

## Mending Fences: The *Real* Purpose of the American Jobs Creation Act of 2004

I. OVERVIEW.....	421
II. BACKGROUND.....	423
A. <i>What Are the WTO and EU Anyway?</i> .....	423
B. <i>From a Skirmish to a Brawl</i> .....	425
1. The WTO’s Stance on Subsidies and Method for Dispute Resolution.....	425
2. Turbulence over the Atlantic.....	426
C. <i>A Titanic Clash: The Aircraft Paradigm</i> .....	428
III. THE CONGRESSIONAL DECISION.....	430
IV. ANALYSIS.....	430
V. CONCLUSION.....	433

### I. OVERVIEW

“We think this will meet the test,” Senate Finance Chairman and Iowa Republican Charles Grassley optimistically told the *Wall Street Journal* after a long weekend of debate following a three-decade trade dispute with the European Union.<sup>1</sup> In his statement, Senator Grassley referred to the American Jobs Creation Act of 2004 (AJCA),<sup>2</sup> which he and the rest of Congress hoped would end “the largest trade fight yet” between the United States and the European Union.<sup>3</sup>

The latest and most heated chapter of the trans-Atlantic brawl first made international headlines in February 2000 when the World Trade Organization (WTO) found that the United States violated international trade law by providing illegal subsidies to U.S. corporations operating overseas through the “foreign sales corporation” (FSC) tax regime.<sup>4</sup> The

---

1. Shailagh Murray & David Wessel, *Corporate Tax Bill Passes Senate, Goes to President*, WALL ST. J., Oct. 12, 2004, at A1; see also Jill Barshay, *EU Threat of Punitive Tariffs Forces Congress to Act on Taxes*, CQ WKLY., Sept. 14, 2002, at 2365. European countries first challenged American export subsidies in 1971 after the United States allowed American exporters to deduct portions of export earnings from gross income, thereby lowering tax liability. *Id.* However, the dispute did not escalate until the World Trade Organization (WTO) ruled the U.S. “foreign sales corporation” (FSC) tax regime unlawful almost thirty years later. *Id.*

2. Murray & Wessel, *supra* note 1.

3. Scott Miller, *EU Moves to Lift Trade Sanctions on U.S. Exporters*, WALL ST. J., Oct. 26, 2004, at A2; H.R. 4520, 118 Stat. 1418, 108th Cong. (2004).

4. Murray & Wessel, *supra* note 1 (noting that the FSC regime allowed American exporters to gain tax benefits for exports).

ruling came after EU countries filed numerous complaints with the WTO's dispute resolution forum alleging that the FSC tax regime violated WTO subsidies policies, thus giving American exporters a competitive advantage over their European counterparts.<sup>5</sup> In November 2000, the U.S. government answered the WTO ruling by enacting a modified version of the tax break entitled the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (ETI), which granted U.S. companies doing business overseas a revised form of the FSC break called an exclusion for "extraterritorial income."<sup>6</sup> Following further complaints by the European Union, the WTO responded in January 2002, ruling that the "extraterritorial income" revision was also an illegal tax break based on illegal subsidies.<sup>7</sup> In March 2004, and with the WTO's endorsement,<sup>8</sup> the European Union began to levy punitive tariffs on U.S. goods beginning at 5% and increasing at a rate of 1% each subsequent month to a 17% ceiling, which the tariff rate would have reached in March 2005 unless the United States enacted an acceptable tax regime.<sup>9</sup> The FSC and ETI regimes sparked particular controversy in the aircraft manufacturing industry, culminating in simultaneous complaints at the WTO by the United States on behalf of Boeing Company<sup>10</sup> and by the European Union on behalf of Airbus Industrie on October 6, 2004.<sup>11</sup>

---

5. *Id.*

6. 26 U.S.C. § 114 (2000), *repealed by* American Jobs Creation Act of 2004, § 101(a), 118 Stat. 1418, 1423, 108th Cong. (2004); JOINT COMM. ON TAXATION, DESCRIPTION OF H.R. 4520: THE "AMERICAN JOBS CREATION ACT OF 2004," H.R. Doc. No. JCX-41-04, 2 (2004), available at <http://waysandmeans.house.gov/Media/pdf/hr4520/jcx-41-04.pdf> [hereinafter JOINT COMM. ON TAXATION].

7. Murray & Wessel, *supra* note 1; see *United States—Tax Treatment for "Foreign Sales Corporations": Recourse to Article 21.5 of the DSU by the European Communities*, WTO Doc. 02-0152, ¶ 256 (Jan. 14, 2002), available at [http://docsonline.wto.org/GEN\\_viewerwindow.asp?D:/DDFDOCUMENTS/T/WT/DS/108ABRW.DOC.HTM](http://docsonline.wto.org/GEN_viewerwindow.asp?D:/DDFDOCUMENTS/T/WT/DS/108ABRW.DOC.HTM) [hereinafter WTO Doc. Jan. 14, 2002].

8. Murray & Wessel, *supra* note 1. The WTO endorsed the European Union's proposal to levy US\$4 billion of punitive tariffs per year against the United States to compensate the European Union for the damages sustained from the ETI. *Id.*

9. *Id.*; DELEGATION OF THE EUROPEAN COMM'N TO THE U.S., *FSC: Commission to Study News [sic] US Tax Legislation Aimed at Removing WTO Illegal Export Subsidies from 2007*, available at <http://www.eurunion.org/News/press/2004/200400138.htm> (Oct. 12, 2004) [hereinafter DELEGATION OF THE EUROPEAN COMM'N TO THE U.S.].

10. Jill Barshay, *Thomas' Style and Controversial Bill Come Under Fire from His Own Party*, CQ WKLY., Sept. 14, 2002, at 2367. As of September 2002, Boeing was "[t]he largest recipient of the export subsidy, at more than \$200 million a year." *Id.*

11. J. Lynn Lunsford & Daniel Michaels, *Boeing, Airbus Face Challenge of Backing Up Subsidy Claims*, WALL ST. J., Oct. 8, 2004, at A11.

Although originally proposed in 2002,<sup>12</sup> the AJCA became law on October 22, 2004.<sup>13</sup> Both Houses of Congress passed, and United States President George W. Bush signed, the AJCA which, among many other things, attempted to end the WTO sanctions resulting from the FSC and ETI regimes.<sup>14</sup>

## II. BACKGROUND

### A. *What Are the WTO and EU Anyway?*

Founded in 1995, the WTO is an international organization with 148 member countries from around the globe, including the United States, with a goal to “help producers of goods and services, exporters, and importers conduct their business.”<sup>15</sup> The WTO claims that “its main function is to ensure that trade flows as smoothly, predictably and freely as possible.”<sup>16</sup> The WTO is a descendant of the General Agreement on Tariffs and Trade (GATT), a multilateral trading system established following the Second World War.<sup>17</sup> The WTO’s “multilateral trading system” employs international negotiations and agreements to lower trade barriers among member nations.<sup>18</sup> The WTO also provides a dispute settlement mechanism for alleged violations of its agreements

---

12. Barshay, *supra* note 10, at 2365. House Ways and Means Chairman Bill Thomas proposed to end the ETI in 2002 on the heels of the WTO ruling that the ETI was illegal. See H.R. 5095, 107th Cong. (2d Sess. 2002). The hotly debated bill did not gain enough support to get out of the Ways and Means Committee, mainly because of the popularity of the ETI tax credit among American exporters. Barshay, *supra* note 10, at 2367. Contributing to the dissatisfaction with the proposed bill, Boeing reported it would be forced to cut 10,000 jobs if the government terminated the ETI tax deduction for export income. *Id.* Businesses were sharply divided between supporters of the Thomas proposal and opponents of the suggestion to end the ETI tax breaks. *Id.* However, other corporate giants like General Motors and Wal-Mart Stores reportedly backed the bill. *Id.*

13. American Jobs Creation Act of 2004, H.R. 4520, 108th Cong. (2004). The AJCA passed in the Senate on July 15, 2004, after passing in the House of Representatives on June 17, 2004. BILL TRACKING REP., H.R. 4520 (2004), at LEXIS 2004 Bill Tracking H.R. 4520; Murray & Wessel, *supra* note 1. President Bush signed the AJCA on October 21, 2004. Miller, *supra* note 3.

14. H.R. 4520; Miller, *supra* note 3.

15. WTO, *What Is the WTO?*, at [http://www.wto.org/english/thewto\\_e/whatis\\_e/whatis\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm) (last visited Nov. 8, 2004).

16. WTO, *The WTO . . . In Brief*, at [http://www.wto.org/english/thewto\\_e/whatis\\_e/inbrief\\_e/inbr00\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr00_e.htm) (last visited Nov. 8, 2004).

17. WTO, *The WTO in Brief: Part 1: The Multilateral Trading System-Past, Present and Future*, at [http://www.wto.org/english/thewto\\_e/whatis\\_e/inbrief\\_e/inbr01\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr01_e.htm) (last visited Nov. 8, 2004).

18. WTO, *supra* note 16.

with detailed procedures for complaints and settlements of different violations.<sup>19</sup>

The European Union is a conglomerate currently consisting of twenty-five European countries and originally formed by six founding nations after the Second World War to so economically intertwine Europe as to prevent a third intra-European war.<sup>20</sup> The economic interdependence of EU Member nations has unified much of Europe, especially Western Europe.<sup>21</sup> In essence, the structure and agreements of the European Union allow Member countries to economically act as a single country.<sup>22</sup> All EU countries are also members of the WTO.<sup>23</sup> The United States and European Union economically depend on each other as approximately “40 percent of US investment abroad goes to the EU, as does some 20 percent of US exports, making the EU one of the top two markets for the US.”<sup>24</sup> U.S. officials have praised the united Europe; in 2001, then United States Secretary of State Colin Powell applauded that “a strong united Europe is good, indeed essential, for the United States, for Europe, and for the world.”<sup>25</sup>

---

19. *Id.*

20. DELEGATION OF THE EUROPEAN COMM'N TO THE U.S., *EU in Brief*, at <http://www.eurunion.org/infores/euguide/chapter5.htm> (last visited Jan. 16, 2005). The European Union consists of Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, and the United Kingdom. *Id.*

21. *See id.*

22. *See* DELEGATION OF THE EUROPEAN COMM'N TO THE U.S., *The European Union: Guide for Americans: Chapter 3: The Euro: Completing Economic Unity* (arguing that the introduction of the euro in 2002 into the European Union illustrates its growing economic unity), at <http://www.eurunion.org/infores/euguide/Chapter3.htm> (last visited Jan. 17, 2005); *see also* Europa, *The Euro: Our Currency* (describing the euro as “a stimulus to further integration”), at [http://www.europa.eu.int/comm/economy\\_finance/euro/benefits/benefits\\_6\\_en.htm](http://www.europa.eu.int/comm/economy_finance/euro/benefits/benefits_6_en.htm).

23. *See* DELEGATION OF THE EUROPEAN COMM'N TO THE U.S., *supra* note 9; WTO, *Understanding the WTO: The Organization*, at [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm) (last visited Oct. 23, 2004).

24. Eur. House, *Europe House Capability Statement*, at [http://www.europehouse.com/general\\_info.htm](http://www.europehouse.com/general_info.htm) (last visited Jan. 18, 2005).

25. DELEGATION OF THE EUROPEAN COMM'N TO THE U.S., *The European Union: Guide for Americans: Chapter 5: EU Relations with the United States*, at <http://www.eurunion.org/infores/euguide/Chapter5.htm>. Former Secretary Powell made this comment in the wake of the September 11, 2001, attacks on the United States. *Id.* Powell commended the European Union for its support of the United States' call for a fight against terrorism, stating that this support “is just the latest demonstration of the fact that a strong united Europe is good, indeed essential, for the United States, for Europe, and for the world.” *Id.*

*B. From a Skirmish to a Brawl*

## 1. The WTO's Stance on Subsidies and Method for Dispute Resolution

With certain enumerated exceptions, the WTO explicitly condemns government subsidies provided to domestic but not foreign goods.<sup>26</sup> The Agreement on Subsidies and Countervailing Measures (SCM Agreement) proclaims that a subsidy exists when a government or other public body's financial contribution results in a benefit concurred in a circumstance where:

- (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
- (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
- (iii) a government provides goods or services other than general infrastructure, or purchases goods;
- (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.<sup>27</sup>

Furthermore, subsidies must be "specific."<sup>28</sup> The SCM Agreement enumerates several definitions of specificity. One common example of a specific subsidy is "[w]here the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises."<sup>29</sup>

Not all subsidies violate WTO policy, however.<sup>30</sup> The SCM Agreement defines illegal subsidies as "(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance . . . , [and] (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over

---

26. Agreement Establishing the World Trade Organization, Apr. 15, 1994, Annex 1A: Multilateral Agreements on Trade in Goods, Agreement on Subsidies and Countervailing Measures, art. 3, [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm#wtoagreement](http://www.wto.org/english/docs_e/legal_e/legal_e.htm#wtoagreement) [hereinafter SCM Agreement].

27. *Id.* art. 1.1.

28. *Id.* art. 2.1.

29. *Id.* art. 2.1(a).

30. *Id.* art. 27. In addition to the exceptions enumerated herein, the WTO affirmatively excludes developing nations from limitations on subsidies. *Id.* The WTO recognizes that "subsidies may play an important role in economic development programmes of developing country Members." *Id.* art. 27.1.

imported goods.”<sup>31</sup> The SCM Agreement stipulates that subsidies should not cause “injury to the domestic industry of another Member” or “serious prejudice to the interests of another Member,” and a subsidy should not violate any benefit provided by the WTO founding agreement.<sup>32</sup> Even specific subsidies can be permissible in certain circumstances, such as assisting in research activities,<sup>33</sup> assisting in “disadvantaged regions within the territory of a Member,”<sup>34</sup> and assisting in achieving compliance with environmental regulations.<sup>35</sup>

If a WTO member country suspects a violation of the SCM Agreement, the WTO may grant a fact-finding consultation between the two nations.<sup>36</sup> After weighing evidence, the WTO may find the accused nation in violation of the SCM Agreement and order the subsidizing nation to modify its policy to conform to the SCM Agreement.<sup>37</sup> If the guilty nation does not alter its subsidy policy to conform to the SCM Agreement, the adversely affected nation may impose countervailing measures to compensate for the competitive advantage of the foreign firm.<sup>38</sup> The SCM Agreement provides that “[a] countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury.”<sup>39</sup>

## 2. Turbulence over the Atlantic

Europe first challenged U.S. export policy in 1971,<sup>40</sup> although the dispute between Europe and the United States did not come to fruition until the participating countries founded the WTO nearly two and a half

---

31. *Id.* art. 3.1 (noting, however, “except as provided in the Agreement on Agriculture”).

32. *See id.* art. 5. *See generally id.* art. 6 (explaining “serious prejudice.”)

33. *Id.* art. 8.2(a). This exception is limited to 75% of the cost of industrial research and 50% of the cost of precompetitive development activity. *Id.* The exception is further limited to costs of personnel, instruments, equipment, land, certain buildings, consultancy, overhead directly resulting from research activity, and other running costs “incurred directly as a result of research activity.” *Id.*

34. *Id.* art. 8.2(b). This exception is limited to contiguous geographic regions that are objectively deemed to be disadvantaged on the basis of a three-year study of per capita income or unemployment rate. *Id.*

35. *Id.* art. 8.3(c). This exception is limited to one-time subsidies of 20% or less of the cost of adaptation. *Id.* It may not “cover the cost of replacing and operating the assisted investment . . . [and it must be] directly linked to and proportionate to a firm’s planned reduction of nuisances and pollution.” *Id.* The subsidy must be available to all similarly situated firms. *Id.*

36. *Id.* arts. 9.1, 9.4.

37. *Id.* art. 9.4.

38. *Id.* art. 19.1. A countervailing duty may not exceed the amount of the subsidy. *Id.* art. 19.4.

39. *Id.* art. 21.1.

40. Barshay, *supra* note 10, at 2365.

decades later.<sup>41</sup> In February 2000, the WTO found, after renewed complaints from the European Union, that the U.S. FSC tax regime violated the SCM Agreement and ordered the United States to repeal the illegal subsidy or modify the FSC regime to comply with WTO regulations.<sup>42</sup> The United States responded in November 2000 by repealing its FSC regime and enacting the ETI tax legislation, which presented a new tax rule for foreign income.<sup>43</sup> The ETI legislation allowed U.S. taxpayers to exclude extraterritorial income from gross income for tax purposes.<sup>44</sup>

The European Union still objected, and the WTO responded in January 2002 by ruling that the ETI also violated the SCM Agreement, requiring that it be repealed or modified.<sup>45</sup> The WTO appellate panel reasoned that the ETI tax legislation violated article 3.1(a) of the SCM Agreement because the ETI granted subsidies “contingent . . . upon export performance.”<sup>46</sup> When the United States did not immediately respond, the European Union issued continued complaints to the WTO, and the WTO ruled that the European Union could legally impose countervailing tariffs against the United States to compensate for the U.S. illegal subsidies under the ETI.<sup>47</sup> The European Union began to impose countervailing tariffs against the United States in March 2004 in an effort to compensate for the damages imposed on it by ETI.<sup>48</sup>

---

41. WTO, *supra* note 15. The WTO was founded on January 1, 1995. *Id.*

42. Murray & Wessel, *supra* note 1; *United States—Tax Treatment for “Foreign Sales Corporations”*: Report of the Panel, WTO Doc. 99-4118 (Oct. 8, 1999), art. 8.1, available at [http://docsonline.wto.org/gen\\_home.asp?language=1&\\_=1](http://docsonline.wto.org/gen_home.asp?language=1&_=1).

43. 26 U.S.C. § 114 (2000), repealed by American Jobs Creation Act of 2004, § 101(a), 118 Stat. 1418, 1423, 108th Cong. (2004).

44. *Id.* § 114(a). “Extraterritorial income” is “the gross income of the taxpayer attributable to foreign trading gross receipts . . . of the taxpayer.” *Id.* § 114(e).

Foreign trading gross receipts are gross receipts derived from certain activities in connection with “qualifying foreign trade property” with respect to which certain economic processes take place outside of the United States. Specifically, the gross receipts must be: (1) from the sale, exchange, or other disposition of qualifying foreign trade property; (2) from the lease or rental of qualifying foreign trade property for use by the lessee outside the United States; (3) for services which are related and subsidiary to the sale, exchange, disposition, lease, or rental of qualifying foreign trade property (as described above); (4) for engineering or architectural services for construction projects located outside the United States; or (5) for the performance of certain managerial services for unrelated persons.

JOINT COMM. ON TAXATION, *supra* note 6, at 2; see also 26 U.S.C. § 942.

45. WTO Doc. Jan. 14, 2002, *supra* note 7, ¶ 256.

46. *Id.* ¶ 5(a).

47. Murray & Wessel, *supra* note 1.

48. *Id.* The countervailing tariff started at 5% and rose 1% per month for one year. *Id.* The European Union would cap the tariffs at 17%. *Id.* The European Union enacted the tariff under Council Regulation 2193/2003, 2003 O.J. (L 328) 3.

In supporting its complaints to the WTO regarding the U.S. ETI tax regime, the European Union estimated that American subsidies amounted to approximately US\$4 billion per year, a damaging blow to international competition and European industry.<sup>49</sup> The United States has subtly acknowledged this estimate.<sup>50</sup>

### C. *A Titanic Clash: The Aircraft Paradigm*

A dispute in the civil aircraft industry sparked by the FSC/ETI controversy provides an illustration of the multibillion-dollar conflict between the United States and the European Union. Boeing Company is a large, American aircraft manufacturer whose 2003 revenues exceeded US\$50 billion.<sup>51</sup> Boeing's main competition, Airbus Industrie, is headquartered in Toulouse, France and also operates in Germany, Spain, and the United Kingdom.<sup>52</sup> In 2003, Airbus enjoyed a €19.2 billion turnover,<sup>53</sup> or approximately US\$24.4 billion.<sup>54</sup> In 2003, and for the first time, Airbus's total airplane sales exceeded Boeing's total airplane sales.<sup>55</sup> Airbus plans to deliver more planes than Boeing again in 2005.<sup>56</sup>

Over 30% of Boeing's 2003 revenues were realized outside the United States, including a large portion in the European Union.<sup>57</sup> Because of its high volume of exports, Boeing benefited under the

---

49. Europa, *Foreign Sales Corporations (FSC): US to Repeal Illegal Export Subsidies as from 2007*, at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/1203&format=HTML&aged=0&language=EN&guiLanguage=en> (Nov. 8, 2004) [hereinafter *US to Repeal Subsidies*].

50. See Bill Thomas, *Industry Tax Relief Awards*, WASH. TIMES, Oct. 21, 2004 (acknowledging that the ETI regime resulted in a US\$4 billion annual dispute), available at <http://www.washingtontimes.com/functions/print.php?StoryID=20041020-092925-6251r>.

51. BOEING, *Boeing in Brief*, at <http://www.boeing.com/companyoffices/aboutus/brief.html> (June 2004).

52. AIRBUS, *Airbus Today*, at [http://www.airbus.com/about/euro\\_manufact.asp](http://www.airbus.com/about/euro_manufact.asp) (last visited Nov. 8, 2004).

53. *Id.*

54. *Exchange Rates*, WALL ST. J., Oct. 28, 2004, at C12 (using exchange rate of €1.2706). Admittedly, the euro-to-dollar exchange rate was slightly different in October 2004 as compared to the time of Airbus's 2003 turnover calculation. In fact, value of the dollar has fluctuated from about US\$1 per euro in the beginning of 2003 to about US\$1.3 per euro in 2004. Craig Karmin et al., *Dollar Bears Growl, End Hibernation of 2004*, WALL ST. J., Oct. 28, 2004, at C1. However, these figures are only included to illustrate the relative size of Boeing and Airbus to each other and to other corporations.

55. Paul Blustein, *U.S. Files Grievance over Airbus with WTO; E.U. Responds with Boeing Complaint*, WASH. POST, Oct. 7, 2004, at E1, available at 2004 WL 93181940.

56. Associated Press, *Update 6: U.S., EU Clash on Airbus, Boeing Subsidies*, at <http://www.forbes.com/associatedpress/feeds/ap/2004/10/06/ap1578347.html> (Oct. 6, 2004).

57. BOEING, *Global Scope*, at [http://www.boeing.com/special/aboutus/overview/overview\\_files/slide0005\\_image006.gif](http://www.boeing.com/special/aboutus/overview/overview_files/slide0005_image006.gif) (last visited Oct. 26, 2004).



FSC/ETI tax regimes by decreasing its taxable income.<sup>58</sup> The European Union estimates that Boeing has profited from US\$23 billion in subsidies from the U.S. government since 1992.<sup>59</sup> The European Union further alleges that the U.S. government granted Boeing US\$200 million per year under the ETI regime and an additional US\$3.2 billion for the development of the new 7E7 Dreamliner jet.<sup>60</sup> Believing the FSC/ETI tax breaks constituted illegal subsidies according to the WTO SCM Agreement, the European Union filed a complaint in the WTO against the United States and Boeing on October 6, 2004.<sup>61</sup> Adding to the dispute, the United States filed a similar WTO complaint against Airbus the same day.<sup>62</sup> While both the aircraft industry and the underlying government dispute escalated, the United States Congress intervened to address the larger problem of ETI tax subsidies.

---

58. DELEGATION OF THE EUROPEAN COMM'N TO THE U.S., *Foreign Sales Corporations (FSC): EU Welcomes US Repeal of Illegal Export Subsidies—EU to Lift Sanctions and Ask for Check on WTO Compatibility*, at <http://www.eurunion.org/News/press/2004/200400147.htm>.

59. Europa, *WTO Dispute Settlement: US-Boeing: EU Takes US to the WTO over Subsidies Granted to Boeing*, at [http://europa.eu.int/comm/trade/issues/respectrules/dispute/pr061004\\_en.htm](http://europa.eu.int/comm/trade/issues/respectrules/dispute/pr061004_en.htm) (Oct. 6, 2004).

60. *Id.*

61. *United States—Measures Affecting Trade in Large Civil Aircraft: Request for Consultations by the European Communities*, WTO Doc. 04-4275 (Oct. 12, 2004), [http://docsonline.wto.org/gen\\_home.asp?language=1&\\_=1](http://docsonline.wto.org/gen_home.asp?language=1&_=1); Europa, *supra* note 59.

62. *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft: Request for Consultations by the United States*, WTO Doc. 04-4274 (Oct. 12, 2004), [http://docsonline.wto.org/gen\\_home.asp?language=1&\\_=1](http://docsonline.wto.org/gen_home.asp?language=1&_=1) [hereinafter *Request for Consultations by the United States*]; see also Blustein, *supra* note 55. The United States alleged that Airbus benefited from at least US\$15 billion in subsidies provided by European countries for the development of aircraft. Blustein, *supra* note 55; Lunsford & Michaels, *supra* note 11. However, the crux of the U.S. complaint hinged on a 1992 agreement between the United States and several European countries collectively known as the European Economic Community. *Request for Consultations by the United States, supra*, Agreement Between the European Economic Community and the Government of the United States of America Concerning the Application of the GATT Agreement on Trade in Civil Aircraft on Trade in Large Civil Aircraft, Oct. 17, 1992, O.J. (L 301) at 32, [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=21992A1017\(01\)&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=21992A1017(01)&model=guichett) [hereinafter *GATT Agreement on Trade in Civil Aircraft*]. The agreement, though not particularly relevant here, addressed civil aircraft trade. *Id.* In fact, the United States Congress passed a resolution urging the President to withdraw the United States from the GATT Agreement on Trade in Civil Aircraft. S. Con. Res. 140, 108th Cong. (2004), LEXIS 2004 S. Con. Res. 140. Boeing issued a press release embracing the United States' action. BOEING, *Boeing Responds to U.S. Efforts to End Subsidies to Airbus*, at [http://www.boeing.com/news/releases/2004/q4/nr\\_041006a.html](http://www.boeing.com/news/releases/2004/q4/nr_041006a.html) (Oct. 6, 2004).

## III. THE CONGRESSIONAL DECISION

In the noted legislation, the American government repealed the ETI tax regime altogether.<sup>63</sup> The AJCA simply removed 26 U.S.C. § 114 from the United States Code, ridding the tax code of the deduction for extraterritorial income.<sup>64</sup> The AJCA took effect in January 2005.<sup>65</sup> However, it allows for a two-year transition period,<sup>66</sup> providing US\$8 billion in transitional relief for three years.<sup>67</sup> In 2005, 20% of extraterritorial income must be included in gross income,<sup>68</sup> and 40% must be included in 2006.<sup>69</sup> Beginning in 2007, the AJCA will take full effect, forcing exporting American businesses to include all 100% of their extraterritorial income in their gross income calculations.<sup>70</sup>

## IV. ANALYSIS

As acknowledged by the Chairman of the House Ways and Means Committee, Bill Thomas, the bill has produced headlines mostly for its alleged “special interest giveaways.”<sup>71</sup> News media have poked fun at the bill for providing tax breaks to, among others, “NASCAR track owners and importers of Chinese ceiling fans.”<sup>72</sup> However, the elimination of the ETI tax regime is the only portion of the 650-page bill relevant for this discussion.<sup>73</sup> Furthermore, Representative Thomas, sponsor of the AJCA, emphasized that the termination of the ETI tax regime is “[f]irst and foremost” in the legislation.<sup>74</sup>

U.S. officials had hoped the bill would end the growing countervailing tariffs and the dispute with the European Union.<sup>75</sup> Representative Thomas lauded the AJCA as the solution to the EU

---

63. H.R. 4520 § 101(a), 118 Stat. 1418, 1423, 108th Cong. (2004).

64. *Id.*

65. *Id.* § 101(c).

66. *Id.* § 101(d).

67. HOUSE COMM. ON WAYS AND MEANS, Conf. Rep. on H.R. 4520, *The American Jobs Creation Act of 2004*, H.R. REP. NO. 108-4520, at 1 (2004).

68. H.R. 4520 § 101(d)(2)(A).

69. *Id.* § 101(d)(2)(B).

70. *See id.* § 101 (establishing transition period and terms for the repeal of the exclusion for extraterritorial income).

71. Thomas, *supra* note 50. The special interest provisions amount to 5% of the total tax relief in the AJCA. *Id.* For example, the AJCA classifies Starbucks as a manufacturer of coffee, thus allowing manufacturing tax breaks for the coffeehouse. Murray & Wessel, *supra* note 1.

72. Jeffrey Sparshott, *President OKs Overhaul of Corporate Tax Law*, WASH. TIMES, Oct. 23, 2004, available at <http://www.washingtontimes.com/business/20041022-093809-2404r.htm>; H.R. 4520 §§ 704, 713.

73. Murray & Wessel, *supra* note 1.

74. Thomas, *supra* note 50.

75. *Id.*; Murray & Wessel, *supra* note 1; *see also* Barshay, *supra* note 10, at 2365-66.

countervailing sanctions against the United States.<sup>76</sup> Thomas assured exporters that “[t]he bill ends [the] punitive sanctions by repealing FSC-ETI.”<sup>77</sup> Senate Finance Chairman Charles Grassley lamented less confidently that, “[w]e never get a definitive statement out of [the European Union].”<sup>78</sup>

However, the initial EU reaction to the AJCA was a bit more cautious.<sup>79</sup> In a statement issued immediately after the news of the AJCA crossed the Atlantic, then-European Union Trade Commissioner Pascal Lamy said, “We will now carefully study the details in the final compromise between both chambers, in particular regarding transition periods, grandfathering clauses, as well as all other relevant fiscal provisions.”<sup>80</sup>

Within a week of President Bush’s signing the bill into law, the European Union moved to lift countervailing tariffs levied against the United States.<sup>81</sup> The European Union requested that the WTO review the AJCA, however, to ensure that it would sufficiently comply with the SCM Agreement.<sup>82</sup> If the AJCA complies, the European Union and the WTO may remove the punitive tariffs.<sup>83</sup> However, EU officials remain

---

76. Thomas, *supra* note 50.

77. *Id.*

78. Murray & Wessel, *supra* note 1.

79. See *US to Repeal Subsidies*, *supra* note 49 (European Union Trade Commissioner Laney said, “I am pleased that Congress has finally taken this step towards US compliance.”).

80. *Id.*

81. Miller, *supra* note 3; *EU Welcomes US Repeal*, *supra* note 58. The European Union also requested consultations with the United States, which were held on January 11, 2005, in Geneva, Switzerland, “with a view to reaching a mutually satisfactory solution of the matter.” *United States—Tax Treatment for “Foreign Sales Corporations”: Second Recourse to Article 21.5 of the DSU by the European Communities*, WTO Doc. 05-0183 (Jan. 14, 2005), <http://docsonline.wto.org/DDFDocuments/t/WT/DS/108-29.doc> [hereinafter *EU Second Recourse*]. Although the consultations “allowed a better understanding of the respective positions,” they did not lead to resolution. *Id.* The parties did agree, however, “not to extend any fresh subsidies or to seek arbitration at the World Trade Organisation,” for ninety days while the parties tried “to resolve their dispute over state aid to Airbus and its US rival Boeing.” *US Still Anxious for Talks with EU on Boeing-Airbus*, Apr. 15, 2005, <http://www.eubusiness.com/afp/050415140213.pujnucez>. That ninety-day period expired on April 11, 2005, without resolution in the Boeing-Airbus dispute. Although both sides say they would rather settle this via negotiation than via the WTO, neither side appears ready to budge. See Don Phillips & Katrin Bennhold, *United States and Europe Still Deadlocked on Jet Subsidies*, N.Y. TIMES, Apr. 12, 2005, available at <http://www.nytimes.com/2005/04/12/business/worldbusiness/12air.html>; see also Ambrose Evans-Pritchard, *Europe and US Head for War over Airbus Support*, TELEGRAPH, Apr. 13, 2005, available at <http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2005/04/13/cnairb13.xml&menuId=242&sSheet=/money/2005/04/13/ixcity.html>.

82. *EU Second Recourse*, *supra* note 81, at 2. The WTO will review the AJCA to determine whether the two-year transition period included in the “grandfathering clauses” violates the SCM Agreement. *Id.* The review process should last about ninety days. *Id.*

83. *Id.*

skeptical of the two-year transition period and have not ruled out extending the tariffs accordingly.<sup>84</sup> Then-European Union Trade Commissioner Pascal Lamy explained, "We have been trying to put FSC to bed for a long time. . . . It's now in bed, but we need to just check before the lights go out."<sup>85</sup> The *Wall Street Journal* estimates that the European Union had collected between US\$200 million and US\$300 million in 2004 before the AJCA put the ETI to bed in October 2004.<sup>86</sup> The newspaper further estimates that if the tariffs remained in effect, the European Union would collect a whopping US\$666 million in 2005.<sup>87</sup> U.S. exporters remain hopeful that the lights will officially be out on the ETI as soon as possible to avoid these exorbitant tariffs in 2005 and 2006.<sup>88</sup>

One glaring inconsistency in the AJCA is its timing. Despite Congress's obvious motive of avoiding punitive tariffs, Congress did not eliminate the ETI tax regime until nearly three years after the WTO ruled that ETI deductions violated the SCM Agreement and almost eighteen months after the WTO approved the EU plan to impose punitive tariffs on U.S. exports.<sup>89</sup> The sponsor of the AJCA proposed a similar bill in 2002, shortly after the news of the illegality of the ETI deduction.<sup>90</sup> However, this bill did not even make it out of the House Ways and Means Committee.<sup>91</sup> Passing the AJCA in 2004 with bipartisan support<sup>92</sup> is inconsistent with soundly defeating a similar bill in 2002.<sup>93</sup> Congress should not have been shocked when the European Union imposed punitive tariffs on U.S. exports, so a proactive measure would have been more appropriate.

The impact on American and European trade and markets will not be completely understood for some time. Boeing and other corporate

---

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. *See id.*

89. *See* Murray & Wessel, *supra* note 1. The WTO ruled that the ETI violated the SCM Agreement in January 2002, the WTO endorsed the EU plan to impose tariffs in May 2003, and the United States Congress repealed the ETI deduction in October 2004. *See also* WTO Doc. Jan. 14, 2002, *supra* note 7, ¶ 256, for the WTO's 2002 ruling.

90. Barshay, *supra* note 10, at 2365.

91. *Id.*

92. Thomas, *supra* note 50.

93. Of course, the 2002 proposal came during the 107th Congress, and the AJCA came during the 108th Congress. *See* H.R. 5095, 107th Cong. (2d Sess. 2002); *see also* H.R. 4520, 118 Stat. 1418, 108th Cong. (2004). Also, other provisions in the bills could have contributed to both votes on both sides. However, the policy of avoiding hundreds of millions of dollars in punitive tariffs imposed on American businesses would seem to be as valid in 2002 as in 2004.

giants like Caterpillar and General Electric fear the loss of the ETI tax break,<sup>94</sup> but the AJCA attempts to alleviate the losses sustained by American exporters. Congress hopes to offset exporters' losses by a reduction in corporate tax rates<sup>95</sup> and other tax breaks.<sup>96</sup> With regard to Boeing, the AJCA should suffice to end Airbus's complaint against them. However, negotiations between the United States and the European Union have been unsuccessful so far. In January 2005, the parties agreed to conduct "three months of intensive negotiations on eliminating subsidies to both companies."<sup>97</sup> The agreement included promises by both parties to avoid government aid and to refrain from WTO litigation as long as the negotiations continued.<sup>98</sup> Unfortunately for all parties, talks broke down in early April 2005 when U.S. Deputy Secretary of State Robert Zoellick accused EU Trade Commissioner Mandelson of refusing to negotiate in good faith.<sup>99</sup> Zoellick and Mandelson subsequently traded insults in the financial press.<sup>100</sup> Meanwhile, the international soap opera could turn into "the largest case handled by the WTO."<sup>101</sup> "Even though Mr. Zoellick is set to be replaced by Rob Portman as U.S. trade representative, . . . the acrimony has raised the likelihood that the dispute will require arbitration before the [WTO]."<sup>102</sup> Only time will tell whether the dispute will be settled with or without the WTO and whether the new tax breaks will sufficiently compensate the aircraft manufacturer for the loss of the ETI deduction.

## V. CONCLUSION

The WTO's policy seeks to minimize trade barriers between member countries, thereby promoting lower trade costs and competition among nations.<sup>103</sup> Thus, allowing one member state to subsidize a business could skew international competition in a particular industry. This distortion could conceivably exceed the distortion caused by

---

94. Miller, *supra* note 3.

95. JOINT COMM. COMMITTEE ON TAXATION, *supra* note 7, at 4. The AJCA reduces the highest corporate tax rate for large corporations from 35% to 32%, effective in 2007. *Id.*

96. *See generally* H.R. 4520.

97. Daniel Michaels et al., *U.S., EU Agree to Aerospace Talks*, WALL ST. J., Jan. 12, 2005, at A2.

98. *Id.*

99. Edward Alden, *US Ends Aircraft Subsidy Talks*, FIN. TIMES, Mar. 19, 2005, at 1.

100. Rafael Minder, *Zoellick Accuses Mandelson of Using Spin in Dispute over Aircraft Subsidies*, FIN. TIMES, Apr. 6, 2005, at 1.

101. Michaels et al., *supra* note 97.

102. Rafael Minder & Alan Beattie, *Trade Commissioner Revels in Leading Role on World Stage*, FIN. TIMES, Apr. 22, 2005, at 8.

103. WTO, *supra* note 16.

discriminatory tariffs imposed by a nation on imports. Assuming this policy, tolerating some sort of WTO restriction on subsidies seems quite logical and beneficial in working towards the WTO's goal. However, as the AJCA demonstrates, the current SCM Agreement is functionally unenforceable. Of course, violations of the SCM Agreement can be prosecuted in the WTO dispute resolution forum, but shrewd lawmakers could easily circumvent the SCM Agreement while providing domestic firms with a competitive advantage over foreign firms, as the U.S. Congress has done in the AJCA.<sup>104</sup> To offset the effects of repealing the ETI, the AJCA grants tax relief to many of the same businesses that benefited from both the FSC and ETI. Thus, a government desiring to give domestic businesses a competitive advantage in the international market could lower tax rates for the appropriate domestic businesses,<sup>105</sup> as the AJCA did.<sup>106</sup> This strategy would accomplish the same goal as directly providing subsidies by allowing businesses to save a comparable amount on federal tax, while protecting them from countervailing tariffs by other WTO nations.<sup>107</sup>

Because of the possibility of avoiding the SCM Agreement, the timing<sup>108</sup> of the AJCA is expensive to American businesses and their consumers.<sup>109</sup> The AJCA also may not completely prevent further EU

---

104. See generally SCM Agreement, *supra* note 26; see also H.R. 4520. The United States Congress will have successfully circumvented the SCM Agreement only if the WTO rules, as expected, that the AJCA sufficiently complies with the SCM Agreement. See Miller, *supra* note 3.

105. In adopting this strategy, lawmakers must carefully acknowledge the role in the SCM Agreement of specificity of subsidies. See SCM Agreement, *supra* note 26, art. 2. A tax break for domestic businesses would not likely be deemed specific if it did not target specific enterprises, it did not only target exporters, and it did not encourage discrimination against foreign goods in favor of domestic goods. *Id.* arts. 2-3.

106. The sponsor of the AJCA wrote:

With more than 95 percent of the world's consumers outside the United States, U.S. businesses and workers must be able to compete in the world marketplace to survive and prosper. This bill provides \$42 billion of reforms to bring the tax code into the 21st century by reducing double taxation and enhancing competitiveness so American businesses continue to be the best in the world.

Thomas, *supra* note 50.

107. One potential cost of this strategy is the overextension of tax relief. This problem could prove costly because a law must not provide a specific subsidy according to the SCM Agreement. Creative lawmakers could probably avoid this potentially expensive cost.

108. If the U.S. government had ended the subsidies before the European Union began levying countervailing tariffs against American exporters, U.S. businesses likely would have avoided the expensive tariffs because there would have been no need for the European Union to retaliate. This would have been feasible as the WTO first ruled that the ETI tax regime was illegal over two years before the European Union began imposing countervailing tariffs. Murray & Wessel, *supra* note 1; WTO Doc. Jan. 14, 2002, *supra* note 7, ¶ 256.

109. The cost of the countervailing tariffs levied by the European Union against American exporters will no doubt trickle down to consumers of the products. The American consumer will

countervailing tariffs against American exporters until 2007.<sup>110</sup> With a bit of luck, the AJCA could prevent these punitive duties as early as 2005.<sup>111</sup> Thus, the AJCA will not fully meet its goal of ending the largest trade war<sup>112</sup> ever between the United States and the European Union for at least a year and a half, and possibly as many as three and a half years, after the WTO endorsed the EU proposal to impose countervailing tariffs on the United States.<sup>113</sup> Thus, the ETI repeal is long overdue. The AJCA became law after the European Union levied between US\$200 and US\$300 million in countervailing tariffs against the United States.<sup>114</sup> As AJCA sponsor Bill Thomas said, “[w]e anxiously await the rest of the story.”<sup>115</sup> Although the rest of story may eventually be free from ETI controversy, trade relations between the United States and the European Union promise to remain turbulent as many other disputes remain between the economic powers.<sup>116</sup>

Jeff Stancill\*

---

likely bear more of the burden of the tariffs than the EU consumers. This is because American exporters will be hesitant to raise prices for EU consumers in order to maintain competition with EU producers. Increases in prices for the American market would probably be more practicable than simply raising prices proportionally related to the tariffs in Europe. For example, Boeing would probably be forced to keep European prices low to compete with Airbus in Europe. Boeing would probably have a better chance of success with higher prices in the United States because of other lower costs, including the transportation of finished goods. Thus, the tariffs indirectly, yet profoundly, impact the American consumer.

110. If the WTO rules that the AJCA's transition period violates the SCM Agreement, some form of countervailing tariffs will likely remain until the AJCA takes full effect in 2007.

111. The European Union will likely discontinue the countervailing tariffs when the WTO rules that the U.S. policy does not violate the SCM Agreement. If the WTO quickly rules that the AJCA's two-year transition period does not violate the SCM Agreement, the countervailing tariffs will probably be lifted very soon. However, if the WTO deems the transition period to be in violation of the SCM Agreement, the tariffs will probably remain, in some form, until 2007 when American exporters will not benefit from the ETI deductions at all. *See* Miller, *supra* note 3, at A2.

112. *Id.*

113. The WTO originally allowed the European Union to levy punitive tariffs from the United States in May 2003. Murray & Wessel, *supra* note 1. Depending on the WTO ruling, the tariffs will not be fully lifted until 2005 or possibly 2007. *Id.*

114. Miller, *supra* note 3. This estimate includes all tariffs levied until October 2004. *Id.*

115. Thomas, *supra* note 50.

116. *See, e.g.*, Miller, *supra* note 3. The United States has complained that the European Union does not consistently enforce customs procedures in its twenty-five Member States. *Id.* Seven WTO countries plan to impose sanctions on the United States for the Byrd Amendment's continued violation of antidumping rules and countervailing duties. Europa, *US Byrd Amendment: WTO Authorises Retaliation—US Urged to Conform to WTO Ruling*, at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/1410&format=HTML&aged=0&language=EN&guiLanguage=en>.

\* J.D. candidate 2006, Tulane University School of Law; B.A. History 2003, University of Mississippi.