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# The GATT Panel Report on Domestic International Sales Corporations: Illegal Subsidy Under the GATT



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# THE GATT PANEL REPORT ON DOMESTIC INTERNATIONAL SALES CORPORATIONS: ILLEGAL SUBSIDY UNDER THE GATT

The trade distortive effects of four nations' tax practices were recently studied[1] by a panel of experts (the Panel)[2] of the General Agreement on Tariffs and Trade (GATT).[3] The Panel reported that the Domestic International Sales Corporation (DISC) provisions of the United States Internal Revenue Code (the Code)[4] create an export subsidy incompatible with Article XVI of the GATT. In particular, the Panel determined that thdisc legislation confers tax benefits upon domestic exporters which serve to increase exports by attracting more resources to export activity. Such benefits were found to constitute an export subsidy which nullifies or impairs benefits that other contracting parties are entitled to expect under the GATT.[5]

*Description of the DISC Program*

The DISC provisions were created by the Revenue Act of 1971[6] with the aim of stimulating the exportation of American goods. Before the advent of the DISC legislation, it was felt that the tax structure as it then existed contributed to the United States balance-of-payments deficit by encouraging domestic corpora-

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1. UNITED STATES TAX LEGISLATION (DISC), *Report of the Panel,* GATT DOC. L/4422 (2 November 1976) [hereinafter cited as *Panel Report*]; INCOME TAX PRACTICES MAINTAINED BY FRANCE, *Report of the Panel,* GATT DOC. L/4423 (2 November 1976); INCOME TAX PRACTICES MAINTAINED BY BELGIUM, *Report of the Panel,* GATT DOC. L/4424 (2 November 1976); INCOME TAX PRACTICES MAINTAINED BY THE NETHERLANDS, *Report of the Panel,* GATT DOC. L/4425 (2 November 1976).

2. The Panel was chaired by L. J. Mariadason, Counsellor of the Permanent Mission of Sri Lanka, Geneva. The Panel members were W. Falconer, Director of Trade Policy, Department of Trade and Industry; Wellington; F. Forte, Professor of Public gfinance, University of Turin; T. Gabrielsson, Counsellor of Embassy, Permanent Delegation of Sweden to the European Communities, Brussels; A. R. Prest, Professor of Economics of the Public Sector, London School of Economics.

3. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. pt. 5 at A-11, T.I.A.S. No. 1700, 55 U.N.T.S. 194 (*effective* Jan. 1, 1948).

4. I.R.C. §§ 991-97.

5. *Panel Report, supra* note 1, at 15-17.

6. Pub. L. No. 92-178, Title V, § 501, 85 Stat. 535 (codified at 26 U.S.C. §§ 991-997 (Supp. II 1972)).

tions to establish manufacturing subsidiaries in foreign countries.[7] By enacting the DISC incentive, the United States hoped to induce domestic concerns to establish overseas markets and to supply these markets with domestically manufactured goods. This, in turn, would strengthen the balance of payments position of the United States by increasing exports and eliminating, at least to some degree, the financial advantages traditionally associated with the creation of overseas manufacturing affiliates.[8] Accordingly, the 1972 amendments provided that by establishing a Domestic International Sales Corporation, a domestic manufacturer (parent corporation) could channel its export sales through a DISC subsidiary, thereby entitling the domestic parent to the tax advantages described more fully below.

To qualify for the tax benefits under DISC, a corporation is required to confine its activities exclusively or almost exclusively to the selling of goods for export and activities related thereto. Specifically, the prospective DISC candidate must be a United States corporation. Furthermore, 95% of the corporation's gross receipts for each taxable year must be export-derived.[9] Finally, the DISC must possess a minimum capitalization of US$2,500.[10]

Acquiring a DISC structure can create several significant tax advantages for a company and its shareholders.[11] First, one-half of a DISC's earnings may be deferred until distribution to its shareholders in the form of dividends while the other half is deemed distributed and taxed currently to the shareholders.[12] This

7. Anninger, *DISC and GATT: International Trade Aspects of Bringing Deferral Home,* 13 HARV. INT'L L. J. 391 (1972) [hereinafter cited as Anninger].

Before the enactment of the DISC provisions in 1972, U.S. corporations were generally subject to tax on all income on a current basis, even if derived from foreign trade or export, whereas foreign corporations were generally free from United States tax on foreign-source income, even if owned by an American company, until such profits were distributed to the domestic parent. Int. Rev. Code of 1954, ch. 1, §§951-64, 76 Stat. 1006 (1962).

8. Comment, *DISC: A Tax Primer,* 20 LOYOLA L. REV. 325 (1973-74).

9. I.R.C. §992.

10. U.S. DEP'T. OF THE TREASURY, DISC — A HANDBOOK FOR EXPORTERS [hereinafter cited as DISC HANDBOOK]. In essence, a DISC is a subsidiary corporation of an American manufacturer designed to be no more than a conduit for export earnings.

11. The corporation itself that qualifies as a DISC is not subject to U.S. federal income tax on its current or retained export earnings. I.R.C. §991; Treas. Reg. §1.991-1(a) (1974).

12. I.R.C. §995(b)(1). This deferral would end if the shareholder sold his DISC stock or the corporation lost its DISC status. *Id.* §995(c).

postponement of tax results in cash being currently available to the parent corporation for qualified uses, among which is the effectuation of "producer's loans".[13] The parent corporation is permitted to borrow income from a DISC in a five-year producer's loan. This is an attractive provision, because the parent may borrow funds from its DISC subsidiary essentially interest-free.[14] Moreover, producer's loans can be renewed indefinitely for five-year periods, as long as certain conditions are met at the time of each renewal.[15]

A second benefit available to the DISC involves the advantages of intercompany pricing in the determination of a DISC's income. Special intercompany price rules enable a DISC to earn considerably more profit than it would under the arms length pricing requirements normally applied in the case of parent and subsidiary corporations.[16] The result is that some profits of the parent manufacturers can be shifted to the DISC subsidiary and receive the preferential tax treatment.[17]

Thus, it seems clear that by employing the DISC mechanism a domestic producer can enjoy substantial tax advantages not available to conventional exporters.[18] The Panel Report condemns

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13. I.R.C. § 993(d); Treas. Reg. § 1.993-4 (1974).

14. Such loans are interest-free assuming the interest is actually distributed as a dividend by the DISC. "The reason for this is that the interest is not taxed to the DISC and is a deduction for the borrower-shareholder and the dividend is taxed to the borrower-shareholder." DISC HANDBOOK, *supra* note 10, at 21; I.R.C. § 995(b)(1)(A).

15. DISC HANDBOOK, *supra* note 10, at 20. The conditions which must be met at each renewal are (1) the producer's loans may not exceed an amount determined by multiplying the borrower's total United States plant, machinery, equipment, inventory, and research and development expenditures by the percentage of the borrower's export receipts to his total receipts; and (2) the borrower must increase his investment in the year in which the loan is made in United States assets listed above or in research and development. *Id.* at 21-22; I.R.C. § 995(b).

16. *See* I.R.C. § 482 for the normal arms length pricing requirements. The two "safe-haven" rules of I.R.C. § 994 enable a DISC to earn on its sales of export property either 4% of the qualified export receipts on the sale, or 50% of the combined taxable income of the DISC and its related manufacturer from the sale of export property, whichever is greater, plus, in either case, 10% of export promotion expenses. For industries with low rates of return on sales, the 4% of sales rules will permit all profits on the transaction to be attributed to the DISC. The 50% rule, which comes into effect when the profit rate on sales is above 8%, is also intended to produce a result more generous than present arms length pricing rules.

17. For examples of applications of these rules, see Treas. Reg. § 1.994-1 (1974).

18. One commentator has calculated that taking into account both the 50% deferral and the intercompany pricing rules, utilization of the DISC provisions

this preferential treatment as a violation of Article XVI of the GATT.

*GATT Provisions*

The GATT was established in 1946 to give substantive form to the basic principles of free international trade by imposing legal obligations on the contracting parties. Tariff and non-tariff barriers to trade, as well as other governmental distortions of the free flow of goods and services were to be eliminated, thereby allowing international trade to flow in an "undistorted" pattern.[19]

One form of non-tariff barrier to free trade which the GATT seeks to minimize is the export subsidy, which has been considered more trade-distortive than either tariffs or domestic subsidies:

> The difference in treatment of import and export hindrances to trade is part of a notion evident throughout the General Agreement that a country has a greater right to interfere with its own domestic markets than with markets of other countries. Artificially reducing imports by tariffs or domestic subsidies is regarded as more acceptable than artificially increasing exports by means of export subsidies, domestic subsidies, or dumping.[20]

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makes it possible to reduce current federal income taxes on the manufacture and sale of export products generally from 48% to 36% and, in certain cases, to as low as 24%. Anninger, *supra* note 7, at 400. For example, for a manufacturer whose normal rate of return on export sales is 4% or less, the special intercompany pricing rules of § 994 enable attribution of all profits on the transaction to the DISC. Thus, inasmuch as only 50% of the DISC income is deemed distributed, the parent presently incurs an effective tax rate of 24% on the gain from the entire transaction (manufacture and sale). *Id.*

19. R. BALDWIN, NONTARIFF DISTORTIONS OF INTERNATIONAL TRADE 5 (1970) [hereinafter cited as BALDWIN]; G. HABERLER, THE THEORY OF INTERNATIONAL TRADE 321-22 (1936).

20. BALDWIN, *supra* note 19, at 47 and n.44. *See generally,* K. DAM, THE GATT — LAW AND INTERNATIONAL ECONOMIC ORGANIZATION 132-135 (1970) [hereinafter cited as DAM], where it is noted that the GATT provisions are designed to be hostile to subsidies, and the reasoning behind those provisions is questioned. Dam proposes that since tariffs are considered lawful for protection purposes, subsidies, or at least production subsidies designed to permit local industry to compete with imports in the local market, should also be considered lawful for protection, and that they may, in fact, be more compatible with a free trade ideology than would be a tariff. *See also* Anninger, *supra* note 7, at 395.

Reflecting this philosophy, GATT Article XVI(1) sets forth the obligations imposed upon countries maintaining export subsidies,[21] while Article XVI(4) upon which the Panel based its findings enumerates certain types of prohibited export subsidies. Article XVI(4) states in part:

> [C]ontracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.

The prohibitory language of Article XVI(4) thus comes into effect upon the coexistence of two elements: (1) the governmental program must be an export subsidy of a nonprimary product,[22] and (2) this export subsidy must be found to result in the sale of

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21. Art. XVI(1) requires that any contracting party granting or maintaining a subsidy which directly or indirectly increases exports of any product from, or reduces imports of any product into, its territorq is to notify the CONTRACTING PARTIES (i.e., the GATT parties as a group) of the extent and nature of the subsidization, an estimate of its effect, and the circumstances making the subsidization necessary. Thus, one effect of the Panel's determination that the DISC system constitutes an export subsidy is that the notification obligations of Art. XVI(1) become effective upon the United States.

Some commentators have voiced skepticism with regard to the likelihood of compliance with such notification requirements, in that such information disclosed by the subsidizing country could later be the basis for imposition of countervailing duties. *See* Butler, *Countervailing Duties and Export Subsidization: A Re-emerging Issue in International Trade*, 9 VA. J. INT'L L. 82, 94 (1969) [hereinafter cited as Butler]. *See* Comment, *The DISC Legislation as a Violation of the General Agreement on Tariffs and Trade*, 41 MO. L. REV. 180, 182–85 (1976) [hereinafter cited as Comment]. See also DAM, *supra* note 20, at 146, for a discussion of the notification requirements as they apply to primary and nonprimary products.

22. A primary product is "any product of farm, forest or fishery, or any mineral in its natural form or which has undergone such process as is customarily required to prepare it for marketing in substantial volume in international trade." GATT, Annex I, Ad Art. XVI sec. B(2). Such a distinction between primary and nonprimary products has been regarded us stemming from the desire of many governments to use subsidies or their equivalent to protect their farmers from market price fluctuations. DAM, *supra* note 20, at 134. Most DISC's concern themselves with the export of nonprimary products. In fact, the legislative history of the DISC provisions indicates that its emphasis was in the area of increasing the export of manufactured goods and that primary product producers showed little interest in the passage of DISC. Anninger, *supra* note 7, at 401–02.

such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.[23]

The Panel's study focused on the first of these elements, and addressed the longstanding problem of determining what practices do or do not constitute a subsidy.[24]

The GATT does not specifically define the term "subsidy." Apparently, this is because there was a fear among the drafters of the agreement that a comprehensive definition would inevitably be construed to include practices not intended by the contracting parties to be subject to the restrictions imposed by Article XVI.[25] However, there is language in Article XVI(1) indicating that the term is to be given an expansive meaning. That provision describes a subsidy as a practice "which operates directly or indirectly to increase exports of any product from, or reduce imports of any product into, its territory. . . ."[26] One commentator has recently stated that a subsidy occurs whenever exporters are singled out for assistance, for the purpose of promoting exports, at the expense of government.[27]

Attempts have been made to apply these vague conceptions of a subsidy to concrete situations. The interpretive notes to Article XVI delineate certain measures that are not to be regarded as subsidies.[28] More pertinent to the present inquiry, however, is a 1960 working party report containing a list (1960 list) of other measures which are generally to be regarded as subsidies by the governments adopting the 1960 declaration promulgated pursuant

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23. This second element is referred to as the "price differential clause." The reason for the inclusion of such clause in Article XVI is not clear. *See* Anninger, *supra* note 7, at 408–09.

24. Of course, direct payments to exporters upon shipment of goods abroad is the clearest example of aid to exports through subsidy. However, such direct subsidies are infrequently used because other trading nations would be likely to respond with the imposition of countervailing duties on the subsidized products. *See* Butler, *supra* note 21, at 102.

25. *See* GATT, 10th Supp. BASIC INSTRUMENTS AND SELECTED DOCUMENTS 208 (1962) L [hereinafter cited as BISD]. *See generally,* Evans, *Subsidies and Countervailing Duties in the GATT: Present Law and Future Prospects,* 3 INT'L TRADE L. J. 211 (1977).

26. GATT, 3d Supp. BISD 222, 224–27 (1955).

27. Anninger, *supra* note 7, at 405–06.

28. GATT, Annex I, Ad Art. XVI provides:

The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

to that report.[29] Two of the items in this list of "forbidden practices" are of particular importance for the purpose of DISC, *viz.*, tax rebates (item (c)) and exemptions (item (d)). Item (c) classifies as a subsidy the "remission, calculated in relation to exports, of direct taxes. . . ."[30] This most likely refers to a refund

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29. Declaration Giving Effect to the Provisions of Article XVI(4) of GATT, 19 November 1960. [1962] 3 U.S.T. 2605, T.I.A.S. No. 5227, 445 U.N.T.S. 318 (signed by 17 developed nations, including the United States, which signed with a reservation as to primary-product export subsidies). The practices "generally considered as subsidies" by the governments accepting the 1960 declaration are:

a. Currency retention schemes or any similar practices which involve a bonus on exports or re-exports;

b. The provision by governments of direct subsidies to exporters;

c. The remission, calculated in relation to exports of direct taxes or social welfare charges on industrial or commercial enterprises;

d. The exemption, in respect of exported goods, of charges or taxes, other than charges in connection with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connection with importation or in both forms;

e. In respect of deliveries by governments or governmental agencies of imported raw materials for export business on different terms than for domestic business, the charging of prices below world prices;

f. In respect of government export credit guarantees, the charging of premiums at rates which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions;

g. The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;

h. The government bearing all or part of the costs incurred by exporters in obtaining credit.

GATT, 9th Supp. BISD 186-87 (1961).

30. A distinction is drawn between "direct" and "indirect" taxes. Direct taxes are those levied upon the income derived from the production and sale of the product (as is the income tax in the United States). Indirect taxes, on the other hand, are those levied on the transfer of the product such as a sales tax or turnover tax. The distinction was originally drafted into the GATT, because at that time, most economists made the assumption that indirect taxes are fully passed on to the consumer, while direct taxes are absorbed by the seller and not reflected in the purchase price. Consequently, under this reasoning, it was felt that an exemption or remission of a direct tax would constitute a subsidy in favor of the seller, thus frustrating the purpose of GATT. On the other hand, an exemption or remission of an indirect tax to the seller would operate in favor of the foreign consumer in the form of lower prices and not aid the seller. *See* Comment, *supra* note 21, at 193. This, in essence, allows member countries to relieve exports of indirect taxes as they leave the country, and to impose on imports a tax equal to that borne by the like domestic product. The United States is one of the few countries which depends

of all or part of a tax already assessed or paid,[31] and thus does not fall within the DISC provisions. However, as the aforegoing examination of the mechanics of the DISC system has shown, item (d), the "exemption, in respect of exported goods, of charges or taxes . . ." arguably comes close to falling within the DISC deferral system, as, at some point in time, a deferral may be effectively equivalent to an exemption. This is, in fact, the precise conclusion reached in the Panel Report.

*Panel Conclusions*

The representatives of the European Economic Community (EEC) contended before the Panel that the DISC legislation conflicted with the provisions of Article XVI(4), that a *prima facie* case of nullification and impairment existed, and that the interests of a number of contracting parties had been seriously prejudiced. The Panel accepted this conclusion, resting their determination on several aspects of the DISC provisions.

The Panel determined that the DISC tax deferral provisions violated Article XVI(4). The Panel adopted the adage "taxes delayed are taxes saved", although the members were not totally convinced that a deferral, simply because it is given for an indeterminate period, is equal to a remission or exemption in violation of items (c) and (d) of the 1960 list.[32] In addition, the

almost entirely on direct taxes, such as the income tax, as its revenue source. Thus, foreign exporters, in countries where indirect taxes are a primary revenue source, are able to receive tax "subsidies" on exportation far greater than can the United States. *See* Marks and Malmgren, *Negotiating Nontariff Distortions to Trade,* 7 LAW & POL'Y INT'L BUS. 327, 351 *et seq.* (1975).

The economic distinction between direct and indirect taxes has come under much criticism, mostly justified. *See* Comment, *supra* note 21, at 193; DAM, *supra* note 20, at 214-15. The Panel avoided the issue altogether, stating that "the extent to which direct and indirect charges were shifted on to prices was a particularly complex problem on which the Working Party had not reached unanimous views." *Panel Report, supra* note 1, at 13.

31. Anninger, *supra* note 7, at 403.

32. Other commentators have been more insistent in their determinations that the fact that producer's loans can be indefinitely renewed effectively makes the tax liability non-existent and clearly amounts to a subsidy on export production. *See* Anninger, *supra* note 7, at 404, wherein he states that the DISC deferral feature is most accurately described as a tax exemption, and quotes from statements made during the Congressional hearings on the DISC:

> But even indefinite deferral is not required. For a profitable company the present value of fifteen years deferral of tax is just about worth the amount of the tax itself — which makes deferral the equivalent of exemption. The reason is

Panel noted that the DISC legislation provides for the termination of the deferral under specified circumstances. The Panel further noted, however, that the deferral did not attract the interest component of the tax normally levied for late or deferred payment and therefore concluded that, to this extent, the DISC legislation constituted a *partial* exemption which was covered by one or both of paragraphs (c) and (d) of the illustrative list.[33]

The United States representative argued unsuccessfully that, strictly speaking, GATT does not prohibit deferral of taxes as such, but that only outright rebates and exemptions are forbidden.[34] The representative noted that the only official action taken by the Contracting Parties to define subsidies was the adoption of the 1960 list. Remission and exemption were expressly included in the list, he argued, however, the Working Party report made no mention of tax deferral, tax exemption for foreign source income, or other more complex direct tax practices. He argued that the illustrative list did not cover the DISC system since the latter was a mere deferral and not a remission or exemption, cancellation, release or forgiveness of direct taxes calculated in respect of exports.[35] The Panel flatly rejected this notion, finding that in economic terms there was little distinction.

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> that the deferred tax money that a company keeps over such a period (in effect an interest-free loan for that period) can be put to work earning additional money.

Statement of S. Surrey, *Hearings on H.R. 10947 Before the Senate Comm. on Finance*, 92d Cong., 1st Sess., pt. 2, at 729 (1971) [hereinafter cited as Surrey]. Numerous other commentators on the subject have concluded that the deferral system is an exemption due to the potentially perpetual deferral. *See* Comment, *supra* note 21, at 194, for a collection of these authorities.

33. *Panel Report, supra* note 1, at 15. The representative of the European Communities had argued that even if tax deferral were to end sometime, either in exceptional circumstances or through the elimination of the DISC system, there would still be an exemption of the compound interest on the deferred tax. *Id.* at 17.

34. This was one of the Treasury Department's arguments when it initially presented the DISC legislation. *See* Letter from Roy T. Englert to Hon. Wilbur D. Mills, June 16, 1970, reprinted in Anninger, *supra* note 7, at 393, n.12.

35. *Panel Report, supra* note 1, at 7. Though perhaps an appealing argument, it loses much of its cogency when it is considered that the present value to a corporation of 15 years of tax deferral is approximately equal to the tax itself. *See* Surrey, *supra* note 32, at 733. The U.S. representative conceded that a deferral could have the same economic effect as an exemption if the deferral extended for a sufficiently long period of time. *Panel Report, supra* at 7. However, he maintained that the benefits of the DISC legislation were sufficiently uncertain as to duration and amount to negate any analogy to remission or exemption of taxes. One reason for this was that continued deferral depended on a company's ability to qualify as

The Panel also found fault with DISC's intercompany pricing provisions, in that, given the various options under the DISC legislation for the allocation of profits from export sales between parent manufacturers and DISC's, there was too much leeway for the parent company to influence the size of the exemption.[36] The Panel thus implicitly rejected the argument of the United States delegate who contended that the DISC legislation had brought its intercompany pricing rules more closely into line with those of other countries with respect to exports, and that the treatment of export sales income allowed under tax practices in many European countries was substantially equivalent to, and in many cases more favorable than that provided by the DISC provisions.[37]

The United States representative also argued the propriety of DISC as a compensatory export subsidy which works to rectify pre-existing distortions in international competitive conditions created by the tax practices of certain other contracting parties.[38] The Panel concluded, however, that one distortion could not be justified by the existence of another one. It noted that if the United States had determined that other contracting parties were violating the General Agreement, it could have had recourse to the remedies set out in the GATT.[39] The Panel also remarked that the

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a DISC for each taxable year. He also stated that it was often difficult to meet the 95% qualified export assets test, that the most useful assets in this regard were the trade receivables generated on export sales of the parent of the DISC, but that the ability to use these depended upon exports growing at an increasingly rapid rate. *Id.*

36. *Id.* at 16. The European Communities had argued that the 4% and 50% rules of thumb, *see* note 16, *supra,* were inconsistent with the arm's length principle under which profits are allocated to different, even if closely related, entities by reference to conditions of fully effective competition. *Id.* at 8.

37. *Id.* The United States representative argued that the DISC legislation in most cases established a 75–25 allocation of profits between those currently taxable and those subject to tax deferral, while some GATT party nations provided for a 50–50 allocation of profits between those taxable and those subject to complete exemption.

38. *Id.* at 9. The obvious implication of such an argument is "if they can do it, we can do it." Anninger, *supra* note 7, at 419. For the European Communities' response to the U.S. representative's argument, see *Panel Report, supra* note 1, at 10–11.

39. *Id.* at 17. *See also* Anninger, *supra* note 7, at 420, where he indicates that to the extent that the DISC system does compensate for the distortions caused by other countries' tax practices, it invites retaliation in the form of either offsetting countervailing duties or competitive export subsidies. To this extent, DISC could precipitate a spiraling of trade restrictions.

fact that tax practices of certain other countries had been in force for some time without being the subject of complaints was not, in itself, conclusive evidence that there was a consensus that they were compatible with the General Agreement.[40]

Having determined that the DISC legislation constitutes an export subsidy in terms of the 1960 list, the Panel noted that the contracting parties who had accepted the 1960 Declaration had agreed that the practices in the illustrative list were generally considered to be subsidies in the sense of Article XVI(4).[41] That is, the practices contained in the illustrative list could be presumed to result in bi-level pricing, thereby violating the price-differential element of Article XVI(4).[42] This presumption could therefore be applied to the DISC legislation, making it a violation of Article XVI.[43]

The Panel thus rejected the United States arguments in defense of the legality of the DISC system in light of the GATT, and determined that there was a *prima facie* case of nullification or impairment of benefits which other contracting parties were entitled to expect under the General Agreement.[44]

*Effect of the Panel Report on the U.S. DISC Program*

At the present time, the possible repercussions of the Panel's determinations on United States tax law would be purely speculative. Although the GATT has never been submitted to the Senate for ratification, it is valid and enforceable in the United States as an executive agreement, as long as it is not in conflict with any domestic legislation.[45]

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40. *Panel Report, supra* note 1, at 17.

41. *Id.* at 16.

42. *Id.* At least one author agrees. *See* Anninger, *supra* note 7, at 407.

43. The Panel did conclude, however, from the descriptive words heading the list, "generally to be considered," that the CONTRACTING PARTIES did not consider the presumption absolute. *Panel Report, supra* note 1, at 16. It is interesting to note that if the DISC provisions had not been found to fit into items (c) or (d) of the forbidden practices list, thus triggering the presumption, the price differential test for bi-level pricing would have had to be confronted and satisfied before DISC could be condemned as a violation of Article XVI. The Working Party's conclusion that the presumption was triggered obviated the arguments of the United States and European Communities as to who had the burden of producing the price differential data. *See Panel Report, supra* note 1, at 12–13.

44. *Id.* at 17.

45. For a thorough discussion of the status of the GATT as domestic law, see Jackson, *The General Agreement on Tariffs and Trade in the United States*

The GATT itself does not contain any punitive or enforcement provisions to be applied to contracting parties who choose to violate its provisions.[46] Rather, individual self-help in the form of retaliation has been left to the contracting parties as the most functional remedy.[47] Contracting parties who perceive themselves as victims of the DISC system may feel compelled to avail themselves of such retaliatory measures, promoting a chain reaction which would result in the erection of a myriad of defensive trade barriers.[48] Not only would these retaliatory acts undermine the purpose of the GATT, but such actions by other nations would also operate to defeat the purpose for which the DISC system was designed.[49]

This is not to suggest that prompt repeal of the DISC legislation is either mandatory or in the offing.[50] In light of the Panel's similar condemnation of the tax practices of other European nations,[51] and the generally acknowledged questionable

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*Domestic Law,* 66 MICH. L. REV. 249 (1967). It should be noted that executive agreements are a valuable tool of international relations which cannot be lightly disregarded by Congress.

46. *Cf.* Hudec, *The GATT Legal System: A Diplomat's Jurisprudence,* 4 J. WORLD TRADE L. 615, 624, 627 (1970).

47. DAM, *supra* note 20, at 81. Although restrictive tariffs are perhaps the most well-known retaliatory impediment to a violating country's products, many non-tariff trade barriers could conceivably be implemented. For example, quantitative restrictions on imports are considered the most effective, although perhaps the most cumbersome to administer. Metzger, *Non-Tariff Trade Barriers: New Liberalization or New Protectionism?,* 63 AM. SOC'Y INT'L L. PROC. 203 (1969). Other conceivable non-tariff retaliatory measures would be the use of anti-dumping or countervailing duties, manipulation of size and quality controls, tax incentives for exporters, artificially high valuations of imports for customers' purposes, and "buy national" programs for government procurement.

48. Comment, *supra* note 21, at 198.

49. *Id.*

50. In early January 1977, House Ways and Means Committee Chairman Al Ullman stated that the DISC provisions "probably will stay until we get something else to take its place." [1977] U.S. EXPORT WKLY. BNA No. 140 at A-2 (Feb. 1, 1977). He also noted that any comprehensive tax revision hearings probably would not be held until the end of 1977, with mark-up sessions following in early 1978. *Id.*

51. The tax practices of the Netherlands, France and Belgium differ from the DISC provisions in that these countries employ a system of levying income and corporate tax whereby profits made by an individual or corporation are taxed in the country where the profits were made. Thus a domestic manufacturing firm which channels its sales through its foreign branches or foreign sales subsidiaries will not be subject to tax on that export sales income, regardless of whether the

practices of other contracting parties, unilateral United States abolition of DISC may not be the most prudent course. Perhaps the United States should use DISC abolition as a negotiating chip in its efforts to secure modifications of other countries' export incentives.[52] Rather than unilateral abandonment, such a strategy may unwind the spiral of trade barriers and bring the contracting parties closer to the free trade principles underlying the General Agreement.

*J. Michael McGuire*

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foreign country makes use of its taxation rights. In this manner, foreign income which includes the sales element on exports would not be taxed by the home country, arguably resulting in a remission or exemption of taxes. The Working Party determined that these taxing systems create a distortion in conditions of international competition in that they afford a remission or exemption of direct taxes in violation of those countries' commitments as contracting parties, under GATT Art. XVI(4). *See* the *Panel Reports* cited *supra* note 1.

52. The GATT Council, which in the past has usually approved GATT panel findings, has postponed final decision several times on the Panel's examination of DISC, primarily because of United States insistence that all four panel reports be considered together. [1977] U.S. EXPORT WKLY. BNA No. 149 at A-3 (March 22, 1977). The United States hopes that by consudering all of the panel reports together, a framework for negotiation on a broad range of trade problems can be set. It is feared that a singular consideration of the finding on the DISC system could undermine the United States' bargaining position. *See* Letter from David C. Garfield, Chairman of the Special Committee for U.S. Exports, to all U.S. Senators on the tax advantages of retaining tax benefits for DISCs, the text of which is reprinted *id.* at P-1.