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A History of the Extraterritorial Income (ETI) and Foreign Sales Corporation (FSC) Export Tax-Benefit Controversy

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Summary

Prior to 2004, the U.S. tax code's extraterritorial income (ETI) provisions provided a tax benefit for exports. However, ETI and several statutory predecessors embroiled the United States in a three-decade controversy with the European Union (EU) over their legality under the World Trade Organization (WTO) agreements. The EU complained that the U.S. export tax benefits were prohibited subsidies, and a succession of WTO panels supported that view. A WTO panel also ruled that the EU could impose retaliatory tariffs on U.S. products. Initially, the EU indicated that it would not impose tariffs while the United States was making progress in bringing its laws into WTO-compliance. However, while Congress began deliberations on ETI in 2002, it had not repealed the measure by 2004, and the EU began a phased-in implementation of tariffs in March 2004.

The controversy began with the 1971 enactment of the Domestic International Sales Corporation (DISC) export tax benefit. European countries complained under the General Agreement on Tariffs and Trade (GATT, the WTO's predecessor) that DISC was a prohibited export subsidy. A GATT panel ruled against DISC, and the United States did not concede DISC's illegality but replaced DISC in 1984 with the Foreign Sales Corporation (FSC) provisions, designed to achieve GATT-legality while still providing an export benefit. In 1997, however, the EU began proceedings against FSC. A WTO panel ruled against FSC, leading the United States to enact the ETI provisions in 2000; the EU began WTO proceedings against ETI in November of that year.

After consideration of several alternative approaches to ending the controversy, Congress repealed ETI in 2004 as part of the American Jobs Creation Act (AJCA; P.L. 108-357). The measure coupled ETI's repeal with enactment of a deduction generally applicable to all domestic manufacturing production — not just exports. The EU suspended its tariffs beginning in January 2005, but at the same time lodged a new WTO complaint about several transition rules included with AJCA's repeal. The WTO supported the EU's complaint, and in May 2006 provisions included in the Tax Increase Prevention and Reconciliation Act (P.L. 109-222) repealed the transition rules, apparently ending the decades-long controversy.

U.S. exporters argued that ETI was necessary to protect U.S. competitiveness, but traditional economic theory questions the efficacy of export benefits. Theory suggests that exchange rate adjustments reduce most of any increase the tax benefits may cause in exports while at the same time triggering an increase in imports; the net result is no change in the balance of trade. Theory also suggests that export subsidies reduce the economic welfare of the subsidizing country in two ways. First, part of the subsidy's benefit flows abroad, transferring welfare from U.S. taxpayers to foreign consumers. Second, the benefit likely distorts the U.S. economy, inducing it to trade more than is economically efficient.

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A History of the Extraterritorial Income (ETI) and Foreign Sales Corporation (FSC) Export Tax-Benefit Controversy

A long-running dispute between the United States and the European Union (EU) over U.S. export tax benefits may have reached a conclusion. For more than 30 years, U.S. tax law provided a tax benefit to exporters: first, as the Domestic International Sales Corporation (DISC) provisions; then, with the Foreign Sales Corporation (FSC) benefit; and finally with the Extraterritorial Income (ETI) provisions. The EU maintained for virtually the entire period that the U.S. export benefits violated international trade agreements' prohibitions of export subsidies, arguing that DISC violated the General Agreement on Tariffs and Trade (GATT), and later complaining that FSC and the ETI provisions violated the World Trade Organization (WTO) agreements that replaced GATT. Successive attempts by the United States to redesign its export tax benefits so as to achieve legality under GATT and the WTO were not successful; GATT and WTO panels without exception ruled against the U.S. provisions. WTO rulings against the U.S. export benefits culminated in 2002 with the approval of up to \$4.03 billion in retaliatory tariffs by the EU. Congress began consideration of legislation to repeal ETI, and initially, the EU deferred application of its tariffs. By early 2004, however, the United States had not enacted repeal legislation, and the EU began to phase in its tariffs in March of that year.

In October 2004, the U.S. Congress repealed ETI with enactment of the American Job Creation Act (AJCA; Public Law 108-357). The act provides for the phase out of ETI over two years and also implemented a number of tax benefits for domestic U.S. production in general (i.e., for exports and non-exports alike) as well as tax cuts for overseas operations. The EU suspended its tariffs, effective January 2005, but also lodged a WTO complaint regarding the transition provisions of ETI's repeal, arguing that AJCA's phaseout (rather than immediate repeal) contravened the WTO agreements. In May 2006, Congress repealed the transition provisions as part of the Tax Increase Prevention and Reconciliation Act (P.L. 109-222), apparently ending the decades-long controversy.

Domestic International Sales Corporations (DISCs) and Their Rationale

The Domestic International Sales Corporation (DISC) provisions were enacted as part of the Revenue Act of 1971 (P.L. 92-178). DISC was a small part of a broader economic package announced in August 1971 by the Nixon Administration, a program designed to alleviate a range of economic problems that included a

deteriorating U.S. balance of payments.¹ In contrast to the current regime of flexible exchange rates, international exchange rates at the time were fixed, and the U.S. balance of payments problem was highlighted by a current account deficit and large outflows of capital from the United States, leading to a balance of payments deficit that placed severe pressure on the U.S. dollar. The major aspects of the curative program were suspension by the United States of the dollar's convertibility into gold and a 10% surcharge on imports. For its part, DISC was intended both to stimulate U.S. exports and to encourage U.S. firms to locate their production for foreign markets in the United States rather than abroad.²

DISC was designed, in part, to counter the effect of another tax code provision, a still-existing tax benefit known as "deferral," under which U.S. firms can indefinitely postpone U.S. tax on their overseas operations. By providing a tax benefit for income earned abroad, deferral poses a tax incentive for U.S. firms to invest and produce in countries with relatively low tax rates. DISC was designed to counter deferral's incentive with an incentive of its own for investment in U.S.-based production of exports. Instead of building factories abroad to serve their foreign markets, U.S. firms could obtain a tax benefit by producing in the United States and shipping their goods overseas. Indeed, the DISC benefit's statutory design mirrored the mechanics of deferral in many respects.

To see how the 1971 DISC provisions were designed to provide preferential tax treatment to exports, it is useful to take a brief look at the overall U.S. tax structure in its international setting. In broad terms, the United States bases its tax jurisdiction on the residence of a corporation or individual, not on the source of the taxpayer's income. Under this so-called "residence" system of taxation, U.S. taxes apply to both the foreign and U.S.-source income of corporations chartered in the United States (U.S. corporate "residents"). Thus, without a special provision such as DISC or its successors, a U.S.-chartered corporation that sells exports directly to its foreign customers is taxed in full on its export income, regardless of whether export income is considered to have a U.S. or a foreign source.

The aforementioned deferral benefit complicates this picture. Deferral works like this: while the United States taxes its residents on their worldwide income, it taxes foreign-chartered corporations only on income from the conduct of a U.S. trade

¹ Thomas W. Anninger, "DISC and GATT: International Aspects of Bringing Deferral Home," *Harvard International Law Journal*, vol. 13, Summer 1972, p. 392.

² DISC was first proposed in 1969, and was championed by the Treasury Department before its ultimate inclusion in the 1971 economic proposals: John H. Jackson, "The Jurisprudence of International Trade: The DISC Case in GATT," *American Journal of International Law*, vol. 72, Oct. 1978, p. 752. For an overview of the 1971 economic package, see the testimony by Treasury Secretary John Connally in U.S. Congress, House Committee on Ways and Means, *Tax Proposals Contained in the President's New Economic Policy*, 92nd Cong., 1st sess., Sept. 8, 1971 (Washington: GPO, 1971), pp. 7-8. For the congressional rationale for DISC, see U.S. Congress, Joint Committee on Taxation, *General Explanation of the Revenue Act of 1971* (Washington: GPO, 1971), p. 86. For a discussion of the balance of payments problems, see Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton, NJ: Princeton Univ. Press, 1996), pp. 128-135.

or business. To use the deferral benefit, a U.S. firm with multinational operations arranges to earn its foreign income through a subsidiary corporation chartered in a foreign country. Since the foreign subsidiary is exempt from U.S. tax (at least to the extent it does not earn U.S. income), U.S. taxes can be postponed until the subsidiary's income is paid to the U.S.-chartered parent firm as dividends, a deferral that constitutes a tax benefit as long as the subsidiary's income is subject to low foreign taxes in the interim. (Note here that U.S. corporations can normally deduct some or all of dividends received from U.S.-chartered corporations as a means of alleviating multiple applications of corporate-level tax. However, dividends received from foreign corporations are not deductible.)

Even without DISC (and later FSC and ETI), certain tax planning opportunities are available to exporters using the deferral benefit. Conceivably, a U.S. exporter can avoid at least some amount of U.S. tax by selling its exports to a foreign subsidiary corporation which then sells the U.S.-made products to foreign customers. To the extent income from the export can be attributed to the foreign subsidiary, it can achieve deferral of U.S. tax. Two aspects of the U.S. tax code, however, limit this technique. First, the Internal Revenue Service (IRS) is empowered by the tax code to reallocate income among related taxpayers so as to accurately reflect each entity's actual production of income. And, in general, the IRS allocates income on the basis of hypothetical "arm's-length" prices that are assigned to transfers of goods and services between related firms as though the firms were, in fact, unrelated. Since the bulk of an export's value is, by definition, added by the home-country exporter, presumably little in the way of export income can be allocated to a foreign sales subsidiary, and little export income can thus benefit from deferral.

A set of tax code rules known as Subpart F also limits deferral's benefit for exports. Subpart F is generally designed to restrict U.S. taxpayers from concentrating foreign income in low-tax foreign "tax havens," the better to take advantage of deferral. To that end, Subpart F identifies certain types of income that are subject to current U.S. taxation, even if earned through a foreign subsidiary, generally income from passive investment (i.e., interest, dividends, and similar income) and a variety of income types whose source is thought to be easily manipulated. Included in this latter category is what Subpart F terms "foreign base company sales income," income from sales transactions between related entities. Thus, even if a tax-planning exporter were to successfully allocate export profits to a foreign subsidiary, Subpart F potentially denies the deferral benefit.

The DISC provisions carved an export benefit into this structure by establishing an indefinite tax deferral for income from exporting, emulating certain aspects of the deferral benefit that was already on the books. A firm availed itself of the DISC benefit by setting up a subsidiary through which it sold its exports, a "DISC" in this case meaning a corporation chartered domestically rather than abroad. DISCs themselves were tax exempt under special tax code provisions; any income attributed to the DISC could thus be deferred until remitted to the parent firm as intra-firm dividends. And while a DISC could be simply a paper corporation performing few economic activities of its own, the DISC provisions contained special income allocation rules under which specified portions of a firm's export income could be

attributed to the DISC rather than the parent corporation.³ These allocation rules departed from the arm's-length pricing method of dividing income that U.S. tax rules normally applied. As a result of the various rules governing income allocation and other aspects of DISC, firms could use the benefit to indefinitely defer taxes on somewhere between 16% and 33% of their export income from taxation.⁴

In addition to countering deferral, DISC was designed to offset what were perceived to be tax advantages provided by foreign countries to their own exporters. Some countries, then as now, operate “territorial” rather than residence-based tax systems under which tax jurisdiction is based on the source of income rather than the identity of the taxpayer. Territorial systems generally tax only domestic-source income and exempt income attributed to foreign sources. The structure of territorial tax systems can provide export subsidies under certain circumstances, for example, if arm's-length pricing is not rigorously applied so that a large fraction of export income can be concentrated in exempt offshore branches.

Another perceived advantage for foreigners was the “border tax adjustments” provided by countries that make extensive use of value-added taxes (VATs). Countries that use VATs, including those in the EU, commonly rebate the VAT that has been paid on exports while applying the VAT to imports. These adjustments are intended to ensure that products made in VAT-utilizing countries do not face a price disadvantage in competing against goods from other countries. However, some U.S. businesses argued (and some still argue today) that VAT rebates give foreign goods an advantage over U.S. exports; a provision such as DISC was thought necessary to place U.S. and foreign products on an even footing, tax-wise.

Again, DISC was designed to address a balance of payments deficit, both by reducing outflows of capital and the U.S. trade deficit. Shortly after DISC was enacted, however, the U.S. abandoned the gold standard, and the world's major trading countries ultimately adopted a regime of flexible exchange rates. According to economic theory, the new regime neutralized any impact DISC may have had on exports. Under flexible exchange rates, an export subsidy such as DISC drives up the price of the exporting country's currency (in this case, the dollar), making its exports more expensive for foreigners and its own imports cheaper. Any initial export expansion from the tax benefit is reduced, while imports increase. Ultimately, the export benefit has no impact on the balance of trade although it does increase the overall level of trade. (According to economists, these same adjustments refute the argument that VAT rebates provide an advantage to foreigners; exchange rate adjustments offset any effect the rebates may have.)

³ For a detailed description of how DISC worked, see U.S. Congress, Joint Committee on Taxation, *General Explanation of the Revenue Act of 1971*, 92nd Cong., 2nd sess. (Washington: GPO, 1972), p. 86. An economic analysis of both DISC and deferral is in CRS Report 78-20 E, *Deferral and DISC: Two Targets of Tax Reform*, by Jane G. Gravelle and Donald W. Kiefer (an out of print report available from the author).

⁴ CRS Report 83-69, *DISC: Effects, Issues, and Proposed Replacements*, by David L. Brumbaugh, p. 7 (an out of print report available from the author).

More importantly, economic theory also questions the efficacy of export subsidies regardless of their impact on the balance of trade. According to theory, export subsidies reduce the economic welfare of the subsidizing country in two ways. First, any expansion in exports is likely accomplished by a reduction in prices that foreign consumers pay for the exports: a price reduction that is financed by the subsidizing country's taxpayers. Second, an export subsidy reduces economic welfare by distorting resource use in the subsidizing and subsidized countries alike; it induces countries to trade more than is economically efficient. However, in the case of DISC, FSC, and ETI alike, these deleterious effects were probably not large, in part because of exchange rate adjustments.

DISC and the General Agreement on Tariffs and Trade

DISC was enacted on December 10, 1971, and went into effect on January 1, 1972. Almost immediately, the European Community (EC; the precursor of the European Union) began proceedings against the provision under GATT.

GATT was created in 1947 as an agreement among the major trading countries that would govern acceptable commercial policy in the conduct of trade. GATT's purpose was to reduce the tariffs and other trade barriers as well as discriminatory trade practices that had grown up in the inter-war years and that had contributed to the worldwide economic collapse that preceded World War II. In promoting free trade, it was believed that GATT would promote rising standards of living and full employment.

GATT did not have autonomous power and was not a formally constituted organization like the World Bank or International Monetary Fund. Further, decisions required a consensus among the contracting countries, effectively giving each country veto power. Nonetheless, the Agreement included a prohibition against subsidies for exports of manufactured goods, and procedures were developed within GATT for settling trade disputes. Under the procedures, an aggrieved country would first request consultations with the country it believed to be in violation of the Agreement. If the differences remained unresolved, the GATT Council could appoint a panel that would issue a report on the dispute. The GATT Council could either adopt, reject, or take no action on the panel report. In cases where a country was found to have violated GATT, the complaining country could request permission to apply sanctions.

The EC took the first step in this process in February 1972, by requesting consultations with the United States on DISC.⁵ The United States, in turn, requested consultations under GATT with the Netherlands, France, and Belgium, each of which

⁵ European doubts about DISC's legality were expressed before the provision was actually enacted. The U.S. Treasury, however, was prepared to maintain that DISC was GATT-compatible. Thomas W. Anninger, "DISC and GATT: International Aspects of Bringing Deferral Home," *Harvard International Law Journal*, vol. 13, Summer 1972, p. 393; Jackson, "The Jurisprudence of International Trade," p. 761.

maintained “territorial” tax systems. The consultations produced no solution to the dispute, and in May 1973, both the EC and the United States took the next step in the dispute process by filing formal complaints with GATT. The GATT Council, as set forth under its procedures, established independent panels to examine and report on the complaints.

The European complaint against DISC relied on the conclusions of a 1960 GATT Working Party report containing an illustrative list of subsidies, a report that had been adopted by the major GATT countries. The report’s list included the “remission” of direct taxes on exports as well as the “exemption” of export income from tax, although it did not specifically list tax deferrals. The EC argued that because the DISC deferral was, in principle, unlimited, it was the economic equivalent of an outright remission or exemption.⁶ In response, the United States pointed out the omission of tax deferrals as an explicit item on the 1960 list.⁷

The U.S. response struck an additional theme to which the United States was to return in future episodes of the controversy: that a parallel existed between the U.S. export tax benefits and the territorial systems maintained by the several European countries. The United States argued that since income of foreign sales branches is not taxed under territorial systems, and because the EC countries did not rigorously apply arm’s-length pricing, territorial systems subsidized exports. (Indeed, this was exactly the argument the United States mounted against the EC territorial systems in its own GATT complaint.) At the same time, however, the United States argued that GATT had, by custom, always considered territorial systems acceptable. DISC, the United States maintained, simply removed the distortion introduced by the territorial systems by introducing another; if the first distortion (the territorial systems) was legal, so too was the other.⁸

The GATT panel report was issued in November 1976; it found elements of subsidy in both the U.S. and territorial systems. In the first place, the panel concluded that DISC was a prohibited export subsidy notwithstanding its deferral rather than exemption of income from taxes. The subsidy was conferred, the panel reasoned, because no interest charge was assessed by the U.S. tax authorities on the deferred tax liability. With respect to the U.S. defense of DISC as a counterweight

⁶ General Agreement on Tariffs and Trade, “United States Tax Legislation (DISC): Report of the Panel Presented to the Council of Representatives on 12 November 1976,” *Basic Instruments and Selected Documents*, 23rd Supp., Jan. 1977, p. 103.

⁷ *Ibid.*, p. 104.

⁸ *Ibid.*, p. 106. The belief that there was linkage between DISC and territorial systems was apparently not confined to DISC’s defense before GATT. See the assessment by Robert Hudec, who cites U.S. officials’ “conviction that the European tax systems were not merely permitting tax-haven operations, but were actively helping exporters to enlarge that tax advantage by adopting very generous ... pricing rules for tax haven transactions. United States tax officials, who took some pride in their own fairly rigorous arm’s length pricing rules, found it particularly irritating to be accused of subsidizing by tax officials who, they believed, were actively promoting even worse practices at home.” Robert E. Hudec, “Reforming GATT Adjudication Procedures: The Lessons of the DISC Case,” *Minnesota Law Review*, vol. 72, June 1988, p. 1459.

to the territorial systems, the panel concluded that one distortion (i.e., the territorial systems) does not justify another, and that mere custom, furthermore, did not necessarily make territorial systems GATT-legal. As for the U.S. complaint against the territorial systems, the panel report concluded that the territorial systems in question provided a tax subsidy for export sales through low-tax countries and that lenient intra-firm pricing and cost allocation rules amplified the benefit.⁹

Following the issuance of the panel reports, the next step in the dispute-resolution process would normally have been for the GATT Council to consider whether or not to adopt the reports. However, the United States and the EC were at an impasse. The United States was willing to accept the finding against DISC, but only if the findings against the three territorial systems were also adopted; the three European countries were only willing to adopt the finding against DISC.¹⁰ A GATT Council decision remained in abeyance for nearly five years. In part, the hiatus was due to the increased opposition to DISC within the United States itself. In 1978, the Carter Administration initially proposed repealing DISC, before withdrawing its proposal in the face of strong opposition; in the face of a possible unilateral repeal of DISC by the United States, the controversy lost its urgency. In addition, negotiation of a new GATT Subsidies Code occurred during GATT's Tokyo Round, and appeared to point to a resolution of the dispute. The Code explicitly included tax deferrals as subsidies, casting doubt on DISC's legality, while affirming the importance of using arm's-length pricing in intra-firm transfers — again, a key element of the United States complaint against territorial systems. At the same time, the Subsidies Code appeared to countenance the legality of territorial systems in general.¹¹

In December 1981, the four DISC panel reports were finally adopted by the GATT Council, subject to an Understanding. The Understanding, which later assumed an important role in the U.S. defense of FSC before the WTO, was an agreement on three points. First, countries need not tax economic processes occurring outside their territory. Notwithstanding the panel reports, territorial tax systems did not, in other words, generally contravene GATT. Second, arm's-length pricing should be followed in allocating income among related firms. Third, GATT does not prohibit measures designed to alleviate double-taxation of foreign-source income.¹²

The Understanding and adoption of the reports, however, did not end the controversy.

⁹ General Agreement on Tariffs and Trade, "United States Tax Legislation (DISC)," p. 126.

¹⁰ Hudec, "Reforming GATT Adjudication Procedures," pp. 1488-1489. As a testament to the growing intractability of the dispute, Hudec points out that the failure to adopt the reports was almost unprecedented. Before 1976, there had been 20 GATT legal rulings and all but one had been adopted by the GATT Council.

¹¹ *Ibid.*, p. 1492.

¹² The Understanding is reprinted in General Agreement on Tariffs and Trade, "Tax Legislation," *Basic Instruments and Selected Documents*, 28th Supp., March 1982, p. 114.

The Advent of Foreign Sales Corporations (FSCs)

The meaning of the 1981 Understanding itself shortly became an item of contention, and during 1982 a debate occurred in the GATT Council over how the Understanding applied to DISC. The EC continued to argue that DISC was an illegal export subsidy, while the United States maintained that every export involves at least some extraterritorial income, and that DISC was a reasonable means of approximating the extraterritorial portion.¹³ However, policymakers in the United States noted that the dispute was becoming more serious and “threatened breakdown of the dispute resolution process” and that the United States had become isolated over the issue.¹⁴ The U.S. Treasury thus proposed what ultimately were enacted as the 1984 Foreign Sales Corporation (FSC) provisions.

The FSC provisions were designed to achieve GATT legality by providing an export tax benefit incorporating elements of the territorial tax system countenanced by the 1981 Understanding. The FSC provisions worked as follows: in a manner similar to DISC, exporters obtained a tax benefit by selling their exports through a specially qualified subsidiary corporation, in this case, an FSC. But in contrast to DISCs, FSCs were required to be incorporated outside the United States. And also in contrast to DISCs, FSCs were required to conduct certain management activities or economic processes abroad. Examples of management activities included maintaining a bank account abroad, having a board of directors that included at least one person who was not a U.S. resident, and holding all shareholder meetings outside the United States. “Foreign economic process” requirements were met if an FSC at least participated in activities such as advertising, arrangement of transportation, transmittal of invoices and receipt of payment, processing of orders, and assumption of credit risk.¹⁵ Notwithstanding these requirements, an FSC, like DISCs before it, could be little more than a paper corporation.

As with DISC, the FSC itself was the entity that received special tax status, in this case a partial tax exemption. The tax code granted the partial exemption by classifying qualifying FSC income as foreign-source income not connected with the conduct of a U.S. trade or business; because foreign firms are subject to U.S. tax only on U.S. income, this placed FSC income outside the U.S. tax jurisdiction. Further, U.S. parents of FSC subsidiaries were permitted a 100% dividends-received deduction, despite the fact that FSCs were foreign-chartered corporations. And to rule out possible U.S. taxation under Subpart F’s foreign base company sales income rules, FSC income was exempted from Subpart F’s anti-deferral rules.

Since the FSC was the tax-favored entity, the size of the benefit (as with DISC) depended heavily on how much income a firm was permitted to allocate to its tax-favored subsidiary. As with DISC, the FSC provisions contained “administrative” income allocation rules that assigned more income to the subsidiary than generally

¹³ Hudec, “Reforming GATT Adjudication Procedures,” p. 1497.

¹⁴ U.S. Congress, Joint Committee on Taxation, *General Explanation of the Deficit Reduction Act of 1984*, committee print, 2nd sess. (Washington: GPO, 1984), p. 1041.

¹⁵ A detailed explanation of the FSC provisions is available at Ibid., pp. 1037-1070.

could be allocated under arm's-length pricing, although firms could use the latter method if they wished. Under these "administrative pricing" rules, a firm could choose to allocate either a flat 23% of taxable income from exporting to the FSC or an amount equal to 1.83% of gross receipts. The portion of income allocated to the FSC that was tax exempt depended on the income allocation method the firm used: 15/23 was exempt if either of the administrative pricing methods was used; 30% if arm's-length pricing was used. As a final element, a parent firm was permitted to deduct 100% of dividends received from its FSC subsidiary, thus setting the treatment of FSC dividends apart from that of the fully-taxable dividends received from other foreign corporations.¹⁶ The combination of specified exemptions and pricing rules resulted in a total tax exemption that ranged from 15% to 30% of export income, a benefit very slightly smaller than that available under DISC.¹⁷

FSC and the World Trade Organization

The adoption of FSC in 1984 dampened the export-benefit controversy for a period; the EC did not formally bring the matter of U.S. export tax benefits before GATT for almost 15 years, although there were some indications of European dissatisfaction with the redesigned benefit.¹⁸ In the meantime, the ability of GATT to maintain compliance with its own rules was increasingly being criticized. Subsidies in general and the DISC controversy in particular were cited as problem areas.¹⁹ The outlines of what was to become the World Trade Organization were developed during GATT's Uruguay Round of trade negotiations during the early 1990s. GATT was supplanted by the WTO on January 1, 1995. In general, the WTO continued the principles of GATT: reduction of trade barriers and non-discrimination in trade practices. However, in contrast to GATT, the WTO was a formally constituted organization rather than just an agreement. Also, its underlying agreements included a strengthened dispute-settlement process contained in its Dispute Settlement Understanding, or DSU. Further, a new Subsidies and Countervailing Measures (SCM) agreement was negotiated during the Uruguay Round and subsumed in the WTO agreements; the SCM clarified the definition of prohibited subsidies.²⁰

¹⁶ Note that domestic corporations are permitted to deduct some or all of dividends received from other domestic corporations, as a means of preventing multiple layers of corporate-level tax. In general, however, dividends received from foreign corporations are not eligible for the dividends-received deduction.

¹⁷ CRS Report RL30684, *The Foreign Sales Corporation (FSC) Tax Benefit for Exporting: WTO Issue and an Economic Analysis*, by David L. Brumbaugh, p. 5.

¹⁸ The EC expressed doubts about FSC's GATT-legality even before the new benefit was adopted, and held consultations (outside the GATT settlement process) with the United States in 1985. During the early 1990s, representatives of the European aerospace industry complained that FSC gave U.S. aircraft exports an unfair advantage. For complaints of Airbus Industrie, see *Journal of Commerce*, Sept. 9, 1992, p. 1A.

¹⁹ Jackson, "The Jurisprudence of International Trade," pp. 747-781.

²⁰ George Kleinfeld and David Kaye, "Red Light, Green Light?: The 1994 Agreement on (continued...)"

The WTO's dispute settlement process generally followed the same procedures that had grown up under GATT, but with the addition of a standing Appellate Body to hear appeals of panel decisions. An important strengthening of the process under the WTO, however, is this: under GATT, a consensus was required for decisions, meaning, for example, that the "loser" of a panel decision could, in effect, veto the report. Under the WTO, however, consensus is required for a decision *not* to be approved at each stage in the process, thus, for example, requiring the "loser" of a case to persuade the "winner" to overturn a panel decision.²¹

The hiatus in the dispute ended on November 18, 1997, when what had become the European Union (EU) took the first step in the WTO's dispute settlement process by formally requesting consultations with the United States over FSC.²² The consultations failed to produce a solution, and in July, 1998, the EU requested the establishment of a dispute settlement panel, which the WTO formed in September.

The heart of the EU's complaint was that FSC violated Article 3.1(a) of the SCM Agreement, which prohibits provision of subsidies that are "contingent on export performance." Article 1.1, in turn, defines subsidies as a "financial contribution" by a government where "government revenue that is otherwise due is foregone or not collected." In general, the EU argued that the FSC rules provided special tax exemptions where export income would otherwise be taxed, for example, under Subpart F or as income from the conduct of a U.S. business. The EU also argued that FSC's administrative pricing rules constituted an export subsidy.

The United States, in turn, argued that territorial taxation was WTO-legal and that FSC was analogous to territorial taxation. More specifically, the United States maintained that the 1981 GATT Understanding together with the SCM Agreement provided that countries need not tax income from "foreign economic processes," which established the acceptability of territorial taxation.²³ The United States then argued that FSC's various foreign economic presence and management requirements

²⁰ (...continued)

Subsidies and Countervailing Measures, Research and Development Assistance, and U.S. Policy," *Journal of World Trade Law*, vol. 28, Dec. 1994, p. 43.

²¹ For an explanation of the WTO dispute settlement procedures, see CRS Report RS20088, *Dispute Settlement in the World Trade Organization: An Overview*, by Jeanne J. Grimmett. See also: Gilbert R. Winham, "World Trade Organisation: Institution-Building in the Multilateral Trade System," *World Economy*, vol. 21, May 1998, p. 351-352. Winham interprets the differing consensus requirements between the WTO and GATT in terms of national sovereignty, with GATT's consensus requirement being consistent with sovereignty and the WTO's "reverse consensus" placing constraints on unilateral action.

²² In 1993, the EC was subsumed into the European Union. Although the complaint was technically filed by the EC as a component of the EU, this report nonetheless uses the term EU in describing events in 1993 and after.

²³ The relevant part of the SCM Agreement is contained in the Agreement's Annex I, which presents an illustrative list of practices that do and do not constitute export subsidies. Paragraph (e) of Annex I generally provides that exemption, remission, or deferral of direct taxes on exports are export subsidies. Footnote 59 qualifies the paragraph by allowing that countries need not tax income from foreign economic processes.

linked the tax benefit to foreign economic processes. The United States further maintained that the SCM Agreement gives countries considerable latitude in setting required intra-firm pricing methods, and FSC's administrative pricing rules merely identified the portion of income attributable to foreign economic processes.

The WTO panel issued its report on October 8, 1999. In general, the report concluded that FSC was indeed a “subsidy contingent on exporting,” and so violated the SCM Agreement. In reaching its conclusion, the panel rejected the U.S. analogy between FSC and territorial taxation. Although the panel accepted that countries need not tax income from foreign economic processes, whether a provision forgives taxes “otherwise due” — and thus whether a subsidy exists — depends on how the provision in question compares to a country's own general method of taxation. In the panel's words:

we consider that the United States has made an unwarranted leap of logic from the proposition that “income arising from foreign economic processes may be exempted from direct taxes” to the proposition that “if countries are under no obligation to tax income from foreign economic processes, then they should be free to exempt all such income *or just part of it*” (emphasis added).²⁴

In short, because FSC carved out an exception from the way the United States normally taxed exports, it was, the panel concluded, an export subsidy.

The United States appealed the panel's decision almost immediately, generally arguing again that the WTO rules hold that a country need not tax income from foreign economic processes and that FSC was therefore permissible. However, on February 22, 2000, the WTO Appellate Body concluded that, having decided to tax foreign source income in general, the United States provided a subsidy by carving out an exception to that treatment, thus again rejecting the analogy between FSC and territorial taxation.²⁵

The Extraterritorial Income Benefit

As described above, the advent of flexible exchange rates called into question the ability of export benefits such as FSC and DISC to reduce the U.S. trade deficit. Nonetheless, many in the United States believed that the decision against FSC confronted the United States with a dilemma: achieve WTO-legality or maintain the “competitiveness” of U.S. exports. Some prominent U.S. policymakers, including then-Chairman of the House Ways and Means Committee Bill Archer, suggested the dilemma could be solved by adopting relatively broad tax reforms rather than making small adjustments in the benefit's design. For example, some suggested the United States adopt a form of consumption tax, thus foregoing taxation of business profits altogether; another suggested alternative was adopting a pure territorial tax system

²⁴ World Trade Organization, *United States — Tax Treatment for Foreign Sales Corporations, Report of the Appellate Body*, Feb. 24, 2000, AB-1999-9 p. 273.

²⁵ World Trade Organization, *United States — Tax Treatment for 'Foreign Sales Corporations,'* p. 59.

as maintained by several European countries and apparently countenanced under WTO rules.²⁶

The Clinton Administration, however, did not rule out the possibility of a narrower approach: finding a reformulation of just the FSC benefit that would nonetheless be WTO-compatible. In April 2000, the United States informed the WTO that it would comply with the panels' rulings, but would do so in a way that would ensure that "U.S. exports are not disadvantaged in relation to their foreign counterparts."²⁷ In May, the United States briefed EU representatives on a planned replacement for FSC. The plan contained the basics of what were later enacted as the ETI provisions. The general approach it took was to attempt WTO-legality by extending the tax benefit beyond exports to income from foreign operations, thus attempting to provide a tax benefit that included exports but that was not "export contingent," as prohibited by the SCM Agreement.²⁸ However, after examining the plan EU representatives stated their belief that it, too, was not WTO-compliant because its benefit was still export-contingent. EU officials indicated that the measure, if enacted, would be challenged under WTO rules.²⁹

Notwithstanding the EU's objections, Congress passed the ETI provisions in November 2000, and President Clinton signed them into law on November 15 (P.L. 106-519). In general, the ETI provisions begin by exempting what they term "extraterritorial income" from U.S. tax, but continue by defining "extraterritorial income" and a chain of other concepts in a way that confines the exemption to a firm's U.S. exports and, at most, a matching amount of income from foreign operations. The initial link in the chain of definitions is "qualifying foreign trade property," which is generally products manufactured, produced, grown, or extracted within or outside the United States. Unlike the parallel FSC concept of export property, qualifying foreign trade property can be partly manufactured outside the United States. However, not more than 50% of the value of qualified property can be added outside the United States.

The next link in the chain is "foreign trading gross receipts," which the provisions define as income from the sale or lease of qualifying foreign trade

²⁶ Ryan J. Donmoyer, "Legislative Fix for FSCs Needed 'This Year or Soon,' Archer Says," *Tax Notes*, March 13, 2000, p. 1524.

²⁷ U.S. Ambassador to the World Trade Organization Rita Hayes, as quoted in *BNA Daily Tax Report*, April 10, 2000, p. G-1.

²⁸ Joe Kirwin, et al., "U.S. Outlines FSC Fix to Europeans, Offers Elective Regime for Foreign Sales," *BNA Daily Tax Report*, May 3, 2000, p. GG-1.

²⁹ Joe Kirwin and Daniel Pruzin, "Europeans, U.S. Officials to Face Off Following EU Rejection of FSC Proposal," *BNA Daily Tax Report*, May 31, 2000, p. GG-1. The United States and the EU, however, worked out a procedural agreement under which the EU would not ask the WTO for permission to impose sanctions related to FSC until the WTO had ruled on the compatibility of FSC's replacement with WTO rules. Further, the EU agreed to relax an October 1, 2000, deadline for the United States to comply with WTO rules that would otherwise have applied under normal WTO procedures. Joe Kirwin et al., "U.S., EU Reach Procedural Pact in FSC Case; U.S. Loss Could Still Lead to Huge Sanctions," *BNA Daily Tax Report*, Oct. 3, 2000, p. G-7.

property, and which parallels the FSC concept of gross receipts. As with FSC, a firm would only be treated as earning foreign trading gross receipts if it conducts economic processes abroad. However, FSC's foreign management requirements would be dropped.

The provisions next define "foreign trade income" as taxable income attributable to foreign trading gross receipts. The provisions term a specified part of this foreign trade income "qualifying foreign trade income," and grant such income a tax exemption. The bill sets qualifying foreign trade income (and thus the exclusion) equal to either 1.2% of foreign trading gross receipts, 15% of foreign trade income, or 30% of the income attributable to the foreign economic processes undertaken under the foreign trading gross receipts requirements. (The rule exempting 30% of income is similar in its effect to the FSC rule that applies to firms that use arm's-length pricing.) As with FSC and the May 2000 proposal before it, the arithmetic result of these rules is that a firm can exempt somewhere between 15% and 30% of qualified income from U.S. tax.³⁰

As noted above, in contrast to FSC, the ETI provisions do not require a firm to sell its exports through a foreign-chartered corporation to qualify for the benefit. Since a U.S. corporation could qualify for the exemption directly, the special dividends-received deduction language in the FSC provisions is not necessary. The provisions also contain language providing that a foreign corporation that uses the benefit can elect to be taxed like a U.S. corporation. This mechanism rules out the possible application of Subpart F, which applies only to income earned by firms that are foreign corporations, for tax purposes.

On November 17, 2000, the EU formally requested consultations with the United States over the ETI provisions. The consultations failed, and on December 7, the EU requested that the WTO establish a panel to determine ETI's legality. The panel was appointed on December 20, and issued its report on August 20, 2001.

In defending ETI, the United States first argued that the provision addressed the previous (FSC) panel's finding that FSC created an exception to the general U.S. tax practice and was thus a subsidy. The United States argued that ETI was broader, and revised the general U.S. method of taxing overseas income because the provisions could be applied to income from foreign operations as well as exports. Thus, according to the U.S. argument, ETI is neither an exception to the general U.S. practice (and is therefore not a subsidy) nor contingent on exporting. A second U.S. argument held that, even if ETI were an export subsidy, it is a means of alleviating double taxation of foreign income and is therefore permissible under WTO rules by virtue of language contained in footnote 59 of the SCM Agreement.

But the WTO panel ruled against the United States, finding that the ETI provisions imposed enough special conditions on their use that they were an

³⁰ A firm can always choose to exempt 15% of income from tax. Alternatively, if its return on sales is sufficiently high, it could use the gross receipts method to exempt up to twice that amount from tax. The range of exemption, in other words, is 15%-30%.

exception to the general U.S. tax practice, and was therefore a subsidy.³¹ The panel also concluded that the subsidy was “contingent on export performance.” According to the panel, the fact that the benefit could apply to exports made the benefit export contingent despite the fact that the benefit could also apply to income from foreign operations (i.e., non-export income).³² Finally, the panel rejected the U.S. argument that ETI was intended to avoid double-taxation, concluding that the scope of the benefit was considerably broader than the type of income that would ordinarily be at risk of double-taxation.³³ (For example, nations do not usually include foreigners’ income from home-country exports within their own tax base.)

On October 10, 2001, the United States announced it would appeal the panel’s decision on ETI, asking the WTO Appellate Body to reverse the panel’s findings that ETI is a subsidy, that the subsidy is contingent on exporting, and that it is not a measure to alleviate double taxation. However, on January 14, 2002, the Appellate Body issued a report upholding the panel’s ruling on each of the three main arguments advanced by the United States.³⁴

ETI’s Repeal

WTO procedures permit a complaining country (in this case, the EU) to ask the WTO for permission to impose sanctions if the non-compliant country (in this case, the United States) does not take action to come into compliance. WTO procedures also permit the level of sanctions to be arbitrated at the defending country’s request. In the case of ETI, the EU asked the WTO to authorize imposition of \$4.043 billion in sanctions on its imports from the United States, an amount based on the EU’s estimate of the full value of the U.S. subsidy to all countries. The United States, in turn, argued before WTO arbitrators that the authorized tariffs should be only \$956 million, based on the United States’ estimate of the impact of the U.S. export benefit on European producers alone.³⁵ On August 30, 2002, WTO arbitrators ruled that the EU could impose the full \$4.043 billion it requested.³⁶

Following the Appellate Body’s decision, the U.S. Congress again began active consideration of the export benefits. The House Committee on Ways and Means held

³¹ World Trade Organization, *United States — Tax Treatment for “Foreign Sales Corporations”*: Report of the Panel, WT/DS108/RW, Aug. 20, 2001, p. 23.

³² *Ibid.*, p. 32.

³³ *Ibid.*, p. 43.

³⁴ The Appellate Body’s report was published as World Trade Organization, *United States — Tax Treatment for “Foreign Sales Corporations”*: Report of the Appellate Body, WT/DS108/AB/RW, Jan. 14, 2002, p. 79.

³⁵ For a description of the disagreement over retaliatory measures, see Daniel Pruzin and Myrna Zelaya-Quesada, “Punitive Damages in FSC/ETI Dispute Should Not Exceed \$1 Billion, U.S. Says,” *BNA Daily Tax Report*, Feb. 15, 2002, pp. G-1 - G-2.

³⁶ Alison Bennett et al., “WTO Gives EU Green Light for \$4 Billion in Sanctions Against United States over FSCs,” *BNA Daily Tax Report*, Sept. 3, 2002, p. GG-1.

a series of hearings, designed, according to Committee Chairman William Thomas, to “carefully and thoroughly address the problems created at the intersection of our Tax Code, and our international trade obligations.”³⁷ The chairman also voiced skepticism about the merits of additional efforts to redesign the tax benefit as had been done with FSC and ETI, stating: “Our corporate tax structure is in need of major restructuring, not another attempt at a short-term fix. More fundamental reform is required.”³⁸ During the hearings, Administration officials also expressed the view that mere redesigns of the ETI provisions would likely not be a workable solution, but expressed their intention to work closely with Congress to find a solution.³⁹ For its part, the EU indicated its willingness to postpone applying sanctions to U.S. goods as long as it perceived that Congress was making progress toward a solution.⁴⁰

On July 11, 2002, Chairman Thomas introduced H.R. 5095, a bill that proposed outright repeal of the ETI provisions rather than their redesign. At the same time, the bill proposed a broad range of tax cuts for U.S. firms operating abroad, reductions designed to improve the competitiveness of U.S. firms in international markets. The tax cuts included changes in foreign tax credit rules and in Subpart F. In addition, the bill contained revenue-raising provisions designed to restrict “earnings stripping” and corporate “inversions,” the former being the artificial shifting of U.S.-source income from U.S. subsidiary corporations to foreign parents and the latter, a tax-motivated corporate reorganization whereby U.S. corporations would reincorporate in a foreign country.

H.R. 5095 encountered criticism from several sources. Business groups such as the National Foreign Trade Council argued that the tax cuts in the bill did not make up for repeal of the ETI provisions. Congressional Democrats and several Republicans argued that the bill penalized firms that manufacture in the United States while benefitting those operating abroad. In the 108th Congress, Representatives Crane and Rangel introduced H.R. 1769, a bill that would phase out ETI while phasing-in a special tax deduction linked with income from domestic (but not foreign) production activities. Senator Hollings subsequently introduced S. 970, an identical bill. On July 25, 2003, Chairman Thomas introduced H.R. 2896, consisting of provisions similar to those contained in H.R. 5095, his bill in the 107th Congress, but with the addition of several substantial tax benefits for domestic investment; the bill thus contains a mix of tax incentives for domestic and foreign investment. In the Senate, Senator Hatch introduced S. 1475, containing a somewhat different mix of

³⁷ Statement at the hearings of the Committee on Ways and Means, Feb. 27, 2002. Available on the committee’s website at [<http://waysandmeans.house.gov/hearings.asp?formmode=archive&hearing=42>].

³⁸ Ibid.

³⁹ See, for example, the statement by the U.S. Treasury Department’s International Tax Counsel Barbara Angus: “We do think that significant change in the system would be necessary and that legislation that simply replicates the FSC or ETI provisions would be unlikely to pass muster.” In U.S. Congress, House Committee on Ways and Means, hearing, 107th Cong., 2nd sess., Feb. 27, 2002. Available on the Committee’s website at [<http://waysandmeans.house.gov/hearings.asp?formmode=archive&hearing=42>].

⁴⁰ Alison Bennett, “EU Satisfied with Export Regime Progress, But Pressing for Swift Action, Lamy Says,” *BNA Daily Tax Report*, June 24, 2002, p. G-9.

benefits for foreign and domestic investment.⁴¹ On October 1, the Senate Finance Committee approved S. 1637 (Senators Grassley and Baucus), which would also replace ETI with a mix of investment incentives both for domestic and overseas investment. On October 28, the House Ways and Means Committee approved a modified version of H.R. 2896. Several other bills were introduced in the Senate that, like the Crane/Rangel/Hollings bill, would repeal ETI and implement a tax benefit restricted to domestic investment. These bills included S. 1688 (Senator Rockefeller), S. 1922 (Senators Smith and Breaux), and S. 1964 (Senators Stabenow and Graham).

In the meantime, the EU moved towards adoption of a deadline for U.S. compliance. In May 2003, EU officials stated that the EU would review the situation in the fall of 2003 and, if necessary, begin procedures that would impose tariffs by January 1, 2004. In November, EU officials stated that if compliance was not achieved by March 1, 2004, the EU would begin a phase in of retaliatory tariffs.⁴² ETI legislation had not been enacted by March, and the EU began to phase in its tariffs on March 1.

In the United States, some suggested that an alternative approach to the ETI dispute might be negotiations, possibly coupled with some manner of tax law change. At the opening of hearings conducted by the Senate Finance Committee on July 30, 2003, Chairman Max Baucus pointed out that the conference report (H.Rept. 107-624) on the 2002 Trade Promotion Authority bill (H.R. 3009; P.L. 107-210) directed U.S. negotiators to address the disparate treatment of border tax adjustments under the WTO, which permits the rebate of indirect taxes (such as the value-added taxes imposed by EU countries) but not income tax exemptions for exports, as with the ETI.⁴³ Also, an op-ed article in the *Financial Times* on September 16 by Ways and Means Committee ranking minority member Charles Rangel and Republican committee member Philip Crane voiced a similar view, that the goal of WTO compliance “can be accomplished through changes in our tax law and/or changes to trade rules negotiated within the new round of negotiations that was launched in Doha, Qatar.”⁴⁴ In response, however, U.S. Trade Representative Robert Zoellick stated that “if the EU determines that [negotiation] is the course Congress has chosen, we are likely to trigger earlier trade retaliation against U.S. exporters.”⁴⁵

⁴¹ For a description and analysis of the bills in the 108th Congress, see CRS Report RL32066, *Taxes, Exports, and International Investment: Proposals in the 108th Congress*, by David L. Brumbaugh.

⁴² Joe Kirwin, “EU Sets March 1 Deadline for ETI Repeal, Details Plan to Phase in Sanctions Otherwise,” *BNA Daily Tax Report*, Nov. 6, 2003, p. GG-1.

⁴³ Statement of Chairman Max Baucus in U.S. Congress, Senate, Committee on Finance, hearing, 107th Cong., 2nd sess., July 30, 2002, on the role of the extraterritorial income exclusion act in the international competitiveness of U.S. companies. Available on the Committee’s website at [<http://finance.senate.gov/hearings/statements/073002mb.pdf>].

⁴⁴ *Financial Times* (London), Sept. 16, 2002, p. 23.

⁴⁵ Letter by U.S. Trade Representative Robert B. Zoellick to Representative Philip M. Crane, dated Sept. 23, 2002. Reprinted in *BNA TaxCore*, Sept. 23, 2002.

In Congress, legislation to repeal ETI gradually gained momentum in 2004. The Ways and Means Committee bill was not taken up by the full House during the first months of 2004, but the Senate began floor consideration of the Finance Committee bill in March. The bill initially encountered difficulties, with opponents objecting to those portions of the bill's tax cuts accruing to foreign-source income. On May 11, however, the Senate approved a slightly modified version of the Finance Committee bill, after rejecting amendments that would have removed the bill's international provisions.

In the House, Chairman Thomas in June introduced a somewhat modified version of his earlier bills as H.R. 4520. The new bill had the same general thrust as S. 1637 and H.R. 2896 before it; it proposed to repeal ETI while enacting a mix of domestic and international benefits while offsetting part of the cost with assorted revenue-raising provisions. Prominent among H.R. 4520's differences from the earlier Thomas bills were the addition of an optional individual income tax deduction for state sales taxes and a tobacco "buyout" provision which would compensate tobacco growers for the end of federal price-support and quotas. On July 15, the Senate approved a version of H.R. 4520, amended to include the tax provisions of its earlier bill (S. 1637) and its own tobacco buyout provision. On October 7, the House approved a conference agreement on the bill, and the full Senate approved the measure on October 11. The President signed the bill on October 22, and it became law (P.L. 108-357).

The EU Response

By October, 2004, the EU's phased-in tariffs had reached 12% (a five percent initial rate in March, followed by seven monthly one-percentage-point increases). However, in response to the benefit's repeal, EU Trade Commissioner Lamy stated that he would recommend to the EU Council of Ministers that the sanctions be suspended on January 1, 2005, the beginning date of ETI's phaseout.

At the same time, however, the EU indicated its intention of lodging a WTO complaint against the transition provisions of ETI's repeal. If the complaint is upheld, re-imposition of part of the tariffs is a possibility. One aspect of the transition rules is ETI's phase out over two years. The provisions permit firms to claim 80% of their otherwise applicable ETI benefit in 2006 and 60% in 2007 before ending in 2008.

However, EU officials are apparently more concerned about a second transition provision, which "grandfathers" existing contracts. Under the provision, the full ETI benefit applies to exports made under contracts entered into before September 17, 2003. EU officials have argued that the "grandfather" provisions favor producers of large capital goods that have long delivery times and would favor large U.S. exporters such as Boeing, Microsoft, Intel, Motorola, and Caterpillar.⁴⁶ Some U.S.

⁴⁶ Joe Kirwin, et al. "Extraterritorial Income: EU to End Sanctions in Wake of Export Bill But Plans Appeal of Grandfather Provisions," *BNA Daily Tax Report*, Oct. 26, 2004, p. G-1.

observers have suggested that the EU appeal is linked to a separate WTO complaint lodged by the United States against Airbus.⁴⁷

On November 5, the EU announced it had taken the first step in the WTO process by requesting consultations with the United States over the transition provisions. In August 2005, a WTO panel supported the EU's complaint, and the EU announced it would resume the phase in of its tariffs if the United States had not fully repealed ETI by mid-May 2006. On May 9, Congress repealed the ETI transition rules as part of the Tax Increase Prevention and Reconciliation Act (P.L. 109-222), thus apparently ending the controversy.

⁴⁷ Alison Bennett, "Extraterritorial Income: Transition, Grandfather Relief in Export Bill Reasonable, Finance Democratic Memo Says," *BNA Daily Tax Report*, Oct. 27, 2004, p. G-8.