WTO Rules U.S. Tax Breaks Illegal; EU May Retaliate

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The European Union said it may re- impose sanctions on as much as $4 billion a year in American goods after the World Trade Organization stood by a ruling that found the U.S. failed to end an illegal tax rebate for exporters.

A three-judge panel in Geneva today rejected a U.S. appeal of a Sept. 30 ruling, saying Congress ignored the WTO's order to scrap the tax credit immediately. Congress instead voted to phase out the measure over a 2 year period ending in 2006.

``The U.S. now has three months to act to avoid the re- imposition of retaliatory measures,'' EU Trade Commissioner Peter Mandelson said in a statement from Brussels. ``The EU will not accept a system of tax benefits which give U.S. exporters including Boeing an unfair advantage. We are seeking nothing more than the re-establishment of a level playing field.''

Congress voted in October 2004 to replace $50 billion in export credits with $145 billion in tax cuts for manufacturers and companies with overseas operations including Boeing Co., Caterpillar Inc. and Microsoft Corp. Phasing out the tax credits through 2006 rather than ending them immediately became a point of contention with the EU, and was deemed to violate WTO orders.

``I doubt Congress will revisit this legislation,'' U.S. Senate Finance Committee Chairman Charles Grassley said in a statement. ``That's especially so since the two-year transition is over at the end of this year.''

The U.S. plans to continue lobbying the EU to hold off on resuming sanctions, said Neena Moorjani, a spokeswoman for the U.S. Trade Representative's office in Washington.

``Prolonging this dispute will not serve to foster harmonious trans-Atlantic relations,'' she said.

Trade Ties

The EU argued that under WTO rules, the U.S. had to end the tax credits immediately because they were classified as ``prohibited.''

In the decision today, the WTO judges said the U.S. ``continues to fail to implement fully'' the arbitrators' recommendation ``to withdraw the prohibited subsidies.''

EU retaliation against U.S. goods ranging from paper and wood to jewelry and clothing began with an extra 5 percent duty in March 2004 and reached 14 percent nine months later. The 25- nation EU suspended the penalties shortly after the October congressional vote in Washington.

Sanctions will resume at 14 percent, rising 1 percent a month to a maximum of 17 percent, the EU said. The sanctions were the biggest permitted by the WTO.

``It will fall to the USTR to see if they can negotiate another resolution,'' said Pamela Olson, a partner with Skadden Arps in Washington, who helped craft the 2004 law as the U.S. Treasury Department's assistant secretary for tax policy. ``Given the current mood on trade in Congress, this is not a good time to take the issue back.''

Mood in Congress

After WTO judges ruled against the U.S. four months ago, the EU linked the tax dispute for the first time to a separate clash over development subsidies to European aircraft maker Airbus SAS that is also before the WTO. Boeing, Airbus's chief rival, is the biggest recipient of the U.S. tax breaks, according to the EU.

Moorjani said that imposing new EU sanctions over that tax break would only reinforce the perception that Europe is retaliating against the U.S. because of the Bush administration's WTO complaint against Airbus.

Boeing pocketed at least $168 million in 2004 from the export credits, one of several rebates that allowed the aircraft maker to reduce its tax burden to $140 million from $686 million, its annual report shows. Its rebate was $115 million in 2003 and $195 million in 2002. The company stands to gain $750 million over the next decade, the EU has said.

The EU first filed a case against the U.S. tax breaks in 1997. After a first WTO decision, American lawmakers overhauled the law in 2000, and the WTO then backed a second EU complaint that the changes were inadequate and authorized retaliation.

A provision of the rewritten law allows exporters to continue receiving the tax benefit beyond 2006 if a binding contract was entered into a year ago that includes a future purchase option, or renewal option. The phase-out will reduce the amount of the benefit by $1.4 billion this year, according to estimates prepared by the independent congressional Joint Committee on Taxation.

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