1 ANNEX I

1.1 Text of Annex I

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ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

(a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

(b) Currency retention schemes or any similar practices which involve a bon.3 (r51N Tc 0.005 Tw ((i)-e)-

advantages bestowed on competing products from another Member.[4] Regarding items (e) to (i), the Panel stated that "there is no hint that a tax advantage would not constitute an export subsidy simply because it reduced the exporter's tax burden to a level comparable to that of foreign competitors."[5]

1.5 Footnote 59 of Item (e)

1.5.1 Fifth Sentence: "double taxation of foreign source-income"

1.5.1.1 Scope of application

4. In the context of footnote 59, the Appellate Body in *US – FSC (Article 21.5 – EC)*, considered that the fifth sentence of footnote 59 applies to measures taken by a Member to avoid taxation of income earned by a taxpayer of that Member in a foreign state:

> "'[D]ouble taxation' occurs when the same income, in the hands of the same taxpayer, is liable to tax in different States. The fifth sentence of footnote 59 applies to a measure taken by a Member to avoid such double taxation of 'foreign-source income'. In examining the phrase 'foreign-source income', we observe that, in ordinary usage, the word 'source' can refer to the place where a thing originates, and that the words 'source' and 'origin' can be synonyms. We consider, therefore, that the word 'source', in the context of the fifth sentence of footnote 59, has a meaning akin to 'origin' and refers to the place where the income is earned. This reading is supported by the combination of the words 'foreign' and 'source' as 'foreign' also refers to the place where the income is earned. Used in this way, the word 'foreign' indicates a source which is external to the Member adopting the measure at stake. Footnote 59, therefore, applies to measures taken by a Member to avoid the double taxation of income earned by a taxpayer of that Member in a 'foreign' State."[6]

1.5.1.2 Scope of discretion to avoid double taxation

5. The Appellate Body in *US – FSC* considered that Members have a discretion to avoid double taxation:

> "[I]t is 'implicit' in the requirement to use the arm's length principle that Members of the WTO are not obliged to tax foreign-source income, and also that Members may tax such income less than they tax domestic-source income. We would add that, even in the absence of footnote 59, Members of the WTO are *not* obliged, by WTO rules, to tax *any* categories of income, whether foreign- or domestic-source income. The United States argues that, since there is no requirement to tax export related foreign-source income, a government cannot be said to have 'foregone' revenue if it elects not to tax that income. It seems to us that, taken to its logical conclusion, this argument by the United States would mean that there could *never* be a foregoing of revenue 'otherwise due' because, in principle, under WTO law generally, *no* revenues are ever due and *no* revenue would, in this view, ever be 'foregone'. That cannot be the appropriate implication to draw from the requirement to use the arm's length principle."[7]

6. The Appellate Body in *US – FSC (Article 21.5 – EC)*, noted that Members have the authority to determine their rules of taxation, provided they comply with WTO obligations. The Appellate Body upheld the Panel's findings that footnote 59 does not require Members to adopt particular legal standards to define when income is foreign-source for the purposes of their double taxation--

footnote 59 must grant relief from *all* double tax burdens. Rather, Members retain the sovereign authority t

"[I]n the absence of an established link between the income of such taxpayers and their activities in a 'foreign' State, we do not believe that there is 'foreign-source income' within the meaning of footnote 59 of the *SCM Agreement*.

… In our view, however, sales income cannot be regarded as 'foreign-source income',

The fifth sentence of footnote 59 provides that item (e) 'is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member.' In the (

losses. An analysis under item (j) may examine both retrospective data relating to a programme's historical performance and projections of its future performance. Evidence concerning a programme's structure, design, and operation may be relevant in situations where financial data is not available. It may also serve as a supplementary means for assessing the adequacy of premiums where relevant data are available."[24]

1.6.2 The definition of the terms

1.6.2.1 "export credit guarantee ... programmes"

17. The Panel in *US – Upland Cotton* declined to read caveats or conditions into the text of item (j), and rejected the position of the United States that the nature of US export credit guarantee programmes called for a cohort-specific examination by the Panel under item (j):

"We see no explicit reference to the term 'cohort' in the text of item (j). Nor do we read any caveat or condition in the text of item (j) which would require us to await the closure of any or all United States export credit guarantee cohorts before being able to conduct an objective assessment of the matter before us. Our task is not to ita56 UPduraUpsp9Uof

field of export credit terms", would not be prohibited export subsidies within the meaning of Article 3.1(a). The Appellate Body in *Brazil – Aircraft* did not follow the Panels' findings to the

practice the *OECD Arrangement* is at present the only international undertaking that fits this description. Thus, we understand the essence of the second paragraph of item (k) at least at present to be that 'an export credit practice' which is in 'conformity' with 'the interest rates provisions' of the *OECD Arrangement* 'shall not be considered an export subsidy prohibited by' the SCM Agreement".[69]

1.7.6 "a successor undertaking"

) 39. In *Brazil – Aircraft (Article 21.5 – Ci26gTTBTw 1.92 0Td[an)-6T-4( )-26irre s mh ( )-26i tA dud*

and, as such, is currently in effect, whereas the 1992 *OECD Arrangement* is no longer in effect. This raises the question of which successor undertaking is the *relevant* successor undertaking if there is more than one. The text of the second paragraph of item (k) does not explicitly answer that question.[73]

We consider that the relevant successor undertaking is the *most recent* successor undertaking which has been adopted. It would not, in our view, have been rational for the drafters to consider, *without specifying so*, that, say, the fifth successor undertaking should be the relevant one. Indeed, the fact that the drafters used the simple and unqualified term 'a successor undertaking' strongly suggests to us that they intended to incorporate, and thus give effect to, the relevant provisions of *all* adopted successor undertakings. This, however, would not logically be possible, unless effect is given also to the changes introduced by the most recent successor undertaking. On that basis, we find that, in the absence of other textual directives, the most recent successor undertaking is the relevant benchmark undertaking for purposes of the second paragraph of item (k), subject to the one condition that it must have been adopted.

> qualify an export credit practice for the safe haven in the second paragraph of item (k)."[77]

42. As regards the discussion on whether the relevant successor undertaking to the 1979 OECD Arrangement was the 1992 or 1998 version, see paragraphs 39-40.

1.7.8 "export credit practice"

43. In the context of Canada's defence under the second paragraph of item (k), the Panel in *Canada – Aircraft (Article 21.5 – Brazil)* considered that the phrase "export credit practice", must, in its ordinary meaning, be a relatively broad term.[78] The Panel continued:

> "[T]his term on its own suggests any practices that might be associated in some way with export credits (i.e., export financing). This certainly would involve export credits as such, but presumably other sorts of practices as well. The first paragraph of item (k) provides useful context in this regard. In particular, we note that the first paragraph refers exclusively to 'export credits' and 'credits', in contrast to the second paragraph's reference to 'export credit practices'. This supports the conclusion that the

1.7.9.2.2 "Concept of conformity" under the OECD Arrangement

50. The Panel in *Canada – Aircraft (Article 21.5 – Brazil)* considered that the text of the OECD Arrangement provides the following guidance on how the term "conformity" should be understood:

> "In the first place, the *Arrangement* text provides explicitly that derogations from provisions of the *Arrangement*, and the matching of such derogations, do not 'conform' with the provisions of the *Arrangement*. Thus, any transaction that involves derogations or matching of derogations by definition cannot be in conformity with the *interest rate provisions* of the *Arrangement*, as … conformity with the interest rate provisions requires conformity not just with the minimum interest rate rule but also with the other provisions that support/reinforce that rule. As such, an otherwise eligible transaction involving derogations or matching of derogations could not qualify for the safe haven of the second paragraph of item (k). On the other hand, the *Arrangement* explicitly defines permitted exceptions and the matching of permitted exceptions, within the allowed limits, to be in compliance, i.e., in conformity with the relevant provisions of the *Arrangement*. Therefore, … making use of permitted exceptions, within the specified limits, would not disqualify an eligible transaction from the safe haven, so long as the transaction conformed with the minimum interest rate and all of the other applicable disciplines."[88]

51. The Panel in *Canada – Aircraft (Article 21.5 – Brazil)* found that the Canadian Policy Guideline did not qualify for the "safe haven" under the second paragraph of item (k) of the Illustrative List. The Panel first held that it was "incumbent upon Canada to provide an explanation not only of what in its view constituted conformity with the interest rate provisions of the *OECD Arrangement*, but also how the Policy Guideline ensured such conformity."[89] The Panel then turned to the Policy Guideline and found:

> "[E]ven if the Policy Guideline contained all of the details that Canada has provided in its arguments concerning 'conformity' with the 'interest rates provisions' of the *Arrangement*, we would find on substantive grounds that it would not ensure that future Canada Account transactions would so conform. We note, however, that in fact the Policy Guideline contains no details at all, but simply indicates that transactions that 'do not comply' with 'the OECD Arrangement' will not be considered to be in the national interest. Thus, we find that the Policy Guideline is insufficient to accomplish what Canada says it will accomplish, namely to 'ensure that any future Canada Account financing transactions will be in conformity with the interest rate provisions of the [OECD] Arrangement and therefore the provisions referred to in the second para1 (t15.4 (nts)7 (a)7 (r)4.0 Td[(i5.1717.653 13.Tj)]TJ50.004 T4 1.627 0 o.4 (ef)112.4 1 (n).3 (d)2.- (r

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violation. As is clear from relevant WTO jurisprudence, the burden of establishing an affirmative defence rests with the party raising it.[95]" [96]

1.7.12 "Matching of a derogation"

1.7.12.1 General

56. The Panel in *Canada – Aircraft (Article 21.5 – Brazil)* considered that:

> "Member's conformity with GATT/WTO rules [should not be] defined by the behaviour of non-Members', the Panel considered that this concern would arise even if the inclusion of the matching of a derogation in the item (k) safe haven would mean that matching Members were acting in accordance with their WTO obligations. This is because the inclusion of the matching of a derogation in the item (k) safe haven would not establish any objective benchmark against which to determine whether or not a Member is in accordance with its WTO obligations. In any given case, the benchmark would be set by reference to the terms and conditions of the non-conforming offer. To the extent that the non-conforming offer were made by a non-WTO Member, the benchmark for determining whether or not a matching Member acts in accordance with its WTO obligations would therefore be the non-conforming terms and conditions offered by the non-Member. Thus, the fact that the matching of a derogation is included in the second paragraph of item (k) would not remove the potential for a 'Member's conformity with GATT/WTO rules [to be] defined by the behaviour of non-Members".[97]

57. The Panel in *Canada – Aircraft Credits and Guarantees* concluded that, as a matter of law, the matching of a derogation is not "in conformity with" the interest rates provisions of the OECD Arrangement and therefore cannot fall within the scope of the item (k) safe haven.[98] The Panel held:

> "Indeed, if one were to accept that the matching of a derogation could fall within the item (k) safe haven, one would effectively be accepting that a Member could be 'in conformity with' the 'interest rates provisions' of the *OECD Arrangement* even though that Member failed to respect the CIRR (or a permitted exception). In our view, such an interpretation would be unjustified."[99]

58. For the Panel in *Canada – Aircraft Credits and Guarantees*, the fact that the OECD Arrangement allows matching of derogations, or the *fact* that participants' view matching of derogations as a means of disciplining export credits, does not necessarily mean that the SCM Agreement should allow matching of derogations. The Panel considered that unlike the OECD Arrangement, the SCM Agreement is not an "informal" "gentleman's agreement". The SCM Agreement therefore does not need to allow recourse to the matching of derogations in order to instil discipline. The SCM Agreement is a binding instrument, and is therefore enforceable

> "[T]he fact that the *OECD Arrangement* allows matching of derogations does not logically imply that it should also be allowed under the *SCM Agreement.* Indeed, the *OECD Arrangement* and the *SCM Agreement* are very different … In those circumstances, matching may serve an important deterrent and enforcement function and that rationale for matching does not apply to the *SCM Agreement* because the *SCM Agreement* is a binding instrument, and it is enforceable through the WTO dispute settlement mechanism."[101]

1.7.12.2 Burden of proof in the framework of a derogation

60. The Panel in *Canada – Aircraft Credits and Guarantees* considered that the transaction under consideration could not be justified under the safe haven and that consequently such financing is a prohibited export subsid3 (t)]TJ06 Tc(he)04 Tw Tw 5.549i614 (m)5.74 (m)5.74 (m)5.3 (tioTc(he)

We have stated above that the Member invoking an exception as an affirmative defence has the burden of esta