR- AUTO programme does not meet. Argentina understands that the EU has not identified them, and consequently its argument does not appear to fulfill the standard set forth by the Appellate Body in EC-Tariff Preferences for raising this type of claims.[12]

III. OBLIGATIONS UNDER ARTICLE III.2 OF THE GATT 1994 CLEARLY QUALIFY AS NON-TARIFF MEASURES

Argentina considers that is well established among all WTO Members, that while Articles I and II relate to MFN and tariff measures treatment respectively, the provision embodied in Part II of GATT 1994, relate to non-tariff measures visions embodied in Article III of the GATT 1994 are non-tariff measures.

Consequently, being Article III.2 place in the above mentioned Part of the GATT 1994, and having in mind that Article III of GATT 1994 sets out National Treatment obligation for goods once internalized in the Member's territory, prohibiting the imposition of internal measures so as to discriminate imports and afford protectionism of their domestic production, Argentina considers it is undisputed that matters ruling by Article III.2 are clearly non-tariff measures. Prior WTO case law supports this view.[13]

In this context, Argentina shares the Brazil's view when it argues: "that internal taxes are applied inside a Member's territory on domestic products as well as on foreign products that have already been imported for reasons other than customs clearance and not with a view to administer international trade. They are, therefore non-tariff measures as they are unrelated to tariffs and trade regulation".[14]

---

[8] EC- Tariff Preferences. para 110.

[9] EC- Tariff Preferences (AB), citing Appellate Body Report, *US – Carbon Steel*, para. 125 (referring to Appellate Body Report, *Guatemala – Cement I*, paras. 69-76).

[10] EC- Tariff Preferences (AB), citing Appellate Body Report, *US – Carbon Steel*, para. 126.

[11] EC- Tariff Preferences (AB). para 113 (citing Appellate Body Report, Chile – Price Band System, para. 164).

[12] EC- Tariff Preferences (AB). para 113.

[13] Japan — Alcoholic Beverages II (AB) pp. 16 citing *United States - Section 337 of the Tariff Act of 1930,* para. 5.10 and.
Italy — Agricultural Machinery, para. 11. See also Brazil's First Written Submission. para 714.

[14] Brazil's First Written Submission. paras. 714 -715.

IV. THE TREATMENT PROVIDED TO MERCOSUR AND LATIN-AMERICAN INTEGRATION ASSOCIATION (LAIA) MEMBERS IS CONSISTENT WITH THE WTO AGREEMENTS

Brazil submits that the preferential treatment given to Argentina, Mexico and Uruguay in INOVAR-AUTO is inscribed in the process of the Economic Complementation Agreements (ECAs) negotiated under the auspices of Treaty of Montevideo 1980 (here in after TM 80) in order to progressively achieve the reduction and elimination of tariff and non-tariff barriers in the automotive sector among its Members, in line with LAIA's objectives. Negotiated under TM 80 the ECAs at issue themselves, and their implementing measures also fall within the scope the Enabling Clause.[15]

Brazil further explained that the TM 1980 was established as an umbrella treaty upon which its Members could negotiate specific agreements among them, such as the ECAs, pursuant Article 11 of this Treaty, that establish that such kind of agreements are aimed, among other objectives, to promote maximum utilization of production factors, stimulate economic complementation, ensure equitable conditions for competition, facilitate entry of products into the international market, and encourage the balanced and harmonious development of member countries.[16]

Finally, Brazil argued that the treatment provided to Argentina and Uruguay under INOVAR-AUTO program falls within the scope of the Enabling Clause, since they are Members State of the LAIA.[17]

In this context, Argentina agrees with Brazil that the tax treatment conceding on the ground of INOVAR-AUTO for Member having signed an ECA under the LAIA system, qualifies as an exception to MFN obligations of Article I:1 of the GATT 1994, as a non-tariff measure.[18] Indeed, Argentina concurs with Brazil that since the Enabling Clause is an exception to the obligations in article I.1 of the GATT 1994 (as interpreted by the Appellate Body in EC Tariff Preferences), and being the commitments regarding National Treatment non tariff measures, the concessions provided to certain MERCOSUR Members clearly fall under the Enabling Clause. That provision allows under Article 2, the concession among developing countries of differential and more favourable treatment with respect to the tariff and non-tariff measures in the context of ECAs agreements and regional integration processes.[19] This is specially true regarding the LAIA's purpose to speed up their economic and social development process and a long-term objective of gradual and progressive establishment of a Latin-American common market.[20]

V. THE ENABLING CLAUSE IS AN EXCEPTION TO ALL OBLIGATIONS EMBODIED IN THE NMF CLAUSE

In Argentina's view, it flows from Articles 1 and 2.a), b) and c) of the Enabling Clause that WTO provisions permit developing WTO Members to concede each other "differential and more favorable treatment" in the context of bilateral an regional agreements regarding tariff and non tariff measures (such the one as dispute), since the Enabling Clause provides for a derogation of the MFN obligations in Article I.1 of the GATT 1994.

In this regard, Argentina would like to draw the attention to the panel the interpretation made by the Appellate Body in the case **EC-Tariff Preferences** when stated that: "*In our view, the special status of the Enabling Clause in the WTO system has particular implications for WTO dispute settlement. As we have explained, paragraph 1 of the Enabling Clause enhances market access for developing countries as a means of improving their economic development by authorizing preferential treatment for those countries, 'notwithstanding' the obligations of Article I. It is evident that a Member cannot implement a measure authorized by the Enabling Clause without according an 'advantage' to a developing country's products over those of a developed country. It follows, therefore, that every measure undertaken pursuant to the Enabling Clause would*

[15] Brazil's First Written Submission. para. 707.
[16] Brazil's First Written Submission. para. 706.
[17] Brazil's First Written Submission. para. 710.
[18] Brazil's First Written Submission. para. 710.
[19] Brazil's First Written Submission. para 708
[20] Preambule TM 80

necessarily be inconsistent with Article I, if assessed on that basis alone, but it would be exempted from compliance with Article I because it meets the requirements of the Enabling Clause".[21]

According to Argentina, the Appellate Body in the **EC-Tariff Preferences** clearly supports its legal interpretation. Indeed, in the context of this dispute the Appellate Body first found that the Enabling Clause actually operates as an "*exception*" to Article I.1 of the GATT 1994, upholding in this way the Panel's finding in this regard.[22] Secondly, in the same case the Appellate Body has also confirmed the interpretation made by the Panel, in the sense that the term "*notwithstanding*" mentioned in article 1 of the Enabling Clause, makes references to all obligation established and measures mentioned in article I.1 of the GATT 1994, and not to certain of them.[23]

In addition, Argentina submits that its legal view that the Enabling Clause represents an exception to all the measures embodies in Article I.1 of the GATT 1994, not only flows from the above mentioned Panel's and Appellate Body's report in EC-Tariff Preferences, but also from the fact that if WTO Members would have pretended to excluded certain measures embodied in the MFN Clause of the general application of the exception containing in Article 1 of the Enabling Clause they would have done so explicitly.

Finally Argentina asserts that Argentina's legal view is also confirmed by the Appellate Body in **EC-Tariff Preferences.**[24]

In this legal context, and in case that the Panel found that the INOVA-AUTO programme is inconsistent with Article III.2 of the GATT 1994, Argentina submits that an interpretation of the Enabling Clause according to its history, objectives and purpose, supportive by the WTO case law will necessary lead to conclude that the Enabling Clause allows developing countries to deviate from the MFN obligation when exchanging trade concessions and with regards mutual reduction or elimination of non-tariff measures, on products imported from one another, like the tax treatment conferred in INOVAR-AUTO for certain Members within the LAIA system and MERCOSUR, either in the context of bilateral or regional integration agreements.

EXECUTIVE SUMMARY OF ARGENTINA THIRD PARTY SUBMISSION (DS 497)

VI. JAPAN'S CLAIMS REGARDING THE INCONSISTENCY OF THE INOVAR-AUTO PROGRAMME WITH ARTICLES III.2 AND I.1 OF THE GATT 1994.

1.1. In its First Written Submission Japan argues that INOVAR-AUTO is a tax incentive programme that imposes a generally applicable 30 percentage point increase in the Tax on Industrialized Products (IPI) for motor vehicles, while also allowing for the possibility of a reduction or exemption from this 30-point increase.[25]

More specifically Japan alleges that INOVAR-AUTO favours domestic motor vehicles with respect to the three following circumstances under which companies can benefit from the above mentioned tax reduction: i.e. accreditation, the calculation of IPI tax credits, and the use of IPI tax credits. The result is a level of taxation applied to imported motor vehicles that exceeds that applied to domestic motor vehicles and that afford protection to domestic production, which violates Article III:2 first and second sentence of the GATT 1994.[26]

On the other hand, Japan submits that INOVAR-AUTO, as a measure that denies motor vehicles originating in most WTO Members the same advantages as those granted to motor vehicles originating in Mercosur and Mexico, is also inconsistent with Article I:1 of the GATT 1994.[27]

---

[21] EC- Tariff Preferences. (AB) para. 110.
[22] EC- Tariff Preferences. (AB) para.90. 99.
[23] EC- Tariff Preferences. (AB).para. 110.
[24] EC- Tariff Preferences. (AB) para 101.
[25] First Written Submission of Japan. para 127..
[26] First Written Submission of Japan. para 237.
[27] First Written Submission of Japan. para 193.

VII. THE BURDEN OF RAISING THE ENABLING CLAUSE

In its First Written Submission Japan submits that its is pursuant to Articles 21 and 22 of the Decree 7,819, that motor vehicles produced in other Mercosur countries and Mexico, if imported by accredited companies (i.e. domestic manufacturers or investors), receive an automatic 30 percentage point reduction in the applicable IPI rate, effectively eliminating the higher IPI rate introduced by INOVAR-AUTO for motor vehicles in general.[28]

In addition, and regarding the Decree 7,819 Japan argues that: "(…) the legal instruments referenced in this provision are treaties between Brazil and Mexico and other Mercosur countries, as well as domestic Brazilian legal instruments implementing such treaties. In other words, it means that INOVAR–AUTO essentially establishes an automatic exemption of the elevated 30 percentage point IPI rate for vehicles originating in other Mercosur countries or Mexico".[29]

In response, Brazil primarily argues that INOVAR-AUTO falls outside the scope of Article III of the GATT 1994 and, consequently, it also falls outside the scope of Article I:1. However. Brazil also argues that if the Panel finds that INOVAR-AUTO falls within and violates Article I:1 of GATT 1994, the treatment afforded by the regime to Argentina, Uruguay and Mexico is justified under the Enabling Clause.[30] Indeed, Brazil submits that the tax treatment given to Argentina, Uruguay and Mexico is a measure created to meet commitments undertaken as a member of the Latin-American Integration Association or LAIA's system, and therefore is justified under the provisions of the 1980 TM. Consequently, since the measure was notified to WTO under the purview of the Enabling Clause in 1982, the measure challenged by Japan qualifies as a legal exception to MFN obligations.

In this context, and having in mind the Japan states that the Decree 7,819 as the domestic legal instrument that implements international treaties, such as the Treaty of Asuncion and the Economic Complementation Agreements N° 14 (ECA N° 14) are the legal based on which Brazil would had granted benefits to certain MERCOSUR and LAIA'members states, Argentina considers the Appellate Body's Report in "**EC – Tariff Preferences"** informative. Indeed, in this dispute the Appellate Body found that: "(…), *we are of the view that a complaining party challenging a measure taken pursuant to the Enabling Clause must allege more than mere inconsistency with Article I:1 of the GATT 1994, for to do only that would not convey the "legal basis of the complaint sufficient to present the problem clearly".*[31] *In other words, it is insufficient in WTO dispute settlement for a complying to allege inconsistency with Article I:1 of the GATT 1994 if the complying seeks also to argue that the measure is not justified under the Enabling Clause. (…)*[32]

In that dispute, the Appellate Body also interpreted that: "In the light of the extensive requirements set forth in the Enabling Clause, we are of the view that, when a complaining party considers that a preference scheme of another Member does not meet one or more of those requirements, the specific provisions of the Enabling Clause with which the scheme allegedly falls afoul, form critical components of the "legal basis of the complaint" and, therefore, of the "matter" in dispute (…).[33]

In view of the foregoing, and taking into account that the Treaty of Montevideo (TM 80) was duly notified to WTO under the umbrella of the Enabling Clause, Argentina fails to see, which are those requirements that the INOVAR-AUTO programme does not meet. In Argentina's view Japan has not even made any reference to the Enabling Clause. Consequently, Japan's argument does not appear to fulfill the standard set forth by the Appellate Body in EC-Tariff Preferences for raising this type of claims.[34]

---

[28] First Written Submission of Japan. para 177- 178.
[29] First Written Submission of Japan. para 181.
[30] Brazil's First Written Submission. para 633.
[31] EC- Tariff Preferences (AB), citing Appellate Body Report, *Korea – Dairy*, paras. 120, 124, and 127.
[32] EC- Tariff Preferences. para 110.
[33] EC- Tariff Preferences (AB), citing Appellate Body Report, *US – Carbon Steel*, para. 125 (referring to Appellate Body Report, *Guatemala – Cement I*, paras. 69-76). EC- Tariff Preferences (AB), citing Appellate Body Report, *US – Carbon Steel*, para. 126. EC- Tariff Preferences (AB). para 113 (citing Appellate Body Report, Chile – Price Band System, para. 164).
[34] EC- Tariff Preferences (AB). para 113.

VIII. OBLIGATIONS UNDER ARTICLE III OF THE GATT 1994 QUALIFY AS NON-TARIFF MEASURES

In its First Written Submission Brazil alleges that the structure of the articles and obligations of the GATT makes a clear distinction between tariff measures and non-tariff measures in the first three and most fundamental articles of the Agreement. According to Brazil this distinction appears on Article I GATT 1994, in defining the scope of the Most Favored Nation Clause (MFN)[35] Brazil further submits that these distinctions are also mirrored in the Enabling Clause Decision. [36]

Secondly, Brazil argues that the term "*tariff measures*" relates to customs duties, while the term "non tariff measures" covers the definition of internal taxes.[37] Indeed, in Brazil's views, Article II of GATT relates to tariff measures because it rules the application of customs duties by WTO Members,[38] while Article III relates to non-tariff measures (NTMs), that is, measures that are not applied at the border in order to regulate trade,[39] this is so because Article III establishes obligations that apply once goods have cleared customs and have already fulfilled tariff measures at the border or related to the importation of goods.[40]

In this regard, Argentina concurs with Brazil that is well established among all WTO Members, that while Articles I and II relate to MFN and tariff measures treatment respectively, the provisions embodied in Part II of GATT 1994 relate to non-tariff measures.

In Argentina's views the World Trade Report 2012[41] and prior WTO case law clearly supports this interpretation advanced by Brazil and Argentina in the present dispute also supports this legal interpretation.[42]

With this legal framework in mind, Argentina contends that considering that Article III is placed in the above mentioned Part of the GATT 1994, and also that Article III of GATT 1994 sets out National Treatment obligation for goods once internalized to the Member's territory, it is undisputed that matters ruled by Article III are clearly non-tariff measures.[43]

IX. THE ENABLING CLAUSE IS AN EXCEPTION TO ALL OBLIGATIONS EMBODIED IN THE NMF CLAUSE

At the outset, Argentina would like to recall that Article 1 of the Enabling Clause establish an exception to the obligation in Article I.1 of GATT 1994 since the provision states: "*1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting partie*s."[44]

On the other hand Paragraph 2 of the Enabling Clause identifies the different types of measures to which the authorization of paragraph 1 applies: (a) Preferential tariff treatment, (b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT, and c) Differential and more favourable treatment in the context

---

[35] Brazil's First Written Submission. para 648.

[36] Brazil's First Written Submission. para 643.

[37] Brazil's First Written Submission. para 643.

[38] Brazil's First Written Submission. para 653.

[39] Brazil's First Written Submission. para 659. See also the World Trade Report 2012. Trade and public policies: A closer look at non-tariff measures in the 21st century. Published by World Trade Organization 2012.pp. 38.

[40] Brazil's First Written Submission. para 654.

[41] World Trade Report 2012. Trade and public policies: A closer look at non-tariff measures in the 21st century. Published by World Trade Organization 2012.pp 47.

[42] Japan — Alcoholic Beverages II (AB) pp. 16 citing *United States - Section 337 of the Tariff Act of 1930,* para. 5.10 and
Italy — Agricultural Machinery, para. 11. See also Brazil's First Written Submission. para 714.

[43] World Trade Report 2012.pp. 40.

[44] GATT Document L/4903. December 3, 1979.

of Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs.[45]

Secondly, Argentina considers that the Appellate Body reasoning in the "**EC-Tariff Preferences"** clearly supports its legal interpretation. Indeed, in the context of that dispute the Appellate Body first found that the Enabling Clause actually operates as an "*exception*" to Article I.1 of the GATT 1994, upholding in this way the Panel's finding in this regard.[46] Then, the Appellate Body also confirmed the interpretation of the Panel that the term "*notwithstanding*" mentioned in article 1 of the Enabling Clause, makes references to all obligation established and measures mentioned in article I.1 of the GATT 1994, and not to certain of them.[47]

In addition, is the Argentina's legal view that if the Enabling Clause represents an exception to all the measures encompass in Article I.1 of the GATT 1994, including those covered by Article III.2 and III.4, if WTO Members would have pretended to excluded such measures of the general application from the exception in Article 1 of the Enabling Clause, they would have done so explicitly.

In view of the foregoing, Argentina agrees with Brazil that Article I:1 explicitly extends the MFN obligation to "all matters referred to in paragraphs 2 and 4 of Article III" and that therefore, internal taxes are subject to MFN obligations.[48]

Argentina further submits that, in case that the Panel found that the INOVAR-AUTO programme is inconsistent with Article III of the GATT 1994, an interpretation of the Enabling Clause according to its text, objectives and purpose as well as to its history, will necessary lead to conclude that the Enabling Clause allows developing countries to deviate from the MFN obligation when exchanging trade concessions and regarding mutual reduction or elimination of non-tariff measures (such as the measure at issue), on products imported from one another, like the tax treatment conferred in INOVAR-AUTO for certain Members within the LAIA system and MERCOSUR, either in the context of bilateral or regional integration agreements.

X. THE TREATMENT PROVIDED TO MERCOSUR AND LAIA MEMBERS IS CONSISTENT WITH THE WTO AGREEMENTS

Brazil submits that: "Vehicles imported under the framework of the Economic Complementation Agreements 14 and 55 by accredited companies that manufacture vehicles in Brazil or new-comers have a 30 p.p. IPI reduction. The specific rules for trade with each of the countries are the relevant agreements and their additional protocols and must be followed in order to benefit for the reductions".[49]

Brazil contends that the tax treatment for vehicles originating from members of the LAIA system are an exception to the MFN treatment since it falls within the scope of Paragraph 2(b) of the Enabling Clause, for being a measure governed by the TM 80. Brazil further states that it is a non-tariff measure since it is applied on products that have already been imported and for reasons other than customs clearance.[50]

Firstly and foremost Argentina shares that legal view and in this respect also considers it relevant to recall that as stated by the Appellate Body in **"EC – Tariff preferences"**[51], the Enabling Clause is considered *lex specialis* as far as the Most Favored Nation rule is concerned. As a consequence, the challenged measure needs to be analyzed in the light of both provisions. If the measure

[45] Enabling Clause. Article 2 a), b) and c).

[46] EC- Tariff Preferences. (AB) para.90. 99. EC- Tariff Preferences. (AB) para. 110.

[47] EC- Tariff Preferences. (AB).para. 110. See also EC- Tariff Preferences (AB). para 101 citing Appellate Body Report, *Canada – Autos*, para. 69. See also, Appellate Body Report, *US – Section 211 Appropriations Act*, para. 297.

[48] Brazil's First Written Submission. para 661.

[49] Brazil's First Written Submission. para 470.

[50] Brazil's First Written Submission. para 664.

[51] See Appellate Body Report, *EC – Tariff Preferences*, para. 101 and 102.

complies with the requirements of the Enabling Clause, then it is a justified exception of the MFN principle that must prevail over Article I:1.[52]

In this context, Argentina agrees with Brazil that the tax treatment conceded on the ground of INOVAR-AUTO to certain Mercosur and LAIA Members is inscribed in the process of the ECAs negotiated under the auspices of TM 80 in order to progressively achieve the reduction and elimination of tariff and non-tariff barriers in the automotive sector among its Members, in line with LAIA's objectives.

As a consequence, Argentina submits that since the Enabling Clause is an exception to all the obligations embodied in article I.1 of the GATT 1994 (as interpreted by the Appellate Body in EC Tariff Preferences), and being the commitments regarding National Treatment non tariff measures, the concessions provided to certain MERCOSUR Members clearly fall under the Enabling Clause. As already submitted, that provision allows under Article 2, the concession among developing countries of differential and more favourable treatment with respect to the tariff and non-tariff measures in the context of ECAs agreements and regional integration processes.[53]

[52] Brazil's First Written Submission. para 632
[53] Brazil's First Written Submission. para 708.
See also Preambule TM 80

ANNEX C-2

EXECUTIVE SUMMARY OF THE ARGUMENTS OF AUSTRALIA

I. ARTICLE III:4 of GATT 1994

1. Australia contends that Brazil's INOVAR-AUTO program is in breach of III:4 of the General Agreement on Tariffs and Trade 1994 (GATT) due to less favourable treatment to imported goods which impacts on competitive conditions so as to afford protection to domestic production.

2. Australia submits that in assessing Brazil's compliance with Article III:4 of GATT 1994, the Panel should have regard to the test for "less favourable treatment" used by the Appellate Body in *Korea – Various Measures on Beef,* that is, whether a measure modifies the conditions of competition in the relevant market to the detriment of imported like products.[1]

3. In addition, the Panel should note the jurisprudence provided by the Appellate Body in *EC – Bananas III* that Article III:4 of GATT 1994 does not require a separate examination of whether a measure affords protection to domestic production.[2]

4. We note that a wide interpretation of "affecting" was found to be appropriate by the Panel in *Canada – Autos* and covers: "...any laws or regulations which might adversely modify the conditions of competition between domestic and imported products".[3] This finding was not reviewed by the Appellate Body.

5. Given the jurisprudence supporting a broad interpretation of "affecting", and the broad and encompassing nature of Brazil's measures, in Australia's view, it is likely that Brazil's measures adversely "affect" the conditions of competition in the market.

II. ARTICLE III:5 of GATT 1994

6. The first sentence of Article III:5 disciplines the application of quantitative regulation, and is, in Australia's view a prohibition on local content requirements. It provides that, any internal regulation which requires the mixture, processing or use of products based on domestically sourced products is inconsistent with Article III:5 of GATT 1994.

7. The reference in Article III:5 of GATT 1994 to processing does not mean that, when read with Article III:8(b) of GATT 1994, a Member may not subsidise processing activities within its territory. Rather, in Australia's view, the first sentence of Article III:5 of GATT 1994 means that where a Member provides subsidies designed to encourage manufacturing activities within its territory, including for specific industry sectors, it must do so consistent with Article III:5 of GATT 1994, that is, it must not directly or indirectly require the use of domestic products.

8. Australia contends that a distinction needs to be made between the payment of subsidies which encourage manufacturing activities as opposed to the payment of subsidies to manufacturing activities where there are effectively local content requirements.

9. Australia notes the number of "processing or production steps" required by Brazil which must be increased over time in order to qualify under the program. In particular Australia notes the European Union's concerns that the INOVAR-AUTO programme by setting a minimum number of processing steps to be performed in Brazil, may be in fact defining in a quantitative manner the minimum threshold of local content for a product to be eligible and retain the tax incentives under the INOVAR-AUTO programme.

10. In carrying out its examination, an issue the Panel may wish to examine is whether requiring a minimum number of processing activities be carried out in Brazil in order to receive a tax credit amounts to an internal quantitative regulation which requires, directly or indirectly, a specified amount or proportion of any product be supplied from domestic sources.

[1] Appellate Body Report, *Korea — Various measures on Beef*, para. 137
[2] Appellate Body Report, *EC — Bananas III*, para. 216
[3] Panel report *Canada – Autos,* para. 6.256

ANNEX C-3

EXECUTIVE SUMMARY OF THE ARGUMENTS OF CANADA

1. The findings of the Panel in this dispute will have important consequences for the way in which the Agreement on Subsidies and Countervailing Measures (SCM Agreement) is interpreted and applied in future disputes. Canada therefore welcomes the opportunity to present its views to the Panel. Canada's submission addresses the issue of prohibited import-substitution subsidies under Article 3.1(b) of the SCM Agreement.

2. The European Union claims that Brazilian subsidies in the form of tax benefits to domestic producers under five incentive programs covering key sectors of the Brazilian economy are contingent upon the use of domestic over imported goods in violation of Article 3.1(b) of the SCM Agreement.

3. Canada agrees with the European Union that a subsidy contingent on the purchase of domestic goods constitutes an import-substitution subsidy under Article 3.1(b).

4. However, Canada disagrees with what appears to be an interpretation of Article 3.1(b) which would improperly extend the provision to cover situations where subsidy recipients are required to produce goods. The European Union appears to be arguing that a subsidy is contingent on the use of domestic over imported goods where the producer of a final good is required to produce certain components of that good in order to receive the subsidy.

5. Canada considers that a WTO Member is not prohibited from providing subsidies to its domestic producers, including where the subsidy to the producer of a final good is contingent on the production of an intermediate good by that same producer.

6. Nothing in the General Agreement on Tariffs and Trade (GATT) or the Agreement on Subsidies and Countervailing Measures (SCM Agreement) prohibits a subsidizing Member from making the granting of a subsidy contingent on a recipient producing goods in its territory. In fact, GATT Article III:8(b) explicitly allows WTO Members to provide subsidies to their domestic producers. A producer of a final good that is required to produce an intermediate good is obviously also a producer of the intermediate good. Therefore, a subsidy can be made contingent on the production of an intermediate as well as a final good.

7. Neither the GATT nor the SCM Agreement limit a subsidizing Member's ability to define the level of production required for subsidy eligibility purposes. As part of this discretion, a Member may explicitly require the production of an intermediate good. A Member's ability to condition the provision of a subsidy on a production requirement would be significantly curtailed if a Member could not require the production of an intermediate good. A production requirement would then have to be limited to simple assembly operations.

8. This position is supported by the Appellate Body's report in Canada – Autos. In that dispute, the Appellate Body assessed whether a measure providing Canadian automobile manufacturers with an import duty exemption contingent, inter alia, on satisfaction of a Canadian value-added (CVA) requirement, was inconsistent with Article 3.1(b) of the SCM Agreement. Under the measure, a manufacturer could meet the CVA requirement by disclosing the aggregate of certain costs of producing vehicles in Canada listed in the definition of "Canadian value added". A number of costs were included in the definition of CVA. The most relevant for the Appellate Body's analysis were (1) the cost of domestic goods, that is, those domestic parts and materials purchased by the manufacturer for use in the production of its motor vehicles, and (2) the cost of domestic labour, that is, the cost of all labour reasonably attributable to the production of vehicles. The latter would include the cost of labour used to produce intermediate goods.

9. In analyzing whether the CVA requirement was inconsistent with Article 3.1(b), the Appellate Body in Canada - Autos distinguished between the cost of labour and the cost of domestic goods. It found that the CVA requirement would violate Article 3.1(b) only if it required

the manufacturer to use domestic goods. However, it did not consider that a requirement to use domestic labour, regardless of whether that requirement may imply the production of intermediate goods, would violate Article 3.1(b).

10. The European Union's interpretation would nullify the right of a WTO Member to require a subsidy recipient to produce goods, as defined by the Member, in its territory, in order to receive a subsidy. This has no basis in law, and would have considerable, negative consequences for industry given that most manufacturers produce intermediate goods as part of the production of their final goods. As such, and for the reasons set out above, the Panel should reject the interpretation advanced by the European Union.

ANNEX C-4

EXECUTIVE SUMMARY OF THE ARGUMENTS OF KOREA*

1. Korea thanks the Panel for this opportunity to present its views in these proceedings. Korea has systemic interest with respect to some key issues in this dispute, including the appropriate interpretation of the relevant provisions of the GATT 1994 and SCM Agreements. Today, Korea would like to comment on these issues and request the Panel's clear guidance.

2. First, we turn to whether Article III:8(b) of the GATT 1994 justifies a possible breach of Articles III:2, III:4 and III:5 of the GATT 1994, as Brazil claims. Article III:8(b) stipulates that the provisions of Article III shall not prevent the payment of subsidies exclusively to domestic producers. But like all provisions in the WTO agreements, Article III:8(b) does not exist in isolation and should be read in conjunction with other relevant provisions.

3. In this case, we find the Panel ruling in *Indonesia – Autos* to be instructional. That Panel ruled that "the purpose of Article III:8(b) is to confirm that subsidies to producers do not violate Article III, so long as they do not have any component that introduces discrimination between imported and domestic products." (However, Korea notes that in *EC-Commercial Vessels*, the Panel ruled that even when the subsidy may adversely affect the conditions of competition between domestic and imported products, Art.III:8(b) may be applicable. We hope that the Panel will clarify the seemingly contradictory rulings in the two disputes.)

4. The objective of Article III:8(b) is to allow members to develop their economies through the granting of subsidies to domestic producers. But Korea believes, and as the Panel ruling in *Indonesia – Autos* clearly notes, this right of members is not without limits. Article III:8(b) is applicable so long as it is applied in a manner that is consistent with the other provisions of Article III.

5. Some of these other provisions stipulate the national treatment principle, a fundamental pillar of the WTO system. A complete and contextual reading of Article III would thus affirm that while payment of subsidies to domestic producers is indeed permitted under Article III:8(b), this is only to the extent that the non-discrimination principle set forth in the other paragraphs of the same article are not in violation.

6. We would guard against an excessively narrow interpretation of Article III:8(b) that would render the provision inutile, thereby nullifying the right of members to provide subsidies to domestic producers. However, in order for Brazil's measures to be justified under Article III:8(b), the Panel would need to find that Brazil's tax benefits do not explicitly discriminate imported products as compared to domestic products. The Panel would also need to find that the structure and design of the measures is such that the competitive opportunities for imported products in the Brazilian market are not adversely affected.

7. Next, Korea turns to the issue of whether Brazil's tax exemptions and suspensions constitute subsidies prohibited by Articles 3.1(b) and 3.2 of the SCM Agreement.

8. We believe that the provisions of the SCM Agreement should be interpreted strictly. We also note that the burden of proving the existence of prohibited subsidies rests with the claimants. In this regard, we support Canada's interpretation of Article 3.1(b), outlined in its third party submission, that Articles 3.1(b) and 3.2 should not be inappropriately expanded to cover situations where producers are required to simply produce goods domestically in order to qualify for subsidies.

9. Nothing in Article 3.1(b) places restrictions on where a member produces goods. The only instance that is regulated by the provision is when the contested measure provides that subsidies be contingent "upon the use of domestic over imported goods." Korea is not convinced that requiring a producer to manufacture locally as a condition for receiving subsidies is – in and of itself and without further analysis – tantamount to requiring the use of domestic over imported

* Korea has requested that their oral statement be considered as their executive summary.

goods. A rather extreme example that can underscore this point would be a hypothetical measure that provides subsidies on the condition that the producer produce domestically, but using only imported contents. Such a measure would not be in breach of Article 3.1(b) of the SCM Agreement.

10. The key question in this dispute is whether Brazil's measures which contain requirements to produce locally do in fact take the prohibited additional step of requiring or incentivizing usage of domestic contents over imports as condition for receiving subsidies. To answer, the Panel would need to assess how Brazil's measures are designed and structured. It would need to determine whether Brazil's contested programs effectively limit benefits to goods of Brazilian origin.

11. In this regard, Korea would suggest that the Panel review what manufacturing steps are required to be undertaken domestically under Brazil's measures. Here, we would make a distinction between: a. the effects of the measures as they apply to a producer exporting finished products; and b. the effects of the measures as they apply to a producer exporting components or inputs. Exporters of finished products by definition could not possibly meet domestic manufacturing requirements. In the present case, while Brazil claims that its measures relate only to production and have no bearing on products, such requirements would close off opportunities for exporters of finished products to benefit from Brazil's tax programs that are available to domestic producers.

12. On the other hand, a member's requirement that certain manufacturing and processing operations take place domestically may not necessarily disadvantage producers who export components to that member. A domestic producer can, in theory, just as easily benefit from tax breaks when using imported products as when using domestic products – if that is how the measure is structured or designed.

13. However, depending on how a measure is structured or designed, even producers exporting components or parts can be placed at a comparative disadvantage vis-à-vis domestic producers. A measure may be designed to *explicitly* contain specific local content requirements. But a requirement that parts and components be produced locally in accordance with certain production steps may have the same end result as specific local content requirements. As the United States points out in its submission, if Brazil requires the use of inputs that themselves must conform to domestic production requirements in order for producers to benefit from certain programs, it is not difficult to envision producers in Brazil choosing domestic over imports.

14. In sum, regarding the first point we touched upon, namely the relationship between the national treatment provisions of Article III and Article III:8(b) of the GATT 1994, Korea is mindful that the WTO Agreements permit the use of subsidies as a legitimate policy tool of members. At the same time, we recognize that non-discrimination is a bedrock principle of the WTO that must be guarded vigorously and that this principle delineates the operational boundaries of Article III's other provisions. Regarding our second point on Article 3.1(b), we would be wary of a loose interpretation of the SCM Agreement, especially since certain carefully defined subsidies have been designated as prohibited subsidies. Nevertheless, we do not believe that a strict interpretation of the SCM Agreement should prevent the Panel from considering the structure and design of a measure in an effort to accurately assess its effects in the market place.

15. This concludes Korea's oral statement. Thank you.

ANNEX C-5

EXECUTIVE SUMMARY OF THE ARGUMENTS OF UKRAINE

1. Ukraine has joined as a third party in the dispute between Brazil and Japan on Certain Measures Concerning Taxation and Charges to provide its views on a number of fundamental issues relating to the interpretation of the Article I:1, III:2, III:4, III:5 of the General Agreement on Tariffs and Trade 1994 (GATT 1994), Article 2.1 of the Agreement on Trade-Related Investment Measures (TRIMs) and Articles 3.1(b) and 3.2 of the Agreement on Subsidies and Countervailing Measures (SCM) because of its systemic interest in the correct and consistent interpretation and application of the referred provisions.

2. Ukraine agrees that preferential treatment conferred to Argentina, Mexico and Uruguay under INOVAR-AUTO can be justified under Paragraph 2(b) of the Enabling Clause and cannot be qualified as violation of MFN principle according to the Article I:1 of the GATT 1994. Thus, Brazil was required to follow procedures prescribed by the Transparency Mechanism for Preferential Trade Arrangements before granting preferential treatment to Argentina, Mexico and Uruguay. Moreover Ukraine takes notice that proving of the compliance with the requirements of the Enabling Clause remains on the responding party invoking the Enabling Clause as a defence.

3. In its First Written Submission Brazil claims that programmes at issue including the Informatics Programme, PADIS, PATVD, INOVAR-AUTO are not a subject of requirements of Article III as they constitute a subsidy pursuant to Article III:8 (b) of the GATT 1994.

4. Ukraine considers that exemption under Article III:8(b) should not be applicable in the present dispute because programmes at issue including the Informatics Programme, PADIS, PATVD, and INOVAR-AUTO do not involve a payment of subsidies, in particular a government expenditure, which should prevent Brazil from relying on this exemption. Therefore, programmes at issue should be considered within the requirements of Article III of the GATT 1994.

5. Ukraine also holds the view that the WTO Members can provide to their domestic producers only those subsidies which are not prohibited by the provisions of the SCM Agreement.

6. As explained by the Panel in *Canada — Aircraft*, a legitimate mandate to support and develop trade does not "amount to a mandate to grant subsidies, since such support and development could be provided in a broad variety of ways". Ukraine understand Brazil's intentions, but still wants to notice that such legitimate objectives may not justify a violation of SCM or GATT 1994 if the Panel finds one in the present case.

7. According to the Illustrative list of the TRIMs local content requirement refers to the prohibited TRIMs, it requires the purchase or use by a foreign enterprise of products of domestic origin or domestic source. Such requirement is inconsistent with Article III:4 of GATT 1994 and subjects the imported products to less favourable conditions than domestic ones.

8. Ukraine is of the view that Brazil's measures can be qualified as TRIMs recalling *the China – Publications and Audiovisual Products* Appellate Body Report which referred to the illustrative list in the Annex to the TRIMs Agreement and observed that "measures that did not directly regulate goods, or the importation of goods, have nonetheless been found to contravene GATT obligations". In this context the measures related to research, development and production that restrict the rights of traders may violate obligations under GATT and the TRIMs with respect to trade in goods.

9. Moreover, within the scope of the paragraph 1(a) of the Annex to the TRIMs Agreement the Informatics Programme, PADIS, PATVD, and INOVAR-AUTO programme, Digital Inclusion Programme, may be considered as a trade-related investment measures, because Brazil's national treatment provided for in paragraph 4 of Article III of GATT 1994 include requirements of the purchase or use of products (including automotive components and/or tooling, Brazilian inputs and manufacturing equipment) from domestic sources in order to obtain tax advantages. Such measures may put domestic companies in a more privileged position as they are not required to fulfil any additional requirements as importers do.

10. Ukraine thanks the Panel for this opportunity to express the foregoing comments and for the reasons stated above, requests the Panel, in deciding the dispute, to take into account observations and comments stated in its written submission and oral statement.

ANNEX C-6

EXECUTIVE SUMMARY OF THE ARGUMENTS OF THE UNITED STATES

EXECUTIVE SUMMARY OF THE U.S. THIRD PARTY WRITTEN SUBMISSION

I. INTERPRETATION AND APPLICATION OF ARTICLE III:2 OF THE GATT 1994

1. The European Union and Japan assert that the disputed programs result in imported ICT products being taxed in excess of domestic ICT products, contrary to the first sentence of Article III:2 of the GATT 1994. Brazil claims that any differences in taxation between imported and domestic goods resulting from the disputed programs "do not relate to the origin of the goods, but rather to the participation of the producing company" in the programs.

2. However, if the Panel agrees with the facts as presented by complainants, the requirements imposed by the disputed programs would appear to limit the benefits of the programs to goods of Brazilian origin. For example, the programs at issue condition certain tax benefits on the sale of products that conform to a Brazilian Productive Process ("PPB"). Brazil does not dispute that these PPBs require that a number of manufacturing steps take place in Brazil, including manufacturing of intermediate components and the assembly of various components into a final product. For example, the main PPB for IT products requires the following production steps take place in Brazil: (1) "assembly and soldering of all components on the printed circuit boards"; (2) "assembly of the electrical and mechanical parts, totally separated, at a basic component level"; and (3) "integration of the printed circuit boards and the remaining electrical and mechanical parts in the formation of the final product". If the Panel finds that the facts are as presented by the complainants, it would appear that the number and type of manufacturing steps required to comply with such PPBs would lead to the resultant products being of Brazilian origin. It would not appear that imported products could meet the domestic manufacturing requirements of PPBs, and therefore imported products could not receive the same tax benefits that are available to domestic goods that comply with PPBs. Thus, only Brazilian products would be able to comply with a PPB and receive preferential tax treatment under these programs.

II. INTERPRETATION AND APPLICATION OF ARTICLE III:4 OF THE GATT 1994

3. The European Union and Japan assert that the disputed programs result in imported ICT products being accorded less favorable treatment than domestic ICT products contrary to Article III:4 of the GATT 1994, because they provide tax benefits for domestic ICT products that are unavailable to imported ICT products and because, in certain instances, they incentivize the purchase and use of domestic inputs over imported inputs. Brazil claims that the requirements of the disputed programs do not affect products in the marketplace, but instead "deal with *pre-market* activities," and are therefore outside the scope of Article III:4.

4. The distinction that Brazil attempts to draw between measures that deal with "pre-market activities" and measures that affect "products" is not a useful one, nor is it a distinction that is found in the text of Article III:4. Simply because a measure imposes a so-called "pre-market" requirement does not mean it does not *affect* the "internal sale, offering for sale, purchase, transportation, distribution or use" of a product. As the Appellate Body has noted, "[t]he ordinary meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a broad scope of application." Based in part on the breadth of this definition, panels and the Appellate Body have interpreted the scope of Article III:4 to "go[] beyond laws and regulations which directly govern the conditions of sale or purchase to cover also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products." Measures that otherwise fall within this scope should not be excluded simply because they impose requirements on production or development. To the extent that any such measures "affect" the "internal sale, offering for sale, purchase, transportation, distribution or use" of products, the text of Article III:4 clearly would cover those measures.

5. In this case, for example, PPBs require that a number of production steps take place in Brazil, including intermediate manufacturing steps and final assembly. Although Brazil claims that PPBs "are not related to the product, but to production," PPBs do appear to relate to products.

Specifically, PPBs define the "minimum set of operations performed at a manufacturing facility that characterises the actual industrialisation *of a given product*." Under the disputed programs, such products may be exempt from certain taxes when they are sold, thereby modifying the conditions of competition in the marketplace to the benefit of covered products and to the detriment of non-covered products. Moreover, since companies cannot obtain these tax advantages until the product is sold on the market, Brazil's characterization of the disputed measures as strictly "pre-market" would not seem to be accurate.

6. The disputed programs also affect the purchase and use of inputs that are used in the production of certain covered products. As all the parties agree, certain PPBs require the use of inputs that themselves conform to another PPB. As discussed above, if the Panel finds that the facts are as presented by the complainants, foreign inputs would not appear to be able to satisfy the relevant PPBs, because they would not have been produced and assembled in Brazil. By providing tax benefits for products that are manufactured according to these "nested" PPBs, the disputed programs incentivize the purchase and use of products made in Brazil as inputs into the production process, thereby modifying the conditions of competition to the detriment of imported inputs.

III. INTERPRETATION AND APPLICATION OF ARTICLE III:5 OF THE GATT 1994

7. The European Union and Japan assert that the disputed programs violate Article III:5 of the GATT 1994. If the Panel determines that the programs at issue violate Articles III:2 and III:4, the United States does not see the value of addressing additional claims under Article III:5. That said, the United States notes that Article III:5 prohibits regulations that relate to the "use of products in specified amounts or proportions" and require "that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources." As discussed above, certain PPBs require the use of a specified proportion of inputs that themselves conform to a PPB. If the Panel finds that goods produced in accordance with a PPB are necessarily domestic products, and insofar as these programs condition preferential tax treatment on compliance with such PPBs, the disputed programs would appear to require the use of specified amounts or proportions of domestic products.

IV. Interpretation and Application of Article XX(a) of the Gatt 1994

8. Brazil asserts that PATVD is necessary to protect public morals because it provides access to culture, information, and education through digital television in Brazil, and is thus justified by the exception under paragraph (a) of Article XX of the GATT 1994.

9. In considering whether a GATT-inconsistent measure is provisionally justified under Article XX(a), a panel must determine whether a measure contributes to a covered objective and, if so, whether that contribution is such that the measure is "necessary" to achieving the objective. The analysis may also entail consideration of whether a complaining party has identified a reasonably available, less trade-restrictive alternative.

10. Objective. Without directly addressing whether the provision of information and education via digital television falls within the scope of a measure to protect public morals under Article XX(a), the United States notes that a certain degree of deference must be given to WTO Members with respect to determining what constitutes public morals and measures to protect same. As the *Colombia – Textiles* panel explained: "[T]he term 'public morals' denotes standards of right and wrong conduct maintained by or on behalf of a community or nation, and its content may vary in time and space, depending on the prevailing factors. Members have the right to determine the level of protection that they consider appropriate and some scope to define and apply for themselves the concept of 'public morals' in their respective territories, according to their own systems and scales of values."

11. Necessity. In this case, Brazil's stated objective with respect to protecting public morals is to ensure "proper and timely access of the Brazilian population to information and education" via digital television. However, Brazil fails to explain why digital TV transmitters must be developed and manufactured *in Brazil* in order to accomplish the objective of providing access to information and education via digital television. Making sure digital TV transmitters are available to Brazilians may be relevant to this objective, but there would not seem to be any reason why those

transmitters must be developed or made in Brazil to provide such access. The public would have as much access to information and education if it were conveyed by imported transmitters as by domestic transmitters. Thus, there does not appear to be a genuine relationship between the provision of tax benefits to domestic producers of digital TV transmitters via PATVD and the goal of making digital television accessible in Brazil.

12. Less trade-restrictive alternative. As noted above, it is for the complainants to identify a reasonably available, less trade-restrictive alternative measure. As a general matter, there would appear to be a number of reasonably available alternative measures that would achieve the same end of ensuring access to digital television, while being less trade restrictive than the PATVD program. For example, Brazil could provide tax exemptions for sales of *all* digital TV transmitters that comply with Brazil's digital TV standards, regardless of whether they are imported or domestically produced. Alternatively, Brazil could eliminate tariffs on the importation of digital TV transmitters, or provide subsidies for producers of digital TV transmitters. Each of these measures would provide the Brazilian population with access to digital television, while avoiding the trade-restrictive impact of the PATVD program.

V. Interpretation and Application of Articles 1.1(a)(1)(ii) and 1.1(b) of the SCM Agreement

13. The European Union and Japan assert that the tax exemptions and suspensions provided by the disputed programs constitute subsidies "contingent...upon the use of domestic over imported goods," contrary to Article 3.1(b) of the SCM Agreement. In determining whether a subsidy exists, the Appellate Body has identified two distinct elements: (1) a financial contribution by a government, which may be met if government revenue that is otherwise due is foregone or not collected; and (2) the financial contribution must confer a benefit.

14. Government revenue otherwise due is foregone or not collected. With respect to this element, the Appellate Body stated in *US – Large Civil Aircraft (2nd complaint)* that "the foregoing of revenue otherwise due implies that less revenue has been raised by the government than would have been raised in a different situation," and that "the word 'foregone' suggests that the government has given up an entitlement to raise revenue that it could 'otherwise' have raised." The United States notes that insofar as the disputed programs *exempt* taxes that would otherwise have to be paid but for the program, a financial contribution has been provided: government revenue, otherwise due, is clearly foregone. In addition, to the extent the disputed programs *suspend* taxes that are later paid further down the production chain, a financial contribution has still been provided: at the moment in which government revenue would otherwise be due, it is foregone (albeit temporarily). Moreover, given the time-value of money, suspending the collection of a tax may also result in less revenue being raised.

15. A benefit is thereby conferred. As the Appellate Body explained in *Canada – Aircraft*, "there can be no 'benefit' to the recipient unless the 'financial contribution' makes the recipient 'better off' than it would otherwise have been, absent that contribution." Under the programs at issue, producers whose goods are tax-*exempt* are clearly better off than those who must pay taxes. A producer that does not have to pay a tax may be able to charge less, or earn a greater profit, for the same goods when compared with a producer whose goods are not tax-exempt. This is true even in the case of intermediate goods—while taxes might be charged later in the production chain, the intermediate producer still receives the benefit of an exemption on its own sales. Moreover, there is a benefit even in the case of tax *suspensions*. A producer whose payment of taxes is suspended is better off than one who must pay the taxes, but receives a credit that can be redeemed later. In particular, funds that would otherwise be tied up by the payment of taxes are instead available for use and reinvestment.

EXECUTIVE SUMMARY OF U.S. THIRD PARTY ORAL STATEMENT

I. Interpretation and Application of Article III:2 of the GATT 1994

16. The complaining parties assert that the disputed programs result in imported ICT products being taxed in excess of domestic ICT products, in a manner inconsistent with the first sentence of Article III:2 of the GATT 1994.

17. Article III:2 provides that imported products shall not be subject to internal taxes "in excess of" those applied to like domestic products. The programs at issue in this dispute condition certain tax benefits on the sale of products that conform to a Brazilian Productive Process, or "PPB." PPBs require that a number of manufacturing steps take place in Brazil, including manufacturing of intermediate components and the assembly of various components into a final product. Based on the facts presented by the complaining parties, it would appear that complying with a PPB would necessarily result in a domestic product benefitting from a lower tax on its sale. An imported product could not meet the domestic manufacturing requirements of a PPB, and therefore could not receive the same tax benefits that are available to a domestic product that complies with a PPB.

18. The United States therefore agrees that insofar as the disputed programs result in a tax applied to products manufactured in Brazil in conformance with a PPB lower than the tax for like imported products, these programs would appear to tax imported products "in excess of" like domestic products.

II. INTERPRETATION AND APPLICATION OF ARTICLE III:4 OF THE GATT 1994

19. The complaining parties assert that the disputed programs provide tax benefits for domestic ICT products that are unavailable to imported ICT products and, in certain instances, incentivize the purchase and use of domestic inputs over imported inputs. The complaining parties allege that this situation results in imported products being accorded less favorable treatment than domestic products contrary to Article III:4.

20. Article III:4 provides that imported products "shall be accorded treatment no less favourable" than like domestic products with respect to "all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." Panels and the Appellate Body have interpreted the scope of Article III:4 to include "any laws or regulations which might adversely modify the conditions of competition between domestic and imported products." Under the disputed programs, products that are manufactured in Brazil in conformance with a PPB may be exempt from certain taxes when they are sold, whereas imported products would not receive such an exemption. Therefore, insofar as the programs at issue exempt domestic products from taxes that would otherwise be due upon sale, but do not provide the same exemption for like imported products, these programs would appear to "affect[] the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products" by adversely modifying the conditions of competition for imported products compared to like domestic products.

21. For the subset of PPBs that require the use of input products that themselves conform to another PPB, a different analysis applies. For example, the PPB for "Tablet PCs with a Touch Screen" requires that 90 percent of the "motherboards" used during production of "tablet PCs with a touch screen" comply with the PPB for printed circuit boards. To obtain tax benefits under the disputed programs, companies seeking to comply with these "nested" PPBs must therefore purchase and use the required amount of PPB-compliant input products. Input products produced in accordance with a PPB would be domestic products; imported input products cannot be produced in accordance with a PPB. Therefore, the requirement to use input products that conform to a PPB necessarily requires the use of domestic products. The United States therefore agrees that by providing tax benefits for products manufactured using input products meeting "nested" PPBs, the disputed programs incentivize the purchase and use of domestic products as inputs by downstream producers, thereby modifying the conditions of competition for those input products to the detriment of imports.

III. INTERPRETATION AND APPLICATION OF ARTICLE III:5 OF THE GATT 19944

22. The complaining parties also assert that the disputed programs are inconsistent with Article III:5, which prohibits regulations that relate to the "use of products in specified amounts or proportions" and "require[], directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources."

23. If the Panel determines that the disputed programs are inconsistent with Articles III:2 and III:4, there would not seem to be value in addressing additional claims under Article III:5. That said, "nested" PPBs specifically require the use of a specified amount or percentage of inputs that

are domestic goods produced in accordance with a PPB. The United States therefore agrees that insofar as the disputed programs condition preferential tax treatment on compliance with such PPBs, the programs would appear to require the use of "specified amounts or proportions" of products "from domestic sources."

IV. INTERPRETATION AND APPLICATION OF ARTICLE 3.1(B) OF THE SCM AGREEMENT

24. The complaining parties assert that the tax exemptions and suspensions available under the disputed programs are contingent on "the use of domestic over imported goods" in part because PPBs may require the producer of the final product to produce certain components of that product domestically. As noted in Canada's third-party submission, interpreting Article 3.1(b) to cover situations in which subsidy recipients are required to produce goods domestically would be an improper expansion of the scope of that provision. The SCM Agreement does not prohibit Members from granting subsidies that are contingent on the recipient producing goods domestically. Rather, Article 3.1(b) is directed to conditioning a subsidy on "use" of a domestic over an imported good.

25. Moreover, GATT 1994 Article III:8(b), which the Appellate Body has noted provides relevant context for the interpretation of Article 3.1(b) of the SCM Agreement, expressly permits the payment of subsidies exclusively to domestic producers. By necessity, the derogation in Article III:8(b) extends to subsidies to the productive activities or manufacturing steps that make the recipient a domestic producer. To the extent that these encompass the production of what might be considered intermediate components, a Member remains free to define the domestic producers receiving subsidies as those recipients also producing those components.

26. The United States therefore disagrees with the complaining parties to the extent they claim that a requirement to engage in specified production steps leading to the production of a finished good in the territory of a Member is a subsidy contingent on "the use of domestic over imported goods."

____