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Zenith Radio Corp. v. United States: Countervailing Duty - Application to Nonexcessive Remission of Indirect Taxes

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I. PUBLIC INTERNATIONAL TRADE LAW

A. Regulation of Imports and Exports

COUNTERVAILING DUTY – TREASURY PRACTICE OF NOT COUNTERVAILING THE NONEXCESSIVE REMISSION OF INDIRECT TAXES IS A LAWFULLY PERMISSIBLE INTERPRETATION OF THE U.S. COUNTERVAILING DUTY LAW, § 303 OF THE TARIFF ACT OF 1930, AS AMENDED.

Zenith Radio Corp. v. United States, 437 U.S. 443 (1978).

On April 3, 1970, Zenith Radio Corporation[1] filed a petition[2] with the Commissioner of Customs[3] alleging that the government of Japan paid or bestowed bounties or grants directly or indirectly, upon the manufacture or production of certain consumer electronic products from that country.[4] Included among the alleged bounties or grants was the "forgiveness"[5] by the Japanese of a commodity tax upon the exportation of such products from Japan.[6]

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1. Zenith Radio Corporation is a U.S. corporation engaged in the manufacture of various consumer electronic products including the following: television receivers, radio receivers, radio-phonograph-television combinations, record players and phonographs complete with amplifiers and speakers, tape recorders and color television picture tubes.

2. The petition was filed pursuant to 19 U.S.C. § 1303, § 303 Tariff Act of 1930, as amended [hereinafter cited as 1930 Tariff Act].

3. Although section 303 of the 1930 Tariff Act imposes the burden of making countervailing duty determinations upon the Secretary of the Treasury, regulations in 19 CFR § 16.24(b) (1970) (now 19 CFR § 159.47(b) (1976)), require communication with the Commissioner of Customs.

4. The products include: television receivers, radio receivers, radio-phonograph-television combinations, radio-tape recorder combinations, tape players, tape recorders, record players and phonographs complete with amplifiers and speakers, and parts of television receivers: color picture tubes, resisters and tuners. 37 Fed. Reg. 10,087 (1972), as amended 37 Fed. Reg. 11,487 (1972).

5. Japanese Commodity Tax Law, March 31, 1962, Law No. 48, as revised.

6. The term "forgiveness" was used by Zenith in its appelate briefs. This term encompasses both the remission of taxes already paid and the exemption from taxation when goods are exported. The Court of Customs and Patent Appeals and the Supreme Court chose to use the word "remission" to describe this same phenomenon. That word will hereinafter be implemented.

On January 7, 1976[7] a "Final Negative Countervailing Duty Determination" in the case of "Certain Consumer Electronic Products from Japan," issued by the Acting Commsioner of Customs and approved by the Acting Assistant Secretary of the Treasury, was published in the Federal Register.[8] Zenith then filed timely notice of its desire to contest the Secretary's negative determination.[9] Zenith filed the complaint in Customs Court on April 12, 1976, and the Court assigned a three-judge panel to hear the case.[10] The sole issue facing the Customs Court was whether the remission of the Japanese commodity tax constituted a bounty or grant under the U.S. countervailing duty statute.[11]

In separate but concurring opinions the three-judge Customs Court granted Zenith's motion for summary judgment having determined that the remission of the tax constituted the conferring of a "bounty of grant."[12] On appeal the Court of Customs and Patent Appeals reversed.[13] The Supreme Court granted certiorari and subsequently affirmed the CCPA's decision unanimously.[14]

The High Court's reasoning was rather simple. The countervailing duty law currently in force is, in all relevant aspects, unchanged from the countervailing duty statute enacted by Congress in 1877.[15] In 1898 the Treasury Department determined that the statute did not require

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7. As of January 3, 1975, the date of the enactment of the Trade Act of 1974, 5 U.S.C. §§5312, 5314-16, 19 U.S.C. §§160 et seq. (1976), the Treasury Department had still not rendered a decision in this matter. Section 331(a) of the Trade Act amended the countervailing duty statute to, among other things, require that the Secretary of the Treasury make a final determination within twelve months of the date on which a petition is filed. Section 331(d)(2) of the Trade Act provided, in effect, that with respect to investigations in progress on the date of enactment of the Trade Act, a final determination would have to be made wphin twelve months of the day after the date of enactment.

8. This determination stated that "a final determination is hereby made in this proceeding, that . . . no bounty or grant is being paid or bestowed, directly or indirectly, within the meaning of section 303, Tariff Act of 1930, as amended (19 U.S.C. §1303), upon the manufacturer [sic], production, or exportation of certain consumer electronic products from Japan." 41 Fed. Reg. 1298 (1976).

9. Pursuant to 19 U.S.C. 1516(d) any domestic manufacturer of merchandise of the same class or kind as the merchandise which was the subject of the Secretary's decision, may, within 30 days, file notice of its desire to contest the negative decision.

10. Three-judge panels are only selected for cases which are deemed to be of special significance. 28 U.S.C. 225(a) (1976).

11. 19 U.S.C. §1303 (1976).

12. 430 F. Supp. 242 (Cust. Ct. 1977).

13. The reversal came in a 3-2 decision with both sides putting forth extensive and forceful arguments, 562 F.2d 1209 (C.C.P.A. 1977).

14. 437 U.S. 443 (1978).

15. *Id.* at 448.

countervailance of nonexcessive remissions of indirect taxes.[16] Neither Congress nor the Supreme Court has spoken definitely with respect to that point up to the present time. Consequently, that interpretation is as valid today as it was in 1898.[17]

Zenith provided the Supreme Court with an opportunity to review the eighty-year old interpretation of the U.S. countervailing duty law in light of the tremendous changes which have taken place in the world's tax systems.[18] Unfortunately the Court's decision provides little in the way of critical reevaluation. Even more importantly the decision renders American businesses more vulnerable both at home and abroad.

The Court has caused problems of immediate significance by its use of the term "indirect" when referring to taxes.[19] The Court of Customs and Patent Appeals carefully limited its discussion to excise taxes.[20] The proper treatment to be afforded that particular type of tax was the issue raised by the facts in *Zenith* and the CCPA restricted its holding accordingly. To understand the problem created by the Court's treatment of the term "indirect" it is necessary to examine the word's origin and the significance which it carries in the context of international trade.

The phrase "indirect tax" is believed to be as old as taxation itself. By the eighteenth century some economists believed that all taxes could be divided into two groups — indirect and direct. The key distinction to be made was who bore the ultimate burden of a particular tax. If the person rendering the payment also bore the burden, the tax was considered direct. If the person rendering payment passed the burden on to at least one person the tax was considered indirect.[21]

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16. *Id.* at 450.

17. *Id.* at 457.

18. In the United States, for example, customs and excise taxes, which have traditionally been classified as indirect taxes, made up 79.1% of the Federal Revenue in 1898. In 1976 they only accounted for 7.7%. Similar, though perhaps less dramatic, changes have occurred in other developed countries. Source for U.S. statistics: U.S. BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES, COLONIAL TIMES TO 1970, Table Series Y, 567–89 and 1121 (1976) and U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES, Table 10.407, 268 (1977).

19. The court used the term eighteen times in its opinion, often without clarification, examples or references to the case at bar.

20. 562 F.2d at 1212. The court there further specified that at times the parties had referred to it as a "commodity" and "consumption" tax as well as an "excise" tax. *Id.* n.7.

21. "[T]axes are either direct or indirect. A direct tax is one which is demanded from the very persons, who it is intended or desired, should pay it. Indirect taxes are those which are demanded from one person in the expectation that he shall indemnify himself at the expense of another, such as the excise or customs." J. MILL, PRINCIPLES OF POLITICAL ECONOMY 823 (P. Ashley ed. 1936).

Relying on this deceptively simple distinction governments began giving different treatment to the two categories of taxes in the area of countervailing duties. While most states felt that domestic policies which gave an unfair impetus to exportation caused an improper distortion of international trade, the remission by the government of indirect taxes upon the exportation of domestically-produced goods, was considered a permissible and non-distorting practice.

The United States formally embraced this philosophy in 1898.[22] The theory underlying this practice, which Marshall found "intuitively appealing," maintained that each country should only collect those indirect taxes which arose from purchases made within that country. A minor flaw in the theory as it applies to modern conditions results from the development of new and very complex methods of assessing taxes. These developments have caused the once easy-to-draw line between direct and indirect[23] to become blurred. The more serious flaw is found in the theory's inability to recognize the fact that a portion of a direct tax burden may be passed on to consumers, while some indirect taxes may just as easily be absorbed by a manufacturer or middleman.[24]

The global importance of this archaic theory remains quite substantial even in today's international marketplace. The theory was solidified in the General Agreement on Tariffs and Trade (GATT)[25] and has been vigorously defended up to the present time. In the United States, the Treasury Department relies on this theory in making its decision of whether or not to countervail against remitted taxes in the entire decision. The attempt is contained in the second paragraph of the opinion where Justice Marshall said for the Court, "[T]he electronic products at issue here, are subject to an "indirect" tax — a tax levied on the goods themselves and computed as a percentage of the manufacturer's sale price rather than the income or wealth of the purchaser or seller."[26]

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22. *See* T.D. 19321, 1. TREAS. DEC. 696, (1898); T.D. 19729, 2 TREAS DEC. 157, (1898); T.D. 20407, 2 TREAS. DEC. 996, (1898).

23. Since the turn of the century no fewer than twenty-seven different methods of calculating and assessing taxes have been introduced. One of the most complicated which is currently being scrutinized by the Treasury Department is the Cascade turnover tax. *See Treasury May Reverse Stance on Countervailing Duties,* J. of Com., Dec. 5, 1978, at 3, col. 4.

24. The occurrence of such shifting is supported by what some have characterized as an empirical view of the marketplace. *See* comment, *The Steel Products Decision: An Inquiry into the Treatment of the Value-Added Tax Under the Countervailing Duty Law.* 9 VAND. J. TRANSNAT'L L. 842 (1976).

25. General Agreement on Tariffs and Trade, October 30, 1947, 61 Stat. A 3, T.I.A.S. No. 1700, 55 U.N.T.S. 194 [hereinafter cited as GATT].

26. 437 U.S. at 446.

This quasi-definition is susceptible to only two interpretations. First, indirect taxes must be computed as a percentage of the manufacturer's sales price (hereinafter referred to as type A taxes). Second, indirect taxes are all those taxes which are not computed as a percentage of the purchaser's or seller's income (hereinafter referred to as tupe B taxes). The former definition is unacceptable because it would exclude a host of taxes which are universally considered to be indirect. Included in this group would be those computed on a per-unit basis such as liquor taxes and those computed as a percentage of the retail price as retail sales taxes.

It follows, therefore, that the definition intended by the Court was the latter alternative. The Court has created a serious problem, however, by, in effect, stating that all taxes which are not type A are therefore indirect. Given this new system of tax treatment, foreign governments need only style their taxes so as to fall outside of type A. In so doing the governments can attempt to insure that their taxes are deemed to be indirect.

The High Court's quasi-definition greatly expands the field of taxes which may be classified "indirect." If the Treasury Department chooses to agree with this expansion it can abstain from imposing countervailing duties for the remission of many taxes by foreign countries who are exporting goods to the United States.

The Court compounded this problem by refusing to seriously discuss the questions of interpretation and application which currently arise so as to provide some guidance for future judicial decisions.[27] The failure to address these questions is perhaps the greatest shortcoming of the decision for the Supreme Court is the body which is charged with putting ambiguous wording into concrete form while at the same time determining the role which specific legislation is to play within the U.S. judicial system.

At first glance the Court's decision appears to be merely a vote of support for the Treasury's policy. On a second level the decision represents an abdication of judicial authority to review a substantial portion of the Secretary's activities. This may succeed in giving the executive branch "a more effective weapon in trade negotiations," however, the immediate effects could well be manifested in an undermin-

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27. Zenith was the first domestic manufacturer to protest a "negative determination" pursuant to the amendments contained in the 1974 Trade Act. (*See supra* note 9). Other business concerns followed and it can be expected that many more contests will ensue in the future when U.S. businesses disagree with Treasury's findings.

ing of the countervailing duty law's ability to protect domestic industries.[28]

With this decision the judiciary has become the second branch of the federal government to abdicate its responsibility. Congress has pursued a "hands-off" policy with respect to the key terms of the countervailing duty law for over twenty-five years.[29]

United States manufacturers are experiencing critical problems competing in the international market. The differential treatment goods receive as a result of differing tax programs may have a strong influence on these problems.[30] The United States enacted a countervailing duty law because it was aware that some governments would be willing to sacrifice revenues in return for increased employment and growth of domestic industries. That willingness is as strong today as it was in 1897.[31] The techniques used by foreign governments to carry out this policy have become more sophisticated. Restructuring and redefining taxes so that they could be classified as "indirect" and qualified for remission upon exportation is one such technique. This method has an added advantage in that not only do goods flow from the country with a decreased tax burden but goods which U.S. exporters attempt to ship into that country face an increased border tax adjustment due to the higher "indirect" taxes. That nation's manufacturers are thus twice blessed.[32]

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28. Decisions of the Secretary will still be subject to judicial review in the Customs Court, and the findings must be supported by substantial evidence. Energetic Worsted Corp. v. United States, 53 C.C.P.A. 36 (1966). However in the wake of the *Zenith* decision the Secretary will be able to argue more easily that a given tax falls within the Supreme Court's broad definition of indirect. One commentator has contended that a stronger challenge may be mounted against a Treasury decision because of the provisions of the Administrative Procedure Act. *See* Butler, *Countervailing Duties and Export Subsidization: Re-emerging Issue in International Trade.* 9 VA. J. INT'L. L. 82, 102 (1968) (hereinafter cited as Butler).

29. In 1950 a bill was drafted which would have codified Treasury's practice by amending the U.S. law to preclude countervailence of nonexcessive remissions of indirect taxes. That bill was not enacted into law. *See Hearings on H.R. 5505 Before the Senate Comm. on Finance* 82d Cong., 2d Sess. 2, 115, 124-125 (1952). Since that time the issue was raised on four other occasions all with the same result — no change in the basic terms of the law. In preparing the Trade Act of 1974 Congress considered one amendment which would have effectively countermanded Treasury's practice and another designed to codify that practice. Congress refused to enact either provision. *See Hearings on H.R. 6767 Before the House Comm. on Ways and Means,* 93d Cong., 1st Sess. 2169-71, 2496-500, 3097, 3814-15 and 2244-46, 2419, 2421, 5126-30 (1973).

30. Butler, *supra* note 28, at 112.

31. *See* O'Neill, *United States Countervailing Duty Law: Renewed, Revamped and Revisited Trade Act of 1974,* 17 B.C. IND. & COM. L.R. 832 (1976).

32. It was thought at one time that the effects of such differential tax policies were offset by changes in exchange rates and price levels within individual

To date the United States has not followed the majority of the developed nations in shifting its dependence to excise and value-added as opposed to income taxes. Such a change, however, has not been without support.[33] In the wake of *Zenith,* U.S. policy makers must squarely face the problems caused by the existence of different tax systems in the world marketplace. Had the Customs Court decision been affirmed, reaction on the part of Congress would have been swift. But because the Supreme Court has reestablished the longstanding practice there is a danger that the legislature might return to its semi-conscious state. Moreover, even if several members of Congress to decide to try to amend the countervailing duty law, the legislative process is always long and often uncertain.

Several avenues still remain open for the Secretary of the Treasury, should be decide to move against certain tax remissions by foreign exporting nations. In *Zenith* the Court held only that the Secretary's policy was a reasonable one, not that it was *the only* reasonable one. Consequently the Secretary is free to discard the historical distinction between direct and indirect taxes. There is certainly enough support for this change in policy from leading economists on both sides of the Atlantic.[34] Support can also be drawn from a more careful analysis of the effects which taxes of whatever stripe have on profits and thus on the flow of investment capital in the world marketplace. The archaic concept of consciously "shifting a tax" or not "shifting a tax" is only workable in situations involving a monopoly. Where competition exists the price which one may charge is determined by market forces. The extent to which a seller can "shift" the cost incurred in paying a tax depends entirely on the strength of that seller in the marketplace and not on the

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countries. Two problems exist with this principle: first, these adjustments in exchange rates and price levels occur very slowly; and second, these adjustments only restore the original compartive advantage when the domestic indirect tax rate is applied uniformly to all products. When there is uneven application then goods which are taxed more heavily at home than others still benefit from a remission upon exportation. *See* Butler, *supra* note 28, at 114 and *Destination Principle Border Tax Adjustments for the Corporate Income and Social Security Taxes* prepared by the Office of Tax Analysis, U.S. Treasury Department (December, 1976).

33. Former Secretary of the Treasury, Connally, spoke quite clearly on this subject when he said: "[T]he time has come for us to either demand the same treatment for direct taxes, or to play their game and insist that their value-added tax be treated the same as our direct taxes or that in any future tax measures, that we consider the possibility of adopting the value-added tax." *Hearings of Subcommittee on International Trade of the Senate Committee on Finance,* 92d Congress, 1st Sess. 45 (1971).

34. The Supreme Court gave token recognition to this body of opinion. 437 U.S. at 459.

nature of the tax itself. Thus, it is unimportant whether a manufacturer is assessed a profits tax or an excise tax. The manufacturer will still demand the highest price he can obtain. What is important, however, is the treatment which nations give to those two types of taxes in the area of international trade.

If, for various reasons, one nation favors excise taxes and another profits taxes and neither country remits taxes upon the exportation of taxed goods then neither country will have given its manufacturers an advantage. If, however, one nation remits all excise taxes when a domestic manufacturer's goods are exported and the importing nation does not impose an equivalent or higher excise tax, then that manufacturer will obtain a higher profit than it would have otherwise. Moreover, if the nation which favors profits taxes is not allowed to remit taxes upon exportation of goods and importing nations still impose their local excise taxes then the manufacturer will make less profit. This is the way U.S. manufacturers are currently being detrimentally affected by world tax policies.

The U.S. government has decided to impose a much higher profits tax on corporations and a much lower excise and value-added tax burden than most other developed nations.[35] Global policy currently permits remission of the latter two taxes but not of the former.[36] Foreign goods flow into the United States minus their excise and value-added tax burden but are not met with equivalent American-imposed burdens. Consequently profits are higher for those manufacturers. Similarly, U.S. goods flow from the United States still carrying their considerable profits tax burden and then are met with further impediments in the form of foreign excise and value-added taxes.[37] Obviously, profits are lower for those manufacturers.

The solution to this problem is that no taxes should be remitted. If the underlying theory for remitting consumption taxes was based on the belief that such taxes should only be exacted once, then a new definition of consumption tax is needed. That definition which is easiest to apply would only include those taxes imposed and paid at the point of consumption. That is the only tax which is clearly and entirely paid by

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35. *See* S. CNOSSEN, EXCISE SYSTEMS: A GLOBAL STUDY OF THE SELECTIVE TAXATION OF GOODS AND SERVICES (1977); Butler, *supra* note 28, at 112.

36. The practice is embodied in the GATT (art. V) and followed by all of the developed nations.

37. *See* Feller, *Mutiny Against the Bounty: An Examination of Subsidies, Border Tax Adjustments, and the Resurgence of the Countervailing Duty Law*, 1 LAW & POL. INT'L. BUS. 17 (1969) [hereinafter cited as Feller]. *See also* Butler, *supra* note 28, at 112.

the consumer. All other taxes — excise, value-added, profits, and others, may ultimately be paid in whole or in part by the consumer but it is impossible to ascertain the extent to which that occurs in any given transaction. Therefore, to arbitrarily remit all of one type of tax and none of another unfairly prejudices manufacturers in one system and benefits those in another.

Should the Treasury Department decide to scrap the traditional distinction between direct and indirect taxes, decisions to countervail instances of tax remission could be made on a principled basis by looking to the specific intent of the countervailing duty law.[38] Other GATT participants as well as non-GATT trading partners might well react adversely to such a shift in policy.[39] The Secretary is not, however, restricted by the GATT rules on countervailing duties[40] and the terms of the U.S. countervailing duty law are certainly broad enough to permit such action.[41] Such a policy would have the added advantage of permitting the executive branch to grant special treatment for lesser developed countries on a case-by-case basis.[42]

A second approach which the Secretary has available is to treat both income and commodity taxes as though they were passed on to the

38. That is, decisions to countervail should be made so as to further the purpose of the law. For a discussion of this approach to enforcement of the countervailing duty law *see* Note, *United States v. Zenith Radio Corp.*, 13 TEX. INT'L. L. J. 95, 107-11 (1978).

39. In fact the Supreme Court based its decision in part upon a perceived need for the United States to refrain from upsetting other nations' "reliance interests." 437 U.S. at 457. If the Treasury Department's interpretation of the law is improper, any such reliance interests are not entitled to protection. *See* Note, *The Countervailing Duty Law after Zenith: Unanimity Can be Beguiling*, 18 VA. J. INT'L L. 245, 265-67 (1978). In any event analysis of other nations' reliance is irrelevant when attempting to ascertain the correct interpretation which U.S. courts should grant a piece of U.S. legislation.

40. Under the terms of the protocol by which the United States ratified the GATT, all preexisting U.S. laws were to remain in effect. This "grandfather" clause allows the United States to apply its much stricter countervailing duty provisions despite its status as a GATT trading partner. *See* Protocol of Provisional Application of the GATT, Oct. 30, 1947, 61 Stat. A2051, T.I.A.S. No. 1700, 55 U.N.T.S. 308.

41. As the Supreme Court noted in Nicholas & Co. v. United States, 249 U.S. 34 (1919), "If the word 'bounty' has a limited sense the word 'grant' has not. A word of broader significance than 'grant' could not have been used." *Id.* at 39.

42. Such flexibility has been asked for by South American commentators. *See* Smith, *Export Subsidies of the Carribbean Basin and a Proposed Revision of International Rules Regarding Countervailing Duties*, 4 INT'L. TRADE L. J. 124 (1978).

consumer and compute a tax burden for every item that is produced.[43] Thus imports would be met with a border tax adjustment which reflected U.S. excise and income taxes. At the same time U.S. exports would be exempted from both types of taxes. Such a plan would be hailed by American manufacturers despite the complexity of the mathematical formulations. The reception abroad would of course, be less enthusiastic.

The Secretary could also pursue a more aggressive policy of questioning not only the amount of money a country is remitting but also the exact nature of each tax, payment of which is remitted upon exportation.[44]

Whatever course the Secretary chooses, long-term solutions can only result from international dialogue and agreement. Perhaps by adopting a more forceful policy now, the United States can hasten the arrival of that occasion.

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43. As mentioned *supra* note 24, this position is defensible under modern economic theory.

44. This is precisely the type of inquiry which resulted in the decision to countervail American Express Co. v. United States, 472 F.2d 1050 (C.C.P.A. 1973). The driving force behind the Treasury investigation was a very concerned United States steel producers organization.