



Committee On Finance

Max Baucus, Chairman

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Statement of Chairman Max Baucus Hearing on the Role of the Extraterritorial Income Exclusion Act in the International Competitiveness of U.S. Companies

Today, the Committee hears testimony on the Extraterritorial Income Exclusion Act, known as the "ETI Act." This is the legislation we enacted in 2000, in a good faith effort to comply with the World Trade Organization decision in the foreign sales corporation matter.

In a dispute brought by the European Union, the WTO found the FSC (Foreign Sales Corporation) to be an impermissible export subsidy. It also found that the FSC did not qualify under an exception to the subsidy rules for provisions to avoid double taxation of the same income. Following that earlier WTO decision, we worked diligently, in a bipartisan fashion, to bring our law into compliance with WTO rules. We eliminated the export contingency of the provisions at issue, broadening them to include other categories of foreign source income. Our replacement was designed to avoid double taxation, rather than confer a subsidy.

Nevertheless, the WTO Appellate Body found that the ETI Act failed to cure the problem. This triggered an opportunity for the E.U. to seek authority to impose sanctions against the United States. That proceeding is still pending in Geneva, with a decision now expected in mid-August.

I would like to spend a moment recalling how we got to where we are today. To be perfectly blunt, the E.U.'s challenge to the FSC is a case that never should have been brought. Back in 1981, we reached an agreement with the European Community to resolve challenges to each other's tax laws. That agreement provided the foundation for adoption of the FSC. Recognizing the validity of the FSC, the E.U. refrained from challenging it for over 15 years. Then, only after losing the Beef and Bananas cases in the WTO, the E.U. cast aside our 1981 agreement and launched the FSC dispute. In short, this was a case brought by bureaucrats eager to even the dispute settlement score.

I am extremely disappointed that the E.U. has forced the issue to this point. But, I recognize that there is no use trying to replay the last inning. Rather, we need to decide the best plan for moving forward. To that end, I would suggest a few guiding principles.

First, whatever amount of sanctions the panel authorizes, the E.U. will not be required to retaliate. Indeed I would suggest that, given the complexity of this issue, imposing sanctions would be decidedly unhelpful in bringing about a long-term solution. The only way to resolve this matter once and for all is by working together, not playing tit for tat.

A second principle that should guide us is the goal of leveling the playing field. The January Appellate Body decision, together with the earlier decisions in this matter, leave the playing field significantly skewed. On the one hand, we are told that countries have a sovereign right to choose their own tax systems. On the other hand, WTO rules now have been interpreted to heavily favor one type of system over another. If you rely primarily on what the WTO calls “indirect taxes” – such as the value added tax, or VAT – you can rebate those taxes when goods are exported. On the other hand, if you rely primarily on “direct taxes” – such as income taxes – you risk violating WTO rules if you exclude from taxation certain income from export sales. This is an entirely artificial distinction. It reflects an overly simplistic view of how international corporate taxation works.

To eliminate this artificial distinction and to ensure that countries do indeed enjoy the sovereign right to choose their own taxation systems, we must revisit the interplay between WTO subsidies rules and taxation. That is why the conference report on the Trade Promotion Authority bill directs U.S. negotiators to address this very issue. It is my expectation that USTR will give this objective a high priority and make sure that the issue is included in the agenda for the current round of WTO negotiations. We are fortunate to have USTR Bob Zoellick with us today. I look forward to hearing from Ambassador Zoellick how he proposes to carry out this objective in the round.

A third principle to guide us through this matter is the “Do no harm” principle. In fixing ETI, we should not create incentives for U.S. companies to move abroad. This may sound like a statement of the obvious. But it needs to be said, because there are proposals under discussion that would do harm. I believe there are workable options with far less drastic consequences. Those are the options we should pursue.

Finally, we must recognize that whatever the solution to the FSC matter, it will take time. There are some who favor taking the hand we have been dealt, and using it to bring about radical reform of the corporate tax system. I do not agree with that approach. But, whether the ultimate answer lies in legislation or negotiation, or a combination of the two, it is likely to take several years to finalize. Acknowledging that doing this right will be a slow process, we should develop an understanding with the E.U. on how to operate in the interim. This will reassure businesses on both sides of the Atlantic. It also will help to ensure that FSC does not hinder our efforts to make progress in the new WTO round. Those are the issues on the table.

We are honored to have before us today two of the Administration’s key players in this matter, USTR Bob Zoellick, and Deputy Treasury Secretary Ken Dam. I look

forward to hearing from them and from all our witnesses. I hope that their insights will help to point the way forward.