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Does the United States Still Care About Complying with Its WTO Obligations?

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DOES THE UNITED STATES STILL CARE ABOUT COMPLYING WITH ITS WTO OBLIGATIONS?

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The Tax Cuts and Jobs Act of 2017 ("TCJA")[1] contains a provision that on its face appears to be a blatant violation of the WTO's Subsidies and Countervailing Measures (SCM) rules. New IRC section 250 applies a reduced 13.125% tax rate to "foreign derived intangible income" (FDII), which is defined as income derived in connection with (1) property that is sold by the taxpayer to any foreign person for a foreign use or (2) services to any foreign person or with respect to foreign property. In other words, this category comprises exports for property and services, including royalties from the licensing of intangibles.[2]

While services are excluded from the SCM, the FDII provision applies a lower rate (13.125% instead of 21%) to a domestic US corporation's sales of goods to any foreign person for a foreign use. FDII thus involves the non-collection or forgiveness of taxes otherwise due, i.e., a subsidy under the SCM, and the subsidy is contingent in law and in fact upon export performance.

The FDII is just the latest in a long series of US export subsidies that were struck down by the WTO and its predecessor the GATT (General Agreement on Tariffs and Trade). The first adverse decision was a GATT panel that declared the US "Domestic International Sales Corporation" (DISC) regime to be a prohibited export subsidy in the 1970s. The DISC regime was then replaced by the "Foreign Sales Corporation" (FSC) regime that was declared by the WTO's DSB (Dispute Settlement Body) and Appellate Body to be a prohibited export subsidy in the late 1990s. FSC was in turn replaced by the "Extraterritorial Income" (ETI) regime, which was declared to be a prohibited export subsidy in 2004. This led the GOP-controlled Congress and the Bush administration to repeal the ETI and replace it with a domestic manufacturing provision[3] that did not violate the SCM because it was not contingent on export performance.

This history was well known to the drafters of TCJA. In fact, the FDII provision is a direct descendant of the "border adjusted tax" (BTA) that was proposed by the House Republicans in 2016 and that was broadly declared to be a violation of the SCM. Nevertheless, the drafters of TCJA decided to repeal IRC section 199 (which did not violate the SCM) and replace it with the FDII, which (unlike, for example, the ETI) appears to be a blatant and obvious violation of the SCM.

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[1] Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017) [hereinafter TCJA].
[2] TCJA § 14202.
[3] I.R.C § 199.

The enactment of FDII raises several questions:

1. Is the FDII in fact a violation of the SCM?
2. Why did Congress enact the FDII in a form that seems to invite WTO scrutiny more than, for example, the ETI?
3. How likely is it that the EU or another WTO member will sue the US over the FDII?
4. If the WTO rules against the US, will the US respond as it did in 2004 and repeal the provision, or will it ignore it and bear the ensuing sanctions, or impose retaliatory sanctions?
5. Is the FDII a threat to continuing US membership in the WTO?