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1 ANNEX I I

1.1 Text of Annex II

ANNEX I I

GUIDELINES ON CONSUMPTION OF INPUTS IN THE PRODUCTION PROCESS <sup>1</sup>

I

1. Indirect tax rebate schemes can allow for exemption, remission or deferral of prior -stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported product (making normal allowance for waste). Similarly, drawback schemes can allow for the remission or drawback of import charges levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).

2. The Illustrative List of Export Subsidies in Annex I of this Agreement makes reference to the term "inputs that are consumed in the production of the exported product" in paragraphs (h) and (i). Pursuant to paragraph (i). Pursuant to paragraph (i) also provides for substitution, where appropriate.

II

In examining whether inputs are consumed in the production of the exported product, as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. Where it is alleged that an indirect tax rebate scheme, or a drawback scheme, conveys a subsidy by reason of over-rebate or excess drawback of indirect taxes or import charges on inputs consumed in the production of the exported product, the investigating authorities should first determine whether the government of the exporting Member has in place and applies a system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the system or procedure to see whether it is reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. The investigating authorities may deem it necessary to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the system or procedure is being effectively applied.

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<sup>1</sup> Inputs consumed in the production process are inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product.

2. Where there is no such system or procedure, where it is not reasonable, or where it is instituted and considered reasonable but is found not to be applied or not to be applied effectively, a further examination by the exporting Member based on the actual inputs involved would need to be carried out in the context of determining whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 1.

3. Investigating authorities should treat inputs as physically incorporated if such inputs are used in the production process and are physically present in the product exported. The Members note that an input need not be present in the final product in the same form in which it entered the production process.

4. In determining the amount of a particular input that is consumed in the production of the exported product, a "normal allowance for waste" should be taken into account, and such waste should be treated as consumed in the production of the exported product. The term "waste" refers to that portion of a given input which does not serve an independent function in the production process, is not consumed in the production of the exported product (for reasons such as inefficiencies) and is not recovered, used or sold by the same manufacturer.

5. The investigating authority's determination of whether the claimed allowance for waste is "normal" should take into account the production process, the average experience of the industry in the country of export, and other technical factors, as appropriate. The investigating authority should bear in mind that an important question is whether the authorities in the exporting Member have reasonably calculated the amount of waste, when such an amount is intended to be included in the tax or duty rebate or remission.

## 1.2 General

1. In explaining the relevance of Annex II to the SCM Agreement outside the context of countervailing duty investigations, the Panel in *India – Export Related Measures* pointed out that :

"Next, footnote 1 must also be read 'in accordance with' Annex II to the SCM Agreement. Annex II sets forth 'Guidelines on Consumption of Inputs in the Production Process'. As Annex II itself recalls, both items (h) and (i) in Annex I refer to 'inputs that are consumed in the production of the exported product', and the Guidelines in Annex II relate to the examination, for that purpose, of 'whether inputs are consumed in the production of the exported product'.

Part II of these Guidelines is expressly directed at this examination 'as part of a countervailing duty investigation'.

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