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BRAZIL – CERTAIN MEASURES CONCERNING TAXATION AND CHARGES

REPORTS OF THE PANEL

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US – Continued Zeroing	Appellate Body Report, *United States – Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, adopted 19 February 2009, DSR 2009:III, p. 1291
US – COOL	Appellate Body Reports, *United States – Certain Country of Origin Labelling (COOL) Requirements*, WT/DS384/AB/R / WT/DS386/AB/R, adopted 23 July 2012, DSR 2012:V, p. 2449
US – COOL (Article 21.5 – Canada and Mexico)	Appellate Body Reports, *United States – Certain Country of Origin Labelling (COOL) Requirements – Recourse to Article 21.5 of the DSU by Canada and Mexico*, WT/DS384/AB/RW / WT/DS386/AB/RW, adopted 29 May 2015
US – COOL (Article 22.6 – United States)	Decisions by the Arbitrator, *United States – Certain Country of Origin Labelling (COOL) Requirements – Recourse to Article 22.6 of the DSU the United States*, WT/DS384/ARB and Add.1 / WT/DS386/ARB and Add.1, circulated to WTO Members 7 December 2015
US – Countervailing and Anti-Dumping Measures (China)	Appellate Body Report, *United States – Countervailing and Anti-Dumping Measures on Certain Products from China*, WT/DS449/AB/R and Corr.1, adopted 22 July 2014, DSR 2014:VIII, p. 3027
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US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, p. 1619
US – FSC	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted 20 March 2000, as modified by Appellate Body Report WT/DS108/AB/R, DSR 2000:IV, p. 1675
US – FSC (Article 21.5 – EC)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, p. 55
US – FSC (Article 21.5 –	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*,

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EC)	WT/DS108/RW, adopted 29 January 2002, as modified by Appellate Body Report WT/DS108/AB/RW, DSR 2002:I, p. 119
US – Gambling	Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, adopted 20 April 2005, DSR 2005:XII, p. 5663 (and Corr.1, DSR 2006:XII, p. 5475)
US – Gambling	Panel Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, adopted 20 April 2005, as modified by Appellate Body Report WT/DS285/AB/R, DSR 2005:XII, p. 5797
US – Gasoline	Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, p. 3
US – Gasoline	Panel Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, adopted 20 May 1996, as modified by Appellate Body Report WT/DS2/AB/R, DSR 1996:I, p. 29
US – Large Civil Aircraft (2nd complaint)	Appellate Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, WT/DS353/AB/R, adopted 23 March 2012, DSR 2012:I, p. 7
US – Large Civil Aircraft (2nd complaint)	Panel Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, WT/DS353/R, adopted 23 March 2012, as modified by Appellate Body Report WT/DS353/AB/R, DSR 2012:II, p. 649
US – Offset Act (Byrd Amendment)	Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R, adopted 27 January 2003, DSR 2003:I, p. 375
US – Poultry (China)	Panel Report, *United States – Certain Measures Affecting Imports of Poultry from China*, WT/DS392/R, adopted 25 October 2010, DSR 2010:V, p. 1909
US – Section 211 Appropriations Act	Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 1 February 2002, DSR 2002:II, p. 589
US – Section 110(5) Copyright Act (Article 25)	Award of the Arbitrators, *United States – Section 110(5) of the US Copyright Act – Recourse to Arbitration under Article 25 of the DSU*, WT/DS160/ARB25/1, 9 November 2001, DSR 2001:II, p. 667
US – Section 337 Tariff Act	GATT Panel Report, *United States Section 337 of the Tariff Act of 1930*, L/6439, adopted 7 November 1989, BISD 36S/345
US – Shrimp	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, p. 2755
US – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, p. 571
US – Tobacco	GATT Panel Report, *United States – Measures Affecting the Importation, Internal Sale and Use of Tobacco*, DS44/R, adopted 4 October 1994, BISD 41S/131
US – Tuna II (Mexico)	Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381/AB/R, adopted 13 June 2012, DSR 2012:IV, p. 1837
US – Tuna II (Mexico) (Article 21.5 – Mexico)	Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products – Recourse to Article 21.5 of the DSU by Mexico*, WT/DS381/AB/RW and Add.1, adopted 3 December 2015
US – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005, DSR 2005:I, p. 3
US – Wool Shirts and Blouses	Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, and Corr.1, DSR 1997:I, p. 323

TABLE OF EXHIBITS CITED IN THESE REPORTS

No.	Full Title	Short Title (where relevant)
BRA-21	Brazilian Federal Constitution	Brazilian Federal Constitution
BRA-26	List of existing PPBs in Brazil concerning the Informatics Law	List of existing PPBs in Brazil concerning the Informatics Law
BRA-28	Implementing Orders adopting PPBs	
BRA-29	Ordinance No. 214, of 20 November 2006	Ordinance No. 214/2006
BRA-30	Ordinance No. 68, of 29 of February 2012	Ordinance No. 68/2012
BRA-31	Ordinance No. 165, of 22 of June 2011	Ordinance No. 165/2011
BRA-38	Brazilian Media Research 2015 (Pesquisa Brasileira de Mídia 2015)	
BRA-39	The Digital Divide, ICT, and Broadband Internet	
BRA-40	Decree No. 4,901, of 26 November 2003	Decree 4,901/2003
BRA-41	Decree No. 5,820, of 29 June 2006	Decree 5,820/2006
BRA-42	"UNESCO convenes session to discuss open and inclusive access to information"	
BRA-43	The Millennium Development Goals Report 2015	
BRA-44	National Survey through Household Sampling (*Pesquisa Nacional por Amostragem de Domicílios* - PNAD)	
BRA-51	Interministerial Explanatory Memorandum (*Exposição de Motivos Interministerial* - EMI) No. 00025/2012 - MF/MDIC/MCTI/MEC/MC/SEP/MS/MPS, dated 2 April 2012	Interministerial Explanatory Memorandum No. 00025/2012
BRA-52	WHO Article on road traffic injuries	
BRA-54	CONAMA Resolution No. 18 of 17 June 1986	CONAMA Resolution No. 18/1986
BRA-56	CONAMA Resolution No. 3 of 25 August 1989	CONAMA Resolution No. 3/1989
BRA-57	CONAMA Resolution No. 4 of 25 August 1989	CONAMA Resolution No. 4/1989
BRA-58	CONAMA Resolution No. 1 of 15 February 1993	CONAMA Resolution No. 1/1993
BRA-59	CONAMA Resolution No. 6 of 1 October 1993	CONAMA Resolution No. 6/1993
BRA-60	CONAMA Resolution No. 7 of 31 August 1993	CONAMA Resolution No. 7/1993
BRA-61	CONAMA Resolution No. 8 of 31 December 1993	CONAMA Resolution No. 8/1993
BRA-62	CONAMA Resolution No. 16 31 December 1993	CONAMA Resolution No. 16/1993
BRA-63	CONAMA Resolution No. 27 of 30 December 1994	CONAMA Resolution No. 27/1994
BRA-64	CONAMA Resolution No. 14 of 29 December 1995	CONAMA Resolution No. 14/1995
BRA-65	CONAMA Resolution No. 15 of 29 December 1995	CONAMA Resolution No. 15/1995
BRA-66	CONAMA Resolution No. 16 of 29 December 1995	CONAMA Resolution No. 16/1995
BRA-67	CONAMA Resolution No. 17 of 29 December 1995	CONAMA Resolution No. 17/1995
BRA-68	CONAMA Resolution No. 315 of 2 November 2002	CONAMA Resolution No. 315/2002
BRA-69	CONAMA Resolution No. 403 of 12 December 2008	CONAMA Resolution No. 403/2008
BRA-70	CONAMA Resolution No. 415 of 2009	CONAMA Resolution No. 415/2009
BRA-71	Transport and Urban Mobility Sectorial Plan for Climate Change Mitigation and Adaptation (*Plano Setorial de Transporte e de Mobilidade Urbana para Mitigação e Adaptação à Mudança do Clima* (PSTM)	Transport and Urban Mobility Sectorial Plan for Climate Change Mitigation and Adaptation
BRA-75	Article about WHO study on deaths caused by traffic accidents	
BRA-82	Lives Saved by Vehicle Safety Technologies and Associated Federal Motor Vehicle Safety Standard, 1960 to 2012, U.S. Department of Transportation, January 2015	
BRA-83	"Automotive safety: Brazil is still delayed" (*Segurança nos carros: o Brasil ainda está na rabeira*)	
BRA-85	Law 12,715/2012 of 17 September 2012	Law 12,715/2012
BRA-93	Treaty of Montevideo, 1980	
BRA-100	Law 10,637 of December 30, 2002	Law 10,637/2002
BRA-103	Law 11,457 of March 16, 2007	Law 11,457/2007

No.	Full Title	Short Title (where relevant)
BRA-104	Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 - SP (2012/0095341-6)	
BRA-114	Communication from LAIA to the Chair of the Trade and Development Committee, WTO, 19 May 2016	Communication from LAIA
BRA-115	Communication from LAIA to the Chair of the Trade and Development Committee, WTO, 19 May 2016 [english translation]	Communication from LAIA
BRA-116	List of Implementing Orders adopting PPBs	
JE-1	Law 8,248 of 23 October 1991 (Informatics Law)	Law 8,248/1991
JE-2	Law 13,023 of 8 August 2014, amending the Informatics Law (Law 8,248 of 23 October 1991)	Law 13,023/2014
JE-3	Law 5,172, 25 October 1966 (some relevant Articles on IPI only)	Law 5,172/1966 (Articles relevant to IPI only)
JE-5	Decree 7,660 of 23 December 2011 (approving the TIPI)	Decree 7,660/2011
JE-7	Decree 5,906 of 26 September 2006 (regulating Articles 4, 9, 11, and 16-A of Law 8,248 of 23 October 1991 – Informatics Law)	Decree 5,906/2006
JE-8	Decree 6,759 of 5 February 2009 governing customs activities	Decree 6,759/2009
JE-9	Decree 7,212 of 15 June 2010 regulating the charging, inspection, collection and administration of the IPI tax	Decree 7,212/2010
JE-12	Implementing Order (Portaria) MDIC/MCT 202 of 13 February 2014 providing for the adoption of an electronic system for interested companies to request accreditation to enjoy the tax incentives pursuant to the Informatics Law	Interministerial Implementing Order 202/2014
JE-13	Implementing Order (Portaria) MDIC 267 of 30 Aug 2013 providing for provisional qualification for entitlement to the tax benefits of Law 8,248 of 23 October 1991 as set out in Article 23-A of Decree 5,906 of 26 September 2006	Implementing Order 267/2013
JE-15	Implementing Order (Portaria) 1,309 of 19 December 2013	Implementing Order 1,309/2013
JE-16	Ministerial Implementing Order (Portaria) SDP/MDIC 1 of 18 September 2013 regulating provisional accreditation for tax relief pursuant to the Informatics Law	Interministerial Implementing Order 1/2013
JE-17	Interministerial Order (Portaria) 170 of 4 August 2010 laying down provisions governing the composition and operation of the Interministerial Technical Group for the analysis of Basic Productive Processe (GT-PPB), and regulating the procedures for the analysis and approval of the Basic Productive Process	Implementing Order 170/2010
JE-18	MDIC/MCT Interministerial implementing Order (Portaria) 177 of 18 October 2002 on administrative procedures for monitoring compliance with the Basic Production Process	Interministerial Implementing Order 177/2002
JE-20	Implementing Order (Portaria) 685 of 25 Oct 2007 for the inclusion of new models of products eligible for tax benefits under the Informatics Law	Implementing Order 685/2007
JE-21	Implementing Order (Portaria) 148 of 19 March 2007 (Interministerial Technical Chamber to analyse the concession of incentives)	Implementing Order 148/2007
JE-22	Implementing Order (Portaria) 950 of 12 December 2006 (requirement of "development" in the country)	Implementing Order 950/2006
JE-23	Normative Instruction RBF 1,300 of 20 November 2012 (Tax credits)	Normative Instruction RBF 1,300/2012
JE-24	Interministerial Implementing Order No 16 of 28 January 2014 establishing the Basic Production Process for machines for selecting and counting paper money (banknotes)produced in Brazil	Interministerial Implementing Order No 16/2014
JE-25	Interministerial Implementing Order (Portaria) 17 of 28 January 2014 amending the Basic Production Process for semiconductor components, optoelectronic devices, thick and thin film components, photovoltaic cells and standard volatile memory modules, produced in Brazil	Interministerial Implementing Order 17/2014
JE-26	Interministerial Implementing Order (Portaria) 19 of 28 January 2014 establishing the Basic Production Process for fixed x-ray machines with image acquisition via flat digital detector produced in Brazil	Interministerial Implementing Order 19/2014
JE-27	Interministerial Implementing Order (Portaria) 43 of 14 February 2013 on the Basic Production Process for computer products produced in Brazil	Interministerial Implementing Order 43/2013
JE-28	Interministerial Implementing Order (Portaria) 60 of 25 February 2013 on Basic Production Process for netbooks, notebooks and ultrabooks produced in Brazil	Interministerial Implementing Order 60/2013

No.	Full Title	Short Title (where relevant)
JE-29	Interministerial Implementing Order (Portaria) 80 of 14 April 2014 amending the Basic Production Process for low capacity digital processing units, based on microprocessors and assembled on a single body or housing produced in Brazil	Interministerial Implementing Order 80/2014
JE-30	Interministerial Implementing Order (Portaria) 85, of 29 April 2014 amending the Basic Production Process for digital processing units assembled in a single body or housing, of the server type, produced in Brazil	Interministerial Implementing Order 85/2014
JE-31	Interministerial Implementing Order (Portaria) 93 of 1 April 2013 establishing a basic production process for optical splice closures produced in Brazil	Interministerial Implementing Order 93/2013
JE-32	Interministerial Implementing Order (Portaria) 103 of 2 April 2013 on the Basic Production Process for products for speed alarms, tracking and control produced in Brazil	Interministerial Implementing Order 103/2013
JE-33	Interministerial Implementing Order (Portaria) 111 of 29 May 2014 Amending the Basic Production Process for tablet pcs with touch screen, produced in Brazil	Interministerial Implementing Order 111/2014
JE-34	Interministerial Implementing Order (Portaria) 119, of 23 April 2013 on basic production process for fixed/portable digital electrical signalling apparatus to control motor vehicle traffic, produced in Brazil	Interministerial Implementing Order 119/2013
JE-35	Interministerial Implementing Order (Portaria) 203 of 23 August 2012, the basic production process for liquid crystal devices for products with mcn code: 8528 and for products with mcn code: 471 produced in Brazil	Interministerial Implementing Order 203/2012
JE-36	Interministerial Implementing Order (Portaria) 263 of 19 March 2014 amending the Basic Production Process for mobile phones produced in Brazil	Interministerial Implementing Order 263/2014
JE-37	Interministerial Implementing Order (Portaria) 268 of 30 August 2013 on the basic production processes for supplies for multi-functional photocopier machines and laser printers produced in Brazil	Interministerial Implementing Order 268/2013
JE-38	Interministerial Implementing Order (Portaria) 278 of 4 September 2013 on the Basic Production Process for industrial automation goods produced in Brazil	Interministerial Implementing Order 278/2013
JE-39	Interministerial Implementing Order (Portaria) 333 of 16 October 2013 establishing the Basic Production Process for self-service coin counting machines, produced in Brazil	Interministerial Implementing Order 333/2013
JE-40	Interministerial Implementing Order (Portaria) 335 of 16 October 2013 establishing the Basic Production Process for dot matrix printers produced in Brazil	Interministerial Implementing Order 335/2013
JE-41	Interministerial Implementing Order (Portaria) 382 of 30 December 2013 establishing the Basic Production Process for Self-Service Machines and Terminals and Automatic Ticket, Banknote or Coin Dispensers,produced in Brazil	Interministerial Implementing Order 382/2013
JE-42	Interministerial Implementing Order (Portaria) 385 of 30 December 2013 providing for the Basic Production Process for air traffic surveillance radar produced in Brazil	Interministerial Implementing Order 385/2013
JE-43	Interministerial Implementing Order (Portaria) 388 of 30 December 2013 establishing the Basic Production Process for smart cards produced in Brazil	Interministerial Implementing Order 388/2013
JE-44	Interministerial Implementing Order (Portaria) 266 of 7 October 2014 for intelligent card reader produced in Brazil	Interministerial Implementing Order 266/2014
JE-45	Interterministerial Implementing Order (Portaria) 184 of 7 July 2014 notebook, netbook, ultrabook produced in Brazil	Interministerial Implementing Order 184/2014
JE-46	Interministerial Implementing Order (Portaria) 34 of 26 February 2015 (rejection of application)	Interministerial Implementing Order 34/2015
JE-66	Implementing Order (Portaria) 165 of 17 June 2014	Implementing Order 165/2014
JE-71	Law 11,484, of 31 May 2007 providing for the incentives to the Digital TV equipment and electronic semiconductor components industries and on the intellectual property protection of integrated circuit topographies, establishing the Semiconductor Technological Development Support Program - PADIS and Support Program for the Technological Development of the Digital TV Equipment Industry – PATVD	Law 11,484/2007

No.	Full Title	Short Title (where relevant)
JE-73	Decree 6,233, of 11 October 2007 establishing the criteria for the purpose of accreditation to the Semiconductor Technological Development Support Program - PADIS, which grants income tax exemption and reduces PIS/PASEP, COFINS and IPI contributions to zero	Decree 6,233/2007
JE-75	Decree 8,247 of 23 May 2014, amending Decree 6,233/2007	Decree 8,247/2014
JE-76	Regulatory Instruction RFB 852 of 13 June 2008 laying down procedures for qualification for the Programme for the Technological Development of the semiconductor Industry (PADIS) by Secretary of the Federal Revenue Department of Brazil	Regulatory Instruction RFB 852/2008
JE-77	Joint Ordinance MCT/MDIC/MF 297 of 13 May 2008 establishing the procedures and deadline for analysis of the PADIS, implementing Decree 6233 of 11 October 2007 (GTI-PADIS)	Interministerial Implementing Order 297/2008
JE-78	Interministerial Ordinance (Portaria) MCT/MDIC 290 of 7 May 2008 (project proposals)	Interministerial Implementing Order 290/2008
JE-85	Decree 6,234, from 11 October 2007 establishing criteria for the fulfilment of the incentives under the Support Program for the Technological Development of the Digital TV Equipment Industry – PATVD, which reduces the PIS/PASEP, COFINS and IPI tax rates to zero	Decree 6,234/2007
JE-86	Normative Instruction RFB 853 of 13 June 2008 laying down procedures for qualification for the Technological Development Programme for the Digital TV Equipment Industry - PATVD by Secretary of the Federal Revenue Department of Brazil	Normative Instruction RFB 853/2008
JE-88	Interministerial Ordinance 291 of 7 May 2008 (project proposal)	Interministerial Implementing Order 291/2008 (project proposal)
JE-89	Portaria 62 of 31 march 2014 (PPB digital TV transmitter produced in Brazil)	Implementing Order 62/2014
JE-91	Law. 11,196 of November 21 of 2005 Instituting the Program for Digital Inclusion (Lei do Bem)	Law 11,196/2005
JE-92	Law 13,097, of 19 January 2015 (extending the Digital Inclusion programme)	Law 13,097/2015
JE-93	Law 10,833 of 29 December 2003 amending Federal Tax Legislation (COFINS) – non-cumulative regime	Law 10,833/2003
JE-94	Law 10,637 of 30 December 2002	Law 10,637/2002
JE-95	Law 12,715 of 17 September 2012	Law 12,715/2012
JE-97	Decree 5,602 of 6 December 2005 governing the Digital Inclusion Programme by The President of the Republic	Decree 5,602/2005
JE-99	Implementing Order (Portaria) 2 of 26 august 2013 (criteria and procedures relating to the requirement of a minimum applications developed in Brazil, smartphones)	Implementing Order 2/2013
JE-100	Implementing Order 87 (Portaria) of 10 April 2013 (minimum technical requirements for the smartphones that benefit from the reduced tax rate provided for by Law 11,196 of 21 November 2005)	Implementing Order 87/2013
JE-104	CLEPA letter, correspondence between car maker and supplier on traceability of 24 February 2014	
JE-105	Calculating the Presumed IPI Tax Credit for Vehicle Manufacturers, Edison da Matta, Sindipecas, Valoracao da parcela deductivel, September 2014	E. da Matta, "*Valoração da parcela deductível*", Sindipeças, September 2014
JE-109	Interministerial Explanatory memorandum of the provisional measure that then became Law 11,848/2007	Interministerial Explanatory Memorandum No. 00008/2007
JE-127	Decree 7,567 of 15 September 2011	Decree 7,567/2011
JE-129	Law 12,546 of 14 December 2011 (Articles 5, 6 and 52)	Law 12,546/2011 (Articles 5, 6 and 52)
JE-132	Decree 7,819 of 3 October 2012	Decree 7,819/2012
JE-133	Decree 8,015 of 17 May 2013, amending Decree 7,819/2012	Decree 8,015/2013
JE-134	Decree 8,294 of 12 August 2014, amending Decree 7,819/2012	Decree 8,294/2014
JE-143	Reply to access to documents request (confidentiality of Terms of Commitment)	Reply to access to documents request (confidentiality of Terms of Commitment)
JE-154	Portaria 113 of 15 April 2013	Implementing Order 113/2013
JE-157	Portaria MDIC 290 of 14 November 2014	Implementing Order 290/2014
JE-158	Portaria MDIC 257 of 23 September 2014	Implementing Order 257/2014

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JE-159	SINIEF Convention s/n of 15 December 1970 (relevant excerpts), http://www1.fazenda.gov.br/confaz/confaz/convenios/sinief/cvsn_70.htm	SINIEF Convention 15/1970 (relevant excerpts)
JE-160	CONFAZ Convention 38 (relevant excerpts) http://www1.fazenda.gov.br/confaz/Confaz/Convenios/ICMS/2013/CV038_13.htm	CONFAZ Convention 38 (relevant excerpts)
JE-163	Decree 350 of 21 November 1991 on the Treaty for the formation of a common market between the Republic of Argentina, the Federative Republic of Brazil, the Republic of Paraguay and the Oriental Republic of Uruguay (MERCOSUR)	Legislative Decree 350/1991
JE-164	Decree 4,458 of 5 November 2002 on the Economic Complementation Agreement No. 55 between Mercosur and the United Mexican States	Decree 4,458/2002
JE-165	Decree 6,500 of 2 July 2008 on the Economic Complementation Agreement No. 14 between the Republic of Argentina and the Federative Republic of Brazil	Decree 6,500/2008
JE-174	Sindipeças e-mail to members on traceability, 20 January 2014	Sindipeças e-mail to members on traceability
JE-175	Portaria 772 of 12 August 2013	Implementing Order 772/2013
JE-177	Portaria 280 of 4 September 2013	Implementing Order 280/2013
JE-179	Portaria 297 of 30 September 2013	Implementing Order 297/2013
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JE-181	Law 10,865 of 30 April 2004	Law 10,865/2004
JE-182	Law 11,196 of 21 November 2005 (RECAP)	Law 11,196/2005
JE-183	Explanatory Memorandum of Provisional Measure 563 of 2 April 2012	Interministerial Explanatory Memorandum 00025/2012
JE-186	Exporters_2012 study on Brazilian exports - delays in refunds - pages 56-59	Exporters_2012 study on Brazilian exports – delays in refunds – pp. 56-59
JE-187	Decree 5,649 of 29 December 2005	Decree 5,649/2005
JE-188	Decree 5,789 of 25 May 2006	Decree 5,789/2006
JE-189	Provisional Measure 668 of 30 January 2015	Provisional Measure 668/2015
JE-191	Normative Instruction (Instrução Normativa) RFB 948 of 15 June 2009.	Normative Instruction RFB 948/2009.
JE-192	Normative Instruction (Instrução Normativa) RFB 1,424 of 19 December 2013	Normative Instruction RFB 1,424/2013
JE-193	Normative Instruction SRF 595 of 27 December 2005	Normative Instruction SRF 595/2005
JE-194	TIPI Chapter 87 products description	TIPI Chapter 87 products description
JE-195	Normative Instruction SRF 605 of 4 January 2006	Normative Instruction SRF 605/2006
JE-199	Law 12,546 of 14 December 2011	Law 12,546/2011
JE-200	Law 13,137 of 19 June 2015	Law 13,137/2015
JE-201	Normative Instruction (Instrução Normativa) RFB 1,401 of 9 October 2013	Normative Instruction RFB 1,401/2013
JE-203	Decree 6,518 of 30 July 2008 providing for the implementation of the Sixty Eighth Additional protocol to Economic Complementation Agreement No. 2, signed between the Governments of the Federative Republic of Brazil and the Oriental Republic of Uruguay	Decree 6,518/2008
JE-204	Decree 7,658 of 23 December 2011 laying down provisions concerning the implementation of the 69th Additional Protocol to Economic Complementation Agreement No. 2 signed by the Governments of the Federal Republic of Brazil and the Oriental Republic of Uruguay	Decree 7,658/2011
JE-207	Brazilian Ministry of External Relations, "Legal Guide to Foreign Investors in Brazil" (2012)	
JE-219	Normative Instructions SRF 594 of 26 December 2005 (Articles 6 and 7)	Normative Instructions SRF 594/2005 (Articles 6 and 7)
JE-220	Law 9,718 of 27 November, 1998 (Chapter 1)	Law 9,718/1998 (Chapter 1)
JE-222	Law 10,168 of December 29 2000	Law 10,168/2000
JE-245	CMC Decision No. 27/12, Adesão da República Bolivariana da Venezuela ao Mercosul, 30 July 2012	MERCOSUR Decision No. 27/12

ABBREVIATIONS USED IN THESE REPORTS

Abbreviation	Description
ADE	Executive Declaratory Act
BCI	Business Confidential Information
CAPDA	Committee of Research and Development Activities of Amazonia
CATI	Committee of Technology and Information
CDMA	Code Division Multiple Access
CIDE	Contribution of Intervention in the Economic Domain
CIF	Cost, Insurance & Freight value
COFINS contribution	Contribution to Social Security Financing
COFINS importation	Contribution to Social Security Financing applicable to Imports of Goods or Services
CONAMA	Brazilian National Environmental Council
CO_2	Carbon Dioxide
CST	Tax Situation Code
DENATRAN	National Motor Vehicle and Traffic Department
DERAT	Tax Administration Federal Revenue Department Branch
DRF	Federal Revenue Department Branch
DSB	Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
ECA	Economic Complementation Agreement
FM	Frequency Modulation
FNDCT	National Fund for Scientific and Technological Development
GATT 1994	General Agreement on Tariffs and Trade 1994
GPS	Global Positioning System
GPRS	General Packet Radio Service
GSM	Global System for Mobile Communication
GT-PPB	Interministerial Technical Group of PPB's Assessment
GTI-PADIS	Interministerial Technical Group to Evaluate Lawsuits in the context of the PADIS programme
ICMS	Tax on the Circulation of Goods and on Inter-State and Inter-City Transport and Communications Services
ICT	Information and Communication Technology
ICT products	Information and Communication Technology, Automation and Related Goods
IVA	An Indirect Tax similar to a Value-Added Tax
INMETRO	National Institute of Metrology, Quality and Technology
INOVAR-AUTO	Programme to Promote Technological Innovation and Densification of the Productive Chain of Motor Vehicles
IPI tax	Tax on Industrialised Products
LAIA	Latin American Integration Association
LBS	Location Based Service
LCD	Liquid crystal display
LED	Light emitting diode
MC	Ministry of Communications
MCTI	Ministry of Science, Technology and Innovation
MDGs	Millennium Development Goals
MDIC	Ministry of Development, Industry and Trade
MERCOSUR	Mercado Común del Sur (Southern Common Market)
MCN	MERCOSUR Common Nomenclature
MFN	Most Favoured Nation
MF	Ministry of Finance
NC	Common Nomenclature
NTM	Non-Tariff Measure
OLED	Organic light emitting diode
PADIS	Programme of Incentives for the Semiconductors Sector
PASEP	Civil Service Asset Formation Programme
PATVD	Programme of Support to the Technological Development of the Industry of Digital TV Equipment
PDP	Plasma display panel
PEC	Regime for predominantly exporting companies
PIS	Social Integration Programme
PIS/PASEP - Importation	Social Integration and Civil Service Asset Formation Programmes applicable to Imports
PPB	Basic Productive Process
PROCONVE	Motor Vehicle Air Pollution Control Program
PTA	Preferential Trade Arrangements
R$	Brazilian real

Abbreviation	Description
R&D	Research and Development
RECAP	Special Regime for the Purchase of Capital Goods for Exporting Enterprises
REPES	Special Tax Regime for the Exportation Platform of Information Technology Services
RFB	Federal Revenue Service of Brazil
RTA	Regional Trade Agreements
SBTVD	Brazilian digital television standard
SCM Agreement	Agreement on Subsidies and Countervailing Measures
S&D	Special and Differential Treatment
SDP	Secretariat for Production Development
SINIEF	Integrated National System of Economic and Tax Information
SISCOMEX	Integrated Foreign Trade System
STE	Secretary for Telecommunications
SRF	Secretariat of the Federal Revenue Service of Brazil
SUDAM	Superintendency for the Development of the Amazonia
SUDENE	Superintendency for the Development of the Northeast
TFEL	Thin film electroluminescent displays
TIPI	Table of Application of the Tax on Industrialised Products
TRIMs Agreement	Agreement on Trade-Related Investment Measures
TV	Digital Television
UN	United Nations
UNECE	United Nations Economic Commission for Europe
UNESCO	United Nations Educational, Scientific and Cultural Organization
VAT	Value-Added Tax
Vienna Convention	Vienna Convention on the Law of Treaties, Done at Vienna, 23 May 1969, 1155 UNTS 331; 8 International Legal Materials 679
WHO	World Health Organization
WTO	World Trade Organization

1 INTRODUCTION

1.1 Complaints by the European Union and Japan

1.1. On 19 December 2013, the European Union requested consultations with Brazil pursuant to Articles 1 and 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article XXII of the General Agreement on Tariffs and Trade 1994 (the GATT 1994), Article 4 of the Agreement on Subsidies and Countervailing Measures (the SCM Agreement), and Article 8 of the Agreement on Trade-Related Investment Measures (the TRIMs Agreement), with respect to the measures and claims set out below.[1]

1.2. Consultations were held on 13-14 February 2014. An additional consultation meeting took place on 4 April 2014.

1.3. On 2 July 2015, Japan requested consultations with Brazil pursuant to Articles 1 and 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Article XXII:1 of the GATT 1994, Articles 4 and 30 of the SCM Agreement and Article 8 of the TRIMs Agreement with respect to the measures and claims set out below.[2]

1.4. Consultations were held on 15-16 September 2015.

1.2 Panel establishment and composition

1.5. On 31 October 2014, the European Union requested the establishment of a panel pursuant to Article 6 of the DSU, Article XXIII of the GATT 1994, Articles 4.4 and 30 of the SCM Agreement, and Article 8 of the TRIMs Agreement, with standard terms of reference.[3] At its meeting on 17 December 2014, the Dispute Settlement Body (DSB) established a panel pursuant to the request of the European Union in document WT/DS472/5, in accordance with Article 6 of the DSU.[4]

1.6. The Panel's terms of reference are the following:

> To examine, in the light of the relevant provisions of the covered agreements cited by the parties to the dispute, the matter referred to the DSB by the European Union in document WT/DS472/5 and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.[5]

1.7. On 16 March 2015, the European Union requested the Director-General to determine the composition of the panel, pursuant to Article 8.7 of the DSU. On 26 March 2015, the Director-General accordingly composed the Panel as follows:

Chairperson:	Mr Eirik Glenne
Members:	Mr Toufiq Ali Mr Alvaro Espinoza

1.8. Argentina, Australia, Canada, China, Colombia, India, Japan, the Republic of Korea, the Russian Federation, South Africa, Chinese Taipei, Turkey and the United States notified their interest in participating in the Panel proceedings as third parties.

1.9. On 17 September 2015, Japan requested the establishment of a panel pursuant to Articles 4.7 and 6 of the DSU, Article XXIII of the GATT 1994, Article 8 of the TRIMs Agreement, and Articles 4.4 and 30 of the SCM Agreement, with standard terms of reference.[6] At its meeting

[1] See WT/DS472/1, G/L/1061, G/SCM/D100/1, G/TRIMS/D/39.
[2] See WT/DS497/1, G/L/1119, G/SCM/D108/1, G/TRIMS/D/41.
[3] WT/DS472/5.
[4] WT/DSB/M/353.
[5] WT/DS472/6.
[6] WT/DS497/3.

on 28 September 2015, the Dispute Settlement Body (DSB) established a panel pursuant to the request of Japan in document WT/DS497/3, in accordance with Article 6 of the DSU.[7]

1.10. The Panel's terms of reference are the following:

> To examine, in the light of the relevant provisions of the covered agreements cited by the parties to the dispute, the matter referred to the DSB by Japan in document WT/DS497/3 and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.[8]

1.11. On 29 September 2015, following the agreement of the parties, the Panel was composed as follows:

Chairperson:	Mr Eirik Glenne
Members:	Mr Toufiq Ali Mr Alvaro Espinoza

1.12. Argentina, Australia, Canada, China, Colombia, the European Union, India, the Republic of Korea, the Russian Federation, Singapore, Turkey, Ukraine and the United States notified their interest in participating in the Panel proceedings as third parties.[9]

1.3 Panel proceedings

1.3.1 General

1.13. After consultation with the European Union and Brazil, the Panel adopted its Working Procedures[10] and timetable on 28 April 2015.

1.14. Following the establishment of the Panel upon request from Japan, and pursuant to Article 9.3 of the DSU, the Panels were composed with the same persons and, in agreement with the parties, are following a joint procedure.[11]

1.15. After consultation with the European Union, Japan and Brazil, the Panel adopted its Joint Working Procedures[12] and joint timetable on 9 October 2015. Paragraph 26(d) of the Joint Working Procedures provides that each party shall serve on all third parties (WT/DS472 and WT/DS497) its written submissions in advance of the first substantive meeting with the Panel and each third party shall serve any document submitted to the Panel directly on the parties and all other third parties (WT/DS472 and WT/DS497).

1.16. The Panel held a first substantive meeting with the parties from 23 February to 25 February 2016. A session with the third parties took place on 24 February 2016. The Panel held a second substantive meeting with the parties from 31 May to 1 June 2016. On 9 August 2016, the Panel issued the descriptive part of its Report to the parties. The Panel issued its Interim Reports to the parties on 11 November 2016. The Panel issued its Final Reports to the parties on 20 December 2016.

1.3.2 Working procedures on Business Confidential Information (BCI)

1.17. Working procedures on BCI were adopted on 28 April 2015.[13] Additional Joint Working Procedures on BCI were adopted on 9 October 2015.[14]

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[7] WT/DSB/M/368.
[8] WT/DS497/4.
[9] Turkey notified its third party interest on 9 October 2015. See WT/DS497/4.
[10] See the Panel's Working Procedures in Annex A-1.
[11] For the reader's convenience, the Panels in WT/DS472 and WT/DS497 are herein collectively referred to as the "Panel". Additionally, any references to "this report" or the Panel's "report" should be understood to refer to the Panel's Final Reports in both disputes.
[12] See the Panel's Joint Working Procedures in Annex A-3.
[13] See the Panel's Working Procedures on BCI in Annex A-2.

2 FACTUAL ASPECTS

2.1 General description of relevant aspects of the Brazilian tax system

2.1. In this section the Panel outlines certain topics which, although they are not themselves the measures at issue, have been addressed by the parties in their submissions and may be of relevance for the purposes of this Panel's findings. The Panel notes that the parties to the dispute seem to agree on the basic functioning of the tax system in Brazil and most of the aspects of the concerned tax programmes including their defining measures, but disagree with respect to the WTO-consistency of those measures.[15]

2.2. The measures at issue in this dispute concern mainly the following Brazilian Federal taxes and contributions[16]:

a. **IPI** (*Imposto sobre Produtos Industrializados* – Tax on Industrialised Products);

b. **PIS/PASEP** (*Programa de Integração Social* – Social Integration Programme / *Programa de Formação do Patrimônio do Servidor Público* – Civil Service Asset Formation Programme);

c. **PIS/PASEP-Importation** (*Programa de Integração Social e de Formação do Patrimônio do Servidor Público incidente na Importação de Produtos Estrangeiros ou Serviços* – Social Integration and Civil Service Asset Formation Programmes applicable to Imports of Foreign Goods or Services);

d. **COFINS** (*Contribuição para o Financiamento da Seguridade Social* – Contribution to Social Security Financing);

e. **COFINS-Importation** (*Contribuição para o Financiamento da Seguridade Social incidentes sobre a importação de bens e serviços* – Contribution to Social Security Financing applicable to Imports of Goods or Services); and

f. **CIDE** (*Contribuição sobre Intervenção no Domínio Econômico* – Contribution of Intervention in the Economic Domain).

The IPI tax

2.3. The IPI tax is a Brazilian Federal tax that applies to all national or foreign industrialized (i.e. manufactured) products.[17] It is envisaged in item IV of Article 153 of the Brazilian Federal

[14] See the Panel's Additional Joint Working Procedures on BCI in Annex A-4.

[15] In this respect, "Brazil understands that the overall factual explanations made by the complaining parties are correct; the legal consequences from the facts, however, are incorrect". See Brazil's response to Panel question No. 17.

[16] Other taxes concerned are ordinary customs duties, the corporate income tax and the duties on profits from exploitation of patents.

[17] An industrialized product is defined by Decree 7,212 of 15 June 2010 as that which results from any operation defined as industrialization, even if it is incomplete, partial or intermediate. Industrialization, in turn, is defined as any operation that modifies the nature, functioning, presentation or finality of a product, or that perfects its consumption, such as: (i) those carried out on raw materials or intermediary products leading to a new item (transformation); (ii) those which seek to change, improve or in any way alter the functioning, use, finishing or appearance of a product (processing); (iii) those which consist of the joining of products, pieces or parts and which results in a new product or autonomous unit, even with the same tax classification (assembly); (iv) those which seek to change the presentation of the product through placing into packaging, whether to replace the original or not, except when the packaging is only for use during the carriage of the goods (packaging or re-packaging); or (v) those carried out on a used product or remaining part of a deteriorated or unused product, which renews or restores the product for use (renewal or reconditioning). Decree 7,212 of 15 June 2010, (Decree 7,212/2010), (Exhibit JE-9), Articles 2-4.

Constitution[18] and regulated through Laws 5,172 of 25 October 1966[19] and 4,502 of 30 November 1964, and Decree 7,212 of 15 June 2010.[20]

2.4. The IPI tax rates are product-specific, and generally range between 0% and 20%, although they can reach up to 300%. The Brazilian government issued a table (*Tabela de Incidência do imposto sobre produtos industrializados – TIPI*) by means of Decree 7,660 of 23 December 2011[21], setting out the applicable tax rates per product.

2.5. The IPI tax is linked to the price or value of the industrialized product on which it is imposed. In the case of domestic products, the taxable base is the transaction value. In the case of imported products, the taxable base is the customs value plus the import duties and charges paid. In the case of industrialised products acquired in auction, the taxable base is the price of the auctioned product.[22]

2.6. The entities with the legal responsibility for the payment of the IPI tax to the Federal Revenue Service are the industrial establishments, or assimilated entities, that sell an industrialized product. The entities assimilated to industrial establishments under the IPI rules are importers, wholesalers or retailers that commercialize industrialized products. The final economic burden is borne by the purchaser of the final good, whether it is a legal or a natural person.

2.7. The taxable event is, in the case of domestic products, the exit of the industrialized product from the industrial establishment; in the case of an imported product, the customs clearance of the product; and, in the case of abandoned or seized goods, the acquisition of the product at auction.[23]

2.8. The IPI tax is not paid directly by the entity bearing the ultimate burden of paying the IPI tax. In the case of domestic products, the IPI tax is charged by the industrial establishment selling the industrialized product to the industrial establishment, or assimilated entity, buying the industrialized product. The taxes retained by the industrial establishment selling the industrialized product must be remitted to the Federal Revenue Service on a monthly basis, specifically on the 25th day of the subsequent month following the transaction. In the case of imported products, the IPI tax is charged by the customs authorities to the importer of the industrialized product during the customs clearance process.

2.9. It is important to note that the IPI tax applies only with respect to transactions between industrial establishments or assimilated entities or individuals. For instance, an industrial establishment that performed any type of industrialization on a product, but did not finish the product (i.e. did not complete the last stage of a production chain before commercialization of the final product), will charge the IPI tax to an establishment purchasing the industrialized product (or *intermediate* product) to further manufacture it. The industrial establishment that further manufactured the product will charge the IPI tax to the wholesaler or retailer that purchases the industrialized product to commercialize it. However, the IPI tax will not be due on the sale made by the wholesaler or retailer to the final consumer, because there was no further manufacturing of the product.

2.10. By constitutional requirement, the IPI tax "shall be non-cumulative, and the tax due in each transaction shall be compensated by the amount charged in previous transactions".[24] Article 225 of Decree 7,212/2010 states that "non-cumulativeness becomes effective by means of the credit system of the tax due on products entering the facilities of the taxpayer, which will be deducted from the amount due on the exit of products, in the same period".[25] This means that when a taxpayer remits to the government the IPI tax collected for any given transaction, the taxpayer may deduct the IPI tax paid in earlier stages of the supply chain. This ensures that the tax is levied only on the value added.

[18] Constitution of the Federative Republic of Brazil, (Brazilian Federal Constitution), (Exhibit BRA-21).
[19] Law 5,172 of 25 October 1966, (Law 5,172/1966), (Exhibit JE-3).
[20] Decree 7,212/2010, (Exhibit JE-9).
[21] Decree 7,660 of 23 December 2011, (Decree 7,660/2011), (Exhibit JE-5).
[22] Law 5,172/1966, (Exhibit JE-3), Article 47.
[23] Law 5,172/1966, (Exhibit JE-3), Article 46.
[24] Brazilian Federal Constitution, (Exhibit BRA-21), Article 153, para. 3(II).
[25] Brazil's response to Panel question No. 69.

2.11. Under this non-accumulation rule, when an industrial establishment buys an industrialized product that will be subject to further manufacturing (i.e. an *intermediate* product), the seller charges the IPI tax to the buyer and the buyer obtains a credit in the same amount of the tax paid. This credit will be deducted from the buyer's IPI tax debits when paying its monthly IPI tax liabilities due on the 25th day of the subsequent month following the transaction. When the industrial establishment sells the now *finished* product to a wholesaler or retailer, it will charge the IPI tax to that wholesaler or retailer and remit the tax to the Federal Revenue Service when paying its monthly tax liabilities.

2.12. For example, if the industrial establishment pays R$10 of IPI tax when purchasing the industrialized *intermediate* product, it will obtain a credit of R$10 to deduct from its IPI tax debits when paying its IPI tax liabilities due on the 25th day of the subsequent month following the transaction. If the industrial establishment sells the now *finished* product and, after having added some value to the product, charges R$20 of IPI tax to the wholesaler, the industrial establishment selling the product will transfer R$20 to the Federal Revenue Service. However, because it had already obtained, and in normal circumstances used in paying its monthly IPI tax liabilities, the tax credit of R$10, the real amount of tax paid for that specific product by that industrial establishment will have been only R$10, which is the tax corresponding to the value added.

2.13. In the case of a tax exemption (including through zero rates) on the sales of an industrialized *intermediate* product, if an industrial establishment sells an industrialized *intermediate* product with the IPI tax exempted, the industrial establishment that will further manufacture the *intermediate* product will not have to pay the IPI tax to the seller and the seller will not have to remit any money to the Federal Revenue Service. In this situation, the buyer will not obtain a tax credit. For instance, if an industrial establishment buys an industrialized *intermediate* product with an exempted IPI tax that would otherwise be of R$10, it will not be required to pay R$10 to the seller, but it will not obtain a credit of R$10. This industrial establishment will further manufacture the industrialized *intermediate* product to obtain an industrialized *finished* product, and, when it sells the *finished* product, it will charge the IPI tax equivalent to its value added, for example, R$10, plus the previous value added of R$10, to the wholesaler. Thus, the industrial establishment will transfer R$20 to the Federal Revenue Service, but only after the industrialized *finished* product is sold.

2.14. When an industrial establishment sells an industrialized *finished* product to a wholesaler or retailer, it will charge the IPI tax to the wholesaler or retailer and remit the tax to the Federal Revenue Service when paying its monthly tax liabilities, although it will be able to deduct from its tax debits the tax credits previously accrued.

2.15. In the case of a tax exemption (including through zero rates) on the sale of an industrialized *finished* product, if an industrial establishment sells an industrialized *finished* product with the IPI tax exempted, the wholesaler or retailer will not have to pay any IPI tax to the seller and the seller will not have to remit any money to the Federal Revenue Service.

2.16. By the same principle of non-accumulation, industrial establishments are entitled to obtain credits on the amount of IPI tax paid on the purchase of *inputs*, *raw materials* and p*ackaging materials* used in the production of their industrialized products.[26] Thus, as explained in the case of *intermediate* industrialized products (which are inputs for the industrial establishment buying them), when the industrial establishment buys *inputs*, *raw materials* and *packaging materials*, it will pay the IPI tax to the seller, but will obtain a tax credit on the same amount of the tax paid, which it will be able to deduct from its IPI tax debits when paying its monthly IPI tax liabilities due on the 25th day of the subsequent month following the transaction. When the industrial establishment sells the industrialized product to another industrial establishment or assimilated entity, it will charge the IPI tax to the buyer and remit the tax to the Federal Revenue Service when paying its monthly tax liabilities.

2.17. For example, if the industrial establishment pays R$10 of IPI tax when purchasing the *inputs*, *raw materials* and *packaging materials*, it will obtain a credit of R$10 to deduct from its IPI tax debits when paying its IPI tax liabilities due on the 25th day of the subsequent month following the transaction. If the industrial establishment sells an industrialized product (*intermediate* or *finished*) and, after having added some value to the product, charges, for example, R$20 of IPI tax

[26] Brazil's response to Panel's question No. 69.

to the industrial establishment or assimilated entity, then the industrial establishment selling the product will transfer R$20 to the Federal Revenue Service. However, because it had already obtained, and in normal circumstances used, the tax credit of R$10, the real amount of tax paid for that specific product by that industrial establishment will have been R$10, which is the tax corresponding to the value added.

2.18. In the case of tax exemptions (including through zero rates) on the purchases of *inputs*, *raw materials* and *packaging materials*, if an industrial establishment buys *inputs*, *raw materials* and *packaging materials* with the IPI tax exempted or suspended, it will not have to pay the tax to the seller and the seller will not have to remit any money to the Federal Revenue Service. In this situation, the buyer will not obtain a tax credit. For instance, if an industrial establishment buys an input with an exempted IPI tax that would otherwise be R$10, it will not be required to pay R$10 to the seller, but it will not obtain a credit of R$10. This industrial establishment will use the *input* to manufacture an industrialized product (*intermediate* or *finished*) and, when it sells the *finished* product, it will charge the IPI tax equivalent of its value added R$10, plus the previous value added of R$10, to the wholesaler. Thus, the industrial establishment will transfer R$20 to the Federal Revenue Service, but only after the product is sold.

2.19. It is important to note that Article 225 of Decree 7,212/2010 states that "when, during a certain period of analysis, from the comparison of debits and credits, a credit balance is found, it will be transferred to the next period".[27] This means that when the IPI tax credits in a given month exceed the IPI tax debits for that month, the excess credits may be carried forward, i.e. used to offset IPI obligations arising in subsequent months.

2.20. In cases where, in spite of the carry-forward, the IPI tax debits are lower than the IPI tax credits after a 3-month period, the entity liable for the tax may either use the IPI tax credits in question to compensate other Federal tax liabilities, or request a reimbursement of the IPI tax credits, within five years of the accrual of the IPI credits.[28] The reimbursement process may take from several months to years.[29]

The PIS/PASEP and COFINS Contributions

2.21. PIS/PASEP and COFINS are Brazilian Federal contributions that apply to gross revenues earned by all types of legal entities. The PIS/PASEP and COFINS contributions are envisaged in Article 195 of the Brazilian Federal Constitution[30] and regulated through Laws 9,718 of 27 November 1998[31] and 10,637 of 30 December 2002[32], in the case of PIS/PASEP, and Law 10,833 of 29 December 2003, in the case of COFINS.[33]

2.22. The PIS/PASEP and COFINS contributions are subject, as a general rule, to the non-cumulative regime.[34]

2.23. The contribution rates for the non-cumulative regime are, as a general rule, 1.65%[35] for PIS/PASEP and 7.6%[36] for COFINS, for a combined rate of 9.25%, although different rates apply to the revenue arising from sales to certain companies, from sales of certain specific products, or from the provision of certain services.

[27] Brazil's response to Panel's question No. 69.

[28] Normative Instruction RFB 1,300 of 20 November 2012, (Normative Instruction RFB 1,300/2012), (Exhibit JE-23), Article 21.

[29] The general rule, according to Article 24 of Law 11,457 of 16 March 2007, is that an administrative decision must be rendered within not more than three hundred and sixty (360) days from the taxpayer's filing of administrative petitions, answers or appeals. Law 11,457 of 16 March 2007, (Law 11,457/2007), (Exhibit BRA-103), Article 24. See also, i.e. Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 - SP (2012/0095341-6), (Exhibit BRA-104), para. 5.

[30] Brazilian Federal Constitution, (Exhibit BRA-21).

[31] Law 9,718, of 27 November 1998, (Law 9,718/1998), (Exhibit JE-220).

[32] Law 10,637 of 30 December 2002, (Law 10,637/2002), (Exhibits JE-94 and BRA-100).

[33] Law 10,833 of 29 December 2003, (Law 10,833/2003), (Exhibit JE-93).

[34] Brazil's first written submissions, para. 64 (DS472) and para. 28 (DS497).

[35] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 2.

[36] Law 10,833/2003, (Exhibit JE-93), Article 2.

2.24. The taxable base is the taxable legal person's monthly turnover, which is considered to be all income earned by the legal entity, regardless of its name or accounting classification.[37] In the case of a legal entity engaged in trade in goods, the taxable base is the gross revenue from the total sales recognised for the reporting period, minus the revenue resulting from certain deductible items, such as subsidies, capital gains, and cancelled sales.

2.25. The taxable persons are all enterprises that receive revenue from their business activities. A legal entity selling a product will charge the amount of PIS/PASEP and COFINS contributions with respect to that product to the legal entity buying the product, and will then remit the amount of the contributions to the Government when it pays its PIS/PASEP and COFINS liabilities due on the 25th day of the subsequent month following the transaction.

2.26. Similarly to the IPI tax, the PIS/PASEP and COFINS contributions under the non-cumulative regime operate as taxes on value-added, where companies generate credits in relation to their purchases of taxed products, which they can offset with debits when paying their PIS/PASEP and COFINS liabilities due on the 25th day of the subsequent month following the transaction. The system of tax credits ensure that prior-stage PIS/PASEP and COFINS can be deducted at each stage of the supply chain.

2.27. Tax credits can be generated for the contributions paid with respect to purchases of goods for resale; purchases of goods or services used as inputs for the production of goods or the supply of services; any reimbursements linked to cancelled sales; energy, capital lease costs and logistical costs; and machinery, equipment and other goods incorporated into fixed assets (i.e. capital goods).[38]

2.28. As in the case of the IPI tax, if a company cannot use all its credits in a given month, because they exceed its tax liabilities for that period, the credits can be carried forward for future use in subsequent months.[39] If after three months the debits are insufficient, the company can compensate the credits with other liabilities or ask for reimbursement, within five years of generating the credit.[40] The reimbursement process can take from several months to years.[41]

2.29. Companies whose taxation is based on the "presumed profit method" are subject to the cumulative regime.[42] The cumulative regime appears to be used by small businesses.[43] Under the cumulative regime, companies pay a rate of 3.65% (i.e. 0.65% for PIS/PASEP and 3% for COFINS) of their gross monthly revenue. Companies under this regime pay the contributions every month on the basis of their turnover without any offsets resulting from their purchases of goods and services for resale or for use in their production processes. In other words, there are no tax credits corresponding to the PIS/PASEP and COFINS contributions paid by upstream economic operators, and the system does not focus on the value added by each company in the supply chain.[44]

The PIS/PASEP-Importation and COFINS-Importation Contributions

2.30. The PIS/PASEP-Importation and COFINS-Importation are the import-focused variants of PIS/PASEP and COFINS. They are regulated through Law 10,865 of 30 April 2004[45] and Normative Instructions SRF 594 of 26 December 2005[46] and RFB 1,401 of 9 October 2013.[47]

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[37] Law 10,833/2003, (Exhibit JE-93), Article 1; and Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 1.

[38] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 3; Law 10,833/2003, (Exhibit JE-93), Article 3; and Brazil's response to Panel question No. 23.

[39] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 3 §4; and Law 10,833/2003, (Exhibit JE-93), Article 3 §4.

[40] Law 10,637/2002, (Exhibit JE-94 and BRA-100), Article 5 §1 and §2; and Law 10,833/2003, (Exhibit JE-93), Article 6 §1 and §2.

[41] See, for example, Brazil's first written submissions, paras. 774-787.

[42] Brazil's first written submission, para. 64.

[43] European Union's first written submission, para. 70.

[44] See Law 9,781 of 27 November 1998, (Law 9,781/1998), (Exhibit JE-220). See also European Union's first written submission, para. 79; and Japan's first written submission, paras. 12 and 13.

[45] Law 10,865 of 30 April 2004, (Law 10,865/2004), (Exhibit JE-181).

2.31. The contribution rates used to be the standard nominal rates of the PIS/PASEP and COFINS non-cumulative regime. However, due to an amendment effective as of May 2015, the rates are 2.1% for PIS/PASEP-Importation and 9.65% for COFINS-Importation, for a combined rate of 11.75%.[48] For some categories of products, the applicable rates are higher (e.g. the combined rates for pharmaceuticals is 15.79%; for cosmetics 20%; and for tyres 16.56%).[49] These categories of products also have higher PIS/PASEP and COFINS contributions rates.

2.32. The two contributions apply to individual import transactions and are levied upon importation of goods. The taxable base is the customs value of the goods.[50]

2.33. Importers are also subject to the non-cumulative regime, so they can offset the amounts paid upon importation with their domestic PIS/PASEP and COFINS liabilities. Thus, importers pay the contributions only with respect to added value, i.e. the difference between the customs value and the importers' sales price. The tax credit mechanism with respect to the non-cumulative PIS/PASEP and COFINS domestic regime applies equally in the case of importers.

2.34. It is important to note that Law 10,865/2004 envisages that the COFINS-Importation contribution is increased by 1% for imports of certain listed goods.[51] However, contrary to the general rules on non-accumulation, due to an amendment of June 2015 of Law 10,865/2004, the additional 1% does not give right to any COFINS credit for importers, so it cannot be deducted from their domestic COFINS liabilities.[52]

The CIDE Contribution

2.35. CIDE is a Brazilian Federal contribution that applies to remittances/royalty payments abroad. It is regulated by Law 10,168 of 19 December 2000.[53]

2.36. The tax rate is 10%.[54] The taxable persons are legal entities holding a license of use or acquiring technological knowledge, as well as those entering into agreements that imply technological transfer, made with persons residing or domiciled abroad. It is also payable by legal entities entering into agreements aimed at technical and administrative assistance services and similar services to be provided by persons residing or domiciled abroad, as well as by legal entities which pay, credit, deliver, use or remit royalties on any ground whatsoever to beneficiaries residing or domiciled abroad. The contribution does not apply to compensation for license of use or rights for marketing or distribution of computer software, unless they involve the transfer of a relevant technology license. The basis of calculation is the amount paid, credited, delivered, used or remitted every month, to persons residing or domiciled abroad.[55]

[46] Normative Instruction SRF 594 of 26 December 2005, (Normative Instruction SRF 594/2005), (Exhibit JE-219).

[47] Normative Instruction RFB 1,401 of 9 October 2013, (Normative Instruction RFB 1,401/2013), (Exhibit JE-201).

[48] Law 10,865/2004, (Exhibit JE-181), Article 8, as amended by Provisional Measure 668 of 30 January 2015, (Provisional Measure 668/2015), (Exhibit JE-189), Article 1; and Law 13,137 of 19 June 2015, (Law 13,137/2015), (Exhibit JE-200), Article 1.

[49] Law 10,865/2004, (Exhibit JE-181), Article 8, as amended by Provisional Measure 668/2015, (Exhibit JE-189), Article 1; and Law 13,137/2015, (Exhibit JE-200), Article 1.

[50] Normative Instruction RFB 1,401/2013, (Exhibit JE-201), Article 1(II).

[51] Law 10,865/2004, (Exhibit JE-181), Article 8 §21. The list of goods is set out in the Annex to Law 12,546/2011, (Exhibit JE-199).

[52] Law 10,865/2004, (Exhibit JE-181), Article 15 §1-A, as amended by Law 13,137/2015, (Exhibit JE-200), Article 1.

[53] Law 10,168 of 19 December 2000, (Law 10,168/2000), (Exhibit JE-222).

[54] Law 10,168 /2000, (Exhibit JE-222), Article 2 §4.

[55] Law 10,168/2000, (Exhibit JE-222), Article 2.

2.2 The measures at issue

2.37. The claims brought by the European Union and Japan concern certain tax treatment established under the following programmes[56]:

a. The Informatics programme;

b. The programme of Incentives for the Semiconductors Sector (*Programa de Incentivos ao Setor de Semicondutores*), hereinafter the PADIS programme;

c. The programme of Support for the Technological Development of the Industry of Digital TV Equipment (*Programa de Apoio ao Desenvolvimento Tecnológico da Indústria de Equipamentos para TV Digital*), hereinafter the PATVD programme;

d. The programme for Digital Inclusion (*Inclusão Digital*), hereinafter the Digital Inclusion programme;

e. The programme of Incentive to the Technological Innovation and Densification of the Automotive Supply Chain (*Programa de Incentivo à Inovação Tecnológica e Adensamento da Cadeia Produtiva de Veículos Automotores*), hereinafter the INOVAR-AUTO programme;

f. The regime for predominantly exporting companies, hereinafter the PEC programme; and

g. The Special Regime for the Purchase of Capital Goods for Exporting Enterprises (*Regime Especial de Aquisição de Bens de Capital para Empresas Exportadoras*), hereinafter the RECAP programme.

2.38. The European Union's and Japan's respective panel requests state that these programmes "[are] set up and implemented"[57], "established and administered"[58] "through the following [instruments] ….as well as any amendments or extensions, any replacement measures, any renewal measures, any implementing measures, and [any] other related measures"[59]:

<u>The INFORMATICS programme</u>

a. Law 8,248 of 23 October 1991[60];

b. Law 10,176 of 11 January 2001[61];

c. Law 10,637 of 30 December 2002[62];

d. Law 13,023 of 8 August 2014[63];

e. Decree 5,906 of 26 September 2006[64];

f. Decree 6,759 of 5 February 2009 (final and transitional provisions), as amended by subsequent acts[65];

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[56] For ease of reference, the Panel will refer to Informatics, PADIS, PATVD, Digital Inclusion, INOVAR-AUTO, PEC and RECAP as "programmes". The Panel notes, however, that in the Portuguese version the term "programme" is only used in respect to PADIS, PATVD, Digital Inclusion and INOVAR-AUTO.

[57] European Union's request for the establishment of a panel.

[58] Japan's request for the establishment of a panel.

[59] European Union's and Japan's requests for the establishment of a panel.

[60] Law 8,248 of 23 October 1991, (Law 8,248/1991), (Exhibit JE-1).

[61] Law 10,176 of 11 January 2001, (Law 10,176/2001).

[62] Law 10,637/2002, (Exhibits JE-94 and BRA-100). Only in Japan's request for the establishment of a panel.

[63] Law 13,023 of 8 August 2014, (Law 13,023/2014), (Exhibit JE-2). Only in Japan's request for the establishment of a panel.

[64] Decree 5,906 of 26 September 2006, (Decree 5,906/2006), (Exhibit JE-7).

g. Decree 7,212 of 15 June 2010 (especially Chapter VI, Section II)[66];

h. Decree 8,010 of 16 May 2013[67];

i. Interministerial Implementing Order MDIC/MCTI 177 of 18 October 2002[68];

j. Implementing Order MCT 950 of 12 December 2006[69];

k. Interministerial Implementing Order MCTI/MDIC/MF 148 of 19 March 2007[70];

l. Interministerial Implementing Order MCTI/MDIC 685 of 25 October 2007[71];

m. Interministerial Implementing Order MDIC/MCT 170 of 4 August 2010[72];

n. Implementing Order MDIC 267 of 30 August 2013[73];

o. Interministerial Implementing Order SDP/MDIC 1 of 18 September 2013[74];

p. Implementing Order MCT 1,309 of 19 December 2013[75];

q. Interministerial Implementing Order MCTI/MDIC 202 of 13 February 2014[76];

r. Implementing Orders adopting Basic Production Processes ("PPBs") pursuant to the provisions of the above mentioned instruments; and

s. Accreditations (*habilitações*) granted pursuant to the Informatics programme.

<u>The PADIS programme</u>

a. Law 11,484 of 31 May 2007[77];

b. Decree 6,233 of 11 October 2007[78];

c. Decree 8,247 of 23 May 2014[79];

d. Normative Instruction RFB 852 of 13 June 2008[80];

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[65] Decree 6,759 of 5 February 2009, (Decree 6,759/2009), (Exhibit JE-8).

[66] Decree 7,212/2010, (Exhibit JE-9).

[67] Decree 8,010 of 16 May 2013, (Decree 8,010/2013). Only in Japan's request for the establishment of a panel.

[68] Interministerial Implementing Order MDIC/MCTI 177 of 18 October 2002, (Interministerial Implementing Order MDIC/MCTI 177/2002), (Exhibit JE-18).

[69] Implementing Order MCT 950 of 12 December 2006, (Implementing Order MCT 950/2006), (Exhibit JE-22).

[70] Interministerial Implementing Order MF/MCT/MDIC 148 of 19 March 2007, (Interministerial Implementing Order MF/MCT/MDIC 148/2007), (Exhibit JE-21).

[71] Interministerial Implementing Order MDIC/MCT 685 of 25 October 2007, (Interministerial Implementing Order MDIC/MCT 685/2007), (Exhibit JE-20).

[72] Interministerial Implementing Order MDIC/MCT 170 of 4 August 2010, (Interministerial Implementing Order MDIC/MCT 170/2010), (Exhibit JE-17).

[73] Implementing Order MDIC 267 of 30 August 2013, (Implementing Order MDIC 267/2013), (Exhibit JE-13).

[74] Interministerial Implementing Order SDP/MDIC 1 of 18 September 2013, (Interministerial Implementing Order SDP/MDIC 1/2013), (Exhibit JE-16).

[75] Implementing Order MCT 1,309 of 19 December 2013, (Implementing Order MCT 1,309/2013), (Exhibit JE-15).

[76] Interministerial Implementing Order MDIC/MCT 202 of 13 February 2014, (Interministerial Implementing Order MDIC/MCT 202/2014), (Exhibit JE-12).

[77] Law 11,484 of 31 May 2007, (Law 11,484/2007), (Exhibit JE-71).

[78] Decree 6,233 of 11 October 2007, (Decree 6,233/2007), (Exhibit JE-73).

[79] Decree 8,247 of 23 May 2014, (Decree 8,247/2014), (Exhibit JE-75). Only in Japan's request for the establishment of a panel.

e. Decree 7,212 of 15 June 2010 (especially Chapter VI, Section III)[81];

f. Decree 6,759 of 5 February 2009 (especially Book III, Title II, Chapter VII, Section VII), as amended by subsequent acts[82];

g. Interministerial Implementing Order MCT/MDIC/MF 297 of 13 May 2008 establishing the procedures and deadline for analysis of the PADIS implementing Decree 6,233 of 11 October 2007 (GTI-PADIS)[83];

h. Interministerial Implementing Order MCT/MDIC 290/2008[84];

i. Implementing Orders establishing PPBs applicable under PADIS; and

j. Accreditations (*habilitações*) granted pursuant to the PADIS programme.

The PATVD programme

a. Law 11,484 of 31 May 2007[85];

b. Decree 6,234 of 11 October 2007[86];

c. Normative Instruction RFB 853 of 13 June 2008[87];

d. Decree 7,212 of 15 June 2010 (especially Chapter VI, Section IV)[88];

e. Decree 6,759 of 5 February 2009 (especially Book III, Title II, Chapter VII, Section VIII)[89];

f. Interministerial Implementing Order MCT/MDIC 291 of 7 May 2008[90];

g. Implementing Orders establishing PPBs applicable under PATVD; and

h. Accreditations (*habilitações*) granted pursuant to the PATVD programme.

The DIGITAL INCLUSION programme

a. Law 11,196 of 21 November 2005[91];

b. Law 12,507 of 11 October 2011[92];

c. Law 12,715 of 17 September 2012[93];

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[80] Normative Instruction RFB 852 of 13 June 2008, (Normative Instruction RFB 852/2008), (Exhibit JE-76).

[81] Decree 7,212/2010, (Exhibit JE-9).

[82] Decree 6,759/2009, (Exhibit JE-8).

[83] Interministerial Implementing Order MCT/MDIC/MF 297 of 13 May 2008, (Interministerial Implementing Order MCT/MDIC/MF 297/2008), (Exhibit JE-77). Only in Japan's request for the establishment of a panel.

[84] Interministerial Implementing Order MCT/MDIC 290 of 7 May 2008, (Interministerial Implementing Order MCT/MDIC 290/2008), (Exhibit JE-78). Only in Japan's request for the establishment of a panel.

[85] Law 11,484/2007, (Exhibit JE-71).

[86] Decree 6,234 of 11 October 2007, (Decree 6,234/2007), (Exhibit JE-85).

[87] Normative Instruction RFB 853 of 13 June 2008, (Normative Instruction RFB 853/2008), (Exhibit JE-86).

[88] Decree 7,212/2010, (Exhibit JE-9).

[89] Decree 6,759/2009, (Exhibit JE-8).

[90] Interministerial Implementing Order MCT/MDIC 291 of 7 May 2008, (Interministerial Implementing Order MCT/MDIC 291/2008), (Exhibit JE-88). Only in Japan's request for the establishment of a panel.

[91] Law 11,196 of 21 November 2005, (Law 11,196/2005), (Exhibit JE-91).

[92] Law 12,507 of 11 October 2011, (Law 12,507/2011). Only in Japan's request for the establishment of a panel

d. Law 13,097 of 19 January 2015[94];

e. Decree 5,602 of 6 December 2005[95];

f. Implementing Order MC 87 of 10 April 2013[96];

g. Implementing Order STE 2 of 26 August 2013[97]; and

h. Other Implementing Orders establishing PPBs applicable under the Digital Inclusion programme.

The INOVAR-AUTO programme

a. Law 12,546 of 14 December 2011[98];

b. Law 12,715 of 17 September 2012[99];

c. Law 12,844 of 19 July 2013[100];

d. Law 12,996 of 18 June 2014[101];

e. Decree 7,819 of 3 October 2012[102];

f. Decree 8,015 of 17 May 2013[103];

g. Decree 8,294 of 12 August 2014[104];

h. Implementing Order MCTI 296 of 1 April 2013[105];

i. Implementing Order MDIC 106 of 11 April 2013[106];

j. Implementing Order MDIC 113 of 15 April 2013[107];

k. Interministerial Implementing Order MCTI/MDIC 772 of 12 August 2013[108];

l. Implementing Order MDIC 280 of 4 September 2013[109];

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[93] Law 12,715 of 17 September 2012, (Law 12,715/2012), (Exhibit JE-95). Only in Japan's request for the establishment of a panel.

[94] Law 13,097 of 19 January 2015, (Law 13,097/2015), (Exhibit JE-92). Only in Japan's request for the establishment of a panel.

[95] Decree 5,602 of 6 December 2005, (Decree 5,602/2005), (Exhibit JE-97).

[96] Implementing Order MC 87 of 10 April 2013, (Implementing Order MC 87/2013), (Exhibit JE-100).

[97] Implementing Order STE 2 of 26 August 2013, (Implementing Order STE 2/2013), (Exhibit JE-99).

[98] Law 12,546/2011, (Exhibit JE-199).

[99] Law 12,715/2012, (Exhibit JE-95).

[100] Law 12,844 of 19 July 2013, (Law 12,844/2013). Only in Japan's request for the establishment of a panel.

[101] Law 12,996 of 18 June 2014, (Law 12,996/2014). Only in Japan's request for the establishment of a panel.

[102] Decree 7,819 of 3 October 2012, (Decree 7,819/2012), (Exhibit JE-132).

[103] Decree 8,015 of 17 May 2013, (Decree 8,015/2013), (Exhibit JE-133).

[104] Decree 8,294 of 12 August 2014, (Decree 8,294/2014), (Exhibit JE-134).

[105] Implementing Order MCTI 296 of 1 April 2013, (Implementing Order MCTI 296/2013), (Exhibit JE-178).

[106] Implementing Order MDIC 106 of 11 April 2013, (Implementing Order MDIC 106/2013), (Exhibit JE-176).

[107] Implementing Order MDIC 113 of 15 April 2013, (Implementing Order MDIC 113/2013), (Exhibit JE-154).

[108] Interministerial Implementing Order MCTI/MDIC 772 of 12 August 2013, (Interministerial Implementing Order MCTI/MDIC 772/2013), (Exhibit JE-175).

m. Implementing Order MDIC 297 of 30 September 2013[110];

n. Implementing Order MDIC 257 of 23 September 2014[111];

o. Implementing Order MDIC 290 of 14 November 2014[112];

p. Implementing Order MDIC 318 of 26 December 2014[113];

q. ICMS Convention 38 of 22 May 2013[114];

r. SINIEF Convention of 15 December 1970[115];

s. Accreditations (*habilitações*) granted pursuant to the INOVAR-AUTO programme; and

t. Terms of Commitment (*termos de compromisso*) signed by accredited companies.

The PEC programme

a. Law 10,637 of 30 December 2002[116];

b. Law 10,865 of 30 April 2004[117];

c. Law 12,715 of 17 September 2012[118];

d. Decree 6,759 of 5 February 2009 (especially Book III, Title I, Chapter VII, and Book III, Title II, Chapter VII, Section V)[119];

e. Normative Instruction SRF 595 of 27 December 2005[120];

f. Normative Instruction RFB 948 of 15 June 2009[121];

g. Normative Instruction RFB 1,424 of 19 December 2013[122]; and

h. Accreditations (*habilitações*) or registration (*registro*) of individual "predominantly exporting companies" pursuant to the scheme.

The RECAP programme

[109] Implementing Order MDIC 280 of 4 September 2013, (Implementing Order MDIC 280/2013), (Exhibit JE-177).
[110] Implementing Order MDIC 297 of 30 September 2013, (Implementing Order MDIC 297/2013), (Exhibit JE-179).
[111] Implementing Order MDIC 257 of 23 September 2014, (Implementing Order MDIC 257/2014), (Exhibit JE-158). Only in Japan's request for the establishment of a panel.
[112] Implementing Order MDIC 290 of 14 November 2014, (Implementing Order MDIC 290/2014), (Exhibit JE-157). Only in Japan's request for the establishment of a panel.
[113] Implementing Order MDIC 318 of 26 December 2014, (Implementing Order MDIC 318/2014). Only in Japan's request for the establishment of a panel.
[114] ICMS Convention 38 of 22 May 2013, (ICMS Convention 38/2013), (Exhibit JE-160). Only in Japan's request for the establishment of a panel.
[115] SINIEF Convention of 15 December 1970, (SINIEF Convention 1970), (Exhibit JE-159). Only in Japan's request for the establishment of a panel.
[116] Law 10,637/2002, (Exhibits JE-94 and BRA-100).
[117] Law 10,865/2004, (Exhibit JE-181).
[118] Law 12,715/2012, (Exhibit JE-95). Only in Japan's request for the establishment of a panel.
[119] Decree 6,759/2009, (Exhibit JE-8).
[120] Normative Instruction SRF 595 of 27 December 2005, (Normative Instruction SRF 595/2005), (Exhibit JE-193).
[121] Normative Instruction RFB 948 of 15 June 2009, (Normative Instruction RFB 948/2009), (Exhibit JE-191).
[122] Normative Instruction RFB 1,424 of 19 December 2013, (Normative Instruction RFB 1,424/2013), (Exhibit JE-192). Only in Japan's request for the establishment of a panel.

a. Law 11,196 of 25 November 2005[123];

b. Law 12,715 of 17 September 2012[124];

c. Decree 5,649 of 29 December 2005[125];

d. Decree 5,789 of 25 May 2006[126];

e. Decree 6,759 of 5 February 2009 (especially Book III, Title II, Chapter VII, Section IV)[127];

f. Normative Instruction SRF 605 of 4 January 2006[128]; and

g. Accreditations (*habilitações*) granted pursuant to the RECAP programme.

2.2.1 The Informatics programme

2.2.1.1 Introduction

2.39. The Informatics programme provides for exemptions and reductions on the applicable Tax on Industrialised Products (IPI tax) on the sale of information technology goods. It also provides for suspensions of the IPI tax on the purchase or import of raw materials, intermediate goods and packaging materials used in the production of information technology and automation goods incentivised under the Informatics programme.

2.40. The relevant tax exemptions, reductions and suspensions provided for in the Informatics programme entered into force in October 1991 and are due to expire on 31 December 2029.[129]

2.2.1.2 Tax treatment

2.41. The Informatics programme provides for the following exemptions and reductions on the IPI tax on information technology and automation goods:

a. 95% reduction until 31 December 2024, 90% reduction until 31 December 2026 and 85% reduction until 31 December 2029, for goods produced in Central-West Region and in the regions of influence of the Superintendence for the Development of Amazonia (SUDAM) and the Superintendence for the Development of the Northeast (SUDENE)[130]; and

b. 80% reduction until 31 December 2024, 75% reduction until 31 December 2026, and 70% reduction until 31 December 2029, for goods produced in other locations in Brazil.[131]

2.42. The Informatics programme provides for specific reduction rates for portable microcomputers and small-capacity digital processing units based on microprocessors valued at no more than R$11,000.00; magnetic optical disk units; printed circuits with assembled electrical and electronic components; cabinets; and power sources that are recognizable as exclusively or primary designed for such equipment:

[123] Law 11,196/2005, (Exhibit JE-182).
[124] Law 12,715/2012, (Exhibit JE-95). Only in Japan's request for the establishment of a panel.
[125] Decree 5,649 of 29 December 2005, (Decree 5,649/2005), (Exhibit JE-187).
[126] Decree 5,789 of 25 May 2006, (Decree 5,789/2006), (Exhibit JE-188).
[127] Decree 6,759/2009, (Exhibit JE-8).
[128] Normative Instruction SRF 605 of 4 January 2006, (Normative Instruction SRF 605/2006), (Exhibit JE-195).
[129] Law 8,248/1991, (Exhibit JE-1); as amended by Law 13,023/2014, (Exhibit JE-2).
[130] Law 8,248/1991, (Exhibit JE-1), Article 4 §1D and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 4.
[131] Law 8,248/1991, (Exhibit JE-1), Article 4 §1A and §7; as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 4.

a. Full exemption until 31 December 2024, 95% reduction until 31 December 2026 and 85% reduction until 31 December 2029, for goods produced in Central-West Region and in the regions of influence of SUDAM and SUDENE[132]; and

b. 95% reduction until 31 December 2024, 90% reduction until 31 December 2026, and 70% reduction until 31 December 2029, for goods produced in other locations in Brazil.[133]

2.43. The following specific IPI tax reductions apply to information technology and automation goods that have additionally obtained the status of "developed in Brazil":

a. 100% reduction until 31 December 2024, 95% reduction until 31 December 2026 and 90% reduction until 31 December 2029[134]; and

b. Full exemption until 31 December 2024, 95% reduction until 31 December 2026 and 85% reduction until 31 December 2029, for goods produced in Central-West Region and in the regions of influence of SUDAM and SUDENE.[135]

2.44. The Informatics programme also provides for IPI suspensions on raw materials, intermediate goods and packaging materials used in the production of information technology and automation goods incentivised under the Informatics programme, applied at the time that the raw materials, intermediate goods and packaging materials are released from the industrial establishment.

2.45. The suspension is subject to the condition that more than 60% of the company's total gross revenue be derived from the sale of products covered by the Informatics programme.[136] The suspension expires, and the IPI tax becomes definitely non-due, with the export or domestic sale of products in which raw materials, intermediate goods and packaging materials purchased with suspended IPI tax have been used.[137]

2.2.1.3 Product coverage

2.46. The following categories of information technology and automation goods are covered under the Informatics programme:

a. Semiconductor electronic components, optoelectronics, and their respective electronic inputs;

b. Machines, equipment, and devices based on digital technology that function to collect, treat, structure, store, switch, transmit, recover, or present information, and their respective electronic inputs, parts, pieces, and physical support for operation;

c. Programs for computers, machines, equipment, and devices for treating information, and their respective technical documentation (software);

d. Technical services related to goods and services described in paragraphs (a), (b) and (c) above;

e. Landline telephone apparatuses, with a wireless received-microphone that incorporates a digital control, Code 8517.11.00 of the Mercosur Common Nomenclature (MCN);

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[132] Law 8,248/1991, (Exhibit JE-1), Article 4 §1E and §5; as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 3.

[133] Law 8,248/1991, (Exhibit JE-1), Article 4 §1E and §5; as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 3.

[134] Law 8,248/1991, (Exhibit JE-1), Article 4 §7; as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 4.

[135] Law 8,248/1991, (Exhibit JE-1), Article 4 §1E and §5; as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 3.

[136] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §2.

[137] Normative Instruction RFB 948/2009, (Exhibit JE-191), Articles 19-20.

f. Portable terminals for cellular telephony, Code 8517.12.31 of the MCN; and

g. Video output units (monitors) classified in Sub-positions 8528.41 and 8528.51 of the MCN, without interfaces and circuitry for receiving radio frequency signals or even composite video, suitable for operating with machinery, equipment, or devices based on digital technique, of Position 8471 of the MCN (with functions for collecting, treating, structuring, storing, switching, transmitting, recovering or presenting information).[138]

2.47. The specific list of products falling under these categories, identified according to their MCN codes, as well as a list of goods excluded from the Informatics programme, is provided in Annexes I and II of Decree 5,906/2006.[139]

2.2.1.4 Eligible companies

2.48. The eligible companies under the Informatics programme are companies that (i) develop or produce information technology and automation goods and services in compliance with the relevant Basic Productive Processes (PPBs), and (ii) invest in information technology research and development activities in Brazil.[140]

2.2.1.5 Requirements for obtaining the tax treatment

2.49. In order to obtain the tax exemptions, reductions and suspensions provided for in the Informatics programme, companies manufacturing the relevant information technology and automation goods and/or purchasing/importing the relevant raw materials, intermediate goods and packaging materials used in the production of the incentivised products, must obtain an accreditation.

2.50. Companies can get accredited by submitting an application to the Ministry of Science, Technology and Innovation (MCTI). The application must include a project proposal containing, among other information: (a) the products to be manufactured; (b) the research and development plan prepared by the company; (c) proof that the company will adhere to the relevant PPBs; and (d) evidence, when appropriate, that the products satisfy the requirement of having been developed in Brazil.[141]

2.51. Once accreditation is obtained, accredited companies shall report to the Executive Branch annually on their compliance with their R&D obligations during the previous year. If the requirements are not fulfilled or the reports are not approved, accreditation may be suspended, without prejudice to the company being required to reimburse the amounts previously reduced or exempted, updated and increased by monetary penalties applicable to fiscal debts related to the taxes of the same nature.[142]

2.2.1.5.1 Investment in Research and Development (R&D)

2.52. Companies must invest annually in R&D on information and automation technology to be conducted in Brazil a percentage of their gross sales on the internal market resulting from commercialization of incentivized information technology goods and services, after deduction of taxes levied in connection with those sales, as well as deduction of the value of the purchases of products entitled to an exemption or reduction of the IPI tax. Under the Informatics Law, the original minimum percentage of a company's gross revenue obtained with the sales of IT products in the domestic market that had to be invested in R&D was 5%, subject to gradual reductions.[143]

[138] Law 8,248/1991, (Exhibit JE-1), Article 16A; and Decree 5,906/2006, (Exhibit JE-7), Article 2
[139] Decree 5,906/2006, (Exhibit JE-7), Annexes I and II.
[140] Law 8,248/1991, (Exhibit JE-1), Article 4; and Decree 5,906/2006, (Exhibit JE-7), Article 1.
[141] Decree 5,906/2006, (Exhibit JE-7), Article 22.
[142] Law 8,248/1991, (Exhibit JE-1), Articles 9 and 11 §9, as amended by
[143] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

2.53. At the time of the establishment of the panel, one such reduction was already in force. The percentage was reduced by 20% from 1 January 2004 until 31 December 2029.[144] In the case of goods produced in the Central-West Region and the regions of influence of SUDAM and SUDENE, the percentage was reduced by 13% from 1 January 2004 until 31 December 2029.[145]

2.54. Thus, accredited companies have to invest at least 4% of their gross revenue in R&D,[146] and at least 4.35% if investments are related to the sales of ICT products produced in the Mid-west, North (SUDAM) and Northeast (SUDENE) regions.[147]

2.55. The 4% investment is broken down into two parts: the first corresponding to 1.84%[148], and the second corresponding to 2.16%[149], of the company's gross revenue obtained with the sales of IT products in the domestic market.

2.56. The share of 1.84% must be invested as follows:[150]

a. At least 0.8% by means of conventions signed with research centres or Brazilian educational entities accredited with the MCTI's Committee of Technology and Information (CATI)[151];

b. At least 0.64% by means of conventions with research centres or Brazilian educational entities accredited with the CATI and located in the Mid-west, North (SUDAM) and Northeast (SUDENE) regions.[152] At least 30% of that amount must be invested in universities, colleges, educational entities and research centres or institutes created or maintained by Federal, State or District authorities located in such regions[153];

c. At least 0.4% as financial resources quarterly deposited in the National Science and Technology Development Fund (FNDCT).[154]

2.57. Up to two-thirds of the remaining 2.16% share can be invested as financial resources in the Assistance Program for Development of the Information Technology Sector.[155]

2.58. In turn, the 4.35% investment is broken down into two parts: the first corresponding to 2.001%[156], and the second corresponding to 2.349%[157], of the company's gross revenue obtained with the sales in the domestic market of IT products produced in the Mid-west, North (SUDAM) and Northeast (SUDENE) regions.

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[144] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[145] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[146] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[147] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[148] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[149] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Articles 8 and 10.

[150] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[151] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[152] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[153] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[154] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[155] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Articles 8 and 10.

[156] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[157] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Articles 8 and 10.

2.59. The share of 2.001% must be invested as follows:[158]

a. At least 0.87% by means of conventions signed with research centres or Brazilian educational entities accredited with the CATI[159];

b. At least 0.696% by means of conventions with research centres or Brazilian educational entities accredited with the CATI and located in the Mid-west, North (SUDAM) and Northeast (SUDENE) regions.[160] At least 30% of that amount must be invested in universities, colleges, educational entities and research centres created or maintained by Federal, District or State Authorities located in such regions[161];

c. At least 0.435% as financial resources quarterly deposited in the FNDCT[162];

d. Up to two-thirds of the remaining 2.349% share can be invested as financial resources in the Assistance Program for Development of the Information Technology Sector.[163]

2.60. The percentages were also reduced by 25% for accredited companies that produce portable microcomputers and small-capacity digital processing units based on microprocessors valued at no more than R$11,000.00; magnetic optical disk units; printed circuits with assembled electrical and electronic components; cabinets; and power sources that are recognizable as exclusively or primarily designed for such equipment; and calculated exclusively on gross sales derived from the commercialization of those products in the domestic market.[164]

2.2.1.5.2 Compliance with Basic Productive Processes (PPBs)

2.61. Companies must produce the information technology and automation goods in accordance with the terms of particular product-specific PPBs[165], which set out the necessary production steps or minimum set of operations to be carried out in Brazil.

2.62. A PPB is defined as the minimum set of operations performed at a manufacturing facility that characterizes the actual industrialization of a given product.[166] Thus, PPBs indicate the minimum stages or steps of the manufacturing process of a product that must be performed in Brazil.

2.63. Some PPBs also require that specific components, parts and pieces used in the production of the information technology and automation good be produced, in a specific percentage, in accordance with their own respective PPBs. Other PPBs require a percentage of local assembly for specific components, parts and pieces.

2.64. The PPBs are established by product or groups of products in individual Implementing Orders (*Portarias)*.

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[158] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[159] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[160] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[161] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[162] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[163] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 10.

[164] Law 8,248/1991, (Exhibit JE-1), Article 11 §6 and §7, as amended by Law 13,023/2014, (Exhibit JE-2), Article 1; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[165] Implementing Orders establishing or amending PPBs include the following exhibits: Exhibit JE-25, Exhibit JE-26, Exhibit JE-27, Exhibit JE-28, Exhibit JE-29, Exhibit JE-30, Exhibit JE-31, Exhibit JE-32, Exhibit JE-33, Exhibit JE-34, Exhibit JE-35, Exhibit JE-36, Exhibit JE-37, Exhibit JE-38, Exhibit JE-39, Exhibit JE-40, Exhibit JE-41, Exhibit JE-42, Exhibit JE-43, Exhibit JE-44, Exhibit JE-45, Exhibit JE-46, Exhibit JE-66, Exhibit BRA-28, Exhibit BRA-29, Exhibit BRA-30, Exhibit BRA-31, and Exhibit BRA-116.

[166] Decree 5,906/2006, (Exhibit JE-7), Article 16.

2.65. For a PPB to be established, an interested company or group of companies must submit a request for the establishment of a PPB with respect to a specific product or group of products.[167] The request shall be examined by an inter-ministerial technical group (GT-PPB) composed by representatives of the MCTI and the Ministry of Development, Industry and Trade (MDIC).[168] The GT-PPB shall make a project proposal based on the information provided in the request and technical visits made to the company; it shall subject the proposal to public consultation for 15 days; and shall submit its technical opinion and recommendation to the MDIC and the MCTI.[169] The MDIC and the MCTI must then issue an interministerial implementing order approving or refusing the PPB within 120 days from the date of submission of the request by the company.[170]

2.66. Although the PPBs are established with respect to a specific product or group of products upon request of a company, once established the PPBs shall apply to all companies with respect to that specific product or group of products.

2.2.1.5.3 Status of goods "developed in Brazil"

2.67. Products that have obtained the status of "developed in Brazil" are subject to additional tax reductions.

2.68. Two requirements must be met in order for information technology and automation goods to be considered "developed in Brazil":

a. Products must comply with the specifications, rules and standards laid out in Brazilian legislation; and

b. The specifications, projects and developments must have been carried out in Brazil by technicians of proven skill in such activities who are residents and domiciled in Brazil.[171]

2.69. Applications for the status of "developed in Brazil" must be addressed to the MCTI.

2.2.1.6 Related memorandum

2.70. No related memorandum is found on the record.

2.2.2 The PADIS programme

2.2.2.1 Introduction

2.71. The PADIS programme exempts (through zero rates) accredited companies from paying certain taxes with respect to semiconductors and information displays (displays), as well as inputs, tools, equipment, machinery, and software for the production of semiconductors and displays ("production goods").

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[167] The application must contain information about the company, the product, including main inputs or components, market shares, investments, job and production. See Interministerial Implementing Order MDIC/MCT 170/2010, (Exhibit JE-17), Articles 1, 3, 4 and 5, and Annex 1.

[168] According to Article 6 of Interministerial Implementing Order MDIC/MCT 170/2010, (Exhibit JE-17), the GT-PPB will assess the application on the basis of the following criteria: (i) inter-regional equilibrium must be sought, avoiding the relocation of industry from regions where the good in question is traditionally manufactured or the simple transfer of industrial plants operated by the requesting undertaking and that are already established in Brazil; (ii) addition of national value to the production, by attracting investments which will effectively generate an increase in levels of productivity and competitiveness, incorporate state-of-the-art product technologies and production processes and enable the training and qualification of human resources in scientific and technological development; (iii) contribution to attaining the macro-objectives contained in the Productive Development Policy (PDP) and future government policies that promote scientific and technological development; and (iv) increased job creation in the region concerned.

[169] Interministerial Implementing Order MDIC/MCT 170/2010, (Exhibit JE-17), Articles 4 and 11.

[170] Law 8,248/1991, (Exhibit JE-1), Article 4, §2; and Interministerial Implementing Order MDIC/MCT 170/2010, (Exhibit JE-17), Articles 12 and 13.

[171] Implementing Order MCT 950/2006, (Exhibit JE-22), Article 1; and Implementing Order MCT 1,309/2013, (Exhibit JE-15), Article 1.

2.72. The tax exemptions (through zero rates) provided for in the PADIS programme entered into force in 2007 and are in effect until 22 January 2022.[172]

2.2.2.2 Tax treatment

2.73. Pursuant to the PADIS programme, the following tax rates shall be reduced to zero:

a. For imports or sales in the Brazilian market of machinery, apparatus, instruments, equipment, computation tools (software) and inputs used in certain activities provided that they are incorporated into fixed assets of the companies accredited under the PADIS programme that purchase/ import them[173]:

   i. Social Integration Programme (PIS) and Civil Service Asset Formation Programme (PASEP) contributions and the Contribution to Social Security Financing (COFINS) contributions levied on the revenues of the seller when goods are purchased by companies accredited under the PADIS programme[174];

   ii. PIS/PASEP-Importation and COFINS-Importation contributions levied on imports by companies accredited under the PADIS programme[175];

   iii. IPI tax levied on imported or domestic goods when imported or purchased in the Brazilian market by companies accredited under the PADIS programme[176]; and

   iv. CIDE contributions on remittances sent abroad by companies accredited under the PADIS programme to pay for the use of patents or trademarks and for the provision of technology and technical assistance related to the abovementioned activities.[177]

   v. Import tax on machinery, apparatus, instruments, equipment, computation tools (software) to be incorporated into the companies accredited under the PADIS programme as well as on raw materials and inputs might also be reduced to zero when the importer is a company accredited under the PADIS programme.[178]

b. For sales of semiconductor electronic devices, information displays and inputs and equipment intended for the manufacture of electronic semiconductor devices and information displays by companies accredited under the PADIS programme in the Brazilian market[179]:

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[172] Law 11,484/2007, (Exhibit JE-71), Article 64; and Decree 7,212/2010, (Exhibit JE-9), Article 151. Special expiration dates apply with respect to tax reductions on CIDE contributions and on income tax and duties on profits from sales of finished products. See Law 11,484/2007, (Exhibit JE-71), Article 65, as amended by Law 12,715/2012, (Exhibit JE-95), Article 57.

[173] Law 11,484/2007, (Exhibit JE-71), Article 3; Decree 6,233/2007, (Exhibit JE-73), Article 2; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 10. See also Decree 6,759/2009, (Exhibit JE-8), Article 282; Decree 7,212/2010, (Exhibit JE-9), Article 151.

[174] Law 11,484/2007, (Exhibit JE-71), Article 3(I); Decree 6,233/2007, (Exhibit JE-73), Article 2(I); and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 10(I).

[175] Law 11,484/2007, (Exhibit JE-71), Article 3(II); Decree 6,233/2007, (Exhibit JE-73), Article 2(II); and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 10(II).

[176] Law 11,484/2007, (Exhibit JE-71), Article 3(III); Decree 6,233/2007, (Exhibit JE-73), Article 2(III); and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 10(III).

[177] Law 11,484/2007, (Exhibit JE-71), Article 3 §3; Decree 6,233/2007, (Exhibit JE-73), Article 3; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 12.

[178] Law 11,484/2007, (Exhibit JE-71), Article 3 §5; and Decree 6,233/2007, (Exhibit JE-73), Article 2(IV).

[179] These tax reductions do not apply cumulatively with other reductions or benefits relating to the same taxes or contributions. See Law 11,484/2007, (Exhibit JE-71), Article 4 §7; Decree 6,233/2007, (Exhibit JE-73), Article 4 §2; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 11 §2.

i. PIS/PASEP and COFINS contributions on the revenue or income earned and on the revenue generated from the sale of projects (design) by companies accredited under the PADIS programme[180];

ii. IPI tax levied on shipments from the industrial establishment[181]; and

iii. The rate of the income tax and duties on profits from exploitation and on the revenue generated from the sale of projects (design) by the PADIS programme.[182]

2.2.2.3 Product coverage

2.74. The products covered under the PADIS programme are the following:

a. Semiconductor electronic devices[183];

b. Information displays[184];

c. Inputs and equipment intended for the manufacture of electronic semiconductor devices and information displays and manufactured according to the relevant PPB[185];

d. Machinery, appliances, instruments and equipment for incorporation into the fixed assets of the accredited purchaser/ importer, intended for activities related to final products (i.e. those listed in Annex II of Decree 6,233/2007)[186];

e. Inputs intended for activities related to final products (i.e. those listed in Annex III of Decree 6,233/2007)[187]; and

f. Computational tools (software) intended for activities related to final products (i.e. those listed in Annex IV of Decree 6,233/2007).[188]

[180] Law 11,484/2007, (Exhibit JE-71), Articles 4(I) and 4 §1; Decree 6,233/2007, (Exhibit JE-73), Articles 4(I) and 4 §1; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Articles 11(I) and 11 §1.

[181] Law 11,484/2007, (Exhibit JE-71), Article 4(II); Decree 6,233/2007, (Exhibit JE-73), Article 4(II); and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 11(II).

[182] Law 11,484/2007, (Exhibit JE-71), Articles 4(III) and 4 §1; Decree 6,233/2007, (Exhibit JE-73), Articles 4(III) and 4 §1; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Articles 11(III) and 11 §1.

[183] PADIS covers electronic semiconductor devices under NCM headings 85.41 and 85.42, including those assembled and encapsulated under a chip on board (NCM 8523.51). See Decree 6,233/2007, (Exhibit JE-73), Annex I: Final Products, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 2; and Law 11,484/2007, (Exhibit JE-71), Article 2(I). See Law 11,484/2007, (Exhibit JE-71), Article 2 §5, as amended by Law 12,715/2012, (Exhibit JE-95), Article 57; Decree 6,233/2007, (Exhibit JE-73), Article 6 §5 as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1; and Decree 6,759/2009, (Exhibit JE-8), Article 283 §5.

[184] Decree 6,233/2007, (Exhibit JE-73), Annex I: Final Products; and Law 11,484/2007, (Exhibit JE-71), Article 2(II). Information displays must have technology based on components of liquid crystal (LCD), photoluminescents (plasma display panel – PDP), electroluminescents (light emitting diodes – LED, organic light emitting diodes – OLED or thin film electroluminescent displays – TFEL) or similar with microstructures of electric field emission, intended for use as inputs in electronic equipment. Information displays do not include cathode ray tubes. See Law 11,484/2007, (Exhibit JE-71), Article 2 §2; Decree 6,233/2007, (Exhibit JE-73), Article 6 §1; Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 4 §1(I); Decree 7,212/2010, (Exhibit JE-9), Article 150 §3; and Decree 6,759/2009, (Exhibit JE-8), Article 283 §2.

[185] Decree 6,233/2007, (Exhibit JE-73), Annex I: Final Products, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 2; and Law 11,484/2007, (Exhibit JE-71), Article 2(III).

[186] Decree 6,233/2007, (Exhibit JE-73), Annex II: Machinery, appliances, instruments and equipment for incorporation into the fixed assets, for use in activities related to final products, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1.

[187] Decree 6,233/2007, (Exhibit JE-73), Annex III: Inputs intended for activities in relation to final products, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1.

[188] Decree 6,233/2007, (Exhibit JE-73), Article 13(III) and Annex IV: Computational tools for the manufacture of final products; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 13(III).

2.2.2.4 Eligible companies

2.75. The tax exemptions (through zero rates) provided for in the PADIS programme shall be accorded to legal persons previously accredited by the Brazilian Federal Revenue Service (RFB)[189] that:

a. Import or sell in the Brazilian market machinery, apparatus, instruments, equipment, computation tools (software) and inputs to be incorporated into their fixed assets, provided that they are used in activities related to final products listed in Annex II of Decree 6,233/2007[190]; and

b. Sell in the Brazilian market semiconductor electronic devices, information displays and inputs and equipment intended for the manufacture of electronic semiconductor devices and information displays.

2.2.2.5 Requirements for eligibility

2.76. In order to obtain accreditation and become companies accredited under the PADIS programme, legal persons must meet the following requirements:

a. Invest in research and development (R&D)[191]:

Companies accredited under the PADIS programme must invest annually at least 5% of their gross sales in the Brazilian market in R&D activities in Brazil.[192] The taxes levied on the sales of semiconductor electronic devices, information displays and inputs and equipment intended for the manufacture thereof as well as the purchase value of products incentivized under PADIS must be deducted from the gross sales in the Brazilian market.[193] At least 1% out of the 5% shall be directed toward official or accredited research institutes or centres or Brazilian education entities, which are registered with the CATI or the Committee of Research and Development Activities of Amazonia (CAPDA).[194]

b. Engage in the following activities:

i. With respect to semiconductor electronic devices[195]

- Concept, development and design;
- Diffusion or physical-chemical processing; or
- Cutting, encapsulation and testing.

ii. With respect to information displays[196]

[189] Decree 6,233/2007, (Exhibit JE-73), Article 5; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 3.

[190] Decree 6,233/2007, Exhibit JE-73.

[191] Law 11,484/2007, (Exhibit JE-71), Articles 2 and 6; and Decree 6,233/2007, (Exhibit JE-73), Articles 6 and 8, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1. See also Decree 7,212/2010, (Exhibit JE-9), Article 150 §1; Decree 6,759/2009, (Exhibit JE-8), Article 283; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 4.

[192] Law 11,484/2007, (Exhibit JE-71), Article 6; and Decree 6,233/2007, (Exhibit JE-73), Article 8, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1. These provisions also indicate the specific areas in which investment in R&D must be made.

[193] See Decree 6,233/2007, (Exhibit JE-73), Article 8, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1.

[194] Law 11,484/2007, (Exhibit JE-71), Article 6 §2; and Decree 6,233/2007, (Exhibit JE-73), Article 8 §2.

[195] Law 11,484/2007, (Exhibit JE-71), Article 2(I), as amended by Law 12,715/2012, (Exhibit JE-95), Article 57; and Decree 6,233/2007, (Exhibit JE-73), Article 6(I), as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1. See also Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 4(I); Decree 6,759/2009, (Exhibit JE-8), Article 283(I); and Decree 7,212/2010, (Exhibit JE-9), Article 150 §1(I).

[196] Law 11,484/2007, (Exhibit JE-71), Article 2(II); and Decree 6,233/2007, (Exhibit JE-73), Article 6(II), as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1. See also Normative Instruction RFB

- Concept, development and design;
- Manufacture of photosensitive, photo or electroluminescent elements and light emitting diodes; or
- Final assembly of displays and electrical and optical testing.

iii. With respect to inputs and equipment intended for the manufacture of electronic semiconductor devices and information displays: manufacture in accordance with the relevant PPBs.[197]

2.77. It must be noted that, as far as information displays are concerned, either the activities of concept, development and design, or the manufacture of photosensitive, photo or electroluminescent elements and light emitting diodes, must be performed in Brazil in order to obtain the concerned tax treatment on the PIS/PASEP and COFINS contributions and the IPI tax. Similarly, the manufacture of inputs and equipment intended for the manufacture of electronic semiconductor devices and information displays must be performed in Brazil in order to obtain the reductions on the PIS/PASEP and COFINS contributions and the IPI tax.[198]

2.78. The accredited company must exclusively perform one or some of the activities mentioned in paragraph 2.76 above.[199]

2.79. Investment in R&D and the activities mentioned above with respect to semiconductor electronic devices, information displays and inputs and equipment must be made in accordance with a project approved by the MCTI and the MDIC.[200]

2.80. Once accreditation is obtained, accredited companies shall submit reports annually to the Ministry of Science, Technology and Innovation in order to demonstrate compliance with the investment obligation.[201] Failure to meet the established minimum percentage would result in an obligation to invest the residual amount in the National Fund for Scientific and Technological Development, FNDCT (CT-INFO or CT-Amazonia) as well as a fine and interest.[202] Failure to comply with the stated obligation would result in the company having to pay the income tax and duties on profits, together with interest and penalties, including those imposed on contributions and unpaid taxes.[203] Accreditations under PADIS can be suspended, among other reasons, if accredited companies do not comply with their investment commitments in R&D in Brazil.[204] Suspensions of the accreditation shall become cancellations if the company does not address the

852/2008, (Exhibit JE-76), Article 4(II); Decree 6,759/2009, (Exhibit JE-8), Article 283(II); and Decree 7,212/2010, (Exhibit JE-9), Article 150 §1(II).

[197] Law 11,484/2007, (Exhibit JE-71), Article 2 §3, as amended by Law 12,715/2012, (Exhibit JE-95), Article 57; and Decree 6,233/2007, (Exhibit JE-73), Article 6 §3, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1.

[198] Law 11,484/2007, (Exhibit JE-71), Article 4 §2. See also Decree 6,233/2007, (Exhibit JE-73), Article 15; and Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 15.

[199] Law 11,484/2007, (Exhibit JE-71), Article 2(III), as amended by Law 12,715/2012, (Exhibit JE-95), Article 57; and Decree 6,233/2007, (Exhibit JE-73), Article 6(III), as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1. See also Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 4 §3; Decree 6,759/2009, (Exhibit JE-8), Article 283 §3; and Decree 7,212/2010, (Exhibit JE-9), Article 150 §4.

[200] Law 11,484/2007, (Exhibit JE-71), Articles 2 §4 and 5, as amended by Law 12,715/2012, (Exhibit JE-95), Article 57; and Decree 6,233/2007, (Exhibit JE-73), Articles 6 §4 and 7, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1. See also Normative Instruction RFB 852/2008, (Exhibit JE-76), Article 4 §4; Decree 6,759/2009, (Exhibit JE-8), Article 283 §4; and Decree 7,212/2010, (Exhibit JE-9), Article 150 §5. Project approval is subject to: (i) proof of good standing by the company of the taxes and contributions managed by the Brazilian Federal Revenue Service; (ii) compliance with the instructions established under the relevant Interministerial Implementing Order; and (iii) prior verification by the Brazilian Federal Revenue Service that the goods submitted by the accredited company fall under the relevant Annexes of Decree 6,233/2007. See Decree 6,233/2007, (Exhibit JE-73), Article 7 §1. See also Law 11,484/2007, (Exhibit JE-71), Article 5 §1; and Decree 7,212/2010, (Exhibit JE-9), Article 153, sole paragraph.

[201] Law 11,484/2007 (Exhibit JE-71), Article 7; and Decree 6,233/2007 (Exhibit JE-73), Article 9.

[202] Law 11,484/2007 (Exhibit JE-71), Article 8; and Decree 6,233/2007 (Exhibit JE-73), Article 10.

[203] Law 11,484/2007 (Exhibit JE-71), Article 8, paragraph 2; and Decree 6,233/2007 (Exhibit JE-73), Article 10, paragraph 2.

[204] Law 11,484/2007, (Exhibit JE-71), Article 9; Decree 6,233/2007, (Exhibit JE-73); and Decree 7,212/2010, (Exhibit JE-9), Articles 11 and 156.

violation within 90 days from the suspension notification[205] or if a company incurs two suspensions in less than two years.[206]

2.2.2.6 Related memorandum

2.81. Interministerial Explanatory Memorandum No 00008/2007 by the Ministry of Finance, the Ministry of Science and Technology and the Ministry of Development, Industry and Trade describes the aim of the PADIS programme as follows:

> The aim of establishing PADIS is to encourage the setting-up in Brazil of companies involved in the conception, development, design and manufacturing of electronic semiconductor devices and displays, where the latter are to be used as inputs in electronic equipment, with technology based on liquid crystal components - LCD, photoluminescent (plasma display panels - PDP), electroluminescent (light emitting diodes - LED, organic light emitting diodes - OLED or thin film electroluminescent displays - TFEL) or similar with electric field emitting microstructure.[207]

2.2.3 The PATVD programme

2.2.3.1 Introduction

2.82. The PATVD programme exempts accredited companies from paying certain taxes with respect to radio frequency signal transmitting equipment for digital television ("digital television transmission equipment"), as well as machinery, apparatus, instruments, equipment, inputs and software for the production of digital television transmission equipment ("production goods").

2.83. The tax exemptions (through zero rates) provided for in the PATVD programme entered into force in 2007 and are in effect until 22 January 2017.[208]

2.2.3.2 Tax treatment

2.84. Pursuant to the PATVD programme, the following tax rates shall be reduced to zero:

a. For imports or purchases in the Brazilian market of new machinery, apparatus, instruments, equipment, computation tools (software) and inputs used in the manufacture of digital television transmission equipment provided that they are incorporated into fixed assets of the companies accredited under the PATVD programme that purchase/ import them:

   i. PIS/PASEP and COFINS contributions levied on the revenues of the seller when goods are purchased by companies accredited under the PATVD programme[209];

   ii. PIS/PASEP-Importation and COFINS-Importation contributions levied on imports by companies accredited under the PATVD programme[210];

   iii. IPI tax levied on imported or domestic goods when imported or purchased in the Brazilian market by companies accredited under the PATVD programme[211]; and

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[205] Law 11,484/2007, (Exhibit JE-71), Article 9 §1; Decree 6,233/2007, (Exhibit JE-73), Article 11 §1; and Decree 7,212/2010, (Exhibit JE-9), Article 156 §1.

[206] Law 11,484/2007, (Exhibit JE-71), Article 9 §2; Decree 6,233/2007, (Exhibit JE-73), Article 11 §2; and Decree 7,212/2010, (Exhibit JE-9), Article 156 §2.

[207] Explanatory memorandum of the provisional measure that then became Law 11,848/2007, (Exhibit JE-109), para. 2.

[208] Law 11,484/2007, (Exhibit JE-71), Article 66. See also Decree 7,212/2010, (Exhibit JE-9), Articles 159 and 160.

[209] Law 11,484/2007, (Exhibit JE-71), Articles 14(I) and 14 §1; Decree 6,234/2007, (Exhibit JE-85), Article 2(I); and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 10(I).

[210] Law 11,484/2007, (Exhibit JE-71), Articles 14(II) and 14 §1; Decree 6,234/2007, (Exhibit JE-85), Article 2(II); and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 10(II). See also Decree 6,759/2009, (Exhibit JE-8), Article 284.

iv. CIDE contributions on remittances sent abroad by companies accredited under the PATVD programme to pay for the use of patents or trademarks and for the provision of technology and technical assistance related to the development and manufacture of digital television transmission equipment.[212]

v. Import tax might also be reduced to zero when the importer is a company accredited under the PATVD programme.[213]

b. For sales of digital television transmission equipment by companies accredited under the PATVD programme in the Brazilian market[214]:

i. PIS/PASEP and COFINS contributions on the revenue or income earned[215]; and

ii. IPI tax levied on shipments from the industrial establishment.[216]

2.2.3.3 Product coverage

2.85. The products covered under the PATVD programme are the following:

a. Digital television transmission equipment (MCN code 8525.50.2)[217];

b. Machinery, appliances, instruments and equipment for incorporation into the fixed assets of the purchaser/ importer, intended for the manufacture of digital television transmission equipment[218];

c. Inputs for the manufacture of digital television transmission equipment[219]; and

d. Computational tools (software) for the manufacture of digital television transmission equipment.[220]

2.2.3.4 Eligible companies

2.86. The tax exemptions (through zero rates) provided for in the PATVD programme shall be accorded to legal persons previously accredited by the RFB[221] that:

a. Import or sell in the Brazilian market new machinery, apparatus, instruments, equipment, computation tools (software) and inputs to be incorporated into their fixed

[211] Law 11,484/2007, (Exhibit JE-71), Articles 14(III) and 14 §1; Decree 6,234/2007, (Exhibit JE-85), Article 2(III); and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 10(III). See also Decree 6,759/2009, (Exhibit JE-8), Article 284 §4.

[212] Law 11,484/2007, (Exhibit JE-71), Article 14 §3; Decree 6,234/2007, (Exhibit JE-85), Article 3; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 12.

[213] Law 11,484/2007, (Exhibit JE-71), Article 14 §5. See also Decree 6,759/2009, (Exhibit JE-8), Article 284 §5.

[214] These tax reductions do not apply cumulatively with other reductions or benefits relating to the same taxes or contributions. See Law 11,484/2007, (Exhibit JE-71), Article 15, sole paragraph; Decree 6,234/2007, (Exhibit JE-85), Article 4, sole paragraph; Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 11, sole paragraph; and Decree 7,212/2010, (Exhibit JE-9), Article 160, sole paragraph.

[215] Law 11,484/2007, (Exhibit JE-71), Articles 15(I); Decree 6,234/2007, (Exhibit JE-85), Article 4(I); and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 11(I).

[216] Law 11,484/2007, (Exhibit JE-71), Articles 15(II); Decree 6,234/2007, (Exhibit JE-85), Article 4(II); and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 11(II).

[217] Decree 6,234/2007, (Exhibit JE-85), Annex I: Final Products.

[218] Decree 6,234/2007, (Exhibit JE-85), Article 13(I) and Annex II: Machinery, appliances, instruments and equipment for incorporation into the fixed assets, intended for the manufacture of the final products; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 13(I).

[219] Decree 6,234/2007, (Exhibit JE-85), Article 13(II) and Annex III: Inputs for the manufacture of final products; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 13(II).

[220] Decree 6,234/2007, (Exhibit JE-85), Article 13(III) and Annex IV: Computational tools for the manufacture of final products; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 13(III).

[221] Decree 6,234/2007, (Exhibit JE-85), Article 5; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 3.

assets provided that they are used in the manufacture of digital television transmission equipment; and

b. Sell in the Brazilian market digital television transmission equipment.

2.2.3.5 Requirements for eligibility

2.87. In order to obtain accreditation and become accredited under the PATVD programme, legal persons must meet the following requirements:

a. Invest in research and development (R&D)[222]

Companies accredited under the PATVD programme must invest annually at least 2.5% of their gross sales in the Brazilian market, after deduction of taxes levied on sales of transmission equipment, in R&D activities in Brazil.[223] At least 1% out of the 2.5% shall be directed toward official or accredited research institutes or centres or Brazilian education entities, which are registered with the CATI or CAPDA.[224]

The investment in R&D must be in relation to digital television transmission equipment, as well as in software and inputs for digital television transmission equipment.[225]

b. Engage in developing and manufacturing activities of digital television transmission equipment (MCN code 8525.50.2)[226]; and

c. Either comply with the relevant PPB[227] or, alternatively, meet the criteria for a product to be considered "developed in Brazil".[228]

2.88. Investment in R&D and the development and manufacture of digital television transmission equipment must be made in accordance with a project approved by the MCTI and the MDIC.[229]

2.89. Once accreditation is obtained, accredited companies shall submit reports annually to the Ministry of Science, Technology and Innovation in order to demonstrate compliance with the

[222] Law 11,484/2007, (Exhibit JE-71), Articles 13 and 17, Decree 6,234/2007, (Exhibit JE-85), Article 6; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 4. See also Decree 6,759/2009, (Exhibit JE-8), Article 285.

[223] Law 11,484/2007, (Exhibit JE-71), Article 17; and Decree 6,234/2007, (Exhibit JE-85), Article 8. The taxes levied on the sales of the digital television transmission equipment must be deducted from the gross sales in the Brazilian market. See Law 11,484/2007, (Exhibit JE-71), Article 17; and Decree 6,234/2007, (Exhibit JE-85), Article 8.

[224] Law 11,484/2007, (Exhibit JE-71), Article 17, paragraph 2; and Decree 6,234/2007, (Exhibit JE-85), Article 8 §2.

[225] Law 11,484/2007, (Exhibit JE-71), Article 17 §1; and Decree 6,234/2007, (Exhibit JE-85), Article 8 §1.

[226] Law 11,484/2007, (Exhibit JE-71), Article 13; Decree 6,234/2007, (Exhibit JE-85), Article 6. See also Decree 6,759/2009, (Exhibit JE-8), Article 285; and Decree 7,212/2010, (Exhibit JE-9), Article 158 §1.

[227] The PPB is established by Interministerial Implementing Order of the Ministry of Development, Industry and Foreign Trade and the Ministry of Science and Technology. Implementing Order MDIC/MCTI 62/2014 sets out the PPB for digital television equipment "produced in Brazil". See Law 11,484/2007, (Exhibit JE-71), Article 13 §1; Interministerial Implementing Order MDIC/MCTI 62/2014, (Exhibit JE-89); and Decree 6,234/2007, (Exhibit JE-85), Article 6 §1. See also Decree 6,759/2009, (Exhibit JE-8), Article 285 §1; and Decree 7,212/2010, (Exhibit JE-9), Article 158 §2.

[228] The criteria that a product must fulfil in order to be considered as "developed in Brazil" are set out in an Implementing Order adopted by the Ministry of Science and Technology. See Law 11,484/2007, (Exhibit JE-71), Article 13 §1; and Decree 6,234/2007, (Exhibit JE-85), Article 6 §1. See also Decree 6,759/2009, (Exhibit JE-8), Article 285 §1; and Decree 7,212/2010, (Exhibit JE-9), Article 158 §2.

[229] Law 11,484/2007, (Exhibit JE-71), Articles 13 §2 and 16; Decree 6,234/2007, (Exhibit JE-85), Articles 6 §2 and 7; and Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 2. Project approval is subject to: (i) proof of good standing by the company of the taxes and contributions managed by the Brazilian Federal Revenue Service; (ii) compliance with the instructions established under the relevant Interministerial Implementing Order; and (iii) prior verification by the Brazilian Federal Revenue Service of compliance with the requirements of the assets presented by the company. See Law 11,484/2007, (Exhibit JE-71), Article 16 §1 and Decree 6,234/2007, (Exhibit JE-85), Article 7 §1. See also Decree 6,759/2009, (Exhibit JE-8), Article 285 §2; and Decree 7,212/2010, (Exhibit JE-9), Article 158 §3.

investment obligation.[230] Failure to meet the established minimum percentage would result in an obligation to invest the residual amount in the National Fund for Scientific and Technological Development, FNDCT (CT-INFO or CT-Amazonia) as well as a fine and interest.[231] Failure to comply with the stated obligation would result in the company having to pay interest and penalties on late payments in relation to the contributions and unpaid taxes.[232] Accreditations under PATVD can be suspended if accredited companies do not comply with the PPBs or with their investment commitments in R&D in Brazil, among other reasons.[233] Suspensions of accreditation shall become cancellations if the company does not address the violation within 90 days from the suspension notification[234] or if a company incurs two suspensions in less than two years.[235]

2.2.3.6 Related memorandum

2.90. Interministerial Explanatory Memorandum No. 00008/2007 by the Ministry of Finance, the Ministry of Science and Technology and the Ministry of Development, Industry and Trade describes the aim of the PATVD programme as follows:

> The aim of establishing PATVD is to encourage the setting-up in Brazil of companies involved in the development and manufacturing of radio-frequency transmitter equipment for digital television.[236]

2.2.4 The Digital Inclusion programme

2.2.4.1 Introduction

2.91. The Digital Inclusion Programme exempts (through zero rates) Brazilian retailers from paying PIS/PASEP and COFINS contributions with respect to the sale of certain digital consumer goods produced in Brazil in accordance with the relevant PPBs.

2.92. The Digital Inclusion programme entered into force in 2005 and was supposed to be in force until 31 December 2018.[237]

2.2.4.2 Tax treatment

2.93. The Digital Inclusion programme reduces to zero the PIS/PASEP and COFINS contributions on the gross income from the retail sale in Brazil of certain digital consumer goods.[238]

2.2.4.3 Product coverage

2.94. The products covered under the Digital Inclusion programme are the following:

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[230] Law 11,484/2007 (Exhibit JE-71), Article 18; and Decree 6,234/2007 (Exhibit JE-85), Article 9.

[231] Law 11,484/2007 (Exhibit JE-71), Article 19; and Decree 6,234/2007 (Exhibit JE-85), Article 10.

[232] Law 11,484/2007 (Exhibit JE-71), Article 19, paragraph 2; and Decree 6,234/2007 (Exhibit JE-85), Article 10, paragraph 2.

[233] Law 11,484/2007, (Exhibit JE-71), Article 20; Decree 6,234/2007, (Exhibit JE-85), Article 11; and Decree 7,212/2010, (Exhibit JE-9), Article 164. See also Decree 6,234/2007, (Exhibit JE-85), Article 11(IV) and (VI).

[234] Law 11,484/2007, (Exhibit JE-71), Article 20 §1; Decree 6,234/2007, (Exhibit JE-85), Article 11 §1; Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 9 §1; and Decree 7,212/2010, (Exhibit JE-9), Article 164 §1.

[235] Law 11,484/2007, (Exhibit JE-71), Article 20 §2; Decree 6,234/2007, (Exhibit JE-85), Article 11 §2; Normative Instruction RFB 853/2008, (Exhibit JE-86), Article 9 §2; and Decree 7,212/2010, (Exhibit JE-9), Article 164 §2.

[236] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 7.

[237] Law 11,196/2005, (Exhibit JE-91), Article 30(II), as amended by Law 13,097, (Exhibit JE-92), Article 5. According to Brazil, pursuant to Law 13,241/2015, the Digital Inclusion programme is no longer in force. See Brazil's comments on the draft descriptive part, comment on paragraph 2.87 of the draft descriptive part. The complaining parties disagree with Brazil's assertion. See European Union's comments on the interim report, para. 9; European Union's comments on Brazil's request for review of the interim report, para. 3 and fn 1; Japan's comments on Brazil's request for review of the interim report, paras. 2-3. The Panel takes no position on whether the Digital Inclusion programme is in force at the date of the issuance of the report.

[238] Law 11,196/2005, (Exhibits JE-91), Article 28; and Decree 5,602/2005, (Exhibit JE-97), Articles 1 and 2.

a. Digital processing units (TIPI code 8471.50.10) with a maximum retail sale value of R$ 2,000 (Brazilian *reais*), produced in Brazil in accordance with the relevant PPB;

b. Automatic, digital, portable data processing machines with weight of less than 3.5 kg, with screen area greater than 140 cm² (TIPI codes 8471.30.12, 8471.30.19 or 8471.30.90) with a maximum retail sale value of R$ 4,000, produced in Brazil in accordance with the relevant PPB;

c. Automatic data processing machines, working in systems (TIPI code 8471.49), containing exclusively: a) one digital processing unit (TIPI code 8471.50.10); b) one monitor (video output unit) (TIPI code 8471.60.7); c) one keyboard (input unit) (TIPI code 8471.60.52); and d) one mouse (input unit) (TIPI code 8471.60.53) and sold jointly at a maximum retail sale value of R$ 4,000, produced in Brazil in accordance with the relevant PPB;

d. Keyboard (input unit; TIPI code 8471.60.52) and mouse (input unit; TIPI code 8471.60.53), when sold with a digital processing unit with TIPI code 8471.50.10, with a maximum retail sale value of R$ 2,100 jointly;

e. Modems (TIPI codes 8517.62.55, 8517.62.62 or 8517.62.72), with a maximum retail sale value of R$ 200;

f. Portable, automatic data processing machines, without a keyboard, which have a central processing unit with data input and output through a touch screen with area greater than 140 cm2 and less than 600 cm2, and which do not have a remote control function (Tablet PC) (TIPI code 8471.41) with a retail sale value of less than R$ 2,500, produced in Brazil in accordance with the relevant PPB;

g. Cellular network, smartphone type mobile telephones which permit high-speed Internet access (TIPI code 8517.12.31), with a retail sale value of less than R$ 1,500, which in addition to being produced in Brazil in accordance with the relevant PPB, must meet the technical requirements set out in an act from the Ministry for Communications[239]; and

h. Client terminal equipment (digital routers) (TIPI codes 8517.62.41 and 8517.62.77) with a retail sale value of less than R$ 150, developed and produced in Brazil in accordance with the relevant PPB.[240]

2.2.4.4 Eligible companies

2.95. The Digital Inclusion programme provides for zero rates with respect to PIS/PASEP and COFINS contributions for companies that sell in Brazil at retail level certain digital consumer goods produced in accordance with the relevant PPBs (and subject to certain other conditions). Companies subject to the *Simples* tax regime fall outside the scope of this programme.[241]

2.2.4.5 Related memoranda

2.96. No related memorandum is found on the record.

[239] Implementing Order MC 87/213, (Exhibit JE-100) in conjunction with Implementing Order STE 2/2013, (Exhibit JE-99).

[240] Law 11,196/2005, (Exhibit JE-91), Article 28; and Decree 5,602/2005, (Exhibit JE-97), Articles 1 and 2.

[241] Law 11,196/2005, (Exhibits JE-91), Article 30. The *Simples* tax regime is a simplified regime designed for companies that in a calendar year had a gross income equal or lower than R$ 240,000. See Legal Guide for Foreign Investors in Brazil, Ministry of External Relations (Legal Guide for Foreign Investors in Brazil), (Exhibit JE-207).

2.2.5 The INOVAR-AUTO programme

2.2.5.1 Introduction

2.97. The Programme to Promote Technological Innovation and Densification of the Productive Chain of Motor Vehicles (*Programa de Incentivo à Inovação Tecnológica e Adensamento da Cadeia Produtiva de Veículos Automotores*, hereinafter the INOVAR-AUTO programme) provides for a reduction of the IPI tax burden on certain motor vehicles (i) either through presumed IPI tax credits granted to accredited companies; (ii) or through reduced IPI tax rates on the importation of vehicles originating in certain countries, as well as on certain domestic vehicles.

2.98. The INOVAR-AUTO programme started in 2012 and shall remain in effect until 31 December 2017.[242]

2.99. Prior to the entry into force of the INOVAR-AUTO programme, which constitutes the measure at issue in this dispute, Brazil introduced Provisional Measure 540 in August 2011 whereby it reduced the IPI tax on certain automotive products provided that specific conditions were met. This Provisional Measure, which became Law 12,546/2011[243], was subsequently implemented by Decree 7,567/2011.[244]

2.2.5.2 Tax treatment

2.100. INOVAR-AUTO provides for a reduction of the IPI tax due on certain motor vehicles through two instruments: (i) presumed IPI tax credits granted to accredited companies; and (ii) reduced IPI tax rates on the importation of vehicles originating in certain countries as well as on certain domestic vehicles.[245]

2.101. First, accredited companies under the INOVAR-AUTO programme are entitled to tax advantages consisting of "presumed tax credits" to fully or partially offset the IPI tax on motor vehicles listed in Annex I of Decree 7,819/2012 up to 30 percentage points.

2.102. Second, INOVAR-AUTO provides for reduced IPI tax rates in the following instances:

a. For vehicles listed in Annex I of Decree 7,819/2012, when imported by companies accredited as "domestic manufacturers" or "investors" from countries that are signatories to the agreements established by Legislative Decree 350 of 21 November 1991, Decree 4,458 of 5 November 2002 and Decree 6,500 of 2 July 2008[246]:

   From 1 January 2013, a 30 percentage point reduction in the applicable IPI tax rate on these vehicles shall apply until 31 December 2017.[247]

   This reduction shall apply to imports by accredited manufacturers or investors[248] at the time of customs clearance and the exit from the importing establishment[249] and only for

[242] Law 12,715/2012, (Exhibit JE-95), Article 40 §1; and Decree 7,819/2012, (Exhibit JE-132), Article 1 §1.

[243] Law 12,546 of 14 December 2011 (Law 12,546/2011), (Exhibit JE-129 and JE-199).

[244] Decree 7,567 of 15 September 2011 (Decree 7,567/2011), (Exhibit JE-127). The Panel notes that Decree 7,567 modified the IPI tax rates on certain motor vehicles, prior to the entry into force of the INOVAR-AUTO programme. See Decree 7,567, (Exhibit JE-127), Article 10 and Annex V.

[245] Decree 7,819/2012, (Exhibit JE-132), Articles 11-19.

[246] Decree 7,819/2012, (Exhibit JE-132), Article 21, referring to Decree 350 of 21 November 1991 on the Treaty for the formation of a common market between the Republic of Argentina, the Federative Republic of Brazil, the Republic of Paraguay and the Oriental Republic of Uruguay (MERCOSUR), (Decree 350/1991), (Exhibit JE-163); Decree 4,458 of 5 November 2002 on the Economic Complementation Agreement No. 55 between Mercosur and the United Mexican States, (Exhibit JE-164); Decree 6,500 of 2 July 2008 on the Economic Complementation Agreement No. 14 between the Republic of Argentina and the Federative Republic of Brazil, (Exhibit JE-165). The agreements referred to in those decrees include the MERCOSUR Treaty (between Brazil, Argentina, Paraguay, Uruguay and Venezuela), Economic Complementation Agreement (ECA) No. 55 (between Brazil, Argentina, Paraguay, Uruguay and Mexico), and ECA No. 14 (between Brazil and Argentina).

[247] Decree 7,819/2012, (Exhibit JE-132), Articles 1 and 21.

products of the same brand as that of vehicles manufactured by the accredited company.[250] Limitations, requirements and quantitative restrictions set out in the agreements referred to in Legislative Decree 350 of 21 November 1991[251], Decree 4,458 of 5 November 2002[252], and Decree 6,500 of 2 July 2008[253] shall also apply.[254]

b. For vehicles listed in Annex I of Decree 7,819/2012 when imported by any company (including both accredited and unaccredited companies) under the agreement established by Decree 6,518 of 30 July 2008 and Decree 7,658 of 23 December 2011[255]:

2.103. A 30 percentage point reduction in the applicable IPI tax rate shall apply to these vehicles.

2.104. This IPI tax reduction, due to expire on 31 December 2017[256], shall apply at the time of customs clearance and the exit from the importing establishment.[257] Limitations, requirements and quantitative restrictions set out in the agreement referred to in Decree 6,518/2008 and Decree 7,658/2011 shall apply.[258]

a. For vehicles listed in Annex I of Decree 7,819/2012 imported directly by an accredited company, subject to limitations per calendar year[259]:

A 30 percentage point reduction in the applicable IPI tax rate shall apply to a limited number of vehicles listed in Annex I when imported by accredited companies.[260] The maximum number of vehicles covered by this tax reduction is either 4,800 per calendar year or the arithmetic mean of the vehicles imported by the company between 2009 and 2011, whichever is lower.[261] Products listed in Annex VI of Decree 7,819/2012 are explicitly excluded from the scope of this IPI tax reduction.[262]

This IPI tax reduction shall apply at the time of customs clearance and the exit from the importing establishment.[263]

b. For certain national motor vehicles[264]:

Additional Note 87-5 of the TIPI in Annex IX of Decree 7,819/2012 provides for reduced IPI tax rates for vehicles manufactured in Brazil with the following characteristics: (i) manual transmission, (ii) transfer case, (iii) chassis independent from the bodywork, (iv) minimum clear height from the ground of the front or rear axles of 200 mm, (v) minimum clear height from the ground between the axles of 300 mm, (vi) minimum

[248] It covers imports by the accredited company or by order, or on behalf, of the accredited company. See Decree 7,819/2012, (Exhibit JE-132), Article 21 §1(II).
[249] Decree 7,819/2012, (Exhibit JE-132), Article 21 §1(I).
[250] Decree 7,819/2012, (Exhibit JE-132), Article 21 §1(IV).
[251] Decree 350/1991, (Exhibit JE-163).
[252] Decree 4,458/2002, (Exhibit JE-164).
[253] Decree 6,500/2008, (Exhibit JE-165).
[254] Decree 7,819/2012, (Exhibit JE-132), Article 21 §1(III).
[255] Decree 7,819/2012, (Exhibit JE-132), Article 22(I), referring to Decree 6,518 of 30 July 2008 providing for the implementation of the Sixty Eighth Additional protocol to Economic Complementation Agreement No. 2, signed between the Governments of the Federative Republic of Brazil and the Oriental Republic of Uruguay, (Exhibit JE-203); and Decree 7,658 of 23 December 2011 laying down provisions concerning the implementation of the 69th Additional Protocol to Economic Complementation Agreement No. 2 signed by the Governments of the Federal Republic of Brazil and the Oriental Republic of Uruguay, (Decree 7,658/2011), (Exhibit JE-204) The agreement referred to in those decrees is ECA No. 2 between Uruguay and Brazil.
[256] Decree 7,819/2012, (Exhibit JE-132), Article 22 §7, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.
[257] Decree 7,819/2012, (Exhibit JE-132), Article 22 §1(I).
[258] Decree 7,819/2012, (Exhibit JE-132), Article 22 §1(II).
[259] Decree 7,819/2012, (Exhibit JE-132), Article 22(II).
[260] Decree 7,819/2012, (Exhibit JE-132), Article 22(II).
[261] Special rules apply for calendar year 2012. See Decree 7,819/2012, (Exhibit JE-132), Article 22 §4, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.
[262] Decree 7,819/2012, (Exhibit JE-132), Article 22 §2.
[263] Decree 7,819/2012, (Exhibit JE-132), Article 22 §1(I).
[264] Decree 7,819/2012, (Exhibit JE-132), Annex IX.

approach angle of 35º, (vii) minimum departure angle of 24º, (viii) minimum ramp angle of 28º, (ix) resurfacing capacity from 500 mm, (x) combined total gross weight of at least 3000 kg, (xi) maximum weight in running order of up to 2100 kg, (xii) designed for military use or agro-industrial work, and (xiii) classified under codes 8703.32.10[265] and 8703.33.10.[266]

i. The reduced IPI tax rate indicated above is set at 45% between 1 January 2013 and 31 December 2017. From 1 January 2018, the reduced IPI tax rate shall be 15%.[267]

2.105. The Panel also notes that certain tax reductions are provided for vehicles listed in Annex I of Decree 7,819/2012 manufactured by companies whose annual production volume is less than 1,500 units and annual turnover is less than R$ 90,000,000 (90 million real)[268], for vehicles characterized as quadricyles and tricycles[269], and for any company manufacturing products under certain TIPI tariff codes by assembling the body on a chassis.[270] These particular tax reductions are not relevant to the present dispute.

2.2.5.3 Product coverage

2.106. The presumed tax credits and the tax reductions under the INOVAR-AUTO programme apply to the following products:

a. With respect to presumed IPI tax credits granted to accredited companies: motor vehicles listed in Annex I of Decree 7,819/2012.[271]

b. With respect to IPI tax reductions:

i. Vehicles listed in Annex I of Decree 7,819/2012 originating from countries that are signatories to the agreements established by Legislative Decree 350 of 21 November 1991, Decree 4,458 of 5 November 2002 and Decree 6,500 of 2 July 2008;

ii. Imported vehicles from Uruguay listed in Annex VIII of Decree 7,819/2012;

iii. Imported vehicles listed in Annex VIII of Decree 7,819/2012 up to 4,800 vehicles/year or the arithmetic mean of the imported vehicles by the company between 2009 and 2011, whichever is lower;

iv. Vehicles manufactured in Brazil with certain characteristics falling under codes 8703.32.10 and 8703.33.10.[272]

2.107. The Panel notes that certain tax reductions apply to vehicles listed in Annex VIII of Decree 7,819/2012 manufactured by companies with annual production volume less than 1,500

[265] Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), of a cylinder capacity exceeding 1,500 cm3 but not exceeding 2,500 cm3, with carrying capacity of six seated people or less, including the driver. See TIPI Chapter 87 products description, (Exhibit JE-194).

[266] Motor cars and other motor vehicles principally designed for the transport of persons (other than those of heading 87.02), of a cylinder capacity exceeding 2,500 cm3, with carrying capacity of six seated people or less, including the driver. See TIPI Chapter 87 products description, (Exhibit JE-194).

[267] Decree 7,819/2012, (Exhibit JE-132), Annex IX, TIPI Additional Note (NC) 87-5.

[268] Decree 7,819/2012, (Exhibit JE-132), Article 22(IV), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. According to Article 22 §3 of Decree 7,819/2012, these limits can be reviewed annually. See Decree 7,819/2012, (Exhibit JE-132), Article 22 §7, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[269] Decree 7,819/2012, (Exhibit JE-132), Article 22(V), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. See also Decree 7,819/2012, (Exhibit JE-132), Article 22 §1 and §7, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1; and Decree 8,294/2014, (Exhibit JE-134), Article 1.

[270] Decree 7,819/2012, (Exhibit JE-132), Article 23.

[271] Decree 7,819/2012, (Exhibit JE-132), Articles 11-17. The presumed tax credits also apply to operational expenditures in Brazil. See Decree 7,819/2012, (Exhibit JE-132), Article 15 §1(I), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[272] See Decree 7,819/2012, (Exhibit JE-132), Articles 21-23, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

units and annual turnover less than R$ 90,000,000 (90 million real); vehicles listed in Annex VIII of Decree 7,819/2012 characterized as quadricyles and tricycles; and vehicles manufactured by assembling the body on a chassis and classified under the following TIPI tariff codes: 8704.2, 8704.3, 8704.90.00, 8702.10.00 Ex 02, and 8702.90.90 Ex 02. These particular tax reductions are not relevant to the present dispute.

2.2.5.4 Beneficiaries

2.108. Beneficiaries of the INOVAR-AUTO programme differ depending on whether the reduction of the IPI tax burden on motor vehicles takes place (i) through presumed IPI tax credits; or (ii) through reduced IPI tax rates.

2.109. To be entitled to presumed IPI tax credits, a company must be accredited as a "domestic manufacturer", an "investor", or an "importer/distributor", as explained in further detail below.

2.110. To be entitled to the reduced IPI tax rates, a company must fall under one of the following instances of IPI tax reduction:

a. Be accredited as a "domestic manufacturer" or "investor" (that imports certain vehicles from countries that are signatories to the relevant agreements)[273];

b. Import certain vehicles from Uruguay under the relevant agreements[274];

c. Be accredited as an "importer/distributor" of certain vehicles under the INOVAR-AUTO programme[275]; or

d. Manufacture in Brazil motor vehicles that meet certain technical features.[276]

2.111. The Panel notes that companies that manufacture certain vehicles and have an annual production volume of less than 1,500 units and an annual turnover of less than R$ 90,000,000 (90 million real),[277] companies that manufacture vehicles characterized as quadricyles and tricycles[278], and companies that manufacture vehicles under certain TIPI tariff codes by assembling the body on a chassis[279] also benefit from reduced IPI tax rates. These particular tax reductions are not relevant to the present dispute.

2.2.5.5 Requirements for eligibility

2.112. As indicated above, all companies using presumed IPI tax credits, and certain companies using reduced IPI tax rates, must obtain one of three forms of accreditation. Companies are subject to different requirements depending on the type of accreditation they apply for.

[273] Decree 7,819/2012, (Exhibit JE-132), Article 21. The agreements referred to in Article 21 of Decree 7,819/2012 include the MERCOSUR Treaty (between Brazil, Argentina, Paraguay, Uruguay and Venezuela), Economic Complementation Agreement (ECA) No. 55 (between Brazil, Argentina, Paraguay, Uruguay and Mexico), and ECA No. 14 (between Brazil and Argentina). See footnote 246 above.

[274] Decree 7,819/2012, (Exhibit JE-132), Article 22(I). The agreement referred to in Article 22(I) of Decree 7,819/2012 is ECA No. 2 between Uruguay and Brazil. See footnote 255 above.

[275] Decree 7,819/2012, (Exhibit JE-132), Article 22(II).

[276] Decree 7,819/2012, (Exhibit JE-132), Annex IX.

[277] Decree 7,819/2012, (Exhibit JE-132), Article 22(IV), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. According to Article 22 §3 of Decree 7,819/2012, (Exhibit JE-132), these limits can be reviewed annually. See Decree 7,819/2012, (Exhibit JE-132), Article 22 §7, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[278] Decree 7,819/2012, (Exhibit JE-132), Article 22(V), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. See also Decree 7,819/2012, (Exhibit JE-132), Article 22 §1 and §7, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1, and Decree 8,294/2014, (Exhibit JE-134), Article 1.

[279] Decree 7,819/2012, (Exhibit JE-132), Article 23.

2.2.5.5.1 Accreditation requirements

2.113. INOVAR-AUTO provides for three different types of accreditations[280] available for economic operators, in order to be entitled to presumed IPI tax credits:

a. Accreditations for companies that manufacture in Brazil products listed in Annex I of Decree 7,819/2012 ("domestic manufacturers")[281];

b. Accreditations for companies that market in Brazil products listed in Annex I of Decree 7,819/2012 and do not engage in manufacturing activities in Brazil ("importers/distributors"[282])[283]; and

c. Accreditation for companies whose projects for establishing factories in Brazil, or in the case of companies already established in Brazil, projects for setting up new factories or industrial projects, to produce new models[284] of products listed in Annex I of Decree 7,819/2012 ("investors"), have been approved.[285]

2.114. To obtain accreditation, a company must comply with certain requirements of both a general and specific nature. All such companies must comply with the same two general requirements, and each also must comply with certain additional specific requirements that vary by the type of accreditation. The details of these requirements are set forth below.

2.115. A company applying for accreditation as a "domestic manufacturer" shall comply with the two general requirements[286] as well as three out of four specific requirements, one of which must be the performance of a minimum number of defined manufacturing and engineering infrastructure activities in Brazil.[287] Such a company also shall have to provide an estimate of its expenditure on R&D, engineering, basic industrial technology and capacity-building of suppliers in Brazil in relation to its total gross revenue.[288]

2.116. A company applying for accreditation as an "importer/distributor" shall comply with the two general requirements and the following three specific requirements: (i) investments in R&D in Brazil; (ii) expenditure on engineering, basic industrial technology and capacity-building of suppliers in Brazil; and, (iii) participation in the vehicle labelling programme by National Institute of Metrology, Quality and Technology (INMETRO).[289] Such a company shall submit its expected

[280] Granted by the Ministry of Development, Industry, and Foreign Trade for a period of 12 months, renewable once for a period of 12 months upon request by the accredited company. See Law 12,715/2012, (Exhibit JE-95), Article 40 §7; and Decree 7,819/2012, (Exhibit JE-132), Article 3(II).

[281] Decree 7,819/2012, (Exhibit JE-132), Article 2(I), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[282] The European Union and Japan refer to this category as "domestic distributors". Brazil uses the term "importers" to refer to the same category of accredited companies under the INOVAR-AUTO programme. Article 2(II) of Decree 7,819/2012, (Exhibit JE-132), as amended by Article 1 of Decree 8,015/2013 (Exhibit JE-133), refers to "companies …that do not manufacture but market in [Brazil]" the relevant products.

[283] Decree 7,819/2012, (Exhibit JE-132), Article 2(II).

[284] For the purposes of Article 2(III) of Decree 7,819/2012, (Exhibit JE-132), "new models" are those which have never obtained the Make/Model/Version Code from the National Motor Vehicle and Traffic Department - DENATRAN, as manufactured in the country, and that this fact is stated on the request which is sent to DENATRAN for the granting of the abovementioned Make/Model/Version Code. See Implementing Order MDIC 297/2013, (Exhibit JE-179), Article 2.

[285] Decree 7,819/2012, (Exhibit JE-132), Article 2(III). Companies establishing more than one factory or industrial plant must request one accreditation for each factory or industrial plant. This accreditation can be renewed once. See Law 12,715/2012, (Exhibit JE-95), Article 40 §8.

[286] Law 12,715/2012, (Exhibit JE-95), Article 40 §4(I)(II); and Decree 7,819/2012, (Exhibit JE-132), Article 4(I)(II).

[287] Decree 7,819/2012, (Exhibit JE-132), Article 7. This does not apply to companies manufacturing exclusively vehicles listed in Annex IV of Decree 7,819/2012. In such cases, in order to get the accreditation manufacturers must commit to perform a minimum number of manufacturing activities in Brazil and invest either in research and development or in engineering, basic industrial technology and capacity-building of suppliers in Brazil. The requirement relating to the vehicle labelling programme does not apply to them. See Decree 7,819/2012, (Exhibit JE-132), Article 7 §1.

[288] Implementing Order MDIC 113/2013, (Exhibit JE-154) Article 6, as amended by Implementing Order MDIC 280/2013, (Exhibit JE-177), Article 1.

[289] Decree 7,819/2012, (Exhibit JE-132), Article 6.

expenditure and investment to be made in Brazil in the above-mentioned areas[290] and shall demonstrate that it is authorized to import, sale, supply technical assistance services, organize a distribution network and use the brands of the manufacturer with regard to the imported vehicles in Brazil.[291]

2.117. A company applying for accreditation as an "investor" shall submit to the MDIC an investment project containing a description and the technical features of the vehicles to be imported and manufactured.[292] Accreditation shall be granted once the investment project is approved by that Ministry.[293] An "investor" shall be required to apply for a specific accreditation for every factory, plant or industrial project that it plans to establish. Such accreditations can be renewed once, subject to compliance with the physical-financial timetable for the investment project.[294]

2.118. All of the rights and obligations of an accredited company are detailed in its individual Terms of Commitment[295], which should also contain: (i) criteria for the assessment, verification and monitoring of the commitments undertaken; (ii) terms and conditions for the monitoring of commitments and the calculation of presumed IPI tax credits; and, (iii) the methodology for calculation of the value and characteristics of strategic inputs and tools for purposes of the determination of the presumed IPI tax credit accrued as a result of expenditure on these two items, including procedures for the calculation of the value, verification and monitoring and the definition of the goods considered as "strategic inputs" pursuant to Article 12(I) of Decree 7,819/2012.[296]

2.119. Accredited companies must submit quarterly monitoring reports in accordance with Annexes III, IV and V of Implementing Order 113/2013 to the Secretary of Production Development of the Ministry of Development, Industry and Foreign Trade.[297]

2.120. Failure to comply with the requirements or commitments undertaken shall result in the cancellation of a company's accreditation.[298] In the case of presumed IPI tax credits, cancellation shall result in the company being obliged to pay the IPI tax that was otherwise due on the basis of the presumed credit used plus an amount set forth in the corresponding tax legislation.[299]

2.121. The two general requirements that all companies seeking accreditation must meet are as follows:

a. Compliance with all tax obligations at the federal level[300]; and

b. Commitment to achieve certain minimum levels of energy efficiency for products marketed in Brazil.[301]

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[290] Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 5, and Decree 7,819/2012, (Exhibit JE-132), Article 6(I), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[291] Decree 7,819/2012, (Exhibit JE-132), Article 6(II), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[292] Decree 7,819/2012, (Exhibit JE-132), Article 5 §3. See also Annexes I and II to Implementing Order MDIC 297/2013 which set out the terms for the investment project, (Exhibit JE-179).

[293] Decree 7,819/2012, (Exhibit JE-132), Article 5 §1.

[294] Decree 7,819/2012, (Exhibit JE-132), Article 5 §2; and Implementing Order MDIC 297/2013, (Exhibit JE-179), Article 5.

[295] Decree 7,819/2012, (Exhibit JE-132), Article 4 §1, and Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 3(I). The Brazilian government considers the Terms of Commitment as personal data protected under domestic tax confidentiality provisions. See Reply to access to documents request (confidentiality of Terms of Commitment), (Exhibit JE-143).

[296] Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 3(II), (III) and (IV).

[297] Implementing Order 113/2013, as amended by Implementing Order 280/2013, (Exhibit JE-177), Article 7.

[298] Decree 7,819/2012, (Exhibit JE-132), Article 9.

[299] Decree 7,819/2012, (Exhibit JE-132), Article 10.

[300] Law 12,715/2012, (Exhibit JE-95), Article 40 §4(I); and Decree 7,819/2012, (Exhibit JE-132), Article 4(I).

[301] Law 12,715/2012, (Exhibit JE-95), Article 40 §4(II); and Decree 7,819/2012, (Exhibit JE-132), Article 4(II). Annex II of Decree 7,819/2012 establishes a formula to calculate the maximum value of energy consumption for companies to be granted accreditation or a reduction of one or two percentage points on the

2.122. To obtain accreditation, each company also must meet some combination of the following specific requirements:

a. Performance of a minimum number of defined manufacturing and engineering infrastructure activities[302]:

These activities must (i) be carried out directly by the accredited company or through third parties; (ii) cover at least 80% of manufactured vehicles; and (iii) be subject to the following schedule:[303]

	MINIMUM NUMBER OF MANUFACTURING AND ENGINEERING INFRASTRUCTURE ACTIVITIES TO BE PERFORMED IN BRAZIL[304]			
	Manufacture of passenger cars and light commercial vehicles	**Manufacture of trucks**	**Manufacture of chassis fitted with engines**	**Manufacture of automobiles in the situation referred to in Article 12 §5(III)**[305]
Calendar year	(Total number of manufacturing and engineering infrastructure activities: 12)	(Total number of manufacturing and engineering infrastructure activities: 14)	(Total number of manufacturing and engineering infrastructure activities: 11)	
2013	8	9	7	6
2014	9	10	8	6
2015	9	10	8	7
2016	10	11	9	7
2017	10	11	9	8

b. Investment in research and technological development (R&D) in Brazil:

The minimum percentage of gross revenues for sale of goods and services[306] which accredited companies must invest in R&D in Brazil is as follows: 0.15% in 2013, 0.30% in 2014, and 0.50% in 2015-2017.[307]

The activities covered by these investments are (i) directed basic research, (ii) applied research, (iii) experimental development, (iv) technical support services and (v) design, planning, construction or modernisation of laboratories and infrastructure for their

IPI tax rate. In addition, pursuant to Article 4 §2 of Decree 7,819/2012, this commitment does not apply to companies that exclusively manufacture or market in Brazil the vehicles listed in Annex IV of that Decree.

[302] Decree 7,819/2012, (Exhibit JE-132), Annex III.

[303] Decree 7,819/2012, (Exhibit JE-132), Article 7(I).

[304] Decree 7,819/2012, (Exhibit JE-132), Article 7(I), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[305] Manufacture of automobiles by companies established in Brazil, that become accredited as domestic manufacturers, with an investment project relating to the installation of a single factory of vehicles classified in the tariff codes listed in Annex XIII of Decree 7,819/2012, whose maximum annual production capacity is 35,000 units and whose specific investments reach at least R$17,000 real. See Decree 7,819/2012, (Exhibit JE-132), Article 12 §5(III), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[306] Taxes and contributions affecting the sale of goods and services are excluded. See Decree 7,819/2012, (Exhibit JE-132), Article 8(IV).

[307] Decree 7,819/2012, (Exhibit JE-132), Article 7(II).

operation, and acquisition of national equipment, services and spare parts[308] needed to carry out these activities.[309]

Donations of goods and services are not considered to be expenditure.[310] Investments in the FNDCT can fall within the scope of this requirement.[311]

The investment must be made in Brazil (i) directly by the legal person that benefits from the INOVAR-AUTO programme, (ii) through an accredited supplier, or (iii) by means of a contract with a university, research institute, specialised company or self-employed inventor pursuant to Article 2(ix) of Law 10,973 of 2 December 2004.[312]

c. Expenditure on engineering, basic industrial technology and capacity-building of suppliers in Brazil:

The minimum percentage of gross revenues for sale of goods and services[313] which accredited companies must spend in engineering, basic industrial technology and capacity-building of suppliers in Brazil is as follows: 0.5% in 2013, 0.75% in 2014, and 1% in 2015-2017.[314]

The activities covered by this expenditure are (i) engineering development, (ii) basic industrial technology, (iii) training of personnel, (iv) product development, (v) design, planning, construction or modernisation of laboratories, applied research centres, test tracks and infrastructure for their operation, and acquisition of national equipment, services and spare parts[315] needed to carry out these activities, (vi) development of tools[316], moulds and patterns for moulds, matrices and devices, and industrial and quality control instruments and apparatus, and their accessories and parts, used in the production process, (vii) R&D activities in relation to industrial tooling and engineering and (viii) capacity building of suppliers.[317]

Donations of goods and services are not covered by this provision.[318] Investments in the FNDCT can fall within the scope of this requirement.[319]

Expenditure must be made in Brazil (i) directly by the legal person that benefits from the INOVAR-AUTO programme, (ii) through an accredited supplier, or (iii) by means of a contract with a university, research institute, specialised company or self-employed inventor pursuant to Article 2(ix) of Law 10,973 of 2 December 2004.[320]

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[308] Expenditure on the acquisition of software, equipment and spare parts will be considered as made in Brazil provided that they are used in the laboratories indicated in the Terms of Commitment. See Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §8.

[309] Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §1; and Decree 7,819/2012, (Exhibit JE-132), Article 7 §4. Expenditure by accredited companies in the development of new devices of active and passive vehicle safety if they are incorporated in products listed in Annex I of Decree 7,819/2012 no later than 30 July 2017 and constitute technological advances can also fall within this category. See Decree 7,819/2012, (Exhibit JE-132), Article 7 §5; and Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §3.

[310] Decree 7,819/2012, (Exhibit JE-132), Article 8(II). See also Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §6(II).

[311] Decree 7,819/2012, (Exhibit JE-132), Article 8(III). See also Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §6(III).

[312] Decree 7,819/2012, (Exhibit JE-132), Article 8(I).

[313] Taxes and contributions affecting the sale of goods and services are excluded. See Decree 7,819/2012, (Exhibit JE-132), Article 8(IV).

[314] Decree 7,819/2012, (Exhibit JE-132), Article 7(III).

[315] Expenditure on the acquisition of software, equipment and spare parts will be considered as made in Brazil provided that they are used in the laboratories indicated in the Terms of Commitment. See Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §8.

[316] The scope of the term "tools" and the five stages in the development of tools are established in Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Articles 1 §12 and §13.

[317] Interministerial Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §5. See also Decree 7,819/2012, (Exhibit JE-132), Article 7 §6.

[318] See footnote 310 above.

[319] See footnote 311 above.

[320] See footnote 312 above.

d. Participation in the Brazilian Vehicle Labelling Programme established by INMETRO:

The minimum percentage of models of products listed in Annex I of Decree 7,819/2012 which are marketed by the company and subject to this requirement is the following: 36% in 2013, 49% in 2014, 64% in 2015, 81% in 2016 and 100% in 2017.[321]

2.2.5.5.2 Presumed IPI tax credits

2.2.5.5.2.1 Requirements to be entitled to presumed IPI tax credits

2.123. To be entitled to accrue and use presumed IPI tax credits, companies must first obtain an accreditation granted by the MDIC, pursuant to the requirements outlined above.

2.2.5.5.2.2 Accrual and calculation of presumed IPI tax credits

Accredited "domestic manufacturers" and "importers/distributors"

2.124. Companies accredited as "domestic manufacturers" and "importers/distributors" can accrue presumed IPI tax credits by making expenditures on the following items in Brazil: (i) strategic inputs[322]; (ii) tools[323]; (iii) research; (iv) technological development; (v) technological innovation; (vi) contributions to the FNDCT; (vii) capacity-building of suppliers[324]; and, (viii) basic engineering and industrial technology.[325]

2.125. Concerning expenditure on strategic inputs and tools in Brazil, before 1 October 2014 the presumed IPI tax credit was the result of multiplying the amount of expenditure by a coefficient that varies depending on the type of vehicle and the calendar year.[326]Expenditure on strategic inputs and tools incurred directly in the process of production of auto parts by the accredited company shall be taken into account, based on a *pro rata* share of the cost of the industrial activities in proportion to the production in question.[327]

2.126. From 1 October 2014, the calculation of the presumed IPI tax credit accrued from expenditure on strategic inputs and tools in Brazil incorporates a new element introduced by Implementing Order MDIC 257/2014: the deductible part. The deductible part is the sum of the value of imported inputs by Tier 1[328] and Tier 2[329] suppliers. Implementing Order MDIC 257/2014 establishes a traceability system whereby suppliers of strategic inputs and tools to accredited companies (Tier 1) (and their direct suppliers, i.e. Tier 2) are required to provide information to the purchasing accredited companies on the value and characteristics of the products supplied. Suppliers shall indicate not just the value of the invoices but also the value of the deductible

[321] Decree 7,819/2012, (Exhibit JE-132), Article 7(IV). This requirement does not apply to vehicles listed in Annex IV. See Decree 7,819/2012, (Exhibit JE-132), Article 7 §2.

[322] "Strategic inputs" are defined as any raw materials, parts and components used in the manufacture of, and physically incorporated in, the vehicles referred to in Annex I to Decree 7,819/2012. See Implementing Order MDIC 257/2014, (Exhibit JE-158), Article 1.

[323] "Tools" are defined as specific tools for each type of part, linked to a machine and used to stamp or inject auto parts intended for the manufacturing process of vehicles referred to in Annex I to Decree 7,819/2012. See Implementing Order MDIC 257/2014, (Exhibit JE-158), Article 2.

[324] The notion of "capacity building of auto parts suppliers" encompasses concepts and practices related to planning, strategies, production processes, technologies, innovation, development of new products, management and cooperation between the purchasers and the suppliers of auto parts in order to attain further improvements. See Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 1. Article 2 of Implementing Order MDIC 113/2013, (Exhibit JE-154) establishes the activities carried out by the auto parts manufacturers on which expenditure in capacity building of auto parts suppliers must be done in Brazil.

[325] Law 12,715/2012, (Exhibit JE-95), Article 41; and Decree 7,819/2012, (Exhibit JE-132), Article 12.

[326] Decree 7,819/2012, (Exhibit JE-132), Article 12 §3. See also Decree 7,819/2012, (Exhibit JE-132), Article 12 §5.

[327] Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 4. Article 4-A of Implementing Order MDIC 113/2013, as amended by Article 11 of Implementing Order MDIC 257/2014, (Exhibit JE-158), provides for specific rules to calculate the presumed IPI tax credit resulting from expenditure in strategic inputs and tools between 1 June 2013 and 30 September 2014.

[328] Tier 1 suppliers are those who supply strategic inputs and tools to accredited companies.

[329] Tier 2 suppliers are the Tier 1 suppliers' direct providers.

part.[330] This deductible part shall be deducted from the total value of expenditure on strategic inputs and tools made in Brazil, which constitutes the base to calculate the presumed IPI tax credit. The accredited companies will use this information when filing their tax returns.

2.127. The calculation of the deductible part differs depending on whether it is a Tier 1 or a Tier 2 automotive supplier. The deductible part of Tier 2 inputs is calculated based on the Tax Situation Codes (CST) indicated in the tax invoices issued to Tier 1 suppliers.[331] If the CST indicated in the tax invoice is 1, 2, 6, 7 or 8, then 100% of the value is deducted from the expenditure used to calculate the presumed IPI tax credit.[332] If the CST is 3 or 4, 50% of the value is deducted from the expenditure used to calculate the presumed IPI tax credit.[333] If the CST is 0 or 5, no deduction is applied and 100% of the expenditure incurred counts towards calculating the presumed IPI tax credit.[334] The deductible part of Tier 1 inputs is the actual value of direct imports (Cost, Insurance & Freight (CIF) value) plus the import tax (II) plus the Tier 2 deductible part (i.e. imported content).[335]

2.128. Regarding expenditure made in Brazil (referred to as "made in the country" in the legislation) on research; technological development; technological innovation; and payments to the FNDCT[336], the presumed credit shall correspond to 50% of the expenditure, limited to 2% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit.[337]

2.129. Regarding expenditure made in Brazil ("made in the country") on payments to the FNDCT pursuant to the specific legislation; capacity-building of suppliers; and engineering and basic industrial technology[338]; the presumed credit shall correspond to 50% of the expenditure which exceeds 0.75%, up to a limit of 2.75% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit.[339]

2.130. Expenditure on the acquisition of software, equipment and spare parts will be considered to be expenditure "made in the country" provided that the software, equipment and spare parts are used in the laboratories indicated in the Terms of Commitment.[340]

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[330] Annex I of Implementing Order MDIC 257/2014 contains a template of "Consolidated Declaration of the Deductible Part" where suppliers of strategic inputs and tools indicate the supplier's company name and tax number; the purchaser's company name and tax number; the month and year the declaration refers to; the total value of the invoices; and, the total value of the deductible part. See Exhibit JE-158.

[331] See E. da Matta, "*Valoração da parcela dedutível*", Sindipeças, September 2014, (Exhibit JE-105); and Implementing Order MDIC 257/2014, (Exhibit JE-158), Annex III, paragraph 5(b). In the event that no CST is indicated in the tax invoice issued to the supplier, it will be classified as CST 2. See Implementing Order MDIC 257/2014, (Exhibit JE-158), Annex III, paragraph 2(a).

[332] CST 1 (Foreign – Direct import, except as indicated in CST 6), CST 2 (Foreign – Purchased in the internal market, except as indicated in code 7), CST 6 (Foreign – Direct import, without a national equivalent present in a list of a CAMEX Resolution and natural gas), CST 7 (Foreign- Purchased in the internal market, without a national equivalent present in a list of a CAMEX Resolution and natural gas) and CST 8 (National, merchandise or good with Imported Content higher than 70%). See Annex to SINIEF Convention, Un-numbered, of 15 December 1970, (Exhibit JE-159).

[333] CST 3 (National, merchandise or good with Imported Content higher than 40% but lower than or equal to 70%) and CST 4 (National, produced in accordance with the basic productive processes which are dealt with in Decree-Law 288/67, and in Laws 8,248/91, 8,387/91, 10,176/01 and 11,484/07). See Annex to SINIEF Convention, Un-numbered, of 15 December 1970, (Exhibit JE-159).

[334] CST 0 (National, except as indicated in codes 3, 4, 5 and 8) or CST 5 (National, merchandise or good with Imported Content lower than or equal to 40% (forty percent). See Annex to SINIEF Convention, Un-numbered, of 15 December 1970, (Exhibit JE-159).

[335] See E. da Matta, "*Valoração da parcela dedutível*", Sindipeças, September 2014, (Exhibit JE-105); and Implementing Order MDIC 257/2014, (Exhibit JE-158), Annex III paragraph 5(a).

[336] Decree 7,819/2012, (Exhibit JE-132), Article 12(III) to (VI).

[337] Taxes and contributions on sales are excluded. See Decree 7,819/2012, (Exhibit JE-132), Article 12 §9, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[338] Decree 7,819/2012, (Exhibit JE-132), Article 12(VI) to (VIII).

[339] Taxes and contributions on sales are excluded. See Decree 7,819/2012, (Exhibit JE-132), Article 12 §10, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[340] Decree 7,819/2012, (Exhibit JE-132), Article 12§12, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

Accredited investors

2.131. Companies accredited as "investors" shall calculate their presumed IPI tax credits by applying a 30% tax rate on the IPI tax base on the release of vehicles listed in Annex I of Decree 7,819/2012 imported by the import branch of the accredited company.[341] This applies 24 months following the first accreditation and it is linked to complying with the physical-financial timetable foreseen in the investment project.[342] The vehicles covered under this treatment are those covered in the approved investment project[343] and are limited to one twenty-fourth of the annual production capacity set out in the approved investment project multiplied by the remaining months in the calendar year.[344] Furthermore, the IPI tax usually charged on imported vehicles at the time of customs clearance is suspended.[345]

2.2.5.5.2.3 Use of presumed IPI tax credits

2.132. The rules governing the use of the presumed IPI tax credits differ depending on whether the tax credits (i) result from expenditure in Brazil on strategic inputs and tools; (ii) result from expenditure in Brazil on any item set out in Article 12 of Decree 7,819/2012 other than strategic inputs and tools; or (iii) have been accrued by accredited investors.

2.133. First, presumed IPI tax credits resulting from expenditure made in Brazil on strategic inputs and tools can be used from 1 January 2013 to offset the IPI tax due on the exit from the establishment of the products set out in Annex I of Decree 7,819/2012 which either have been manufactured by accredited "domestic manufacturers" or are marketed by accredited "importers/distributors".[346] The use of tax credit is limited to 30% of the tax base.[347]

2.134. If at the end of each calendar month there is a remaining amount of IPI tax credit after using the credit to offset the IPI tax due on the exit of the above-mentioned products, the remaining credit can be used to offset the IPI tax due on vehicles imported by the accredited company. In this case, the use of tax credit is also limited to 30% of the tax base and up to a maximum of 4,800 vehicles per calendar year.[348]

2.135. Where an amount of IPI tax credit remains because of the two limits mentioned above (30% of the tax base or 4,800 vehicles per calendar year), it can be used in subsequent months until 31 December 2017.[349]

2.136. Second, presumed IPI tax credits resulting from expenditure in Brazil on any item set out in Article 12 other than strategic inputs and tools[350] can be used to offset the IPI tax due for operations in the internal market by the parent company of the juridical person.[351]

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[341] Decree 7,819/2012, (Exhibit JE-132), Article 13, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. The calculation of the presumed IPI tax credit is done by the parent company of the accredited company. See Decree 7,819/2012, (Exhibit JE-132), Article 13§5.

[342] Decree 7,819/2012, (Exhibit JE-132), Article 13 §1(I) and (II), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1; and Implementing Order MDIC 297/2013, (Exhibit JE-179), Article 7.

[343] Decree 7,819/2012, (Exhibit JE-132), Article 13 §1(III), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[344] Decree 7,819/2012, (Exhibit JE-132), Article 13 §2.

[345] Law 12,715/2012, (Exhibit JE-95), Article 41 §6.

[346] Decree 7,819/2012, (Exhibit JE-132), Article 14, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[347] Decree 7,819/2012, (Exhibit JE-132), Article 14 §1.

[348] Decree 7,819/2012, (Exhibit JE-132), Article 14 §2, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. This does not apply to the imported vehicles set out in Annex VI and the presumed IPI tax credit resulting from the acquisition of strategic inputs and tools used for manufacturing these vehicles. See Decree 7,819/2012, (Exhibit JE-132), Article 14 §5 and §6, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. The exemption established in Article 14 §6 of Decree 7,819/2012, (Exhibit JE-132), as amended by Article 1 of Decree 8,015/2013 (Exhibit JE-133), does not cover imported automobiles and light commercial vehicles in case of accredited investors who plan to manufacture in Brazil those vehicles set out in Annex I of Decree 7,819/2012. See Decree 7,819/2012, (Exhibit JE-132), Article 14 §7, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[349] Decree 7,819/2012, (Exhibit JE-132), Article 14 §3.

2.137. If an amount of IPI tax credit remains after using the credit to offset the IPI tax due for operations in the internal market by the parent company of the juridical person, the parent company can transfer the remaining credit, in full or in part, to other industrial establishments (or establishments assimilated to an industrial one) of the same legal person.[352] These establishments will be able to use the presumed IPI tax credit at the end of the month in which it was calculated[353] and only to offset the IPI tax due; they will not be entitled to compensation or reparation in kind.[354]

2.138. In case no tax is due for operations in the internal market by the parent company of the juridical person or there is a remaining amount of credit after paying the IPI tax for such operations or the operations of another industrial establishment, the rules governing reparation in kind and compensation shall apply.[355]

2.139. Finally, accredited investors can use their presumed IPI tax credits to offset the IPI tax due on the exit of the products from the importing establishment of the accredited legal person subject to two limits.[356] First, the maximum number of imported vehicles for which the tax credit can be applied is one forty-eighth of the expected annual production capacity set out in the approved investment project multiplied by the remaining number of months of the calendar year, including the month in which the accreditation was granted.[357] The second limit relates to the commitment to comply with the physical-financial timetable of the investment project.[358]

2.140. Any remaining amount of credit after offsetting the IPI tax due according to the previous paragraph can be used to offset the IPI tax due at the time the vehicles manufactured by the accredited company exit the factory, from the beginning of the marketing of the vehicles covered by the investment project up to an amount equivalent to 35% of the debit balance, calculated in each IPI tax calculation period.[359]

2.141. In case there is still a remaining amount of tax credit after using it in the two situations described above, it can be used in the subsequent months, until 31 December 2017.[360]

2.2.5.5.3 Requirements to be entitled to reduced IPI tax rates

2.142. In order to be entitled to reduced IPI tax rates, companies must:

a. Be accredited as "domestic manufacturers" or "investors" that import vehicles classified under the TIPI tariff codes listed in Annex I from countries that are signatories to the

[350] Research; technological development; technological innovation; payments to the FNDCT; capacity-building of suppliers; and, engineering and basic industrial technology. See Decree 7,819/2012, (Exhibit JE-132), Article 12(III) to (VIII).

[351] Decree 7,819/2012, (Exhibit JE-132), Article 15 §1(I), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. The presumed IPI tax credit can be used at the end of the month in which it was calculated. See Decree 7,819/2012, (Exhibit JE-132), Article 15 §2, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[352] Decree 7,819/2012, (Exhibit JE-132), Article 15 §1(II), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. Article 15 §3 - §8 of Decree 7,819/2012 provides for guidelines and requirements that must be fulfilled when transferring the IPI tax credit.

[353] Decree 7,819/2012, (Exhibit JE-132), Article 15 §2, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[354] Decree 7,819/2012, (Exhibit JE-132), Article 15 §7, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[355] Decree 7,819/2012, (Exhibit JE-132), Article 15 §1(III), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[356] Decree 7,819/2012, (Exhibit JE-132), Article 16. Article 17 of Decree 7,819/2012 provides that the use of the presumed IPI tax credit must relate to the products set out in Annex I which exit the industrial establishment (or an establishment assimilated to an industrial one) of the accredited company.

[357] Decree 7,819/2012, (Exhibit JE-132), Article 16(I).

[358] Decree 7,819/2012, (Exhibit JE-132), Article 16(II).

[359] Decree 7,819/2012, (Exhibit JE-132), Article 16 §1, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[360] Decree 7,819/2012, (Exhibit JE-132), Article 16 §2.

agreements established by Legislative Decree 350 of 21 November 1991, Decree 4,458 of 5 November 2002 and Decree 6,500 of 2 July 2008[361]; or

b. Import vehicles classified under the TIPI tariff codes listed in Annex VIII from Uruguay under the agreements established by Decree 6,518 of 30 July 2008 and Decree 7,658 of 23 December 2011[362]; or

c. Be accredited as companies that import products classified under the TIPI tariff codes listed in Annex VIII up to a certain limit per calendar year[363]; or

d. Manufacture in Brazil vehicles with certain characteristics classified under TIPI tariff codes 8703.32.10 and 8703.33.10.[364]

2.143. As noted above, companies that manufacture certain vehicles and have an annual production volume of less than 1,500 units and an annual turnover of less than R$ 90,000,000 (90 million real),[365] companies that manufacture vehicles characterized as quadricyles and tricycles[366], and companies that manufacture vehicles under certain TIPI tariff codes by assembling the body on a chassis[367] are also entitled to reduced IPI tax rates. However, these particular tax reductions are not relevant to the present dispute.

2.2.5.6 Monitoring system

2.144. The INOVAR-AUTO programme uses a monitoring system (*Sistema de Acompanhamento*)[368], also referred to as a traceability system, to ensure compliance with its requirements.

2.145. Accredited companies that have made expenditures on strategic inputs and tools shall submit quarterly reports on such expenditure through the Monitoring System of the INOVAR-AUTO programme.[369]

2.146. Accredited companies must submit quarterly monitoring reports to the Secretary of Production Development of the MDIC.[370] In addition, for monitoring purposes, the Secretary of Production Development shall have access to the Integrated Foreign Trade System (*Sistema Integrado de Comércio Exterior* – SISCOMEX), which is an administrative tool that allows for the registration, monitoring and control of foreign trade operations in a single window.[371]

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[361] Reduced IPI tax rate under Article 21 of Decree 7,819/2012, (Exhibit JE-132), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. This reduced IPI tax rate shall apply from 1 January 2013 until 31 December 2017.

[362] Reduced IPI tax rate under Article 22(I) of Decree 7,819/2012, (Exhibit JE-132).

[363] Reduced IPI tax rate under Article 22(II) of Decree 7,819/2012, (Exhibit JE-132). The limit consists of the arithmetic mean of the number of vehicles imported by the aforementioned company in the calendar years of 2009 to 2011; or 4,800 vehicles, whichever is lower.

[364] Decree 7,819/2012, (Exhibit JE-132), Additional Note NC (87-5) to the TIPI. See paragraph 2.102(d) above.

[365] Decree 7,819/2012, (Exhibit JE-132), Article 22(IV), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. According to Article 22 §3 of Decree 7,819/2012, (Exhibit JE-132), these limits can be reviewed annually. See Decree 7,819/2012, (Exhibit JE-132), Article 22 §7, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[366] Decree 7,819/2012, (Exhibit JE-132), Article 22(V), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1. See also Decree 7,819/2012, (Exhibit JE-132), Article 22 §1 and §7, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1; and Decree 8,294/2014, (Exhibit JE-134), Article 1.

[367] Decree 7,819/2012, (Exhibit JE-132), Article 23.

[368] Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 4-B, as amended by Implementing Order MDIC 257/2014, (Exhibit JE-158), Article 11.

[369] Implementing Order MDIC 257/2014, (Exhibit JE-158), Article 9.

[370] Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 7, as amended by Implementing Order MDIC 280/2013, (Exhibit JE-177), Article 1.

[371] Implementing Order MDIC 113/2013, (Exhibit JE-154), Article 7-A, as amended by Implementing Order 290/2014, (Exhibit JE-157), Article 1.

2.2.5.7 Related memorandum

2.147. Interministerial Explanatory Memorandum No 00025/2012 describes the aim of the INOVAR-AUTO programme as follows:

> [The INOVAR-AUTO programme] aims to strengthen the national automotive industry and create impulses [incentives] for an improvement of the technological content of the vehicles produced in the country.[372]

2.2.6 The PEC programme

2.2.6.1 Introduction

2.148. Pursuant to the regime for "predominantly exporting companies" (the PEC programme), the IPI tax and the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions are suspended with respect to raw materials, intermediate goods and packaging materials purchased by predominantly exporting companies.

2.149. The tax suspensions provided for in the PEC programme entered into force in December 2002 (in the case of the IPI tax) and April 2004 (in the case of the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions).[373]

2.2.6.2 Tax treatment

2.150. The PEC programme provides for the suspension of the IPI tax as well as the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions with respect to raw materials, intermediate goods and packaging materials.[374]

2.151. The above-mentioned suspensions apply on the purchases of raw materials, intermediate goods and packaging materials by legal persons registered (in the case of the IPI tax) or accredited (in the case of the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions) as predominantly exporting companies.[375] The tax suspension applies:

a. at the time the product leaves the industrial establishment in the event of purchases in the domestic market[376]; or

b. at the time of the customs clearance in the event of imports.[377]

2.152. The suspension expires, and the IPI tax, the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions become definitively non-due, upon exportation or sale in the domestic market of the final goods incorporating the raw materials, intermediate goods and packaging materials for which the taxes and contributions were suspended.[378]

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[372] Interministerial Explanatory Memorandum (*Exposição de Motivos Interministerial* - EMI) No. 00025/2012 - MF/MDIC/MCTI/MEC/MC/SEP/MS/MPS, dated 2 April 2012, (Exhibits JE-183 and BRA-51), paras. 44-45.

[373] Law 10,637/2002, (Exhibit JE-94), Article 68 (for IPI tax); and Law 10,865/2004, (Exhibit JE-181), Article 53 (for PIS/PASEP and COFINS contributions).

[374] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §1.II (for IPI tax); and Law 10,865/2004, (Exhibit JE-181), Article 40 (for PIS/PASEP and COFINS contributions).

[375] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §1.II (for IPI tax); Law 10,865/2004, (Exhibit JE-181), Article 40 (for PIS/PASEP and COFINS contributions); Decree 6,759/2009, (Exhibit JE-8), Article 276 (for PIS/PASEP-Importation and COFINS-Importation); and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 1 (for PIS/PASEP and COFINS contributions).

[376] Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 12; and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 8.

[377] Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 13; and Decree 6,759/2009, (Exhibit JE-8), Article 247.

[378] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §I.II; Law 10,865/2004, (Exhibit JE-181), Article 40; Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 20; and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 9.

2.2.6.3 Product coverage

2.153. The products covered by the PEC programme are raw materials, intermediate goods and packaging materials purchased by a legal person registered or accredited as a predominantly exporting company, and used in the production of its final products.[379]

2.154. No definition of the terms "raw materials", "intermediate goods" and "packaging materials" can be found in the Brazilian legislation.

2.2.6.4 Eligible companies

2.155. Companies eligible for the tax treatment provided under the PEC programme are predominantly exporting companies.

2.156. For purposes of the IPI tax suspension, a predominantly exporting company is a legal person whose gross revenue derived from exports to other countries during the calendar year immediately prior to the year of purchase of the covered products, exceeded 50% of its total gross revenue from the sales of goods and services over the same period, after taxes and other contributions levied on sales.[380]

2.157. For purposes of the suspensions of the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions, a predominantly exporting company is a legal person whose gross revenue from exports, in the calendar year immediately prior to the year of purchase of the covered products, was equal to or greater than 50% of its total gross revenue from the sale of goods and services in the same period, after taxes and other contributions levied on sales.[381]

2.158. Companies just starting activities in Brazil, or which did not reach the export percentage required in the previous year may be entitled to the PIS/PASEP and COFINS suspensions if they commit to reach and maintain the required export level for a period of three calendar years.[382]

2.2.6.5 Requirements for eligibility

2.159. In order for predominantly exporting companies to be entitled to this tax treatment, the companies must meet the following requirements:

a. Registration (for IPI tax suspensions) / Accreditation (for suspensions of PIS/PASEP and COFINS, PIS/PASEP-Importation and COFINS-Importation contributions):

   Companies must apply for prior registration/accreditation with the Federal Revenue Department Branch (DRF) or Tax Administration Federal Revenue Department Branch (DERAT).[383] If the application is accepted, the registration/accreditation is granted through an Executive Declaratory Act (ADE) by the DRF or DERAT Delegate.[384]

b. Compliance with the export requirement:

   As mentioned above, in order for a legal person to be registered as a predominantly exporting company, its gross revenue derived from exports to other countries during the calendar year immediately prior to the year of purchase of the covered products must exceed 50% (for IPI tax suspensions) or be equal to or greater than 50% (for

[379] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §1.II; and Law 10,865/2004, (Exhibit JE-181), Article 40.
[380] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §3.
[381] Law 10,865/2004, (Exhibit JE-181), Article 40 §1.
[382] Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 3 §1.
[383] The company must submit its application for registration/ accreditation within the jurisdiction of the company's main establishment, accompanied by relevant information of the company, as well as a declaration, under the penalties of law, that it meets or will meet and maintain the export requirement. See Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 15; and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 4.
[384] Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 17; and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 6.

> suspensions of PIS/PASEP and COFINS, PIS/PASEP-Importation and COFINS-Importation contributions) of its total gross revenue from the sales of goods and services over the same period, after taxes and other contributions levied on sales.[385]

2.160. As regards PIS/PASEP and COFINS suspensions, companies just starting activities in Brazil, or which did not reach the export percentage required in the previous year, may be entitled to the suspensions if they commit to reach and maintain the required export level for a period of three calendar years.[386]

2.161. The registration and/or accreditation shall be cancelled, *ex-officio*, in the event that accreditation/registration requirements are not met, including the export requirement.[387] In the event of cancellation, purchases of the covered products shall no longer benefit from the tax suspensions, and the suspended taxes, plus charges and applicable penalties, shall be due.

2.2.6.6 Related memorandum

2.162. Explanatory Memorandum No. 00211 of 29 August 2002 by the Ministry of Finance explains, with respect to the implementation of the IPI tax suspension under the PEC Programme, as follows:

> Article 31 establishes a suspension of the *Imposto sobre Produtos Industrializados* (IPI), with respect to mentioned products, in order to avoid the accumulation of credits, which implies providing for better operating conditions and cash flow for domestic companies, making them more competitive, including by reducing the prices of their products. Such suspension is extended to predominantly exporting companies in the terms and conditions to be established by the Secretariat of the Federal Revenue (*Secretaria da Receita Federal*), with a view to supporting national export activities.[388]

2.2.7 The RECAP programme

2.2.7.1 Introduction

2.163. Pursuant to the "Special regime for the acquisition of capital goods for exporting companies" (RECAP programme), the PIS/PASEP, COFINS, PIS/PASEP-Importation or COFINS-Importation contributions are suspended with respect to new machinery, tools, apparatuses, instruments and equipment for incorporation into tangible fixed assets by predominantly exporting companies.

2.164. The tax suspensions provided for in the RECAP programme entered into force in November 2005.[389]

2.2.7.2 Tax treatment

2.165. The RECAP programme provides for the suspension of the PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions with respect to purchases of new machinery,

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[385] Law 10,637/2002, (Exhibits JE-94 and BRA-100), Article 29 §3; Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 14; Law 10,865/2004, (Exhibit JE-181), Article 40 §1; and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 3.

[386] Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 3 §1.

[387] See Normative Instruction RFB 948/2009, (Exhibit JE-191), Article 18(II) (for IPI tax suspensions); and Normative Instruction SRF 595/2005, (Exhibit JE-193), Article 7(II) (for the suspension of PIS/PASEP, COFINS, PIS/PASEP-Importation and COFINS-Importation contributions).

[388] Explanatory Memorandum No. 00211 of 29 August 2002, (Exhibit JE-180), para. 20. The Panel notes that the original translation of this Explanatory Memorandum, as provided by the complaining parties, stated that "Such suspension is *appropriate for* predominantly exporting companies…". See Explanatory Memorandum No. 00211, (Exhibit JE-180). Brazil corrected this translation, and Brazil's correction was not objected to by the complaining parties. See Brazil's comments on draft descriptive part, comment on paragraph 2.87 of the draft descriptive part. See generally European Union's comments on Brazil's comments on the draft descriptive part; and Japan's comments on Brazil's comments on the draft descriptive part.

[389] Law 11,196/2005, (Exhibit JE-182), Article 132.

tools, apparatuses, instruments and equipment for incorporation into the tangible fixed assets, by legal persons registered as predominantly exporting companies.[390]

2.166. The suspension becomes a zero rate once the export commitments have been achieved.[391]

2.2.7.3 Product coverage

2.167. The products covered by the RECAP programme are new machinery, tools, apparatuses, instruments and equipment for incorporation to the tangible fixed assets by legal persons registered as predominantly exporting companies.[392]

2.168. The Appendix to Decree 5,789/2006[393] contains the list of goods that can be purchased under the RECAP programme.

2.2.7.4 Eligible companies

2.169. Companies eligible for the tax treatment provided under the RECAP programme are predominantly exporting companies.

2.170. For purposes of the RECAP programme, a predominantly exporting company is a legal person whose gross revenue from exports, in the calendar year immediately before the year in which it became a member of the programme, was equal to or greater than 50% of its total gross revenue from the sale of goods and services over the same period, and who commits to maintaining that percentage of exports for a period of two calendar years.[394]

2.171. Companies just starting activities in Brazil, or which did not reach the export percentage required in the previous year, may be entitled to the suspensions if they commit to reach and maintain the required export level for a period of three calendar years.[395]

2.2.7.5 Requirements for eligibility

2.172. In order for predominantly exporting companies to be entitled to these suspensions, they must meet the following requirements:

a. Accreditation:

Companies must apply for accreditation to the DRF or the DERAT.[396] If the application is accepted, the accreditation is granted through an ADE by the DRF or DERAT Delegate.[397]

b. Compliance with the export requirement:

As mentioned above, in order for a legal person to be accredited as a predominantly exporting company, its gross revenue from exports, in the calendar year immediately before the year in which they became a member of the programme, must be equal to or greater than 50% of its total gross revenue from the sale of goods and services over the

[390] Law 11,196/2005, (Exhibit JE-182), Article 14; Decree 5,649/2005, (Exhibit JE-187), Articles 1 and 9; and Normative Instruction SRF 605/2006, (Exhibit JE-195), Article 2.

[391] Law 11,196/2005, (Exhibit JE-182), Article 14 §8; Decree 5,649/2005, (Exhibit JE-187), Article 10; and Decree 6,759/2009, (Exhibit JE-8), Article 274.

[392] Law 11,196/2005, (Exhibit JE-182), Article 14; and Decree 5,649/2005, (Exhibit JE-187), Article 9.

[393] Decree 5,789/2006, (Exhibit JE-188), Appendix. See also Law 11,196/2005, (Exhibit JE-182), Article 16

[394] Law 11,196/2005, (Exhibit JE-182), Article 13.

[395] Law 11,196/2005, (Exhibit JE-182), Article 13 §2.

[396] The company must submit its application for accreditation within the jurisdiction of the company's main establishment, accompanied by relevant information of the company, as well as a declaration, under the penalties of law, that it meets or will meet and maintain the export requirement. See Normative Instruction SRF 605/2006, (Exhibit JE-195), Article 8.

[397] Normative Instruction SRF 605/2006, (Exhibit JE-195), Article 10. Accreditations last for three years. When an accreditation lapses, a new accreditation may be requested. See Law 11,196/2005, (Exhibit JE-182), Article 14 §1; Decree 5,649/2005, (Exhibit JE-187), Article 9; and Decree 6,759/2009, (Exhibit JE-8), Article 271.

> same period, and must commit to maintaining that percentage of exports for a period of two calendar years.[398]
>
> Companies just starting activities in Brazil, or which did not reach the export percentage required in the previous year, may be entitled to the suspensions if they commit to reach and maintain the required export level for a period of three calendar years.[399]

2.173. The accreditation shall be cancelled in the event that registration requirements are not met, including the export requirement.[400] In the event of cancellation, purchases of the covered products shall no longer receive the tax suspensions, and the suspended taxes, plus charges and applicable penalties, shall be due.[401]

2.174. Also, if an accredited company does not meet the export commitment, or does not incorporate the capital goods into its fixed assets, or sells the goods before the conversion of the suspension into a zero rate, it shall be required to pay the suspended contributions as well as interest and penalties.[402]

2.2.7.6 Related memorandum

2.175. Interministerial Explanatory Memorandum No. 00084/2005 by the Ministry of Finance and the Ministry of Development, Industry and Trade explains, with respect to the RECAP Programme, as follows:

> The creation of RECAP aims at encouraging investment on production and improving exports by correcting the distortions that generate a cost on the capital goods of predominantly exporting companies. This scheme suspends the incidence of the contribution to PIS/PASEP and of COFINS on sales and imports of new machines, appliances, instruments and equipment, listed in a regulation, when purchased by predominantly exporting companies. Like the REPES, the RECAP aims at eliminating the accumulation of PIS and COFINS credits for exporters, complementing the scheme already established by Article 40 of Law No. 10,865 of 30 April 2004, which suspends the levying of the contribution with regard to the sales of raw materials, intermediary products and packaging materials when they are destined to predominantly exporting legal persons.[403]

2.176. Also, Interministerial Explanatory Memorandum No. 00025/2012 explains, with respect to the reduction to 50% of the required percentage of exports to qualify as a predominantly exporting company, as follows:

> By extending the concept of predominantly exporting company to those who export 50% of their gross revenue, including those applying to (…) Recap, almost all Brazilian companies that generate credits to be reimbursed in kind in relation to their export activities are covered. Thus, it is expected that, at least at the federal level, the accumulation of export credits loses relevance. (…) Finally, the adoption of a measure that contributes to solve the serious problem of accumulation of tax credits arising from exports, which erodes the working capital of exporting companies and reduces their competitiveness, undoubtedly makes this proposal for a provisional measure to meet the requirements of emergency and relevance.[404]

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[398] Law 11,196/2005, (Exhibit JE-182), Article 13.

[399] Law 11,196/2005, (Exhibit JE-182), Article 13 §2.

[400] Decree 5,649/2005, (Exhibit JE-187), Article 8; and Normative Instruction SRF 605/2006, (Exhibit JE-195), Article 12.

[401] Decree 5,649/2005, (Exhibit JE-187), Article 8; and Normative Instruction SRF 605/2006, (Exhibit JE-195), Article 16.

[402] Law 11,196/2005, (Exhibit JE-182), Article 14 §4; Decree 5,649/2005, (Exhibit JE-187), Article 12; and Decree 6,759/2009, (Exhibit JE-8), Article 275.

[403] Interministerial Explanatory Memorandum No. 00084/2005, (Exhibit JE-185), para. 5.

[404] Interministerial Explanatory Memorandum No. 00025/2012, (Exhibits JE-183 and BRA-51), paras. 93-97.

3 PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

3.1. The European Union requests the Panel to find that:[405]

i. The INOVAR-AUTO programme, as embodied and developed in the above-mentioned instruments and also as applied by the relevant Brazilian authorities, is inconsistent with Brazil's obligations under:

a. Article I:1 of the GATT 1994, inasmuch as motor vehicles originating in the European Union are not accorded immediately and unconditionally any advantage, favour, privilege or immunity granted to like products originating in certain other countries;

b. Article III:2 of the GATT 1994, inasmuch as motor vehicles of the European Union imported into Brazil are subject to a IPI tax burden in excess of that borne by like domestic products;

c. Article III:4 of the GATT 1994, inasmuch as motor vehicles, automotive components and tools of the European Union imported into Brazil are accorded less favourable treatment than that accorded to like products of Brazilian origin, as a result of the conditions for accreditation to the programme and the rules on the earning and use of tax credits;

d. Article III:5 of the GATT 1994, inasmuch as:

i. The conditions relating to the minimum number of manufacturing activities which manufacturers of motor vehicles need to perform in Brazil amount to an internal quantitative regulation relating to the processing of products, and such conditions require a specified proportion of the final product to be from domestic sources; and

ii. the conditions relating to the minimum number of manufacturing activities in Brazil also amount to an internal quantitative regulation that is applied so as to afford protection to domestic production;

e. Article 2.1 of the TRIMs Agreement, in conjunction with Article 2.2 and with paragraph 1(a) of the Agreement's Illustrative List, inasmuch as the programme is a trade-related investment measure inconsistent with Article III:4 of the GATT 1994 because it requires the purchase or use of strategic inputs and tools of Brazilian origin or from Brazilian sources in order to benefit from tax advantages; and

f. Articles 3.1(b) and 3.2 of the SCM Agreement, inasmuch as the programme provides tax advantages that are subsidies within the meaning of Article 1.1 of the SCM Agreement, which are contingent upon the use of strategic inputs and tools from Brazil over similar goods imported from other WTO Members, including the European Union.

ii. The set of advantages contingent upon domestic production and technological development of information and communication technology, automation and related goods (ICT products), as embodied and developed in the Informatics, PADIS, PATVD and Digital Inclusion programmes and also as applied by the relevant Brazilian authorities, is inconsistent with Brazil's obligations under:

a. Article III:2 of the GATT 1994, inasmuch as they impose a tax burden on imported ICT, automation and related products in excess of that applied to like domestic products, as a result of the operation of tax exemptions or reductions;

b. Article II:1(b) of the GATT 1994, should Brazil argue (or the Panel find) that the PIS/PASEP-Importation and COFINS- Importation are not internal taxes, inasmuch

[405] European Union's first written submission, para. 1254.

as they would amount to "other duties and charges" imposed on imported ICT products in excess of the duties and charges set forth in Brazil's Schedule of Tariff Concessions;

c. Article III:4 of the GATT 1994, inasmuch as:

i. the conditions for accreditation necessary for ICT, automation and related goods to benefit from the exemptions or reductions result in less favourable treatment granted to imported products than that accorded to like domestic products; and

ii. these measures afford less favourable treatment to imported inputs and equipment than that accorded to like domestic products by imposing, under the terms of the corresponding PPBs, an obligation to use local inputs and equipment in the production of ICT, automation and related products, as a condition to benefit from the exemptions or reductions;

d. Article III:5 of the GATT 1994, inasmuch as:

i. the conditions imposed under the terms of the corresponding PPBs regarding the minimum number of processing activities that producers of ICT, automation and related products need to perform in Brazil in order to benefit from the exemptions or reductions, amount to an internal quantitative regulation relating to the processing of products, which requires a specified proportion of the final product to be sourced locally; and

ii. the conditions relating to the minimum number of processing activities in Brazil amount to an internal quantitative regulation that is applied so as to afford protection to domestic production;

e. Article 2.1 of the TRIMs Agreement, in conjunction with Article 2.2 and with paragraph 1(a) of the Agreement's Illustrative List, inasmuch as the measures constitute trade-related investment measures inconsistent with Article III:4 of the GATT 1994 by requiring, under the terms of the PPBs, the purchase or use of inputs and manufacturing equipment of Brazilian origin or from Brazilian sources in order to benefit from the exemptions or reductions; and

f. Articles 3.1(b) and 3.2 of the SCM Agreement, inasmuch as the exemptions or reductions granted in relation to ICT, automation and related products that comply with the terms of the PPBs are subsidies within the meaning of Article 1.1 of the SCM Agreement, that are contingent upon the use of domestic over imported inputs and equipment.

iii. The RECAP programme, as embodied and developed in the above-mentioned instruments and also as applied by the relevant Brazilian authorities, is inconsistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement inasmuch as it provides for subsidies contingent upon export performance; and

iv. The scheme consisting of export contingent subsidies for the purchase of raw materials, intermediate goods and packaging materials, as embodied and developed in the above-mentioned instruments and also as applied by the relevant Brazilian authorities, is inconsistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement inasmuch as it provides for subsidies contingent upon export performance.

3.2. Japan requests the Panel to find that:[406]

i. The tax advantage scheme under the INOVAR-AUTO programme and related measures, and each of the legal instruments through which they are established and administered – both individually and collectively, by and in themselves, or in conjunction with the increased IPI

[406] Japan's first written submission, para. 597.

tax rate for motor vehicles – are inconsistent as such and as applied with Brazil's obligations under:

a. Article I:1 of the GATT 1994, inasmuch as the tax advantages available to motor vehicles imported from Mercosur countries and Mexico are not available to motor vehicles imported from other Members, including Japan;

b. Article III:2 of the GATT 1994, inasmuch as:

i. Imported motor vehicles are subject, directly or indirectly, to an IPI tax burden in excess of that applied, directly or indirectly, to like domestic products; and

ii. Imported motor vehicles and directly competitive or substitutable products that are domestically produced are taxed in a manner that affords protection to domestic production;

c. Article III:4 of the GATT 1994, inasmuch as motor vehicles, automotive components, and tools imported into Brazil are accorded less favourable treatment than that accorded to like products of Brazilian origin, as a result of the conditions for accreditation and for earning and using IPI tax credits;

d. Article III:5 of the GATT 1994, inasmuch as:

i. The criteria and/or requirements to benefit from tax advantages under INOVAR-AUTO, including (inter alia) the requirement to perform certain manufacturing steps in Brazil, and the reduction in the IPI tax credits based on the level of local content in automotive components and tools, amount to internal quantitative regulations relating to the mixture, processing or use of products, which require that specified amounts or proportions of products be supplied from domestic sources; and

ii. The said criteria and/or requirements also amount to internal quantitative regulations that are applied so as to afford protection to domestic production;

e. Article 2.1 of the TRIMs Agreement, separately and in conjunction with Article 2.2 and with paragraph 1(a) of the Agreement's Illustrative List, inasmuch as:

i. INOVAR-AUTO and related legal instruments are TRIMs that are inconsistent with Article III of the GATT 1994; and

ii. They require the purchase or use of products (including automotive components and/or tools) from domestic sources in order to obtain tax advantages; and

f. Articles 3.1(b) and 3.2 of the SCM Agreement, inasmuch as the programme and related legal instruments are and/or confer subsidies within the meaning of Article 1.1 of the SCM Agreement that are contingent upon the use of domestic over imported automotive components and/or tools.

ii. The Informatics, Digital Inclusion, PADIS, and PATVD programmes, and each of the legal instruments through which they are established and administered – both individually and collectively – are inconsistent as such and as applied with Brazil's obligations under:

a. Article III:2 of the GATT 1994, inasmuch as:

i. Imported ICT, automation and related products are subject, directly or indirectly, to internal tax burdens in excess of those applied, directly or indirectly, to like domestic products; and

ii. Imported ICT, automation and related products and directly competitive or substitutable products that are domestically produced are taxed in a manner that affords protection to domestic production;

b. Article II:1(b) of the GATT 1994, only in the event that the Panel finds that the PIS/PASEP-Importation and COFINS-Importation are not internal taxes falling under Article III:2 of the GATT 1994, inasmuch as "other duties or charges" are imposed on ICT, automation and related goods imported from Japan, in excess of the duties and charges set forth in Brazil's Schedule of Tariff Concessions;

c. Article III:4 of the GATT 1994, inasmuch as:

i. The conditions for accreditation result in less favourable treatment for imported products than that accorded to like domestic products; and

ii. The requirement to use local inputs and equipment in the production of ICT, automation and related products results in less favourable treatment for imported inputs and equipment than that accorded to like domestic products;

d. Article III:5 of the GATT 1994, inasmuch as

i. The criteria and/or requirements to benefit from tax advantages under the respective programmes, including (*inter alia*) the requirement to perform certain manufacturing steps in Brazil, and the minimum levels of local content or national value added (including those imposed under the terms of the corresponding PPBs), amount to internal quantitative regulations relating to the mixture, processing or use of products in specified amounts or proportions, which require that a specified amount or proportion of the final product be supplied from domestic sources; and

ii. The said criteria and/or requirements also amount to internal quantitative regulations that are applied so as to afford protection to domestic production;

e. Article 2.1 of the TRIMs Agreement, separately and in conjunction with Article 2.2 and paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement, inasmuch as:

i. The programme and related legal instruments are TRIMs that are inconsistent with Article III of the GATT 1994; and

ii. They require the purchase or use of products (i.e., Brazilian inputs and manufacturing equipment) from domestic sources in order to obtain tax advantages; and

f. Articles 3.1(b) and 3.2 of the SCM Agreement, inasmuch as the programmes and related legal instruments are and/or confer subsidies within the meaning of Article 1.1 of the SCM Agreement that are contingent upon the use of domestic over imported inputs and equipment.

iii. The RECAP programme and each of the legal instruments through which it is established and administered – both individually and collectively – are inconsistent as such and as applied with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement inasmuch as they are and/or confer subsidies within the meaning of Article 1.1 of the SCM Agreement that are contingent upon export performance; and

iv. The PEC programme and each of the legal instruments through which they are established and administered – both individually and collectively – are inconsistent as such and as applied with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement inasmuch as they are and/or confer subsidies within the meaning of Article 1.1 of the SCM Agreement that are contingent upon export performance.

3.3. Brazil requests the Panel to reject the European Union and Japan's claims in this dispute in their entirety.[407]

4 ARGUMENTS OF THE PARTIES

4.1. The arguments of the parties are reflected in their executive summaries, provided to the Panel in accordance with paragraph 21 of the Joint Working Procedures adopted by the Panel (see Annexes B-1 and B-2).

5 ARGUMENTS OF THE THIRD PARTIES

5.1. The arguments of Argentina, Australia, Canada, Ukraine and the United States are reflected in their executive summaries, provided in accordance with paragraph 22 of the Joint Working Procedures adopted by the Panel (see Annexes C-1, C-2, C-5, C-6 and C-7). The Republic of Korea requested that its oral statement be taken as its executive summary (see Annex C-4). Japan also submitted an executive summary of its arguments, as a third party in DS472 (see Annex C-3). The other third parties, China, Colombia, India, Russian Federation, Singapore, South Africa, Chinese Taipei and Turkey did not submit written or oral arguments to the Panel.

6 INTERIM REVIEW

6.1 General issues and editorial matters

6.1. Except where otherwise specifically indicated, the references to paragraph numbers in this section (and throughout this report) refer to the paragraph, section, and footnote numbers in this Final Report, and not the numbering in the Interim Reports.

6.2. In addition to the requests by the parties, discussed below, corrections were made for typographical, stylistic and other non-substantive aspects of the Report, including those identified by the parties.

6.3. All parties requested that the Panel clarify and, in some cases, revise its reasoning and findings in a number of paragraphs. In addition, all parties requested the Panel to revise its depiction of the parties' arguments in a number of paragraphs. In response to these requests, and on its own review of the Report, the Panel adjusted the following aspects of the Report: the Table of Exhibits; paragraphs 2.13, 2.15, 2.18, 2.20, 2.22, 2.71, 2.72, 2.75, 2.83, 2.86, 2.87, 2.91, 2.99, 7.3, 7.24, 7.25, 7.26, 7.31, 7.33, 7.38, 7.67, 7.69, 7.73, 7.80, 7.86, 7.87, 7.88, 7.116, 7.120, 7.134, 7.150, 7.154, 7.161, 7.163, 7.171, 7.173, 7.229, 7.251, 7.272, 7.279, 7.305, 7.309, 7.310, 7.352, 7.356, 7.359, 7.369, 7.370, 7.371, 7.403, 7.404, 7.405, 7.406, 7.432, 7.433, 7.434, 7.436, 7.438, 7.440, 7.441, 7.444, 7.449, 7.450, 7.451, 7.454, 7.456, 7.458, 7.459, 7.460, 7.463, 7.466, 7.468, 7.469, 7.470, 7.473, 7.476, 7.477, 7.478, 7.479, 7.480, 7.518, 7.522, 7.581, 7.582, 7.689, 7.690, 7.696, 7.724, 7.733, 7.746, 7.766, 7.771, 7.796, 7.816, 7.825, 7.888, 7.893, 7.927, 7.929, 7.995, 7.1118, 7.1145, 7.1165, 7.1167, 7.1168, 7.1169, 7.1170, 7.1171, 7.1174, 7.1175, 7.1176, 7.1179, 7.1181, 7.1183, 7.1186, 7.1187, 7.1189, 7.1190, 7.1191, 7.1194, 7.1197, 7.1199, 7.1202, 7.1203, 7.1204, 7.1207, 7.1210, 7.1232, 7.1235, 9.12, 9.16, 9.20, 9.26, 9.30, 9.37, 9.38, 9.49, 9.55, 9.63, 9.87, 9.88, 9.92, 9.97, 9.98, 9.104, 9.107, 9.112, 9.115, 9.116, 9.117, 9.118, 9.121, 9.122, 9.124, 9.134, 9.138, 9.139, 9.142, 9.143, 9.151, 9.152, 9.160, 9.164, 9.168, 9.169, 9.173, 9.174, 9.179, 9.185, 9.186, 9.187, 9.191, 9.197, 9.207, 9.209, 9.210, 9.215, 9.216, 9.217, 9.218, 9.222, 9.225, 9.229, 9.234, 9.235, 9.236, 9.237, 9.242, 9.243, 9.244, 9.249, 9.256, 9.257, 9.260, 9.268, 9.276, 9.285, 9.288, 9.292, 9.296, 9.301, 9.306; the headings of sections 7.2.2, 7.3.5.3.3.2(a), 7.3.5.3.3.2(b), 7.3.5.3.3.2(d), 7.3.5.3.3.2(e), 7.3.5.3.3.2(f), 7.3.5.3.3.2(g), 7.3.5.3.3.2(h), 7.3.5.3.3.2(i), 7.3.5.3.3.2(j), 7.4.5.3.3, and 7.5.1.2.3; and footnotes 237, 388, 471, 476, 484, 485, 512, 531, 532, 533, 535, 587, 680, 691, 789, 801, 814, 827, 845, 856, 1035, 1135, 1295, 1528, 1537, 1552, 1571, and 1605. The Panel inserted paragraphs 2.29, 7.446, 7.465, 7.475, 7.926, 7.1184, 7.1185, 7.1196, 7.1209, 9.223, 9.224, 9.318 and 9.319; and footnotes 11, 42, 43, 44, 442, 443, 444, 469, 505, 506, 578, 579, 586, 672, 791, 795, 796, 803, 807, 809, 816, 821, 829, 835, 839, 847, 853, 857, 1084, 1128, 1129, 1273, 1400, 1487, 1529, 1530, 1539, 1544,

[407] Brazil's first written submissions, para. 868 (DS472) and para. 770 (DS497).

1547, 1554, 1560, 1563, 1573, 1579, 1582, 1583, 1655, 1703, and 1744. The Panel also deleted paragraphs 2.60 and 7.1192 of the Interim Reports, and footnotes 161, 162, 1478, 1493, 1509, 1545, and 1546 of the Interim Reports.

6.4. The Panel made structural changes to section 8 in order to distinguish between its findings and recommendations in respect of DS472 (complaint by the European Union) and DS497 (complaint by Japan).

6.2 Provisions pertaining to developing countries

6.5. The Panel inserted section 7.6 that refers to Articles 12.10 and 12.11 of the DSU. These provisions pertain to developing countries. The Panel explains in section 7.6 how it took these provisions into account in respect of Brazil's participation in this dispute.

6.3 The scope of the parties' requests for review of the Interim Reports

6.6. The European Union requests additional findings on a number of issues. These requests are challenged by Brazil.[408]

6.7. The Panel notes the findings of the previous panels that a request from a party to reverse a decision goes beyond the scope of Article 15.2 of the DSU[409], that the purpose of interim review is "not necessarily" for a party to re-argue previously made arguments[410], and that the purpose of interim review is "not to allow a party to raise new arguments or develop arguments which were at most merely alluded to during the course of the proceeding".[411] However, the Panel also notes that in the latter dispute, the panel did decide to "address certain of the points made by [the requesting Member] in its request for review".[412] The Panel also notes the approach adopted by the panel in *Russia – Pigs*, where the panel reviewed the "Interim Report only in light of the comments made by the parties which relate to 'precise aspects' of the Interim Report."[413] That panel also rejected requests from the parties that amounted "to a party re-litigating arguments" previously made to the Panel.[414]

6.8. The Panel, therefore, declines to address those requests from any party for new findings, or that amount to re-litigation of previous arguments. In addition, the panel will only review the Interim Report in light of the comments made the parties which pertain to precise aspects of the Interim Report.

6.4 The "in-house" argument

6.9. With respect to paragraphs 7.314 and 7.747, the European Union argues that the Panel's completion of its legal analysis in respect of the "in-house scenario" is "essential to secure a positive solution" to the dispute.[415] In the European Union's view, "in order to comply with the Panel's report, Brazil may consider it sufficient to leave the required production steps intact and ask accredited companies to internalise those steps."[416] In the European Union's view, the "complainants would be compelled to start a new panel procedure and repeat their legal claims, even though those legal claims are properly before [the] Panel."[417] The European Union therefore requests the Panel to complete its legal analysis in respect of the "in-house" scenario. In the

[408] See European Union's comments on the Interim Report, paras. 26, 41, 48, 50 and 64. Brazil's comments on the European Union and Japan's requests for review of the interim panel report, paras. 10-11 ((referring to Panel Reports, *China – Raw Materials*, para. 6.69; *Japan – DRAMs (Korea)*, para. 6.2; *US – Poultry (China)*, para. 6.2; *US – Zeroing (EC) (Article 21.5 – EC)*, para. 7.26).

[409] Panel Report, *China – Raw Materials*, para. 6.69.

[410] Panel Report, *Japan – DRAMs (Korea)*, para. 6.2.

[411] Panel Report, *US – Zeroing (EC) (Article 21.5 – EC)*, para. 7.26

[412] Panel Report, *US – Zeroing (EC) (Article 21.5 – EC)*, para. 7.26

[413] Panel Report, *Russia – Pigs*, para. 6.6. The Panel referred to Article 15.2 of the DSU, referring to a party's right to "submit a written request for the panel to *review precise aspects of the interim report*". (emphasis added) See also Panel Report, *India – Agricultural Products*, paras. 6.5-6.6.

[414] Panel Report, *Russia – Pigs*, para. 6.7.

[415] European Union's comments on the Interim Report, para. 26.

[416] European Union's comments on the Interim Report, para. 26.

[417] European Union's comments on the Interim Report, para. 26.

alternative, the European Union requests the Panel to "include in the Report the elements that would allow the Appellate Body to complete the legal analysis".[418]

6.10. The Panel understands the argument raised by the European Union above. However, the Panel recalls that "a panel has the discretion 'to address only those arguments it deems necessary to resolve a particular claim' and 'the fact that a particular argument relating to that claim is not specifically addressed in the 'Findings' section of a panel report will not, in and of itself, lead to the conclusion that that panel has failed to make the 'objective assessment of the matter before it' required by Article 11 of the DSU'".[419]

6.11. In this respect, the Panel has found that the relevant aspects of the programmes concerning production-step requirements, as challenged by the complaining parties in this dispute, are WTO-inconsistent for the reasons elaborated upon in sections 7.3.2.2.4 and 7.4.2.4.2 (in respect of Article III:4 of the GATT 1994) as well as sections 7.3.4 and 7.4.5 (in respect of Article 2.1 of the TRIMs Agreement) and sections 7.3.5 and 7.4.5 (in respect of Article 3.1(b) of the SCM Agreement). In light of these findings, the Panel does not consider it necessary in these proceedings to address the complainants' argument that the relevant production-steps are inconsistent with the exact same provisions, for reasons other than those identified by the Panel.

6.12. With respect to the European Union's request in the alternative, for the Panel to make additional factual findings for the Appellate Body to complete the analysis, the Panel considers that its factual findings are sufficient should the Appellate Body decide to rule on this issue. Indeed, the Panel considers that the European Union admits as much when it states that the "relevant facts under the outsourcing scenario and the in-house scenario are the same … the only difference being that the accredited company carries out those production steps in-house, instead of avail[]ing itself of the possibility to outsource them to another company in Brazil". Contrary to the European Union's suggestion, should the Appellate Body want to review the Panel's analysis, it will be able to benefit from the descriptive part of the Report, the exhibits contained in the Panel record (and identified in the descriptive part), and the Appendix attached to the Report.

6.13. Regarding the European Union's speculations as to the manner in which Brazil could come into compliance with its obligations, the Panel considers it inappropriate at this stage to prejudge the manner in which Brazil may come into compliance with such obligations. In accordance with the relevant provisions of the DSU, and at the appropriate juncture, if the complaining parties consider that Brazil has not brought its measures into compliance, then the complaining parties may have recourse to dispute settlement proceedings pursuant to Article 21.5 of the DSU, if they so wish. Any issues pertaining to the manner of Brazil's compliance can be addressed at that stage.

6.14. For these reasons, the Panel declines the European Union's request to make any additional findings in respect of this particular issue.

6.5 Article 4.7 of the SCM Agreement

6.15. In their requests for interim review, the European Union and Japan requested the Panel to add certain language to section 8, referring to Article 4.7 of the SCM Agreement. Article 4.7 of the SCM Agreement states that:

> If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.

6.16. On 6 December 2016 the Panel submitted an additional question to the parties at the interim review stage of the proceedings, regarding the appropriate time-period that, in the view of the parties, the panel should specify in its recommendation. On 9 December 2016 the Panel received the parties' responses to this question, and on 12 December 2016 the Panel received the parties' comments on each other's responses to the question.

[418] European Union's comments on the Interim Report, para. 26.

[419] Appellate Body Report, *EC – Fasteners*, para. 511 (referring to Appellate Body Report, *EC – Poultry*, para. 135).

6.17. The Panel notes that previous panels addressing the specific time-period contemplated under Article 4.7 of the SCM Agreement have tended to specify 90 days as the time-period in which the subsidy must be withdrawn.[420] In this dispute, such a time-period would be significantly shorter than the period of time ostensibly contemplated in Article 21.3(c) of the DSU.[421] This is because, for example, a local content requirement in a subsidy would need to be remedied "without delay" (i.e. typically 90 days) when challenged as a prohibited subsidy under the SCM Agreement, whereas the same local content requirement in the same instruments when challenged under the GATT 1994 would need to be remedied within a "reasonable period of time" (ostensibly up to 15 months, subject to the arbitrator's discretion). It is difficult for the Panel to reconcile these provisions. However, the Panel notes the Appellate Body's statements in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* to the extent that the expedited remedy provided under Article 4.7 of the SCM Agreement is an "important consideration[422] In light of the Appellate Body's statements, the Panel is of the view that it must respect the specific remedy contemplated in Article 4 of the SCM Agreement. In light of these considerations, the Panel added paragraphs 8.10, 8.11, 8.21 and 8.22 to its conclusions.

6.6 Confidentiality of the Interim Reports

6.18. Pursuant to the DSU, all panel proceedings remain confidential until the Panel Report is circulated to WTO Members. Paragraph 25 of the Panel's Joint Working Procedures states that "The interim report, as well as the final report prior to its official circulation, shall be kept strictly confidential and shall not be disclosed." The confidential nature of the Interim Reports was explicitly reiterated when they were transmitted to the parties on 11 November 2016. On 12 November 2016, the Panel was made aware of press reports about the contents of the confidential Interim Reports. In light of this, the Panel wishes to emphasize its disappointment and concern that the confidentiality of the Interim Reports was not respected.

7 FINDINGS

7.1 Overview of the measures and claims, and the Panel's order of analysis

7.1. The complaining parties challenge the WTO-consistency of specific aspects of seven distinct "programmes" comprised of multiple laws, decrees, implementing orders (*Portarias*) and other legal instruments. Four of these programmes, namely the Informatics, PADIS, PATVD and Digital Inclusion programmes, bear substantial similarities to one another, not only in that all four programmes are related to the information communication technology (ICT) sector, but also in the design and the way they operate. A fifth programme, the INOVAR-AUTO programme, pertains to the automotive sector. Although the complaining parties invoke the same provisions of the covered agreements in respect of the INOVAR-AUTO programme as they do in respect of the ICT programmes, the INOVAR-AUTO programme differs from the ICT programmes not only in terms of its sectoral coverage (the automotive industry), but also in terms of its design and operation. Finally, the complaining parties raise export subsidies claims against two additional programmes – the PEC and RECAP programmes. Since these programmes are only challenged under a single provision, namely Article 3.1(a) of the SCM Agreement, the Panel addresses these claims separately and after the prior mentioned claims.

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[420] See, e.g. Panel Reports, *Korea – Commercial Vessels*, para. 8.5; *Canada – Aircraft Credits and Guarantees*, para. 8.4; *Canada – Autos*, para. 11.7; *Australia – Automotive Leather II*, para. 10.7; *Brazil – Aircraft*, para. 8.5; and *US – Conditional Tax Incentives for Large Civil Aircraft*, para. 8.6.

[421] Article 21.3(c) of the DSU states that: "The reasonable period of time shall be … (c) a period of time determined through binding arbitration within 90 days after the adoption of the recommendations and rulings. In such arbitration, a guideline for the arbitrator should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances."

[422] Appellate Body Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.7 (referring to Appellate Body Report, *EC – Export Subsidies on Sugar*, paras. 332-335). The Appellate Body stated that "[i]n *EC – Export Subsidies on Sugar*, the remedy provided under Article 4.7 was the reason why the Appellate Body found that the panel had improperly exercised judicial economy when it failed to make findings under the SCM Agreement once it had found a violation of the Agreement on Agriculture".

7.2. Specifically with respect to the four ICT programmes (the Informatics, PADIS, PATVD and Digital Inclusion programmes) as well as the INOVAR-AUTO programme, the complaining parties claim that these programmes:

a. Introduce tax and regulatory discrimination in favour of domestic *finished* and *intermediate* products, and against imported *finished*[423] and *intermediate* like products, inconsistently with Article III:2 and III:4 of the GATT 1994;

b. Introduce regulatory discrimination against imported *inputs*, in the form of incentives to use domestic products over imported like products (so-called local content requirements), inconsistently with Article III:4 and III:5 of the GATT 1994;

c. Constitute trade-related investment measures (TRIMs) that are inconsistent with Article III of the GATT 1994, including conditions that require the purchase or use of products from any domestic source, and therefore consequently inconsistent with Article 2.1 of the TRIMs Agreement; and

d. Constitute prohibited subsidies contingent upon the use of domestic over imported goods, inconsistently with Article 3.1(b) of the SCM Agreement.

7.3. These claims, under the various provisions of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement, deal (at least in part) with product discrimination in respect of imported products *vis-à-vis* domestic like products. Thus, the subject matter of these claims overlap to some extent.

7.4. The Panel proceeds by first describing the measures at issue, in the context of which the Panel also addresses a challenge by Brazil to the Panel's terms of reference in dispute DS472. Thereafter, the Panel discusses in general terms the overlaps and differences between the various provisions prohibiting discrimination between imported and domestic like products in Article III of the GATT 1994, as well as the scope of the overlaps and differences between the provisions of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement. Finally, for the purposes of this overview, the Panel describes its order of analysing the complaining parties' various claims.

7.1.1 The measures at issue

7.5. As an initial matter, the Panel considers it useful to describe the precise measures at issue in this dispute, because Brazil claims that one of the instruments of such programme is not included in the Panel's terms of reference. The Panel also considers it useful to make some clarifying remarks on the categories of products discussed in this report.

7.6. In defining the measures as challenged by the complaining parties, the Panel notes the statement by the European Union that "[t]he measures at issue in this dispute are the set of advantages in relation to taxes, duties, contributions and charges embodied in and applied through a comprehensive set of interrelated programmes."[424] The European Union further elaborated that, in respect of the INOVAR-AUTO programme, the European Union challenges the "system of advantages conferred by Brazil to its automotive sector through the … programme".[425] With respect to the ICT programmes (the Informatics, PADIS, PATVD, and Digital Inclusion programmes), the European Union "raises claims against the fiscal schemes … specifically as contained in [the] four programmes".[426] Finally, in respect of the PEC and RECAP programmes, the European Union challenges the "fiscal schemes which are contingent upon export performance and that affect multiple economic sectors in Brazil".[427] Japan, for its part, notes that the challenged

[423] The terms "finished products", "intermediate products", and "inputs" are further explained in section 7.1.1.2 below.
[424] European Union's response to Panel question No. 39.
[425] European Union's response to Panel question No. 39.
[426] European Union's response to Panel question No. 39.
[427] European Union's response to Panel question No. 39.

measures "include the seven programmes", and that "[i]n particular, Japan challenges the discriminatory aspects of these tax incentive programmes".[428]

7.7. The Panel considers that the measures at issue are the sets of allegedly discriminatory advantages embodied in each of the identified programmes. The Panel recalls its description of the functioning of the challenged programs in section 2 above.

7.8. The Panel proceeds by assessing Brazil's argument with respect to the Panel's terms of reference in dispute DS472. Thereafter, the Panel will elaborate on the terms used by the Panel and the parties to describe the categories of products at issue in this dispute.

7.1.1.1 The Panel's terms of reference

7.9. Brazil alleges that Implementing Order 257/2014 is not within the Panel's terms of reference in dispute DS472 because it was not explicitly identified in the European Union's panel request, as required by Article 6.2 of the DSU.[429]

7.10. The Appellate Body in *US – Countervailing and Anti-Dumping Measures (China)* explained that Article 6.2 of the DSU serves a crucial function in WTO dispute settlement as it "establish[es] and delimit[s] a panel's jurisdiction"[430] and "fulfils a due process objective".[431] In particular, insofar as a panel request fails to identify "the specific measures at issue", the panel established thereunder does not have jurisdiction to make any findings in respect of those measures.[432]

7.11. In *China – Raw Materials* the Appellate Body stated that "whether a panel request identifies the 'specific measures at issue' may depend on the particular context in which those measures operate and may require examining the extent to which they are capable of being precisely identified."[433] The Appellate Body in *US – Continued Zeroing* also indicated that "the identification of a measure within the meaning of Article 6.2 need be framed only with sufficient particularity so as to indicate the nature of the measure and the gist of what is at issue."[434]

7.12. Thus, it may not be necessary to identify every aspect of a challenged measure (or legal instrument implementing a challenged measure) in the panel request, provided that the measure or legal instrument not explicitly mentioned in the panel request has a "clear relationship to a 'measure' that is specifically described therein, so that it can be said to be 'included' in the specified 'measure'".[435] Accordingly, such a condition may be satisfied where the measure or legal instrument that is not specified in the request "is subsidiary or so closely related to a measure specifically identified that the responding party can reasonably be found to have received adequate notice of the scope of the claims asserted by the complaining party".[436] Such a condition may also be satisfied where the measures or legal instruments not explicitly referred to in the request "implement, supplement, and amend" or "refine" the measures explicitly identified.[437]

7.13. With these principles in mind, the Panel turns to review Brazil's objection relating to Implementing Order 257/2014.

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[428] Japan's response to Panel question No. 39.

[429] Implementing Order 257 of 23 September 2014, (Exhibit JE-158).

[430] Appellate Body Report, *US – Countervailing and Anti-Dumping Measures (China)*, para. 4.6 (referring to Appellate Body Reports, *Brazil – Desiccated Coconut*, p. 22, DSR 1997:I, 167, at p. 186; *US – Continued Zeroing*, para. 161; *EC and certain member States – Large Civil Aircraft*, para. 640.

[431] Appellate Body Report, *US – Countervailing and Anti-Dumping Measures (China)*, para. 4.7.

[432] See e.g. Appellate Body Report, *US – Continued Zeroing*, para. 161 ("[A]s a panel's terms of reference are established by the claims raised in panel requests, the conditions of Article 6.2 serve to define the jurisdiction of a panel.").

[433] Appellate Body Report, *China – Raw Materials*, para. 220. (footnotes omitted)

[434] Appellate Body Report, *US – Continued Zeroing*, para. 169.

[435] Panel Report, *Japan – Film*, para. 10.8.

[436] Panel Report, *Japan – Film*, para. 10.8. See also Panel Reports, *US – Carbon Steel*, para. 8.11; and *Australia – Salmon (Article 21.5 – Canada)*, para. 7.10.

[437] Appellate Body Report, *EC – Bananas III*, para. 140 (upholding the panel's findings at paragraph 7.27 of the panel report). See also Communication from the Panel (Preliminary Ruling), *India – Agricultural Products*, 28 May 2013, WT/DS430/5, para. 3.43.

7.14. Brazil contends that Implementing Order 257/2014 (alleged to be part of the INOVAR-AUTO programme) and consequently Article 41 of Law 12,715/2012 as applied in accordance with Implementing Order 257/2014, is outside the Panel's terms of reference because the European Union failed to identify this Implementing Order in the panel request as part of the measures at issue.[438]

7.15. According to the European Union, Implementing Order 257/2014 merely develops and implements Decree 7,819/2012, which is explicitly identified in their panel request, and therefore is covered by the phrase in the panel request regarding "any amendments or extensions, any replacement measures, any renewal measures, any implementing measures, and other related measures of the foregoing."[439]

7.16. In assessing Brazil's objection, the Panel must consider the precise content of the Panel's terms of reference and the challenged measures.

7.17. The European Union's panel request indicates that, in respect of the INOVAR-AUTO programme, the European Union is challenging the "tax advantages consist[ing] in a reduction of the IPI tax burden" as well as various other aspects of the INOVAR-AUTO programme, including the "earn[ing of] tax credits which can be used, under certain conditions, to offset the IPI otherwise due on the domestic sale of motor vehicles covered by the programme."[440] The panel request also indicates that the "INOVAR-AUTO programme is set up and implemented through the following [legal instruments]", wherein the European Union lists a number of specific legal instruments.

7.18. For the Panel, the measures at issue (in respect of INOVAR-AUTO) include the tax advantages accorded under the programme, including the rules on earning tax credits, and are implemented through various legal instruments. The Panel, therefore, does not consider that these legal instruments are themselves the measures at issue, but together their operation within the parameters of the programmes, form the "measures". In the Panel's view, the legal instruments indicated by the European Union in its panel request indicate and are evidence of the content of the challenged measures, including the rules on earning tax credits.

7.19. Turning to the legal instrument alleged to be outside the Panel's terms of reference, the Panel notes that Implementing Order 257/2014 lays down, according to its preamble, "additional rules on the incentive scheme … [of] INOVAR-AUTO, regulated by Decree No 7.819 of 3 October 2012, and establishing procedures to be observed as regards expenditure on strategic materials and tools, and the related information processing".[441] In particular, this implementing order develops the language of Article 12 of Decree 7,819/2012 that regulates the calculation of presumed IPI tax credits in the INOVAR-AUTO programme.

7.20. The Panel notes that Article 12 of Decree 7,819/2012 itself implements Article 41 of Law 12,715/2012, and that both Decree 7,819/2012 and Law 12,715 are explicitly identified in the European Union's panel request as legal instruments implementing the INOVAR-AUTO programme. Implementing Order 257/2014 therefore has no purpose apart from specifying the procedure and methodology of calculating the presumed IPI tax credits. Thus, applying the legal standard adopted by the Appellate Body, Implementing Order 257/2014 "has a clear relationship to", *inter alia*, Decree 7,819/2012, which "is specifically described" in the European Union's panel request, "so that it can be said to be 'included' in the specified 'measure'".

[438] Brazil's first written submission, para. 539 (DS472). Brazil maintains in particular that since Implementing Order 257/2014 (dated 23 September 2014) was in force before the date of the European Union's panel request in DS472 (namely 31 October 2014), the European Union was under the obligation to list it explicitly, as it did with the other Implementing Orders in its panel request. Brazil's first written submission, para. 539 (DS472). In its view, allowing for the inclusion of Implementing Order 257/2014 would unwarrantedly enlarge the scope of the dispute DS472 to any aspect of accounting and credit generation within the INOVAR-AUTO programme and violate Brazil's due process rights, since Brazil did not have adequate notice that these measures would be within the scope of the dispute. Brazil's first written submission, para. 544 (DS472).

[439] European Union's responses to the Panel question No. 40.

[440] European Union's request for the establishment of a panel, p. 2.

[441] Implementing Order 257 of 23 September 2014, (Exhibit JE-158).

7.21. The Panel therefore considers that the rules contained in Implementing Order 257/2014 are an integral part of the rules on earning tax credits. In this respect, the Panel does not consider that the rules on calculation of "how tax credits are earned" are additional to, or separate from, the "rules on earning tax credits" that are challenged in the panel request. Furthermore, as noted, the legal instrument embodying these rules on the calculation of the tax credits has a "clear relationship" to those instruments identified in the panel request, as they are fundamentally linked to the legal instruments specifically identified in the panel request as implementing the challenged measure. The Panel further considers that Brazil can reasonably be considered to have received adequate notice of the scope of the claims asserted by the European Union.

7.22. In light of the foregoing, the Panel concludes that the rules on calculation of presumed tax credits under the INOVAR-AUTO programme, as contained in Implementing Order 257/2014, are within the Panel's terms of reference.

7.1.1.2 The categories of products concerned by the various taxes at issue

7.23. The Panel notes that the claims of the complaining parties in respect of the ICT and INOVAR-AUTO programmes pertain to two distinct "types" of products, "incentivised products" and inputs for the "incentivised products". Brazil, in its defence, has subcategorized the "incentivised products" as "intermediate" and "finished" products. Despite not being treaty language, these distinctions form a useful analytical tool in understanding the arguments and claims of the parties. The Panel therefore recalls and elaborates upon its explanation of the functioning of the programmes in section 2.2 above.[442]

7.24. As explained above, a "finished product", as identified by Brazil, is a product that will not undergo any further manufacturing. Such "finished" products will be "incentivised" if the company producing them is accredited under a particular programme. If a finished product is "incentivised", it means that it receives a particular tax benefit on its sale. In sum, if a particular product is not a product that will undergo any further manufacturing, that product can be considered as a "finished" product in the context of this panel report. The complaining parties' claims with respect to alleged discrimination on finished products are under Articles III:2 and III:4 of the GATT 1994, and Article 2.1 of the TRIMs Agreement. The European Union's claims under Article III:5 also concerns finished products.[443]

7.25. Certain other products at issue in this dispute *will* be subject to further manufacturing. Such products have been identified by Brazil as "intermediate" products. These products will also be "incentivised" if the company producing them is accredited under a particular programme. If an intermediate product is incentivised, it will be subject to a particular tax benefit on its sale. However, such intermediate products will be further used in the production of a "finished" product. The complaining parties' claims with respect to alleged discrimination on intermediate products are also under Articles III:2 and III:4 of the GATT 1994, and Article 2.1 of the TRIMs Agreement. The European Union's claims under Article III:5 also concerns intermediate products.[444]

7.26. Finally, "inputs" for incentivized products are products that are incorporated into the intermediate or finished incentivized products during the production process (indeed, all intermediate products can be considered inputs into final products). Thus, some inputs into incentivized products are incentivized intermediate products. Other inputs, whether in the form of basic raw materials or intermediate products are, strictly speaking, not "incentivised", but a company producing an incentivised finished or intermediate product, and accredited under certain programmes, may be entitled to receive a tax benefit on the purchase of such inputs, to the extent that they are incorporated into "incentivised" intermediate or finished products. The complaining parties' claims with respect to alleged discrimination on "inputs" are under Article III:4 and III:5 of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement.[445] The Panel notes that the term "inputs" in the context of the analysis of the PPBs can introduce a

[442] In addition to the categories described in this section, this Report also addresses tools and packaging materials. These products are not relevant for the categorization explained in this section.

[443] See European Union's comments on the interim report, para. 11.

[444] See European Union's comments on the interim report, para. 11.

[445] The Panel notes that although the "discrimination" in respect of Article 3.1(b) of the SCM Agreement is allegedly on *inputs*, Brazil's arguments vary depending whether the "subsidized" (in other words, incentivised) product is *finished* or *intermediate*.

certain confusion. In particular, the term "inputs" encompasses both raw materials and other basic components, on the one hand, and intermediate products in a production chain, on the other hand. The complaining parties' claims with respect to the PPBs do not encompass raw materials and other basic components, and thus are limited to intermediate products, and some intermediate products themselves are incentivized under the challenged programmes. To avoid the potential for confusion, in its analysis of the PPBs, the Panel will refer to the products at issue as "manufactured components and subassemblies".

7.27. Claims and arguments of the parties differ depending on whether the product allegedly discriminated against is an incentivized finished product, an incentivized intermediate product, or a non-incentivized input.

7.1.2 Overview of the relationship between the complaining parties' multiple claims

7.28. Having described the measures at issue, the Panel notes that in respect of the four ICT programmes and the INOVAR-AUTO programme, the complaining parties have presented certain cumulative and overlapping claims, involving multiple provisions of the covered agreements. Indeed, various different aspects of the challenged programmes are claimed to be inconsistent with Article III:2 of the GATT 1994 (covering tax discrimination on products), Article III:4 of the GATT 1994 (covering regulatory discrimination on products) as well as Article III:5 of the GATT 1994 (covering product discrimination imposed through quantitative regulations). Additionally, some of the same aspects of the challenged programmes are claimed to be inconsistent with Article 2.1 of the TRIMs Agreement, as well as Article 3.1(b) of the SCM Agreement.

7.29. The Panel therefore considers it useful to briefly address the relationship between these claims and related WTO provisions in order to establish a coherent order of analysis. Moreover, the Panel notes that the arguments raised by Brazil require a horizontal understanding of the scope of application of Article III of the GATT 1994 and related WTO provisions prohibiting discrimination between imported and domestic like products. Brazil argues generally that the disciplines of Article III (and related provisions of the TRIMs and the SCM Agreements) governing product discrimination are not applicable to the challenged programmes, which are concerned with production requirements, and not products *per se*.[446] Additionally, Brazil argues that its challenged programmes constitute subsidies to domestic producers within the meaning of Article III:8(b) of the GATT 1994, and thus, according to Brazil, the programmes are exempted from the application of Article III:2, III:4 and III:5 of the GATT 1994, and consequently also from Article 2.1 of the TRIMs Agreement.[447]

7.30. In sum, several of the complaining parties' claims concern the WTO prohibitions against product discrimination in respect of imported products *vis-à-vis* domestic like products, as expressed in the GATT 1994, the TRIMs Agreement, and the SCM Agreement. The Panel recalls that it is a basic principle of interpreting the WTO Agreement that all WTO provisions apply cumulatively and simultaneously, and should be interpreted harmoniously.[448] In light of this, the Panel proceeds with its analysis by addressing the relationship between, and scope of, the multiple provisions invoked by the complaining parties in respect of the ICT and INOVAR-AUTO programmes.

7.1.2.1 Differences in scope between Articles III:2, III:4 and III:5 of the GATT 1994

7.31. The complaining parties claim that the four ICT programmes and the INOVAR-AUTO programme entail taxation and requirements applicable to the incentivized products at issue, whether *finished* or *intermediate*, and their *inputs*, inconsistently with Article III:2, III:4 and III:5 of GATT 1994.

7.32. Article III of the GATT 1994 generally prohibits discrimination against imported products. Paragraph 1 of Article III states clearly that, in all forms, governmental acts should not be applied to imported or domestic products "so as to afford protection to domestic production":

[446] See paragraph 7.61 below.
[447] See paragraph 7.71 below.
[448] Appellate Body Report, *Korea – Dairy*, para. 74; Appellate Body Report, *Argentina – Footwear (EC)*, para. 81.

> The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

7.33. Therefore any type of governmental action (including both tax measures and domestic regulations) which favours domestic products over like imported products is contrary to Article III of the GATT 1994. While Article III:2 prohibits tax discrimination between imported and domestic like products, Article III:4 and III:5 deal with discrimination introduced through regulations. Specifically, Article III:4 prohibits regulatory discrimination between imported and like domestic products. As explained in further detail in section 7.3.2.1 below, any regulatory measure that affects the conditions of competition in the domestic market to the detriment of imported like products is inconsistent with Article III:4. Measures prohibited by Article III:4 *include, but are not limited to*, requirements, conditions for obtaining an advantage, and other types of *incentives* that favour the use of domestic products over imported like products.[449] (Similarly, trade-related investment measures in the form of requirements to purchase or use domestic products in order to obtain an advantage are inconsistent with the TRIMs Agreement, and subsidies contingent on the use of domestic over imported goods are inconsistent with the SCM Agreement.) Article III:5 focuses on discrimination between imported and like domestic products, imposed through quantitative regulations relating to mixture proportions.

7.34. It is well established that a single measure can be inconsistent with two or more provisions of Article III at the same time.[450] This is because multiple features of a single measure may operate simultaneously. In such a situation, different aspects of the same measure could be considered to be covered by the disciplines of either or both Article III:2 and III:4.

7.35. In the present dispute, the challenged programmes include both fiscal and non-fiscal aspects, applicable to the products at issue, whether finished or intermediate, as well as non-fiscal aspects applicable to their inputs. The complaining parties allege that certain tax aspects of the programmes, insofar as they apply to incentivized *finished* and *intermediate* products, are discriminatory and inconsistent with Article III:2. The complaining parties also allege that the specific conditions and criteria to be satisfied by incentivized *finished* and *intermediate* products in order to receive the tax advantages, are inconsistent with Article III:4 of the GATT 1994, by consisting of conditions for obtaining the advantage in respect of the incentivized products.

7.36. In addition to this discrimination in respect of the incentivized *finished* and *intermediate* products at issue, the complaining parties allege that the requirements to be satisfied to obtain the tax advantages also function as so-called "local content requirements", resulting in discrimination against imported *inputs* used in the production of the incentivized *finished* and *intermediate* products at issue, in favour of like domestic inputs. The complaining parties allege that these aspects of the ICT and INOVAR-AUTO programmes are also inconsistent with Article III:4 of the GATT 1994.

7.37. The complaining parties also argue that those same regulatory criteria and conditions resulting in discrimination on *inputs* are also inconsistent with Article III:5. In this respect, the complaining parties allege that certain requirements included in the challenged programmes are "internal quantitative regulation[s] relating to the processing of products in specific amounts or

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[449] See paragraph 7.258 and footnote 648 below.

[450] See Appellate Body Report, *Thailand – Cigarettes (Philippines)*, footnote 144 to para. 114:

> We note that even if a measure at issue consisted solely of administrative requirements, we do not exclude the possibility that such requirements may have a bearing on the respective tax burdens on imported and like domestic products, and may therefore be subject to Article III:2. Although Thailand may be correct in stating that prior WTO reports have examined measures consisting of "administrative requirements relating to the sale of imported products" under Article III:4 (Thailand's appellant's submission, para. 69), this does not in our view demonstrate that, if such requirements subject imported and like domestic products to internal taxes or other internal charges, the same measures, or certain aspects of the same measures, could not also be scrutinized under Article III:2. (See Panel Report, *Argentina – Hides and Leather*, para. 11.143 (finding that administrative measures concerning the pre-payment of tax "qualify as tax measures [that] fall to be assessed under Article III:2"))

proportions", and that such requirements are contrary to Article III:5. Article III:5 prohibits "internal quantitative regulations relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources." Article III:5 also explicitly prohibits any regulation from applying internal quantitative regulations "in a manner contrary to the principles set forth in paragraph 1."

7.38. In the current dispute, the complaining parties submit three claims of discrimination under Article III – specifically they allege that each programme introduces origin-based tax discrimination as a result of conditions that consist of local content and quantitative requirements relating to the mixture, processing or use of products in specified amounts or proportions, contrary to Article III:2, III:4 and III:5 of GATT 1994. As much as possible the Panel will address those claims in the order submitted, in light of their overlaps and taking into account the specific functioning of each programme. In doing so the Panel will also ensure due process and the respect of Brazil's dispute settlement rights.

7.1.2.2 Differences in scope between Article III:4 of the GATT 1994, Article 2 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement

7.39. With respect to the ICT and INOVAR-AUTO programmes, in addition to the claims under Article III:2, III:4 and III:5 of the GATT 1994, the complaining parties also bring claims of inconsistency under Article 2.1 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement.

7.40. Article 2.1 of the TRIMs Agreement states that "no Member shall apply any TRIM that is inconsistent with the provisions of Article III … of GATT 1994". Thus, the scope of Article III of the GATT 1994 and Article 2.1 of the TRIMs Agreement overlap broadly; the only difference is that to be inconsistent with Article 2.1 of the TRIMs Agreement, the measure must be a trade-related investment measure (TRIM). As explained by the Panel in *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, it follows that any measure found to be inconsistent with Article III of the GATT, that is also a TRIM, will be incompatible with Article 2.1 of the TRIMs Agreement.[451] In the present dispute, this would apply to *final* products, *intermediate* products, *and* inputs.

7.41. The TRIMs Agreement also lists, in the Illustrative List annexed to the agreement, examples of TRIMs that are specifically inconsistent with Article III:4 of the GATT 1994. Paragraph 1(a) of the Annex to the TRIMs Agreement explains that "TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those … compliance with which is necessary to obtain an advantage, and which require … the purchase or use by an enterprise of products of domestic origin or from any domestic source". This provision therefore refers to so-called "local content requirements". Thus, if a Panel finds that a particular measure is a TRIM, and that such a measure contains a so-called local content requirement, then that local content requirement is necessarily inconsistent with both Article III:4 of the GATT 1994 and Article 2.1 of the TRIMs Agreement.[452]

7.42. In addition, the prohibition on local content requirements is also codified in Article 3.1(b) of the SCM Agreement, which prohibits "subsidies contingent … upon the use of domestic over imported goods". Over and above the similarities in language to paragraph 1(a) of the Annex to the TRIMs Agreement, there are reasons to believe that Article 3.1(b) codifies in the SCM Agreement the principle of non-discrimination already contained in Article III of the GATT 1994. This is demonstrated both by the GATT dispute *Italy – Agricultural Machinery* of 1958, and by the records of the SCM negotiations of the Uruguay Round.

7.43. In the *Italy – Agricultural Machinery* dispute in 1958, the GATT panel found that a subsidy to Italian farmers to purchase Italian-made tractors was inconsistent with Article III:4, because the subsidy programme, which fell within the scope of Article III:4, favoured domestic tractors over imported tractors. The GATT panel found that Article III:8(b) did not apply to the subsidy in question, as the subsidy was not to *producers* of Italian tractors but to *purchasers* thereof.

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[451] Panel Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 7.117.

[452] See Panel Reports, *Indonesia – Autos*, para. 14.61 ("The TRIMs Agreement and Article III:4 prohibit local content requirements that are TRIMs and therefore can be said to cover the same subject matter."); *India – Solar Cells*, para. 7.54 ("TRIMs falling under paragraph 1(a) of the TRIMs Illustrative List are necessarily inconsistent with Article III:4 of the GATT 1994").

7.44. Furthermore, the negotiating history of the SCM Agreement demonstrates the intention by the drafters to include in the SCM Agreement, for clarity and certainty, the pre-existing prohibitions on product discrimination as contained in the GATT 1947:

> Some participants [in the Uruguay Round Negotiating Group on Subsidies and Countervailing Measures] expressed their reservation on the proposed category of other trade-related subsidies [i.e., prohibited subsidies]. They considered that subsidies proposed for this category were already covered by Article III of the General Agreement (subsidies that were contingent upon the use of domestic over imported goods) or by Article XVI:4 (subsidies contingent upon export performance). Some other participants explained that although these subsidies were already prohibited by other provisions of the General Agreement, their inclusion into the category of prohibited subsidies would serve the purpose of better clarity and certainty.[453]

7.45. A harmonious reading of Article 3.1(b) of the SCM Agreement (which prohibits subsidies *contingent upon of the use of domestic over imported products*) and Article III:4 of the GATT 1994 (which prohibits laws, regulations and requirements that discriminate against imported products, including local content requirements), read in light of paragraph 1(a) of the Annex to the TRIMs Agreement, indicates that a subsidy contingent on the use of domestic over imported products would be inconsistent with both Article 3.1(b) of the SCM Agreement and Article III:4 of the GATT 1994.

7.46. Since any measure that is a TRIM and that is inconsistent with Article III of the GATT 1994 is consequently also inconsistent with Article 2.1 of the TRIMs Agreement, it follows that a measure that is both a subsidy and a TRIM[454], and that requires (or is contingent upon) the use of domestic products over imported products, will be inconsistent with Article III:4 of the GATT 1994, Article 2.1 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement.

7.47. Although there is some overlap between these three provisions, as explained above, there are also differences in their respective scope of application. In particular, the scope of Article III:4 of the GATT 1994 is broader than that of Article 2.1 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement, since it refers generally to "laws, regulations and requirements". A measure is only covered by Article 2.1 of the TRIMs Agreement if it is a TRIM within the meaning of that agreement.[455] Similarly, a measure is only covered by Article 3.1(b) of the SCM Agreement if it is a subsidy within the meaning of that agreement. In this regard, on an issue not discussed by the Appellate Body on appeal, the panel in *Canada – Autos* stated as follows:

> We recognize that Article 3.1(b) in some sense has its roots in Article III:4 of GATT and in certain interpretations of that provision, which relates to non-discrimination. *We do not consider however that Article 3.1(b*) ipso facto *has the same scope as Article III:4. To the contrary, while Article III:4 of GATT speaks of "treatment no less favourable" and of requirements "affecting" internal sale, Article 3.1(b) speaks of subsidies "contingent upon the use of domestic over imported goods*".[456]

7.48. The Appellate Body in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* also noted the partial overlaps between Article III:4 of the GATT 1994, Article 2 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement:

> Both the national treatment obligations in Article III:4 of the GATT 1994 and the TRIMs Agreement, and the disciplines in Article 3.1(b) of the SCM Agreement, are cumulative obligations. Article III:4 of the GATT 1994 and the TRIMs Agreement, as

[453] Note by the Secretariat, Meeting of 26-27 September 1989, GATT Doc. MTN.GNG/NG10/13 (Oct. 16, 1989), para. 6.

[454] Therefore presumably also a "law, regulation [or] requirement" within the scope of Article III:4.

[455] The Panel notes the statement by the panel in *Indonesia – Autos* that if a measure constitutes a local content requirement, then it would "necessarily be 'trade-related' because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade." Panel Report, *Indonesia – Autos*, para. 14.82. Nonetheless, for a measure (including a local content requirement) to be a TRIM and therefore subject to paragraph 2.1 of the TRIMs Agreement, such a measure must also be an "investment measure". This must be determined on a case-by-case basis.

[456] Panel Report, *Canada – Autos*, para. 10.215. (emphasis added)

> well as Article 3.1(b) of the SCM Agreement, *prohibit the use of local content requirements in certain circumstances*. These provisions address discriminatory conduct...[457]

7.49. In sum, a subsidy prohibited under Article 3.1(b) of the SCM Agreement would appear to be inconsistent with Article III:4 of the GATT 1994. Such a subsidy would therefore also be inconsistent with Article 2.1 of the TRIMs Agreement to the extent that the measure is a TRIM. By contrast, a demonstration of inconsistency with Article III:4 of the GATT 1994 does not necessarily imply inconsistency with Article 3.1(b) of the SCM Agreement (the scope of which is narrower in prohibiting only *subsidies* that are contingent upon the use of domestic over imported products) or Article 2.1(b) of the TRIMs Agreement (unless the measure is a TRIM, in which case a finding of inconsistency with Article III:4 of the GATT 1994 would imply a finding of inconsistency with Article 2.1 of the TRIMs Agreement).

7.1.3 Order of analysis of the complaining parties' multiple claims

7.50. The Panel needs to explain its order of analysis of the complaining parties' multiple claims.

7.51. The Panel recalls that the complaining parties in the present dispute have alleged that the ICT and INOVAR-AUTO programmes impose tax and regulatory discrimination on *final* products and *intermediate* products, contrary to Article III:2 and III:4 of the GATT 1994; as well as regulatory discrimination on *inputs* in the form of local content requirements, contrary to Article III:4 and III:5 of the GATT 1994. Additionally they have argued that all measures constitute TRIMs, and therefore all findings of inconsistency in respect of Article III must result in consequential findings of inconsistency with Article 2.1 of the TRIMs Agreement. Finally, the complaining parties argue that the measures constitute prohibited subsidies contingent upon the use of domestic over imported goods, contrary to Article 3.1(b) of the SCM Agreement. Additionally, the complaining parties challenge the PEC and RECAP programmes under a single provision, namely Article 3.1(a) of the SCM Agreement.

7.52. With respect to the broad set of claims regarding the ICT and INOVAR-AUTO programmes, Brazil submits two general defences regarding the applicability of Article III of the GATT 1994, Article 2 of the TRIMs Agreement, and Article 3 of the SCM Agreement, to the challenged measures. Brazil also submits additional specific arguments regarding each specific provision invoked by the complaining parties, in respect of all challenged programmes.

7.53. In light of the sweeping nature of Brazil's general defences, the Panel starts its analysis by first assessing Brazil's two general defences, notwithstanding the fact that these defences are not made in respect of two of the challenged programmes, namely the PEC and RECAP programmes.

7.54. Subsequently, the Panel will proceed by addressing the specific claims of the complaining parties with respect to each programme. Recalling that the Informatics, PADIS, PATVD and Digital Inclusion programmes are all related to the ICT sector, and are similar in design and operation, the Panel proceeds by assessing the complaining parties' claims of WTO-inconsistency on these four programmes together, on a programme-by-programme basis, and distinguishing between different claims. Specifically, the Panel conducts its analysis for each programme by first assessing the complaining parties claims under Article III:2 of the GATT 1994, before turning to Article III:4 and the broad WTO prohibition against conditioning an advantage or subsidy on the use of domestic over import products, also included in Article 3.1(b) of the SCM Agreement and the Illustrative List annexed to the TRIMs Agreement. The Panel will decline by judicial economy to consider the claims under Article III:5 of the GATT 1994 and will thus proceed to address the claims that such programmes include subsidies contingent upon the use of domestic over imported products under Article 3.1(b) of the SCM Agreement before turning to the claims that the same programmes constitute TRIMs measure inconsistent with Article 2.1 of the TRIMs Agreement.

7.55. The Panel will continue its analysis by addressing the INOVAR-AUTO programme. The Panel will conduct its analysis of the claims in the same order as its analysis for the ICT programmes, as indicated above.

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[457] Appellate Body Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 5.5. (emphasis added)

7.56. Finally, the Panel will address the sole claims under Article 3.1(a) of the SCM Agreement for the PEC and RECAP programmes, in that order.

7.2 Brazil's general defences

7.57. The Panel now turns to two general defences raised by Brazil in respect of the complaining parties' claims of discrimination (specifically Article III:2, III:4, and III:5 of the GATT 1994, Article 2.1 of the TRIMs Agreement, Article 3.1(b) of the SCM Agreement) for the ICT-related programmes (i.e. the Informatics, PADIS, PATVD and Digital Inclusion programmes) and the INOVAR-AUTO programme.

7.58. First, Brazil submits that Article III of the GATT 1994 does not apply to the challenged measures because the disciplines of Article III govern discrimination on *products*, whereas the challenged programmes are not product-related but rather impose process and production-step requirements. Similarly, the disciplines of Article 2 of the TRIMs Agreement and Article 3 of the SCM Agreement relate to *products*, and are therefore equally inapplicable to the measures at issue.[458]

7.59. Brazil's second general defence is that the challenged measures constitute "payments of subsidies exclusively to domestic producers" within the meaning of Article III:8(b) of the GATT 1994, and, therefore are exempted from the disciplines of paragraphs 2, 4 and 5 of Article III of the GATT 1994. In Brazil's view this would also exclude the challenged programmes from the scope of Article 2 of the TRIMs Agreement. According to Brazil, the disciplines in Article III:2, III:4 and III:5 of GATT 1994 are not applicable to the challenged programmes and therefore the Panel need not consider whether such challenged programmes are inconsistent with Article III:2, III:4 and III:5 of GATT 1994, or other related and overlapping prohibitions included in Article 2 of the TRIMs Agreement and in Article 3.1(b) of the SCM Agreement.[459]

7.60. For due process reasons, and without taking a view at this stage of the analysis on whether Brazil's allegations are correct factually and legally, the Panel will consider these defences by Brazil to the fullest extent possible before entertaining any specific claims by the complaining parties of the challenged programmes' alleged inconsistencies with Article III:2, III:4 and III:5 of the GATT 1994, Article 2 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement.

7.2.1 Whether the challenged programmes are outside the scope of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement, because they regulate production and not products

7.61. Brazil argues that Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement, relate to differences in the treatment of imported and domestic products based on the origin of the relevant products.[460] In the view of Brazil, the measures at issue concern only pre-market obligations regarding production and investment in research and development (R&D) by producers.[461] According to Brazil, "[n]othing in the plain text of these provisions authorizes [an] interpretation that different treatment related to factors other than origin and unrelated to the use of products or to percentages of domestically produced inputs is covered by those provisions."[462] Brazil therefore argues that the challenged measures are not within the scope of these provisions.[463]

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[458] See paragraph 7.61 below.

[459] See paragraph 7.71 below.

[460] Brazil's first written submissions, paras. 80-93 (DS472) and paras. 52-60 (DS497).

[461] Brazil's first written submissions, paras. 167, 173, 181, 184, 229, 231, 232, 287, 327, 340, 377, 461, 477, 489, 578, 586, 744 and sections 5.1.2.3.1, 5.2.2.3.1, 5.3.2.3.1, and 5.4.3.2.1 (DS472) and paras. 125, 140, 143, 182, 185, 186, 208, 238, 276, 290, 318, 333, 398, 413, 424, 426, 497, 514, and 519, and sections 4.1.2.4.1, 4.2.2.4.1, 4.3.2.4.1, and 4.4.2.4.1 (DS497).

[462] Brazil's first written submission, para. 57 (DS497). Brazil specifically asserts that per the Ad Note to Article XVII of the GATT 1994, the term "goods" is "limited to products as understood in commercial practice", which would exclude production step requirements, research and development (R&D) requirements or development requirements. Brazil's first written submissions, para. 241 (DS472) and para. 194 (DS497). Brazil also argues that the Appellate Body has distinguished between goods in the market, and production, in the subsidies context. Brazil's first written submissions, para. 182 (DS472) and para. 141 (DS497) (referring to Appellate Body Report, *EC – Large Civil Aircraft*, para. 1054). According to Brazil, since the measures "are

7.62. In the view of the complaining parties, it is irrelevant whether the measures are imposed on producers or production-steps, and not directly on products in the market itself. The European Union notes that the "key element" to determine whether the measures are within the scope of the relevant provisions is whether the measures modify the conditions of competition to the detriment of imported products, relative to domestic like products, and cites jurisprudence that it considers to support the view "that measures affecting the equality of the conditions of competition between domestic and imported products cannot be limited to measures directly regulating products or imposing market requirements."[464] Japan further argues that "if merely being directed towards particular producers or pertaining to production processes cured any WTO-inconsistency, then circumvention of WTO disciplines would be trivially easy."[465]

7.63. In the Panel's view, the plain text of Article III of the GATT 1994 is sufficient to refute Brazil's argument. Article III:1, containing the overarching national treatment obligation that is then elaborated in the remaining paragraphs of Article III, is phrased in broad and inclusive language, referring to, and covering among other things, "internal taxes and other internal charges, and laws, regulations and requirements *affecting* the internal sale, offering for sale, purchase, transportation, distribution or use of products". Article III:4 contains similar language, also referring to all laws, regulations and requirements affecting […] internal sale, offering for sale, purchase, transportation, distribution or use" of imported and domestic like products. This broad language cannot be seen as limited to measures directed at products only once they are in the market, as Brazil argues. Not only is the language not limited in that way, logically there is no reason why a measure directed at a producer rather than a product could not "affect" the internal sale, offering for sale, purchase, etc. of domestic and imported products. Furthermore, if the formalistic approach advanced by Brazil were correct, it would be simple to entirely avoid the bedrock national treatment requirement of the multilateral trading system.

7.64. Additionally, there is a long line of jurisprudence confirming this view of Article III, extending back to the GATT era. As explained by the GATT panel in *US – Section 337*:

> The fact that Section 337 is used as a means for the enforcement of United States patent law at the border does not provide an escape from the applicability of Article III:4; ... *Nor could the applicability of Article III:4 be denied on the ground that most of the procedures in the case before the Panel are applied to persons rather than products,* since the factor determining whether persons might be susceptible to Section 337 proceedings or federal district court procedures is the source of the challenged products, that is whether they are of United States origin or imported.[466]

7.65. WTO panels and the Appellate Body also have made it clear that if the application of a governmental measure can potentially affect trade in products, then that measure is covered by the national treatment obligation contained in Article III:2 and III:4 of the GATT 1994, even if the measure is presented in the form of requirements on firms, producers, or production, as opposed to direct requirements on products. In this respect, for example, the Appellate Body in *China – Publications and Audiovisual Products* stated that measures that do not directly regulate goods or importation of goods but rather impose obligations on enterprises, can nonetheless be inconsistent with Article III:4, because they can affect trade in products.[467] Thus, Article III:4 of the GATT 1994 disciplines all measures that "affect" the internal sale, offering for sale, purchase, transportation, distribution, or use of products, in such a way that accords less favourable treatment to imported

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related to pre-market conditions that do not fall under the purview of Article III, they do not affect imported products in a manner inconsistent with Article III." Brazil's first written submissions, para. 184 (DS472) and para. 143 (DS497).

[463] See Brazil's first written submissions, paras. 176-185, 200-201, 224-231, 265-268, 329-333, 338-345, 384, 395-400, 477-480, 487-490, 547-548, 581-583, 585-586, 593-594 and 744-745 (DS472) and paras. 135-144, 156-157, 177-185, 206-208, 216-219, 279-283, 288-295, 325, 333-338, 413-414, 416-419, 424-427, 472-473, 497, 510, 516, 518-519, 525-527 and 675-676 (DS497). See also Brazil's opening statement at the first meeting, paras. 39-46. Brazil also argues that because the measures are outside the scope of Article III, the measures are not inconsistent with Article 2.1 of the TRIMs Agreement. Brazil's first written submissions, paras. 286-288, 292, 346-347, 380-381, 460-461, 479-480, 494, and 743-744 (DS472) and paras. 240-242, 296-297, 397-398, 431-432 and 675-676 (DS497).

[464] European Union's second written submission, paras. 12-20.

[465] Japan's second written submission, paras. 25-28.

[466] GATT Panel Report, *US – Section 337*, para. 5.10. (emphasis added)

[467] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 227.

products. The phrase "laws, regulations, or requirements" encompasses a variety of governmental measures, from mandatory rules which apply across the board, to government action that merely creates incentives or disincentives for otherwise voluntary action by private persons.[468]

7.66. Several other WTO disputes have concerned regulations affecting producers or production that also were found to be subject to the disciplines of Article III. In *Thailand – Cigarettes (Philippines)*, the challenged measure subjected resellers of imported cigarettes to VAT when they did not satisfy prescribed conditions for obtaining input tax credits necessary to achieve zero VAT liability. The Appellate Body found that "[w]hether such conditions are satisfied thus has a direct consequence for the amount of tax liability imposed on imported cigarettes". In *Indonesia – Autos*, the panel noted that "[u]nder the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product". The requirements imposed on those car manufacturers fell under the scope of Article III:2 of the GATT 1994 because of the discriminatory effect on imported products. Similarly, the panel in *India – Autos* found that an indigenisation requirement imposed on car manufacturers modified the conditions of competition in the market to the detriment of imported products and was therefore inconsistent with Article III:4. In *Argentina – Hides and Leather*, the panel addressed a tax collection mechanism that required the pre-payment of taxes limited to internal sales made by only certain taxable persons, so-called *agentes de percepción*, whilst in respect of import transactions a pre-payment obligation would arise without regard to who made them. The panel found that by requiring the pre-payment of the IVA (an indirect tax similar to a value-added tax) on imports by non-registered taxable persons when no pre-payment of the IVA or additional IVA payment of equal amount was required on internal sales to non-registered taxable persons, the responding party acted contrary to Article III:2, first sentence. In all of these disputes, the relevant measures were imposed on persons and not directly on products and the cited provisions of Article III continued to apply.

7.67. Brazil's general defence is categorical: that all measures directed at producers (so-called "pre-market" measures) are for that reason alone (and without regard to their actual or potential discriminatory market effects) entirely exempted from Article III.[469] However, in previous disputes such measures have been found to be inconsistent with Article III. As noted in paragraph 7.66 above, there are many such instances, and this general defence by Brazil thus fails.

7.68. Furthermore, because any trade-related investment measure that is inconsistent with Article III of the GATT 1994 is also inconsistent with the TRIMs Agreement, this defence by Brazil fails in respect of the claims under that Agreement.

7.69. The Panel further considers that such reasoning is equally applicable to claims under Article 3.1(b) of the SCM Agreement. In the Panel's view, whether a particular measure is a "pre-market" requirement is not determinative of whether or not the measure is within the scope of the SCM Agreement. Indeed, Brazil's interpretation would enable Members to circumvent their obligations under the SCM Agreement.

7.70. In light of the foregoing, the Panel concludes that Article III of the GATT 1994 is not *per se* inapplicable to certain measures, in particular "pre-market" measures directed at producers. For the same reasons, the Panel concludes that the TRIMs Agreement and the SCM Agreement are not *per se* inapplicable to such measures. The panel will therefore conduct its analysis of each of the challenged measures pursuant to the cited provisions of Article III and the TRIMs Agreement on a case-by-case basis.

7.2.2 Whether Article III:8(b) of the GATT 1994 exempts certain of the challenged measures from the disciplines of Article III of the GATT 1994 and related provisions

7.71. Brazil's second general defence to the claims under Article III of the GATT 1994 is that the disciplines of that Article are inapplicable to the Informatics and INOVAR-AUTO programmes because those programmes provide subsidies paid exclusively to domestic producers within the meaning of Article III:8(b) of the GATT 1994. According to Brazil, these alleged subsidies to producers are provided to offset the costs of participating in the programmes, do not pass through

[468] Panel Report, *China – Publications and Audiovisual Products*, para. 7.1512.

[469] See Brazil's first written submissions, para. 184 (DS472) and para. 143 (DS497). See also Brazil's first written submission, paras. 167 and 173 (DS472).

to the final products, and therefore do not affect the conditions of competition in the market, such that those measures are excluded from the scope of application of the disciplines of Article III of GATT 1994.[470]

7.72. The complaining parties argue that Article III:8(b) does not cover subsidies in the form of exempted or reduced taxes, and instead only exempts payments to domestic producers to the extent that such payments do not discriminate between domestic and imported goods.[471] The European Union also argues that the subsidies at issue in this dispute are not subsidies exclusively to domestic producers within the meaning of Article III:8(b), but rather benefit certain *products* and not producers.[472]

7.73. A number of third parties also have expressed views on this issue. Australia, Korea and Ukraine indicate that for a subsidy to be exempted from the disciplines of Article III, pursuant to Article III:8(b) of the GATT 1994, that subsidy must not discriminate between imported products and domestic products such that the competitive opportunities for imported products in the market are adversely affected.[473]

7.74. Other third parties have referred to Article III:8(b) in the context of interpreting Article 3.1(b) of the SCM Agreement. Canada and the United States rely on Article III:8(b) of the GATT 1994 to support their argument that Article 3.1(b) of the SCM Agreement permits the granting of production subsidies – including subsidies in the form of exempted or reduced taxes – to domestic producers, which necessarily includes the right to impose certain production requirements and production steps, so long as these production steps are required to be performed by the producer receiving the subsidy (i.e. all production steps must take place "under one roof").[474]

7.75. Brazil's argument therefore raises the question of the meaning and operation of Article III:8(b). Among the issues are the scope of the provision, and its role within the overall non-discrimination obligation in Article III. In particular, does Article III:8(b), as Brazil seems to argue, carve out of the application of Article III all subsidies paid exclusively to domestic producers on that basis alone, regardless of whether they introduce or are associated with discrimination based on the origin of products? Or instead does it only clarify, as the complaining parties and some third parties assert, that the act of paying subsidies exclusively to domestic producers by itself does not constitute inconsistency with the national treatment obligation in Article III, but only to the extent that such subsidies do not introduce an element of discrimination between domestic and imported products?

7.76. The Panel turns first to the text of Article III:8(b) of the GATT 1994:

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[470] Brazil's first written submission, paras. 174, 187-199, 289, 290-291, 328, 330, 346, 378, 401, 442, 460, 478, 494, 549-555, 557, 560, and 745 (DS472) and paras. 126, 143, 145-155, 239, 240-241, 277, 280, 296, 319, 397, 414, 431, and 475-483 (DS497). The Panel notes that Brazil argues that under the ICT programmes, the tax treatment afforded to domestic producers of *intermediate* products is not a subsidy because such tax treatment merely compensates for investment in research and development and other costs of compliance. Nevertheless, Brazil insists that if the panel disagrees with such reasoning, then their arguments in respect of domestic producers of *finished* products would also apply to producers of *intermediate* products. Brazil's first written submission, fn 120 (DS472) and fn 111 (DS497).

[471] European Union's second written submission, 23-33; Japan's second written submission, paras. 47-59. In particular, according to Japan, "Article III:8(b) does not categorically *exempt* all subsidies that are granted exclusively to domestic producers from the other paragraphs of Article III; rather, such subsidies may still be subject to the disciplines of the other paragraphs of Article III under certain conditions." Japan's second written submission, para. 50. (emphasis original)

[472] European Union's second written submission, para. 35.

[473] Australia's third party submission, paras. 12-15. Korea's third party statement, paras. 2-6; Ukraine's third party submission, para. 11.

[474] Canada's third party submission, para. 6 and fn 5; United States' third party statement, para. 12. According to Canada and the United States, such subsidies to domestic producers would *not* be subject to the disciplines of Article III of the GATT 1994, even if they amount to discrimination against imported products. However, both Canada and the United States consider that any discrimination resulting from subsidies to domestic producers that are contingent on the use of local content (in the form of products manufactured by domestic producers *other* than the subsidized producer) would constitute discrimination subject to the disciplines of Article III.

> The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

7.77. The Panel notes, first, that at a minimum the text of Article III:8(b) makes clear that subsidies given exclusively to domestic producers, do not *per se* and for that reason alone violate Article III of the GATT 1994. In fact, subsidies as such are not regulated by Article III, but rather by the provisions of Article XVI of the GATT 1994 and by the SCM Agreement. Indeed, all parties agree that Article III:8(b) implies that WTO Members can provide subsidies to their domestic producers without giving the same subsidies to foreign producers without falling afoul of the national treatment obligation of Article III.[475]

7.78. In this regard, the Panel notes that without Article III:8(b), Article III as a whole, and Article III:4 in particular, might be seen as prohibiting all subsidization that was provided only to domestic, and not to foreign, producers. This is because both Article III:1 (the overarching provision establishing the basic rule that is then further elaborated in the remaining paragraphs of Article III) and Article III:4 speak of, and discipline, *inter alia* regulatory measures "affecting" the sale, offering for sale, purchase, transportation, distribution, or use, of products. It is clear that a subsidy is a form of regulatory measure that can and often does "affect" the sale, purchase, etc. of products in ways that create advantages in the domestic market *vis-à-vis* products that have not benefited from the subsidy, including for example imported products. In fact, providing a competitive advantage in relation to market conditions is a typical intention behind subsidization. The "adverse effects" provisions of the subsidy disciplines in Article XVI of the GATT 1994 and the SCM Agreement are precisely aimed at the adverse trade effects that can be caused by the competitive advantages provided by subsidization. Thus, in the absence of a provision such as Article III:8(b), Article III:4 might be read to require governments of importing Members to provide subsidies to foreign competitor firms whenever they subsidize their own domestic firms; or alternatively to prohibit all subsidies provided only to domestic and not also to foreign producers. Such an approach would be inconsistent with the very existence of the SCM Agreement, which in principle permits subsidies, except for two precise types of prohibited subsidies (namely export subsidies and subsidies contingent upon the use of domestic goods), and contains no requirement that subsidies, to be permitted, must be provided to foreign as well as domestic recipients.

7.79. In sum, at a minimum, Article III:8(b) of the GATT 1994 makes explicit that Article III does not require subsidization of foreign producers in tandem with domestic producers. In other words, the provision of subsidies only to domestic producers and not to foreign producers cannot in itself be inconsistent with Article III. Such exclusive provision of subsidies (or any eventual effects therefrom in the domestic market) does not by itself constitute discriminatory treatment in respect of imported products of the type prohibited by Article III.

7.80. Brazil argues that Article III:8(b) stands for more than this principle, however, and that Article III:8(b) effectively *exempts* all tax and regulatory discrimination between imported and domestic products from the disciplines of Article III to the extent that the measures in question are subsidies to domestic producers. By contrast, the complaining parties, citing the panel report in *Indonesia – Autos*, argue that in order for any measure to be excluded from the disciplines of Article III pursuant to Article III:8(b), such a measure must "not have any component that introduces discrimination between imported and domestic products".[476]

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[475] European Union's second written submission, para. 29; Japan's second written submission, para. 50; Brazil's first written submission, paras. 186-199 (DS472) and paras. 145-155 (DS497).

[476] Brazil's second written submission, para. 39 (referring to Panel Report, *Indonesia – Autos,* para. 14.43). See also European Union's second written submission, paras. 29-30; Japan's second written submission, paras. 50-53. Brazil argued in its first written submission that "the Informatics Programme falls outside the scope of Article III of the GATT 1994, since it provides subsidies paid exclusively to domestic producers under Article III:8(b) of [the] GATT 1994", and that "[t]he provision as it is worded ('shall not prevent) means that if a measure is covered by Article III:8(b), it cannot be inconsistent with any provision in Article III". See Brazil's first written submissions, paras. 186-199 (DS472) and 145-155 (DS497). Brazil repeats this argument for all ICT programmes. See Brazil's first written submissions, paras. 328, 330, 346, 378, 401, 442, 460, 478, 494, 549-555, 557, 560, and 745 (DS472) and paras. 277, 280, 296, 319, 397, 414, 431, and 475-483 (DS497). Yet in its second written submission, Brazil concedes that for a measure to be covered by Article III:8(b) it "must not have any component that introduces discrimination between imported

7.81. Brazil's argument thus raises the more specific aspects of the relationship between the national treatment non-discrimination provisions in Article III of the GATT 1994, and the multilateral rules governing the provision of subsidies (contained in Article XVI of the GATT 1994 and the SCM Agreement). In particular, the issue is whether Brazil's reading of Article III:8(b) is the only one that avoids a conflict of law between the non-discrimination obligation in Article III of the GATT 1994 on the one hand, and the ability to subsidize domestic producers on the other hand.

7.82. In this regard, the Panel first notes that multilateral rules on subsidies have coexisted with those on national treatment – including the proviso in Article III (Article III:8(b)) that clarifies the nature of that coexistence – since the entry into force of the GATT 1947. The Panel does not consider that the adoption of the SCM Agreement altered this basic harmonious coexistence. Indeed, as discussed above, the negotiating history of the Uruguay Round suggests that the intention of Article 3.1(b) of the SCM Agreement was simply to codify the already-existing prohibition, pursuant to Article III:4 of the GATT 1994, of subsidies contingent on the use of domestic over imported goods. In this respect, the Panel recalls its discussion from paragraphs 7.39 to 7.49 above to the effect that the provisions on discrimination in Article III of the GATT 1994 and the provisions of the SCM Agreement can apply to the same measure simultaneously. Thus, in principle, there is no conflict between the non-discrimination rules in Article III of the GATT 1994 insofar as they apply to subsidies, and the rules that directly govern subsidies, including both Article XVI of the GATT 1994 and the provisions of the SCM Agreement.

7.83. The Panel considers the panel report in *Indonesia – Autos* to provide useful guidance on this point. Similar to this Panel's observations above, the panel in that dispute found, based on the WTO principle that all WTO provisions are generally cumulative and simultaneously applicable, that Article III and Article XVI of GATT coexist and deal with distinct matters and are simultaneously applicable: Article III is applicable to all forms of product discrimination and Article XVI deals generally with the conditional right of WTO Members to provide subsidies to their domestic producers, a principle reiterated in Article III:8(b) of GATT. The panel found in particular that a subsidy to domestic producers that introduces discrimination between imported and domestic like products is covered by – and inconsistent with - the provisions of Article III, by virtue of such product discrimination, i.e., that Article III:8(b) does not exempt it from that Article simply by virtue of being a subsidy to domestic producers. To the contrary, the panel found that Article III:8(b) confirms that subsidies to domestic producers do not violate Article III so long as they do not have any component that introduces discrimination between imported and domestic products.[477]

7.84. The Panel finds further support for this view of the scope, role and operation of Article III:8(b) in the language of the provision that constitutes its immediate context, namely Article III:8(a), which concerns the application of the substantive provisions of Article III to government procurement. In particular, Article III:8(a) states that the provisions of Article III "shall not *apply* to" government procurement whereas, by contrast, Article III:8(b) states that the provisions of Article III "shall not *prevent* the payment of subsidies exclusively to domestic producers".[478] This difference in wording suggests a different scope of application for Article III:8(b) compared to Article III:8(a). Thus, while discrimination resulting from government procurement is completely exempted from the application of Article III by virtue of Article III:8(a), Article III:8(b) stands for the more limited proposition that the national treatment obligation in Article III does not extend to, or prohibit, the act of limiting subsidization only to domestic (to the exclusion of foreign) producers.

7.85. Concerning the element of discrimination that could be introduced by a subsidy, as referred to by the panel in *Indonesia – Autos*, the language of Article III:8(b) itself confirms that even if a measure is a subsidy that is provided exclusively to domestic producers, this fact is not sufficient to remove the measure from the application of Article III. In particular in respect of measures based on product taxes (the kind of measure specifically at issue in this dispute), Article III:8(b)

and domestic products". Brazil's second written submission, para. 39. The Panel understands that Brazil has at a minimum in its first written submission argued that a production subsidy is exempted from the scope of the non-discrimination provisions in Article III, pursuant to Article III:8(b). The Panel therefore addresses this argument.

[477] Panel Report, *Indonesia – Autos*, paras. 14.43-14.46.

[478] Emphasis added.

indicates that WTO Members can provide subsidies exclusively to their domestic producers *using the proceeds of internal taxes or charges* so long as those taxes or charges are *applied consistently with Article III*. That is, a Member can collect a product tax on a non-discriminatory basis, and then use the funds collected to subsidize only its domestic producers, without violating Article III. The converse, which exactly contradicts Brazil's position, is that directly applying a product tax in a discriminatory fashion (i.e., in a manner "inconsistent with Article III" as a means of subsidizing domestic producers would violate Article III. Put another way, if, as Brazil argues, Article III:8(b) exempts tax discrimination from the scope of Article III, the reference in Article III:8(b) itself to "taxes and charges applied consistently with the provisions of [Article III]" would be meaningless. Thus, Article III:8(b) does not change the applicability of Article III to discriminatory application of a product tax, even where such a discriminatory application constituted a subsidy exclusively to domestic producers. Indeed, this point was explicitly debated during the negotiations of the Havana Charter, and a proposal that would have allowed precisely such discriminatory application of product taxes as a means of indirect subsidization of domestic producers was rejected.[479]

7.86. Nor are discriminatory non-tax regulatory measures that involve the provision of a subsidy exclusively to domestic producers, for that reason alone, placed outside the disciplines of Article III. In particular, the language of Article III:8(b) refers to Article III in its entirety, and not only to Article III:2. Furthermore, Article III:8(b) contains two examples of subsidies exclusively to domestic producers that would be consistent with Article III. The first of these is the tax-based measure referred to in the preceding paragraph, and the second is a non-tax based measure that is more in the nature of a "law, regulation, etc.", namely the provision of a subsidy through government purchase of domestic products. The *Italy – Agricultural Equipment* GATT dispute confirms the applicability of Article III:4 to non-tax-based subsidies that involve product discrimination. In that case, the subsidy was provided for the purchase of Italian tractors only (and not foreign tractors), and on that basis was found to discriminate against imported tractors in the manner prohibited by Article III:4. Article III:8(b) thus did not save the measure from the application of Article III:4 – it was found not to be a subsidy to tractor producers but to tractor purchasers, provided on the basis of their decision to purchase domestic rather than imported tractors. In the Panel's understanding, while the tractor subsidy could be viewed as a subsidy exclusively to domestic (rather than foreign) producers of agricultural goods, this fact would not and did not excuse from the applicability of Article III:4, pursuant to Article III:8(b), the product discrimination effected through the subsidy.

7.87. On the basis of the foregoing considerations, the Panel therefore proceeds with its analysis of the claims under the cited provisions of Article III of the GATT 1994 on the understanding that subsidies that are provided exclusively to domestic producers pursuant to Article III:8(b) of the GATT 1994 are not *per se* exempted from the disciplines of Article III of the GATT 1994.

7.88. The Panel does not prejudge at this stage whether the product-related aspects of any subsidies that it may find to exist under the challenged measures are discriminatory in a manner inconsistent with Article III:2, III:4 and III:5 of the GATT 1994. It suffices for the Panel to conclude that, in light of the foregoing, measures in the form of subsidies provided exclusively to domestic producers are not for that reason alone exempted from the disciplines of Article III of the GATT 1994, because for the reasons explained above, aspects of a subsidy resulting in product discrimination (including requirements to use domestic goods, as prohibited by Article 3.1 of the SCM Agreement) are not exempted from the disciplines of Article III pursuant to Article III:8(b). For the same reason, the Panel concludes that the measures at issue in this dispute are not *per se* exempted from the disciplines of Article 2.1 of the TRIMs Agreement.

[479] E/CONF.2/C.3/6, p. 17; E/CONF.2/C.3/A/W.32, p. 2. The Reports of the Committees and Principal Sub-Committees of the Interim Commission for the International Trade Organization concerning the provision of the Havana Charter for an International Trade Organization that corresponds to Article III:8(b) of the GATT 1994 state that: "nothing in Article 18 could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes". Interim Commission for the International Trade Organization, Reports of the Committees and Principal Sub-Committees: ICITO I/8, Geneva, September 1948, p. 66.

7.3 The ICT programmes

7.3.1 Claims under Article III:2 of the GATT 1994

7.3.1.1 Introduction

7.89. The European Union and Japan raise claims under Article III:2 of the GATT 1994, first sentence, with respect to certain aspects of the ICT programmes (i.e. Informatics, PADIS, PATVD, and Digital Inclusion). Specifically, the complaining parties allege that Brazil imposes a tax burden on imported ICT products in excess of that imposed on domestic like products.

7.90. Japan also raises claims under the second sentence of Article III:2 of the GATT 1994 with respect to certain aspects of the ICT programmes.

7.91. As developed in paragraphs 7.61 and 7.71 above, Brazil argues that these aspects of the challenged programmes are not within the scope of Article III:2, because (i) these aspects of the programmes are pre-market requirements that are not covered by Article III, and (ii) the programmes constitute subsidies paid exclusively to domestic producers within the meaning of Article III:8(b) of GATT.[480]

7.92. The Panel has considered Brazil's threshold arguments in sections 7.2.1 and 7.2.2 above. With respect to Brazil's first argument, the Panel already concluded in paragraph 7.70 above that the fact of the measures' status as a "pre-market" requirement does not have an impact on whether the measure is within the scope of Article III:2 of the GATT 1994.

7.93. With regards to Brazil's second argument, i.e. that the programmes constitute subsidies to domestic producers within the meaning of Article III:8(b) of the GATT 1994, the Panel recalls its finding in paragraph 7.87 above that, as a general principle, Article III:8(b) does not exempt from the substantive disciplines of Article III components of such production subsidies that introduce tax discrimination on imported like products.

7.94. Brazil also distinguishes in its defence with respect to the ICT programmes between finished and intermediate products. In this respect, Brazil states, and the complaining parties have not disputed, that the digital television (TV) transmitting equipment under the PATVD programme; all the digital consumer goods under the Digital Inclusion programme; and 70% of the product coverage of the Informatics programme fall under the "finished products" category. Accordingly, 30% of the products under the Informatics programme, and all of the products under the PADIS programme fall under the "intermediate products" category.[481] Although Brazil does not explicitly define the meaning of the term "intermediate products", the Panel understands from the parties' submissions that "intermediate products" refers to products that require further manufacturing to produce a finished product.[482]

7.95. With respect to finished ICT products, Brazil argues that any possible difference in taxation aims at compensating accredited companies for the costs they must incur in order to meet the requirements provided for in the challenged programmes.[483] With respect to intermediate ICT products, Brazil contends that there is no difference in the tax burden on imported products compared to domestic products, because its tax system is neutral in terms of tax collection throughout the production chain.[484]

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[480] Brazil's first written submissions, paras. 176-199, 327-328, 330, 377-378, 380-381, 477-479 (DS472) and 135-155, 276-277, 280, 318-19, 322-323, 405, 414, 427, and 477 (DS497).

[481] Brazil's first written submissions, paras. 267 (DS472) and 218 (DS497).

[482] Japan's second written submission, paras. 141-142; Brazil's response to Panel question No. 24, Brazil's comments on the other parties' responses to Panel question No. 65

[483] Brazil's first written submissions, paras. 156 and 205 (DS472) and 105 and 161 (DS497).

[484] Brazil's first written submissions, paras. 185 (DS472) and 144 (DS497). Brazil also argues that in practice the tax rates of intermediate imported products are always identical or lower than the tax rates applicable to domestic intermediate products, although Brazil argues that it never undertook the affirmative burden of establishing identical or lower taxation. See Brazil's second written submission, paras. 88-89; Brazil's comments on the European Union and Japan's requests for review of the interim panel report, para. 22.

7.96. For the complaining parties, the distinction between "finished" and "intermediate" products is irrelevant because Article III:2 of the GATT 1994 refers to "products" in general, without making any further distinction.[485]

7.97. The Panel notes that "intermediate products" is not treaty language. Article III:2 of the GATT 1994 does not make any distinction between finished or intermediate products; it simply refers to "products" in general. Therefore, the Panel is of the view that both categories of products (i.e. finished and intermediate goods) are subject to the disciplines of Article III:2 of the GATT 1994. However, to the extent that the relevant taxes operate differently with respect to finished and intermediate products, as stated by Brazil, the Panel believes that it is useful for its analysis to maintain this distinction in order to better scrutinize the effective tax burden imposed by Brazil on these two categories of products. For the purposes of its analysis, the Panel's references to "intermediate products" should therefore be understood as referring to products that are subject to further industrialization in the manufacturing process of another product.

7.98. Article III:2 of the GATT 1994 enshrines the national treatment obligation with respect to internal taxes and other internal charges. Article III:2 and its *Ad Note*[486] read as follows:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*
>
> Ad Article III
>
> A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

7.99. Based on the language of Article III:2 and its *Ad Note*, the Appellate Body established that the national treatment obligation with respect to internal taxes and other internal charges includes two separate obligations. The first obligation is contained in the first sentence and refers to "like products". The second obligation is provided for in the second sentence of Article III:2 and covers "directly competitive or substitutable products".[487]

7.100. The Appellate Body has established that in order to determine whether there is an inconsistency with the first sentence of Article III:2 of the GATT 1994, two questions need to be answered:

a. Whether imported and domestic products are like products; and

b. Whether the imported products are taxed in excess of the domestic products.[488]

7.101. In addition, the Panel notes that in this dispute, a fundamental issue raised by Brazil concerns whether the products receiving the challenged tax treatment are "domestic products", within the meaning of Article III:2. The Panel therefore will address this first. Then, the Panel will

[485] European Union's second written submission, para. 289; European Union's response to Panel question No.48; Japan's second written submission, para. 141; and Japan's response to Panel question No. 42.

[486] Annex I to the GATT contains the 'Notes and Supplementary Provisions'. The portions of the text of the GATT marked with an asterisk should be read in conjunction with notes and supplementary provisions in Annex I of the Agreement.

[487] See Appellate Body Reports, *Japan – Alcoholic Beverages II*, pp. 18-31, DSR 1996:I, 97, at pp. 111-123; and *Canada – Periodicals*, pp. 25-29, DSR 1997:I, 449, at pp. 470-474.

[488] Appellate Body Report, *Canada – Periodicals*, pp. 20–23, DSR 1997:I, 449, at pp. 465-468. See also Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 19–20, DSR 1996:I, 97, at pp. 111-115.

consider the two questions above, to determine whether the internal tax or charge is inconsistent with the first sentence of Article III:2 of the GATT 1994.[489]

7.102. As regards the second sentence of Article III:2 of the GATT 1994, the Appellate Body has established that three separate issues must be addressed:

a. Whether the imported products and the domestic products are "directly competitive or substitutable products";

b. Whether the directly competitive or substitutable imported and domestic products are "not similarly taxed"; and

c. Whether the dissimilar taxation of the directly competitive or substitutable imported and domestic products is "applied ... so as to afford protection to domestic production".

7.103. If the answers to these three questions are affirmative, then the internal tax or internal charge shall be found to be inconsistent with the second sentence of Article III:2 of the GATT 1994.

7.104. Before starting the legal analysis under each of the two sentences of Article III:2, it is important to clarify that, for a measure to fall within the scope of Article III:2, it must qualify as an internal tax or an internal charge.[490] In this connection, the Appellate Body has explained that the time at which a charge is collected or paid is not decisive for a tax or charge to qualify as "internal" within the meaning of Article III:2.[491]

7.105. In the present dispute, the parties agree that the challenged measures are taxes.[492] The relevant taxes under this claim are four indirect taxes levied by the Federal Government of Brazil[493]: (i) the Tax on Industrialised Products (IPI); (ii) the Social Integration Programme contribution (PIS); (iii) the Civil Service Asset Formation Programme contribution (PASEP); and (iv) the Contribution to Social Security Financing (COFINS).[494] The table below summarizes which taxes are relevant with respect to each of the programmes challenged under Article III:2 of the GATT 1994:

RELEVANT TAXES PER ICT PROGRAMME[495]				
Programme → Tax ↓	Informatics	PADIS	PATVD	Digital Inclusion
IPI	X	X	X	
PIS/PASEP		X	X	X
COFINS		X	X	X

[489] Appellate Body Report, *Canada – Periodicals*, pp. 20–23, DSR 1997:I, 449, at pp. 465-468.

[490] See Appellate Body Reports, *China – Auto Parts*, para. 163: "…a key indicator of whether a charge constitutes an 'internal charge' within the meaning of Article III:2 of the GATT 1994 is 'whether the obligation to pay such charge accrues because of an *internal* factor (e.g., because the product was *re-sold* internally or because the product was *used* internally), in the sense that such 'internal factor' occurs *after the importation* of the product of one Member into the territory of another Member'".

[491] Appellate Body Reports, *China – Auto Parts*, para. 162.

[492] See European Union's first written submission, paras. 771, 918 and 1059; Japan's first written submission, paras. 10-16; Brazil's first written submissions, paras. 59 (DS472) and 23 (DS497). The European Union and Japan have raised an alternative claim under Article II:1(b) of the GATT 1994 with respect to the four ICT programmes (Informatics, PADIS, PATVD and Digital Inclusion) in the event that Brazil contends that PIS/PASEP-Importation and COFINS-Importation are not taxes but "other duties and charges" on imports within the meaning of Article II:1(b) of the GATT 1994. Since Brazil has not argued that PIS/PASEP-Importation and COFINS-Importation are "other duties and charges" within the meaning of Article II:1(b), the Panel shall not address these particular claims. See European Union's first written submission, para. 1149; and Japan's first written submission, fn 26 to para. 14.

[493] According to Brazil, the Brazilian tax system has different types of taxes. Taxes are collected at the federal, state and municipal levels. In Brazil, the three levels of government may impose taxes and fees related to state police powers and public services, and "improvement charges" to fund public works. See Brazil's first written submissions, paras. 59 (DS472) and 23 (DS497).

[494] For ease of reference, and following the parties' practice, the Panel will refer to the PIS and the PASEP contributions jointly by using the term PIS/PASEP.

[495] See European Union's first written submission, paras. 613, 774, 920 and 1074.

7.106. Finally, a demonstration of inconsistency with Article III:2 can be made on a *de jure* or *de facto* basis. The Appellate Body in *US – COOL* stated:

> As under Article III:4, the national treatment obligation of Article 2.1 [TBT] prohibits both *de jure* and *de facto* less favourable treatment. That is, "a measure may be *de facto* inconsistent with Article 2.1 even when it is origin-neutral on its face." In such a case, the panel must take into consideration "the totality of facts and circumstances before it", and assess any "implications" for competitive conditions "discernible from the design, structure, and expected operation of the measure". Such an examination must take account of all the relevant features of the market, which may include the particular characteristics of the industry at issue, the relative market shares in a given industry, consumer preferences, and historical trade patterns. That is, a panel must examine the operation of the particular technical regulation at issue in the particular market in which it is applied.[496]

7.107. The Panel shall in turn proceed with its analysis of the complaining parties' claims under Article III:2, first sentence, of the GATT 1994.

7.3.1.2 Whether the products that are the subject of the challenged measures are "domestic products" in the sense of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement

7.108. A first issue that the Panel needs to address is whether the products that are the subject of the challenged measures – that is the incentivized finished and intermediate products and (at least some of) the inputs used to produce them – are "domestic products" for purposes of the cited provisions. This is because some of those provisions juxtapose the treatment of "domestic" and "imported" products. The Panel addresses here the issue of whether the incentivised products can be considered to be "domestic" within the meaning of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement and Article 3.1(b) of the SCM Agreement.

7.109. While there seems to be no difference of views among the parties as to which are the imported products allegedly discriminated against by the challenged measures, Brazil has argued in the context of at least some of the claims that the incentivized products and their inputs are not "domestic" products in the sense of the cited provisions.[497] In Brazil's view, the term "domestic" is not defined in the covered agreements, and must be established on a "case-by-case" basis, in light of the object and scope of specific provisions, and in the factual content of each situation.[498] Brazil considers that the term domestic cannot be interpreted in a manner that would prevent Members from "conferring subsidies to producers contingent upon the performance of production steps of goods in their territory, including those that are meant to be integrated into a local production chain."[499] Brazil argues that a determination of whether a product is "domestic" must be assessed in an "economic" sense, taking into account such factors as the characteristics of the product and sector, and the valued added in the territory of a Member.[500] In Brazil's view, "a product produced according to a PPB cannot be equated with a domestic product", within the meaning of the covered agreements.[501]

7.110. The Panel recalls that Article III:2 of the GATT 1994 prohibits the application to imported products of taxes or internal changes in excess of those applied to like "domestic" products. Article III:4 of the GATT 1994 prohibits less favourable treatment of imported products pursuant to laws, regulations, etc. than that accorded to like products of "national origin". Similarly, Article 2.1 provides that TRIMs that are inconsistent with Article III of the GATT 1994 also are inconsistent with the TRIMs Agreement. Thus, this provision incorporates by reference the concepts of "domestic" products found in the various provisions of Article III. In addition, paragraph 1(a) of the Annex to the TRIMs Agreement prohibits TRIMs that require the purchase or use of "products of domestic origin or from any domestic source". Article 3.1(b) of the SCM Agreement prohibits subsidies contingent on the use of "domestic" over imported goods.

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[496] Appellate Body Report, *US – COOL*, para. 269. (emphasis added)
[497] Brazil's second written submission, paras. 28-37.
[498] Brazil's second written submission, para. 30.
[499] Brazil's second written submission, para. 31.
[500] Brazil's second written submission, para. 32.
[501] Brazil's second written submission, paras. 34-36.

7.111. In the view of the Panel, given the overlapping nature of the cited provisions, as explained above in section 7.1.2.2, a good that is domestic for purposes of one of those provisions normally should be domestic for the others. Article III as a whole is concerned with, and prohibits, discriminatory treatment of imported goods *vis-à-vis* domestic goods. The Panel considers that, to be internally coherent, all of the paragraphs of Article III of the GATT 1994 (and by extension Article 2.1 of the TRIMs Agreement insofar as it refers to Article III) should be based on the same understanding of these concepts. Article 2.1 of the TRIMs Agreement concerns TRIMs that are inconsistent with Article III of the GATT, and Paragraph 1(a) of the Annex to the TRIMs Agreement, in its turn, concerns discriminatory treatment of imported goods that is inconsistent with Article III. Thus, given these cross-references in the TRIMs Agreement, the concepts of imported and domestic goods (in the words of that Agreement "products of domestic origin"[502]) must be the same as in Article III of the GATT 1994. Similarly, the prohibition in Article 3.1(b) of the SCM Agreement of subsidies that are contingent on the use of domestic over imported goods is a codification of that same rule pursuant to Article III:4 of the GATT 1994, meaning that again these concepts in this provision of the SCM Agreement should be the same as those in Article III:4, and thus by extension Article III as a whole. In other words, given the overlaps among these provisions, it would be incoherent for the concept of domestic goods to vary from one to another.

7.112. The Panel notes further that the complaining parties in this dispute have raised multiple claims under both Article III:4 of the GATT 1994 and under the TRIMs Agreement. *A fortiori*, therefore, a good that is domestic for one kind of claim pursuant to Article III:4 of the GATT 1994 must also be domestic for any other claims pursuant to the same provision.

7.113. The Panel recalls that in their specific arguments for the Article III:2 claims and for the claims related to accreditation requirements pursuant to Article III:4 and Article 2.1 of the TRIMs Agreement, the parties express no disagreement on this issue, and thus seem to accept that the incentivized products are domestic for purposes of those claims. In the Panel's view, based on the considerations outlined above, this lack of disagreement would be sufficient to compel a conclusion by the Panel that the same is true, *ipso facto*, for the same products in the context of the claims regarding the alleged requirements to use domestic goods pursuant to Article III:4 of the GATT 1994, paragraph 2(a) of the Annex to the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement.

7.114. Given that Brazil has raised specific arguments to the contrary in respect of those claims, however, the Panel also must address those arguments. In short, Brazil argues that a product produced according to a PPB[503] cannot be equated with a domestic product within the meaning of WTO law, because such a product is simply a product produced according to specific production step requirements.[504] The complaining parties counter that all products are either domestic or imported, such that by excluding imported products from eligibility under the challenged programmes, those programmes discriminate in favour of domestic products in ways prohibited by the cited provisions.[505]

7.115. For the further reasons to be explained below, the Panel finds that the incentivized products produced in accordance with PPBs are, as such, Brazilian domestic products. First, it is clear that on their own terms the challenged programmes are for the development of Brazilian industries to produce the incentivized products. To qualify for the incentives, those products must be produced in Brazil in accordance with the respective PPBs. In this sense, the programmes treat these goods, and only these goods, as "Brazilian enough" in the eyes of the government to qualify for the tax incentives.

7.116. The PPBs make clear that to qualify as an incentivized product, the production process, all of which must be carried out in Brazil, starts with basic raw materials and components unassembled and in many cases unmanufactured. For example, basic components must be welded

[502] The Panel notes that paragraph 1(a) to the TRIMs Agreement refers to "products of domestic origin or from any domestic source". Given that this dispute concerns measures conditioned on the completion of certain manufacturing steps in Brazil, the Panel refers here only to the former phrase "products of domestic origin".

[503] See section 7.3.2.2.4.1 below for a full discussion and explanation of PPBs.

[504] Brazil's second written submission, paras. 28-37.

[505] European Union's second written submission, paras. 406-415.

together to make printed circuit boards; plastics and molds must be used to make injection-molded parts, etc.[506]

7.117. The PPBs describe in relatively general terms of this sort the sequence of steps that must be followed in converting the basic raw materials and components into the incentivized products. What is fundamental is that this manufacturing process, starting with basic materials and resulting in an intermediate or finished good to be sold on the market, must take place in Brazil. This leaves no doubt that these products are Brazilian domestic products. It also is indisputable, by the nature of the PPBs and the requirement that the operations that they describe be undertaken in Brazil, that identical imported products could never comply with these requirements.[507] This further underscores that the incentivized products, i.e., the products produced in compliance with a PPB or analogous production step requirements, are Brazilian domestic products, for purposes of all of the claims in this dispute where this is a relevant issue.

7.3.1.3 Whether the imported and domestic products are "like products" within the meaning of Article III:2, first sentence

7.118. The European Union and Japan argue that the relevant imported and domestic ICT products are like because the differential treatment provided for in the ICT programmes is based exclusively on the origin of the products.[508] In this respect, the European Union argues that the distinctions are drawn based on the place of production of the products (or some production steps); the origin of the components; the obligations undertaken by companies to invest in research and development (R&D) engineering, as well as industrial technology and technological development in Brazil; compliance with the relevant basic production processes (PPBs); and establishment in Brazil.[509]

7.119. In the complaining parties' view, the fact that the differential treatment is exclusively based on the origin of the products at issue precludes the need to examine the four traditional likeness criteria. In any event, the European Union argues that the examination of the four traditional likeness criteria confirms that the products at issue are like because the products (i) are identified based on the Mercosur Common Nomenclature (MCN)[510]; (ii) have similar physical characteristics; (iii) have the same end uses; and (iv) generally attract the same consumers.[511]

7.120. Although Brazil does not take a definite position with regard to the likeness of the products at issue[512], it argues that the tax reductions and exemptions under these programmes do not relate to the origin of the products but to the costs that manufacturers must incur in order to benefit from the ICT programmes.[513] Therefore, Brazil considers that the complaining parties have not demonstrated that the programmes draw origin-based distinctions. For Brazil, the complaining parties have failed to demonstrate that the products at issue are like within the meaning of Article III:2 of the GATT 1994, first sentence.[514]

7.121. The Panel recalls that the concept of "like products" is present in various provisions of the covered agreements. As stated by the Appellate Body, this concept is "a relative one that evokes the image of an accordion … that stretches and squeezes in different places as different provisions of the WTO Agreement are applied".[515]

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[506] See, for example, Implementing Order 146/2010, (Exhibit BRA-116).

[507] See paragraphs 7.135 and 7.136 below.

[508] European Union's first written submission, paras. 326 and 596; and Japan's first written submission, paras. 330, 335, 397, 401, 457, 459, 511 and 515.

[509] European Union's first written submission, paras. 598, 606, 775, 920, 927 and 1070.

[510] European Union's first written submission, para. 608.

[511] European Union's first written submission, paras. 608, 776, 929 and 1072.

[512] Brazil's first written submissions, paras. 211-215, 334 and 483 (DS472) and 167-169, 284 and 420 (DS497). See also Brazil's response to the European Union's question No. 4.

[513] Brazil's first written submissions, paras. 203-204 (DS472) and 159-160 (DS497).

[514] Brazil's first written submissions, paras. 208 and 394 (DS472) and 164 and 331-332 (DS497). Brazil applies *mutatis mutandis* the same arguments developed under the Informatics programme to the PADIS and Digital Inclusion programmes. See Brazil's first written submissions, paras. 334-335 and 483-484 (DS472) and 284-285 and 420-421 (DS497).

[515] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:I, 97, at p. 114.

7.122. The Appellate Body has explained that within the context of Article III:2, first sentence, the concept of like products must be construed narrowly based on the existence of a second sentence in Article III that deals with directly competitive or substitutable products. It has also stated that how narrowly the term "like products" is to be construed is a matter to be determined separately for each tax measure on a case-by-case basis[516], by examining relevant factors[517] including those criteria mentioned in the Working Party Report on *Border Tax Adjustments*, namely: (i) the product's properties, nature and quality; (ii) the product's end-uses in a given market; and, (iii) consumers' tastes and habits that change from country to country.[518] In addition to those three factors, a fourth relevant criterion in order to determine likeness is the tariff classification of the products at issue.[519]

7.123. The Panel also recalls that the Appellate Body has recognized that a determination of likeness involves "an unavoidable element of individual, discretionary judgement" by the panel[520] and that the different likeness criteria are interrelated "although each criterion addresses, in principle, a different aspect of the products involved, which should be examined separately".[521]

7.124. The Panel finds particularly relevant for the present claim the likeness analysis undertaken by numerous panels, which have found that, when a measure makes a distinction between products based exclusively on the origin of the products, the likeness of such products can be presumed. In particular, the panel in *Indonesia – Autos* found that:

> In *Periodicals*, the Appellate Body recognized the possibility of using hypothetical imports to determine whether a measure violates Article III:2, although in that case the Appellate Body rejected the hypothetical example used by the Panel.[522] But this case is different. Under the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product. Appropriate hypotheticals are therefore easily constructed. An imported motor vehicle alike in all aspects relevant to a likeness determination would be taxed at higher rates simply because of its origin or lack of sufficient local content. Such vehicles certainly can exist… In our view, such an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2, without the need to demonstrate the existence of actually traded like products.[523]

7.125. As noted by the Appellate Body, panels have applied such a "presumption" of likeness with respect to Articles III:2, III:4 and I:1 of the GATT 1994.[524] According to this approach, "a

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[516] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 19–21, DSR 1996:I, 97, at pp. 112-114.

[517] Appellate Body Report, *Canada –Periodicals*, p. 21, DSR 1997:I, 449, at p. 466.

[518] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 20–21, DSR 1996:I, 97, at pp. 113-114. See also Border Tax Adjustment Working Party Report, BISD 18S/97, para. 18.

[519] This criterion was also used in GATT disputes such as *EEC - Measures on Animal Feed Proteins*, BISD 25S/49; and *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83. See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:I, 97, at p. 114.

[520] It referred to the likeness criteria cited in the Border Tax Adjustment Working Party Report as well as any other criterion that might be relevant. See Appellate Body Report, *EC – Asbestos*, para. 101 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:I, 97, at p. 114).

[521] In this connection, the Appellate Body explained that:

> [T]he adoption of a particular framework to aid in the examination of evidence does not dissolve the duty or the need to examine, in each case, all of the pertinent evidence. … For instance, the physical properties of a product shape and limit the end-uses to which the products can be devoted. Consumer perceptions may similarly influence – modify or even render obsolete – traditional uses of the products. Tariff classification clearly reflects the physical properties of a product. Appellate Body Report, *EC – Asbestos*, para. 102.

[522] (original footnote referring to Appellate Body Report, *Canada – Periodicals*, pp. 20-21, DSR 1997:1, 449, at pp. 466-467).

[523] Panel Report, *Indonesia – Autos*, para. 14.113.

[524] Appellate Body Report, *Argentina – Financial Services*, para. 6.36 (referring to Panel Reports, *Argentina – Hides and Leather*, para. 11.168; *China – Auto Parts*, para. 7.216; *Argentina – Import Measures*, para. 6.274; *Canada – Autos*, para. 10.74; *Canada – Wheat Exports and Grain Imports*, para. 6.164; *China – Publications and Audiovisual Products*, para. 7.1447; *India – Autos*, para. 7.174; *Thailand – Cigarettes (Philippines)*, para. 7.661; *Turkey – Rice*, paras. 7.214-7.216; and *US – FSC (Article 21.5 – EC)*, paras. 8.132-8.135), *Colombia – Ports of Entry*, paras. 7.355-7.356; and *US – Poultry (China)*, paras. 7.424-7.432).

complainant may establish 'likeness' by demonstrating that the measure at issue makes a distinction based exclusively on the origin of the product".[525]

7.126. The Appellate Body, in the context of a dispute involving claims under the General Agreement on Trade in Services, has provided further clarification on the operation of such "presumption" of likeness by stating the following:

> Once a complainant has made a *prima facie* case that a measure draws a distinction between services and service suppliers based exclusively on origin, the respondent may rebut this by demonstrating that origin is indeed not the exclusive basis for the distinction drawn by the measure between the services and service suppliers at issue. Alternatively, or in addition, a respondent may seek to rebut the *prima facie* case based on the presumption approach by introducing arguments and evidence relating to the criteria for determining "likeness" adapted to trade in services, as explained above, demonstrating that a certain factor affects the relevant criteria for establishing "likeness", and that it therefore has an impact on the competitive relationship between the services and service suppliers.[526]

7.127. In light of this statement by the Appellate Body, the Panel shall examine whether the complaining parties have made a *prima facie* case that the relevant ICT programmes draw distinctions between the relevant products based exclusively on origin. If the Panel finds that the complaining parties have made such *prima facie* case, the Panel shall then examine whether Brazil has successfully rebutted the *prima facie* case made by the complaining parties. The Panel shall start its analysis, however, by defining the products at issue in this dispute for the purposes of its analysis under Article III:2. Only by identifying the products at issue shall the Panel be in a position to determine whether they are like within the meaning of Article III:2, first sentence, of the GATT 1994.

7.128. The complaining parties have identified the following products at issue under their Article III:2 claims related to the ICT programmes:[527]

a. Informatics programme: both the European Union and Japan refer to the ICT products listed in Annex I of Decree 5,906/2006, as amended by Decree 7,010/2009.[528]

b. PADIS programme: the European Union and Japan identify the following products within the scope of the PADIS programme: (i) semiconductors listed in Annex I of Decree 6,233/2007; (ii) displays listed in Annex I of Decree 6,233/2007; and (iii) inputs and equipment, which are strategic for the semiconductors and displays industry, produced in accordance with the relevant PPB, listed in Annex I of Decree 6,233/2007, as amended by Decree 8,247/2014. In addition, Japan identifies the products listed in Annex II of Decree 6,233/2007, as amended by Decree 8,247/2014.

c. PATVD programme: the European Union and Japan refer to the digital TV transmission equipment listed in Annex I of Decree 6,234/2007.

d. Digital Inclusion programme: the European Union and Japan refer to digital consumer goods listed in Article 28 of Law 11,196/2005 (as amended by Laws 12,715 and 13,241/2015) and Article 1 of Decree 5,602/2005 (as amended by Decrees 7,715/2012 and 7,981/2013).[529]

7.129. Before considering the issue of likeness, the Panel considers Brazil's claim that not all the products covered under the relevant programmes are relevant for the Panel's analysis. In particular, Brazil argues that not all the products identified by the complaining parties benefit from

[525] Appellate Body Report, *Argentina – Financial Services*, para. 6.36.
[526] Appellate Body Report, *Argentina – Financial Services*, para. 6.45.
[527] See European Union's and Japan's responses to Panel question No. 71.
[528] Japan further notes that those products falling under Annex I of Decree 5,906/2006 (as amended by Decree 7,010/2009) which fall under Annex II of Decree 5,906/2006 (as amended by Decree 6,405/2008) are not covered under the Informatics programme. See Japan's response to Panel question No. 71.
[529] The European Union also refers to Article 2 of Decree 5,602/2005. See European Union's response to Panel question No. 71 (referring to European Union's first written submission, para. 1034).

the alleged tax advantages because PPBs are not adopted for all products and, therefore, manufacturers cannot comply with all the requirements that must be met in order to benefit from the tax advantages.[530]

7.130. According to Brazil, the products at issue under the complaining parties' Article III:2 claims with respect to the ICT programmes are the following:[531]

a. Informatics programme: products covered under this programme for which PPBs have been adopted.[532]

b. PADIS programme: products covered under this programme for which certain manufacturing activities are performed in Brazil.[533]

c. PATVD programme: transmission equipment for digital TV manufactured in accordance with the PPB established by Implementing Order 62/2014.[534]

d. Digital Inclusion programme: products covered under this programme manufactured in accordance with the corresponding PPBs.[535]

7.131. The Panel agrees with Brazil that not all of the products covered under the challenged programmes currently benefit from the tax reductions and exemptions provided for in the ICT programmes. In this regard, the fact that a certain product falls under the product scope of a specific ICT programme does not automatically entail that this product does benefit at the moment from a tax reduction or exemption. In order for any product covered under the relevant ICT programmes to benefit, accredited companies must comply with certain requirements relating to their manufacture or must reach a certain level of investment in Brazil, as indicated in the descriptive part of this report.[536]

7.132. However, the Panel understands that the fact that not all of the products covered under the programmes currently benefit from the tax reductions and exemptions does not mean that these products should be, or are, excluded from the product scope of this dispute. Indeed, the fact that the products at issue fall under the scope of the challenged ICT programmes means that the tax reductions and exemptions challenged by the complaining parties could potentially apply to these products, if the relevant requirements were to be met. In this respect, the Appellate Body has indicated that "Article III [of the GATT 1994] protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products."[537]

7.133. Consequently, the Panel does not consider that the product coverage of this dispute must be limited to those products covered under the challenged ICT programmes that at the time of the panel's establishment benefit from the tax reductions and exemptions provided therein. To the extent that all products falling under the challenged ICT programmes can potentially benefit from

[530] Brazil's comment on the complaining parties' responses to Panel question No. 71.

[531] Brazil's comment on the complaining parties' responses to Panel question No. 71. The Panel notes that although Brazil maintains that the relevant measures pertain to "producers" not "products", Brazil nonetheless indicates in its comments on the complainants' responses to Panel question No. 71 the list of products that, in its view, are the subject of the complainants' claims.

[532] Brazil has submitted to the Panel a list of all of the Implementing Orders for the existing PPBs for purposes of the Informatics Law with the description of the product subject to the PPB. See List of existing PPBs in Brazil concerning the Informatics Law, (Exhibit BRA-26).

[533] Brazil notes that "although the products at issue are listed in Annex I of Decree 6,233/2007, as amended, the tax incentives under PADIS will only be granted for semiconductors if the activities of 1) conception, development and design; 2) diffusion or physical chemical processing; or 3) encapsulation and testing, are performed; and, for information displays, if the activities of: 1) conception, development and design; 2) manufacturing of photosensitive, photo or electroluminescent elements and light emitting diodes; or 3) final assembly of displays and electrical and optical testing, are performed." Brazil's comment on the complaining parties' responses to Panel question No. 71.

[534] Implementing Order 62/2014, (Exhibit JE-89).

[535] Brazil states that "[t]o be eligible for the tax incentive under the program, a company must comply with the basic production processes for the manufacture of the products described under the corresponding PPBs." Brazil's comment on the complaining parties' responses to Panel question No. 71.

[536] See sections 2.2.1.5, 2.2.2.5, 2.2.3.5 and 2.2.4.4 above.

[537] Appellate Body Report, *Japan – Alcoholic Beverages II,* p. 16, DSR 1996:I, 97, at p. 110.

the tax reductions and exemptions at issue, the Panel is of the view that these products fall under the scope of the present claim.

7.134. Turning to the issue of likeness, the Panel notes that the ICT programmes, on their face, identify their product scope on the basis of the products' tariff codes in the Mercosur Common Nomenclature and not on the basis of their origin. No distinction between imported and domestic products can be found in the text of the ICT programmes. The Panel further observes that, in order for an ICT product to be subject to the tax treatment provided for in the challenged ICT programmes, companies must comply with one or more of the following requirements with respect to the relevant products[538]:

a. Invest in R&D in Brazil (in the case of the Informatics, PADIS, and PATVD programmes);

b. Manufacture in Brazil in accordance with the relevant PPBs (in the case of the Informatics, PADIS, PATVD, and Digital Inclusion programmes[539]) or carry out certain manufacturing steps in Brazil (in the case of the PADIS and PATVD programmes); and/or

c. Develop the products in Brazil[540] (in order to obtain additional tax reductions under the Informatics programme or to obtain tax exemptions (through zero rates) under the PATVD programme).

7.135. With respect to the requirement that ICT products be manufactured in accordance with the relevant PPBs, it is the Panel's view that only ICT products manufactured in Brazil can meet this requirement given that PPBs require that a certain number of manufacturing operations that characterize the effective "production" of a certain product be performed in Brazil.[541] This has been confirmed by Brazil.[542] The same goes for the requirement that certain manufacturing steps be performed in Brazil. Thus, by necessary implication, only a product manufactured in Brazil can benefit from the tax treatment under the ICT programmes. Identical imported products, which are manufactured outside Brazil, can therefore never qualify for the tax treatment under *any* of the ICT programmes since all ICT programmes contain such a requirement.

7.136. With respect to the requirement that products be "developed in Brazil", the relevant Implementing Order explains that in order to meet this requirement, the "specifications, projects and developments [of the products benefiting from the relevant tax treatment] must be carried out in Brazil".[543] Imported products that have been "developed" outside of Brazil, but are like domestic products developed in Brazil, can never meet this requirement, and therefore cannot qualify for the relevant tax treatment.[544]

7.137. As discussed in section 7.3.1.2 above, the Panel concludes that for the purposes of Article III:2 of the GATT 1994, all incentivized products that receive the tax treatment under the challenged programmes, can be considered to be Brazilian domestic products.

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[538] See sections 2.2.1.5, 2.2.2.5, 2.2.3.5 and 2.2.4.4 above.

[539] For Digital Inclusion, the tax exemptions relate to Brazilian retailers of certain digital consumer goods produced in accordance with the relevant PPBs.

[540] Implementing Order 950/2006 establishes that products "developed" in Brazil must comply with two requirements: (i) they must meet the specifications, rules and standards laid out in Brazilian legislation, and (ii) the specifications, projects and developments must be carried out in Brazil by technicians of proven skill in such activities who are residents and domiciled in Brazil. One of the pieces of information that the company developing the product in Brazil must provide is the National Registry of Legal Entities (*Cadastro Nacional da Pessoa Jurídica*, CNPJ number), which is an identification number issued to Brazilian companies by the Secretariat of the Federal Revenue of Brazil. Implementing Order 950/2006, (Exhibit JE-22), Articles 1-2.

[541] Brazil's first written submissions, paras. 128 (DS472) and 85 (DS497).

[542] Brazil's first written submissions, paras. 128 (DS472) and 85 (DS497).

[543] See footnote 228 above.

[544] Under the Informatics programme, products that have obtained the status of "developed in Brazil" are subject to additional tax reductions. See paragraph 2.43 above. One of the requirements for accreditation under the PATVD is to either comply with the relevant PPB or, alternatively, meet the criteria for a product to be considered "developed in Brazil". See paragraph 2.87 above. In addition, under the Digital Inclusion programme, the status "developed in Brazil" is required for client terminal equipment (digital routers) classified under MCN 8517.62.41 and 8517.62.77 with a retail sale value of less than R$ 150. See Law 11,484/2007, (Exhibit JE-71), Article 13 §1; and Law 11,196/2005, (Exhibits JE-91), Article 28(VIII).

7.138. The Panel further notes that Brazil has itself stated that "[f]oreign manufacturers established outside Brazil cannot be accredited companies under the Informatics, the PADIS and the PATVD programs" because the programmes confer subsidies to "domestic producers", that is, to companies that are located and operate in Brazil.[545]

7.139. Therefore, the Panel finds that the complaining parties have made a *prima facie* case that the differential tax treatment provided for in the challenged ICT programmes is exclusively based on the origin of the products and Brazil has not successfully rebutted the *prima facie* case of likeness made by the complaining parties.

7.140. In light of the foregoing, the Panel concludes that:

a. The complaining parties have successfully made a *prima facie* case that the different tax treatment between imported and domestic products resulting from the ICT programmes is based exclusively on the origin of the products; and

b. Brazil has not successfully rebutted the *prima facie* case made by the complaining parties.

7.141. The Panel, therefore, finds that domestic and imported ICT products are presumed to be like for the purposes of the analysis under Article III:2, first sentence, of the GATT 1994.

7.3.1.4 Whether imported products are "taxed in excess of" like domestic products, within the meaning of Article III:2, first sentence

7.142. Having determined that the products at issue are like for the purposes of its analysis under Article III:2, first sentence, the Panel shall proceed by examining whether the differential tax treatment established in the ICT programmes results in imported ICT products being taxed in excess of like domestic ICT products.

7.143. As noted above, the Panel will organize its analysis in line with the distinction raised by Brazil between "finished" and "intermediate" products in order to better scrutinize the effective tax burden imposed on these two categories of ICT products.[546]

7.3.1.4.1 Finished ICT products

7.144. With respect to *finished ICT products*, the European Union and Japan contend that, despite the fact that the TIPI provides for identical IPI tax rates for domestic and imported products, the final tax burden on products from non-accredited companies (i.e. imported products) is higher than on domestic like products, because the latter can be incentivized (i.e. receive the tax reductions or exemptions under the relevant programmes) if manufactured by an accredited company. As explained above, the complaining parties argue that imported products cannot benefit from the tax reductions or exemptions under the relevant programmes because they are not produced in Brazil by accredited companies that can comply with the relevant PPBs and conduct certain manufacturing steps in Brazil.[547] In addition, imported products that are developed outside Brazil cannot benefit from the tax exemptions under the PATVD and Digital Inclusion programmes or additional tax reductions under the Informatics programme.[548]

7.145. The European Union contends that the design, structure and operation of the ICT programmes necessarily impose a heavier tax burden on imported products than on like domestic products. Therefore, in its view there is no need to examine the IPI tax rates currently applicable to individual products according to the TIPI.[549]

[545] Brazil's response to Panel question No. 57.
[546] See section 7.1.1.2 above.
[547] See paragraph 7.135 above.
[548] See paragraph 7.136 above.
[549] European Union's second written submission, para. 291.

7.146. For its part, Brazil argues that the tax benefits granted under the ICT programmes offset the costs companies incur to fulfil the requirements of the programmes.[550]

7.147. The Panel recalls that the Appellate Body has clarified that it is irrelevant whether the taxation "in excess of" within the meaning of Article III:2 of the GATT 1994 is minimal or has no effects on trade. Even the smallest difference in taxation between imported and domestic products is inconsistent with the first sentence of Article III:2 of the GATT 1994:

> Even the smallest amount of "excess" is too much. "The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard."[551]

7.148. It has also been established that in order to determine whether imported products have been taxed "in excess of" like domestic products, it is not enough to look at the nominal tax rates applied but rather at the actual tax burden that both categories of products bear.[552]

7.149. The Panel starts its analysis by noting that in respect of *finished products*, neither the complaining parties nor Brazil question the fact that the challenged programmes establish different levels of taxation.[553] As acknowledged by the parties, the level of taxation on like imported and domestic finished products is different because of the tax reductions and exemptions provided for in the relevant ICT programmes. In this regard, the European Union argues that: "…the IPI rate resulting from the TIPI is in principle the same for imported and like domestic ICT products. Hence, the different level of taxation between imported and domestic products is not based on the product *per se*".[554] Brazil, for its part, argues that: "[t]he nominal difference in taxation between goods manufactured by producers accredited under the Programme and other products is not based upon the origin of such goods. The difference, when it exists, is related to the fulfil[]ment of the requirements of the programme".[555]

7.150. As noted above, the tax reductions and exemptions (including through zero rates) at issue apply to the relevant domestic ICT products, provided that the companies that manufacture these products, which must be located (and operate) in Brazil, fulfil certain requirements.[556] The Panel recalls that the relevant requirements under each programme are as follows:

a. Under the <u>Informatics programme</u>, accredited manufacturers must:

   i. Invest annually a percentage of their gross sales in the internal market resulting from commercialization of incentivized information technology goods and services in R&D in information and automation technology to be conducted in Brazil; and

   ii. Produce the information technology and automation goods in accordance with the terms of particular product-specific PPBs, which set out the necessary production steps or minimum set of operations to be carried out in Brazil; and

   iii. Obtain the status of "developed in Brazil"[557] if they want to enjoy additional tax reductions.[558]

b. Under the <u>PADIS programme</u>, accredited manufacturers must:

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[550] Brazil's first written submissions, paras. 97, 173, 196, 198, 327, 377, 477 (DS472) and 12, 62, 117, 125, 153, 276, 318, 413 (DS497).

[551] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 23, DSR 1996:I, 97, at p. 114.

[552] For example, by looking at the taxation methods. See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, 97, at p. 120 (referring to GATT Panel Report, *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.11).

[553] Brazil's first written submissions, paras. 336, 382 and 485 (DS472) and 286, 324 and 422 (DS497).

[554] European Union's first written submission, para. 597.

[555] Brazil's first written submission, para. 172 (DS497).

[556] For specific product coverage under each of the challenged programmes, please see sections 2.2.1.3, 2.2.2.3, 2.2.3.3 and 2.2.4.3 above.

[557] See footnote 544 above.

[558] See paragraph 2.43 above.

i. Invest annually a percentage of their gross sales in the internal market resulting from commercialization of incentivized products in R&D to be conducted in Brazil;[559] and

ii. Engage in the following activities in Brazil:

- With respect to semiconductor electronic devices[560]:
  - Concept, development and design;
  - Diffusion or physical-chemical processing; or
  - Cutting, encapsulation and testing.

- With respect to information displays[561]:
  - Concept, development and design;
  - Manufacture of photosensitive, photo or electroluminescent elements and light emitting diodes; or
  - Final assembly of displays and electrical and optical testing.

c. With respect to supplies and equipment intended for the manufacture of electronic semiconductor devices and information displays: manufacture in accordance with the relevant PPBs.[562]

d. Under the PATVD programme, accredited manufacturers must:

i. Invest annually a percentage of their gross sales in the internal market resulting from commercialization of incentivized products in R&D to be conducted in Brazil[563]; and

ii. Engage in developing and manufacturing activities of digital television transmission equipment (MCN code 8525.50.2); and

iii. Either comply with the relevant PPB or, alternatively, meet the criteria for a product to be considered "developed in Brazil".

e. Under the Digital Inclusion programme, companies that sell certain digital consumer goods at the retail level in Brazil shall benefit from the tax treatment under this programme provided that these goods are produced in accordance with the relevant PPBs.

7.151. The Panel noted above that only ICT products manufactured in Brazil can satisfy the requirements to benefit from the tax reductions or exemptions.[564] Imported finished ICT products will never be able to qualify for the tax reductions and exemptions established in the relevant ICT programmes, because such products are never manufactured in Brazil by companies located or operating in Brazil; such finished products are never produced in accordance with the relevant PPBs or similar production requirements. Additionally, imported products developed outside of Brazil will never be able to obtain the status of being "developed in Brazil" and thus will never be able to qualify for the additional reductions under the Informatics programme or meet the alternative accreditation requirement under the PATVD programme.[565] Consequently, imported ICT products, which are manufactured outside Brazil, will never be able to obtain the tax reductions and exemptions available to like domestic ICT products manufactured by accredited companies, under the challenged programmes.

7.152. The Panel notes that Brazil argues that the tax reductions and exemptions relate to the costs that companies must incur in order to fulfil the requirements of the programmes.[566] Brazil

[559] Investment must be made in the fields set out in Article 6 §1 of Law 11,484/2007, (Exhibit JE-71).
[560] See paragraph 2.76 and footnote 195 above.
[561] See paragraph 2.76 and footnote 196 above.
[562] See paragraph 2.76 and footnote 197 above.
[563] Investment must be made in the fields set out in Article 17 §1 of Law 11,484/2007, (Exhibit JE-71).
[564] See paragraph 7.135 above.
[565] See paragraph 7.136 above.
[566] Brazil's first written submissions, paras. 204 (DS472) and 160 and 172 (DS497).

asserts that the costs associated with the fulfilment of these requirements are higher than the benefits stemming from the programmes.[567] The complaining parties contest this argument.[568]

7.153. For the Panel, a tax incentive cannot be justified as offsetting a cost imposed through regulation, public policy or otherwise. The WTO-consistency of a tax is assessed on the basis of its applied level, which must be non-discriminatory, but otherwise WTO Members are free to choose the type of taxation they wish and they are free to calculate as they wish the components of such taxes – the WTO rules on taxes are limited to prohibiting their discriminatory application.[569] Furthermore, in light of the legal standard under Article III:2, first sentence, the Panel considers that a finding on the WTO-consistency of the measure is not based on any consideration of the rationale or justification for the measure. The justification for a (WTO-inconsistent) tax treatment can be assessed in the context of the general exceptions of Article XX of the GATT. In any case, were the Panel to accept that the costs imposed by the ICT programmes on accredited companies through the imposition of requirements should be taken into account in the analysis of consistency of these programmes, the Panel considers that Brazil has not demonstrated what these costs are, and how they relate to the tax advantage at issue. Brazil, as the party that asserted this fact, bears the burden of proving its assertion.[570] Brazil has not provided the Panel with enough data to demonstrate that the tax exemptions and reductions are justified to compensate for the costs linked to the requirements of the programmes.

7.154. In light of the above, the Panel concludes that, contrary to domestic finished ICT products manufactured in Brazil by accredited companies, like imported ICT finished products cannot benefit from the tax reductions and exemptions (including through zero rates) established in the ICT programmes and are, therefore, subject to a higher tax burden than like domestic ICT products. Consequently, the Panel finds that imported finished ICT products are taxed in excess of like domestic finished ICT products, contrary to Article III:2, first sentence, of the GATT 1994.[571]

7.3.1.4.2 Intermediate ICT products

7.155. With respect to *intermediate ICT products*, the European Union contends that domestic intermediate ICT products can benefit from tax reductions and exemptions when put on the market, whereas like imported intermediate ICT products will necessarily carry the full tax burden. In addition, the European Union argues that, even if the nominal value of the tax were the same at the end of the production cycle, the real value is not the same due to the cost of money over time. The European Union further adds that the interaction of the different challenged programmes operating together should be taken into account.[572]

7.156. Japan contends that domestic intermediate ICT products produced by accredited companies benefit from cash flow advantages (i.e. cash availability) *vis-à-vis* like imported intermediate ICT products. Japan argues that the purchase of incentivized domestic intermediate ICT products does not involve the payment of the tax, or involves a lower payment, because of the tax exemption or reduction, whereas the purchase of like imported intermediate ICT products requires the payment of taxes by the purchaser, notwithstanding that the purchaser gets a tax credit. Japan also refers to the time-value of money, "i.e. the cost that companies face in the absence of the ICT measures to pay up-front taxes on intermediate products and wait until a subsequent point in time to use the received credits that offset the up-front payments". Japan finally adds that Brazil's argument is not valid with respect to the cumulative regime of PIS/PASEP and COFINS given that the cumulative regime does not provide for offsets.[573]

7.157. Brazil submits that there is no difference in the tax treatment between intermediate ICT products manufactured by accredited and non-accredited companies. Brazil argues that tax reductions or exemptions of indirect taxes applied to intermediate ICT products manufactured by

[567] Brazil's first written submissions, paras. 173, 327, 377, and 477 (DS472) and paras. 117-118, 125, 153, 276, 318, and 413 (DS497).
[568] European Union's second written submission, para. 65.
[569] Taxes as subsidies are not discussed here.
[570] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:I, 323, at p. 335.
[571] The only exception being those instances where the applicable tax rate is zero. See European Union's second written submission, para. 291.
[572] European Union's response to Panel question No. 42.
[573] Japan's response to Panel question No. 42. See also Japan's second written submission, para. 144.

accredited companies are neutral as regards the total tax burden along the production chain, because they do not generate tax credits to be used to offset debits along the production chain.[574]

7.158. Brazil argues that the tax burden on imported intermediate ICT products that follow the credit/debit rule that is generally applicable, on the one hand, and the tax burden on incentivized domestic intermediate ICT products, which do not obtain tax credits because the tax is not paid (pursuant to the relevant programme(s)), on the other, are equivalent. According to Brazil, the only difference is the time at which the tax is charged. Brazil explains that the reason for this difference is to prevent companies from accumulating credits.[575]

7.159. The Panel noted above that Brazil considers 30% of products covered under the Informatics programme and 100% of products covered under the PADIS programme to be intermediate products in the sense that such products always undergo further manufacturing as part of other products. The Panel also recalls that Brazil argues that imported intermediate ICT products, which are never incentivized, are not subject to a higher tax burden than incentivized like domestic intermediate ICT products.[576] The reason provided by Brazil is that tax reductions or exemptions of indirect taxes applied to intermediate products are neutral as regards the total tax burden along the production chain.[577]

7.160. The Panel therefore proceeds to examine how the Brazilian tax system applies to both incentivized domestic intermediate ICT products and like imported intermediate ICT products in order to determine whether the latter bear a higher tax burden, inconsistently with Article III:2, first sentence, of the GATT 1994.[578]

7.161. In the case of sales of *incentivized domestic intermediate ICT products,* which are manufactured *by accredited companies*, companies purchasing these products do not pay the IPI tax and PIS/PASEP and COFINS contributions (under the PADIS programme) or do not pay or pay a reduced IPI tax (under the Informatics programme). Consequently, they do not obtain any credit (in the case of tax exemptions) or they obtain a reduced credit (in the case of tax reductions) to offset against debits when paying their monthly liabilities.[579]

7.162. In the case of sales of *imported intermediate ICT products*, which are never incentivized because they are manufactured by companies that cannot get accredited, the companies purchasing the imported (and, therefore, non-incentivized) intermediate ICT products must pay the IPI tax and PIS/PASEP and COFINS contributions. As a result of this payment, they obtain a tax credit that can later be used to offset debits from the same taxes and contributions, or ask for compensation with other taxes or reimbursement.

7.163. Comparing these two situations described above (i.e. sales of incentivized domestic intermediate ICT products by accredited companies, and sales of like imported (and therefore, non-incentivized) intermediate ICT products by non-accredited companies), the Panel observes the following. First, the tax exemptions (including through zero rates) under the PADIS and the Informatics programmes do not involve any payment by the purchaser of the incentivized domestic intermediate ICT product but, at the same time, do not generate any tax credit that the purchaser can later use to offset future tax liabilities (i.e. tax debits). Second, the tax reductions under the Informatics programme involve a smaller tax payment by the purchaser of the incentivized domestic intermediate ICT product but, at the same time, generate a lower tax credit

[574] Brazil's second written submission, para. 18.
[575] Brazil's second written submission, para. 24.
[576] Brazil's first written submissions, paras. 328 (DS472) and 277 (DS497).
[577] Brazil's first written submissions, paras. 219 (DS472) and 174 (DS497).
[578] The Panel notes that the European Union clarified that in its view, the distinction between final and intermediate products is irrelevant for its claims under Article III:2 of the GATT 1994. However, in light of the different mechanism of taxation on final and intermediate products respectively, the Panel addresses these two categories of products separately.
[579] The Panel notes that, although the non-cumulative regime is the general rule for the PIS/PASEP and COFINS contributions (see paragraph 2.22 above), to the extent that the sales of the intermediate products at issue could be subject to the PIS/PASEP and COFINS cumulative regime, there would be no mechanism of credits and debits. Therefore Brazil's argument regarding intermediate products does not apply to the PIS/PASEP and COFINS cumulative regime. Thus, for the intermediate products, whose taxation is subject to the PIS/PASEP and COFINS cumulative regime, the Panel refers to its conclusion on finished products in paragraph 7.154 above.

to be used later to offset future tax liabilities. Third, the situation absent the tax exemptions and/or reductions involves the full payment of the tax by the purchaser and, at the same time, the granting to the purchaser of tax credits to be used later to offset tax liabilities.

7.164. The Panel is of the view that a thorough look into the operation of the tax holistically is necessary in order to determine the effective tax burden on the products at issue. This requires that the Panel take into consideration the granting of tax credits to purchasers of imported (and, therefore, non-incentivized) intermediate ICT products following the payment of the tax. To the extent that the transaction at issue involves the payment of a tax as well as the granting of a tax credit, these two elements must be taken into account in order to make an overall assessment of the actual tax burden imposed on imported intermediate ICT products, on the one hand, and like domestic incentivized intermediate ICT products, on the other.[580]

7.165. As regards Brazil's argument that the tax system is neutral in terms of tax collection, the Panel recalls that previous panels have stated that the fact that the nominal value of the tax collected may be identical is not determinant of the tax measure's consistency under Article III:2. In this respect, the panel in *Thailand – Cigarettes (Philippines)* stated the following:

> We do not … consider that the scope of scrutiny of a given measure for its consistency with Article III:2, first sentence, can simply be limited to whether the final consumer ultimately pays the same VAT for imported and domestic cigarettes.[581]

7.166. The panel in *Argentina – Hides and Leather* also dealt with the issue of tax neutrality. In that case, the panel addressed a situation in which the nominal tax amount to be paid was identical for imported and domestic products. However, the tax on imported products was required to be paid *earlier* than the tax on domestic products. The panel indicated that Article III:2 governs "actual tax burdens" and not "nominal tax burdens" and that "where imported and like domestic products are subject to identical tax rates, the actual tax burden can still be heavier on imported products".[582] The panel agreed with the respondent that even though there were no *net* tax payments, there was nevertheless a tax burden, resulting from (i) lost disposable capital and the foregone interest on that capital, and (ii) in situations where there is no available capital to pre-pay the tax, the cost of raising the capital and paying the interest.[583]

7.167. In other words, notwithstanding the fact that the same tax rate may be applied, the tax burden in the following two situations differed: (i) when the tax is paid and a corresponding credit to be offset in the future is generated; and (ii) when no tax at all is paid. The panel in that dispute found that the tax burden in these two situations was not identical.

7.168. The Panel considers the panel's finding in *Argentina – Hides and Leather* to be relevant for the purpose of its analysis. As noted above, if tax exemptions or reductions are applied, no credit or a lower tax credit is accrued, because the tax is not due, or it is due at a lower rate, whereas under the credit/debit rule of the non-cumulative system that applies to imported (and, therefore, non-incentivized) intermediate ICT products, a tax credit (of the same value as the tax paid) is granted to the purchaser.

7.169. In this respect, the Panel observes that in a similar (albeit slightly different) vein to the *Argentina – Hides and Leather* panel report, there is a different effective tax burden on imported ICT products *vis-à-vis* like domestic ICT products for two reasons: the availability of cash flow for those companies that benefit from the tax exemption or reduction, and the "time-value" of money.[584]

7.170. First, the Panel finds that the application of the rule of credits and debits for purchases of imported (and, therefore, non-incentivized) intermediate ICT products involves the payment of a tax that is not faced by companies purchasing incentivized intermediate domestic ICT products

[580] Panel Report, *Argentina – Hides and Leather*, para. 11.184.
[581] Panel Report, *Thailand – Cigarettes (Philippines)*, para. 7.610.
[582] Panel Report, *Argentina – Hides and Leather*, para. 11.183.
[583] Panel Report, *Argentina – Hides and Leather*, para. 11.186-11.188.
[584] This point has been argued by the European Union and Japan. See European Union's second written submission, paras. 57-59 and 331; European Union's response to Panel question No. 43, paras. 188-191; and Japan's second written submission, para. 143.

from accredited companies, which are exempted from the tax. Even in the case of tax reductions under the Informatics programme, the tax to be paid would be lower than the tax for like imported intermediate ICT products, which are not incentivized. The Panel is of the view that this has the effect of limiting the availability of cash flow by companies purchasing imported intermediate ICT products and results in a higher effective tax burden on these products.

7.171. Second, the Panel agrees with the complaining parties that the value of the credit generated when the tax is paid diminishes over time. The real value of an amount diminishes with the passage of time, since money depreciates over time through the effect of inflation. Even if credits are generated, and those credits can be offset later in time, imported (and, therefore, non-incentivized) intermediate ICT products are subject to a higher tax burden than like incentivized domestic intermediate ICT products purchased from accredited companies, due to depreciation in the value of money over time.[585] Brazil has indicated that the time-period that it takes a company to offset its tax credits can be very short, resulting in a very small impact on the value of that money. Brazil has also acknowledged, however, that in cases where the IPI tax debits are lower than the IPI tax credits, and the company buying a product cannot offset the credits with debits after a 3-month period, it can request compensation of the credits with other taxes, or reimbursement from the Brazilian Government.[586] However, Brazil claims that the process for compensation with other taxes or reimbursement can take a long time.[587] Regardless, the Panel emphasizes that Article III:2 refers to tax "in excess", which according to the Appellate Body prohibits *any* higher tax, even by a miniscule margin.

7.172. In light of the above, the Panel finds that imported intermediate ICT products, which are never incentivized, are subject to a higher tax burden than like domestic incentivized intermediate ICT products because, at the time of the sale, the purchaser faces a tax payment that purchasers of incentivized domestic intermediate products do not face or face to a lesser extent. This results in a higher tax burden on imported intermediate ICT products than like domestic intermediate ICT products, because the payment of the tax limits the cash availability of the purchaser, and generates a tax credit the value of which diminishes over time. Consequently, the Panel finds that imported intermediate ICT products are taxed in excess of like domestic incentivized intermediate ICT products contrary to Article III:2, first sentence, of the GATT 1994.

7.3.1.5 Conclusion

7.173. In light of the foregoing, the Panel concludes that under the ICT programmes, the production-step requirements and the requirement for products to obtain the status of "developed" in Brazil, result in imported finished and intermediate ICT products bearing a higher tax burden than like domestic finished and intermediate ICT products because:

a. Finished imported products cannot benefit from the tax exemptions (including through zero rates) and reductions established in the challenged ICT programmes, as a result of certain accreditation requirements; and

b. Imported intermediate ICT products, which are not incentivized as a result of certain accreditation requirements, face a tax payment that incentivized like domestic intermediate ICT products do not face or face to a lesser extent. This tax payment results in a limit to the cash availability and the loss of value of the tax credit derived from the transaction for the purchasers of imported intermediate products.

7.174. The Panel therefore concludes that these aspects of the Informatics, PADIS, PATVD, and Digital Inclusion programmes result in imported products being subject to internal taxes in excess of those applied to like domestic products, inconsistently with Article III:2, first sentence, of the GATT 1994.

[585] This is distinct and additional to the concept of cash availability discussed in paragraph 7.170 above.
[586] Brazil's second written submission, paras. 11-12 and 17.
[587] Brazil's closing statement at the first meeting of Panel, para. 15; Brazil's second written submission, paras. 185 and 234; and Brazil's comment on para. 2.28 of the draft descriptive part. In particular, see Brazil's second written submission, para. 234 ("The tax administration takes a long time to process refund or offset requests").

7.3.1.6 Judicial economy with respect to Japan's claim under Article III:2, second sentence

7.175. Japan, the only complaining party that has raised claims under this particular provision, argues that an objective assessment of the ICT programmes leads to the conclusion that these programmes are designed and structured to protect the domestic industry. Japan states that the protective nature of the PADIS programme is confirmed by reference to the statements of the Brazilian government on the objective of this programme. In the case of the PATVD programme, Japan contends that the provisional measure that eventually became Law 11,848/2007 stated that the objective of the PATVD programme is promoting localization in Brazil.[588]

7.176. Brazil does not submit any specific argument with respect to this claim.

7.177. According to Article 11 of the DSU, the function of panels is to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. For that purpose, panels must make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Article 3.4 of the DSU prescribes, in turn, that the recommendations or rulings by the DSB shall be aimed at achieving a satisfactory settlement of the matter. Article 3.7 reaffirms that the aim of the dispute settlement mechanism is to secure a positive solution to the dispute.

7.178. In line with the above provisions, panels are not obliged to rule on each of the claims put forth by the complaining parties. Panels have the discretion to exercise the principle of judicial economy and assess only the claims that they consider necessary to secure a positive solution to a dispute.

7.179. In this respect, the Appellate Body has stated that:

> [T]he principle of judicial economy "allows a panel to refrain from making multiple findings that the same measure is *inconsistent* with various provisions when a single, or a certain number of findings of inconsistency, would suffice to resolve the dispute". Thus, panels need address only those claims "which must be addressed in order to resolve the matter in issue in the dispute", and panels "may refrain from ruling on every claim as long as it does not lead to a 'partial resolution of the matter'." Nonetheless, the Appellate Body has cautioned that "[t]o provide only a partial resolution of the matter at issue would be false judicial economy", and that "[a] panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings 'in order to ensure effective resolution of disputes to the benefit of all Members".[589]

7.180. The Panel has addressed above whether the tax measures challenged by the complaining parties are inconsistent with Article III:2, first sentence, of the GATT 1994. Although Japan presents an additional and not an alternative claim under the second sentence of Article III:2, Japan has not indicated why such findings on the second sentence would be necessary or useful to secure a positive solution to the dispute if the Panel were to find the measures to be inconsistent with the first sentence of Article III:2. Indeed, the Panel considers that, in light of the findings regarding Article III:2, first sentence, additional findings regarding the same measure under the second sentence of Article III:2 are not necessary or useful to secure a positive solution to the dispute. In particular, the Panel notes that its findings on the first sentence are made on the basis of hypothetical likeness, meaning that the analysis in respect of Article III:2, second sentence, would be similar to that under the first sentence. Accordingly, pursuant to the principle of judicial economy, the Panel refrains from making any findings with respect to this particular claim.

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[588] Japan's first written submission, paras. 338, 404, 462, and 518.

[589] Appellate Body Report, *Argentina – Import Measures*, para. 5.190 (quoting Appellate Body Reports, *Canada – Wheat Exports and Grain Imports*, para. 133; *US – Wool Shirts and Blouses*, p. 19, DSR 1997:I, 323, at p. 340; *US – Tuna II (Mexico)*, paras. 403-404; *US – Upland Cotton*, para. 732; *Australia – Salmon*, para. 223). (footnotes omitted; emphasis original)

7.3.2 Claims under Article III:4 of the GATT 1994

7.3.2.1 Claims with respect to the conditions for accreditation, certain calculations related to required R&D expenditures, and administrative burden under the ICT programmes

7.3.2.1.1 Introduction

7.181. The European Union and Japan have raised claims under Article III:4 of the GATT 1994 with respect to the following aspects of the ICT programmes, which in their view accord less favourable treatment to imported products than that accorded to like incentivized domestic products:

a. The conditions for accreditation necessary for products to obtain the tax advantages;

b. The aspect of the mechanism for the calculation of the amount of resources required to be invested in R&D under the Informatics and PADIS programmes, where the amounts paid when purchasing incentivised products are deducted from the calculation; and

c. The lower administrative burden on companies purchasing domestic incentivised intermediate products.

7.182. As developed in paragraphs 7.61 and 7.71 above, Brazil argues that these aspects of the challenged programmes are not within the scope of Article III:4, because (i) these aspects of the programmes are pre-market requirements that are not covered by Article III:4, and (ii) the programmes constitute subsidies paid exclusively to domestic producers within the meaning of Article III:8(b) of GATT.[590] In the event that the Panel finds that Article III:4 of the GATT 1994 applies to the challenged programmes, Brazil contends in the alternative that the challenged programmes do not accord less favourable treatment to imported over domestic products because the regulatory differences are not based on the origin of the products.[591]

7.183. The Panel has considered Brazil's threshold arguments in sections 7.2.1 and 7.2.2 above. With respect to Brazil's first argument, the Panel already found in paragraph 7.70 above that the fact that a measure may involve a "pre-market" requirement does not have an impact on whether the measure is within the scope of Article III:4 of the GATT 1994. The Panel addresses in further detail below whether the challenged measures at issue here are "laws, regulations or requirements" within the scope of Article III:4 of the GATT 1994.

7.184. With regard to Brazil's second argument, that the programmes constitute subsidies to domestic producers within the meaning of Article III:8(b) of the GATT 1994, the Panel recalls its findings in paragraph 7.87 above that, even if a measure is properly characterized as a subsidy exclusively to domestic producers, as a general principle Article III:8(b) does not exempt from the substantive disciplines of Article III components of such production subsidies that involve an element of discrimination to the disadvantage of imported like products.

7.185. Therefore, the Panel will analyse the complaining parties' claims under Article III:4 of the GATT 1994.

7.186. The Panel recalls in this context that the accreditation requirements cited in this set of claims for each of the ICT programmes are described in detail in section 2.2 above. The Panel therefore will not repeat that description here, but instead will refer to these requirements in summary fashion. In this regard, the Panel notes that such summaries suffice for purposes of the analysis of the present claims.

7.187. Article III:4 of the GATT 1994 contains the national treatment obligation with respect to internal laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. Article III:4 of the GATT 1994 provides that:

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[590] See footnote 480 above.

[591] See Brazil's first written submissions, sections 5.1.2.3, 5.2.2.3, 5.3.2.3, and 5.4.2.3 (DS472) and sections 4.1.2.4, 4.2.2.4, 4.3.2.4, and 4.4.2.4 (DS497).

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

7.188. The Appellate Body has explained that for an inconsistency with Article III:4 of the GATT 1994 to be established, three elements must be satisfied:

a. that the measure at issue be a "law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use" of products;

b. that the imported and domestic products at issue be "like products"; and

c. that imported products be accorded "treatment less favourable" than that accorded to like domestic products.[592]

7.189. The Panel examines the challenged measures on the basis of these three elements.

7.3.2.1.2 Whether the measures at issue are laws, regulations, or requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of domestic and imported products

7.190. Article III:4 of the GATT 1994 states that it is applicable "in respect of all laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" of products.

7.191. The European Union argues that the ICT programmes are enacted and implemented by their respective laws and regulations, including laws, decrees and a number of binding legal acts, such as implementing orders and declaratory acts of accreditation. The European Union submits that these laws create obligations to comply with a variety of conditions, which are voluntarily undertaken by applicants asking for an accreditation so as to obtain the tax incentives provided under the program. The European Union submits that because compliance with the conditions for accreditation is necessary for a company to be accredited and hence have access to those incentives, the conditions for accreditation therefore constitute a "requirement" within the meaning of Article III:4 of the GATT 1994.[593] Japan refers to the panel report in *India – Autos* for the proposition that the term "'requirements' includes not only conditions that companies are legally bound to carry out, but also those that they might voluntarily accept in order to obtain an advantage from a government."[594] Additionally, Japan refers to the Appellate Body report in *EC – Bananas* to argue that the term "affecting" means "having 'an effect on'", thereby "encompassing

[592] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

[593] European Union's first written submission, paras. 629-638, 796-803, 947-956 and 1089-1090. The European Union argues that the tax incentives provided under the ICT programmes, once compliance with the conditions for accreditation have been achieved, clearly "affect[] the internal sale, offering for sale, purchase, transportation, distribution, or use" of imported inputs as well as imported ICT products. The European Union asserts that a concrete link exists between the conditions for accreditation and the internal sale, offering for sale, purchase, or use of ICT products and their inputs in the Brazilian market, because the application of a reduced tax or contribution rate on the incentivized products is conditioned upon the producer's fulfilling all of the conditions for accreditation, and the difference in the applicable rate normally has an immediate effect on the selling price. In addition, and only with respect to the Digital Inclusion programme, the European Union submits that that programme is essentially governed by Law 11,196/2005, also known as the "Goods Law", and by Decree 5,602/2005, which according to the European Union lay down the most important rules governing the programme, including which products can benefit from certain fiscal advantages and under what conditions. The European Union asserts that it is indisputable that those acts are of general and prospective application and constitute "laws" and or "regulations" both in the Brazilian legal system and for the purpose of Article III:4 of GATT 1994. European Union's first written submission, paras. 1089-1090.

[594] Japan's first written submission, para. 67 (referring to Panel Report, *India – Autos*, para. 7.418).

anything that has an effect on any aspect of the sale, purchase, transportation, distribution, or use of the products at issue".[595]

7.192. Brazil argues that the requirements established in each of the ICT programmes do not affect products in the marketplace, and thus fall outside the scope of Article III:4 of the GATT 1994.[596] This is an instance of Brazil's general defence that Article III:4 deals only with products and operations in the marketplace, and thus does not concern the pre-market requirements contained in the five programmes, as those only impose production-step requirements without any relationship to the sale of products.[597] The Panel has addressed this defence in section 7.2.1 above.

7.193. It is undisputed that the ICT programmes are enacted and implemented through their respective laws and regulations, including laws, decrees and a number of binding legal acts, such as implementing orders and declaratory acts of accreditation, and that those laws and regulations contain a series of conditions for companies to obtain accreditation and thereby be eligible for the tax exemptions, reductions or suspensions under the programmes.[598]

7.194. The Appellate Body has explained that the word "affecting", which qualifies the types of measures covered by Article III:4, assists in defining them and has a broad scope of application.[599] The Appellate Body has also determined that measures that create an incentive not to use imported products by definition affect their internal sale, offering for sale, purchase or use.[600] Additionally, if the application of a measure can potentially "affect" trade in products and treat imported products less favourably than domestic products, that measure can be considered to be inconsistent on its face with the national treatment obligation, even if the challenged regulation is written in terms of requirements on firms (as opposed to requirements on products). For instance, the Appellate Body in *China – Publications and Audiovisual Products* explained that restrictions imposed on investors, wholesalers, and manufacturers, as well as on points of sale and ports of entry, are inconsistent with Article III:4 of the GATT of 1994.[601]

7.195. This Panel agrees with the panel in *India – Autos* that the term "requirement" within the meaning of Article III:4 of the GATT 1994 includes those requirements that an enterprise voluntarily accepts in order to obtain an advantage from the government.[602] In the present dispute, all of the ICT programmes include conditions or requirements that companies voluntarily undertake in order to be accredited and thereby obtain the tax reductions, exemptions or suspensions. The Panel therefore agrees with the complaining parties that the measures at issue constitute requirements within the meaning of Article III:4 of the GATT 1994.

7.196. With respect to whether these requirements "affect the internal sale, offering for sale, purchase, transportation, distribution or use" of products, the Panel recalls that the Appellate Body has explained that the word "affecting" has a broad scope of application.[603]

7.197. The Panel notes that the purpose of complying with the requirements for accreditation is to obtain a tax exemption, reduction or suspension on the sales or purchases of products, so it is clear that the requirements at issue affect the sale, offering for sale or purchase of products. Furthermore, a tax incentive such as an exemption, reduction or suspension in respect of a product can create an incentive to buy that product, in preference to a product that does not benefit from the exemption, suspension or reduction. Thus, this confirms that the requirements at issue affect the sale, offering for sale or purchase of products.

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[595] Japan's first written submission, para. 69 (referring to Appellate Body Report, *EC – Bananas III*, para. 220).

[596] See paragraph 7.61 above.

[597] See paragraph 7.61 above.

[598] See paragraphs 2.37 and 2.38 above.

[599] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 208-210.

[600] Appellate Body Reports, *China – Auto Parts*, paras. 194–195.

[601] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 227.

[602] Panel Report, *India – Autos*, para. 7.184. *See also* Panel Reports, *Canada – Autos*, para. 10.73; *Turkey – Rice*, para. 7.218; *China – Auto Parts*, para. 7.240; and GATT Panel Report, *EEC – Parts and Components*, para. 5.21.

[603] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 208-210.

7.198. Based on the above, the Panel concludes that the Informatics, PADIS, PATVD and Digital Inclusion programmes fall within the scope of "laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" of products within the meaning of Article III:4 of the GATT 1994.

7.3.2.1.3 Whether the relevant imported and domestic products are "like products"

7.199. First, the Panel recalls its finding in paragraph 7.117 above in the context of Article III:2 of the GATT 1994 that the incentivised products receiving the relevant tax treatment are Brazilian domestic products within the meaning of Article III:2. This is also true for Article III:4.

7.200. The Appellate Body has explained that the concept of "likeness" evokes the image of an accordion.[604] The Appellate Body has found that given that Article III:4 refers exclusively to "like products", the concept of likeness in that provision is broader than that in Article III:2 of the GATT 1994.[605] In particular, the Appellate Body established that the product scope in Article III:4 is broader than in the first sentence of Article III:2, but not broader than the combined product scope of the two sentences of Article III:2[606] which the Panel thus understands to encompass both like and directly competitive products. The Appellate Body has also stated that "the determination of 'likeness' under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products."[607]

7.201. The Appellate Body has clarified that in the context of Article III:4, to determine the requisite "likeness" requires an examination of the competitive relationship between imported and domestic products, using the following criteria: (i) the product's end-uses, (ii) consumers' tastes and habits, and (iii) the product's properties, nature and quality, and (iv) the tariff classification of the products at issue.[608]

7.202. The Panel recalls that the likeness of products can be presumed where the sole basis for the differential treatment is the origin of the products. In that context, the Panel recalls that its discussion about "hypothetical likeness" in the context of the claims under Article III:2 of the GATT 1994 is also applicable in respect of Article III:4.[609] This means that a complainant may establish 'likeness' by demonstrating that the measure at issue makes a distinction based on the origin of the product,[610] without examining the traditional likeness criteria to determine whether particular domestic and imported products can be presumed to be like.[611]

7.203. The European Union and Japan argue that the domestic and imported products incentivised under the ICT programmes (i.e. *finished* and *intermediate* products) at issue are like, and refer to

[604] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:I, 97, at 114.

[605] Appellate Body Report, *EC – Asbestos*, para. 96.

[606] Appellate Body Report, *EC – Asbestos*, para. 99.

[607] Appellate Body Report, *EC – Asbestos*, para. 99.

[608] Appellate Body Report, *EC – Asbestos*, paras 101–102. In the context of Article III:4 of the GATT 1994, the Appellate Body has further clarified the meaning of these four criteria. Regarding the physical properties of products, it has indicated that "in particular, panels must examine those physical properties of products that are likely to influence the competitive relationship between products in the marketplace". Appellate Body Report, *EC – Asbestos*, para. 114. With regard to the end uses of the products, the Appellate Body has stated that this criterion relates to "the extent to which products are capable of performing the same, or similar, functions". Appellate Body Report, *EC – Asbestos,* para. 117. As regards the consumers' tastes and habits, the Appellate Body has considered that this criterion concerns "the extent to which consumers are willing to use the products to perform these functions". Appellate Body Report, *EC – Asbestos*, para. 117. Finally, with respect to the tariff classification criterion, the Appellate Body has explained that it "clearly reflects the physical properties of a product" and that having the same tariff classification is not on its own decisive. Appellate Body Report, *EC – Asbestos*, paras. 102 and 146. It must be noted that the Appellate Body has recognized the end uses and the consumers' tastes and habits as "key elements relating to the competitive relationship between products". Appellate Body Report, *EC – Asbestos*, para. 117.

[609] Appellate Body Report, *Argentina – Financial Services*, para. 6.36 (referring to Panel Reports, *Argentina – Hides and Leather*, para. 11.168; *China – Auto Parts*, para. 7.216; *Argentina – Import Measures*, para. 6.274; *Canada – Autos*, para. 10.74; *Canada – Wheat Exports and Grain Imports*, para. 6.164; *China – Publications and Audiovisual Products*, para. 7.1447; *India – Autos*, para. 7.174; *Thailand – Cigarettes (Philippines)*, para. 7.661; *Turkey – Rice*, paras. 7.214-7.216; and *US – FSC (Article 21.5 – EC)*, paras. 8.132-8.135), *Colombia – Ports of Entry*, paras. 7.355-7.356; and *US – Poultry (China)*, paras. 7.424-7.432).

[610] Appellate Body Report, *Argentina – Financial Services*, para. 6.36.

[611] See Panel Reports, *US – Poultry (China)*, para. 7.426; *Indonesia – Autos*, paras. 14.112-14.113 (citing Appellate Body Report, *Canada – Periodicals*, pp. 20-21, DSR 1997:1, 449, at pp. 466-467).

their arguments regarding product likeness developed under their claims in respect of Article III:2 of the GATT 1994, which are based on a presumption of likeness as just described.[612]

7.204. Brazil argues that the European Union and Japan have not demonstrated that the domestic and imported ICT products at issue are like, and also refers to its arguments developed in respect of the claims under Article III:2 of the GATT 1994.[613]

7.205. The Panel notes that the product coverage under the ICT programmes with respect to the incentivised products, *intermediate* or *finished*, is the same for the claims under Article III:2 of the GATT 1994 and the claims under Article III:4 of the GATT 1994.

7.206. The Panel recalls its conclusion in paragraph 7.140 above that the complaining parties had made a *prima facie* case that there is a differential tax treatment between imported and like domestic products that is based on the origin of the products. The Panel found, for that reason, that domestic and imported products can be presumed to be *like* for the purposes of the analysis under Article III:2, first sentence, of the GATT 1994.

7.207. The same reasoning applies to the likeness analysis under Article III:4 of the GATT of 1994. The Informatics, PADIS, PATVD and Digital Inclusion programmes introduce regulatory distinctions exclusively on the basis of the origin of the concerned products. Therefore, for the exact same reasons described in the assessment of likeness under Article III:2 of the GATT 1994, the Panel finds that domestic and imported products can be presumed to be like for the purposes of the analysis of the claims under Article III:4 of the GATT 1994.

7.208. The Panel notes that this is consistent with the Appellate Body's explanation that the product scope in Article III:4 of the GATT 1994 is broader than that in the first sentence of Article III:2, but not broader than the combined scope of the first and second sentence of Article III:2 together.[614] Therefore, if product likeness exists under Article III:2 of the GATT 1994, first sentence, product likeness will also exist under Article III:4 of the GATT 1994 for the same products at issue. The Panel therefore finds that for the purpose of its analysis under Article III:4, the relevant domestic and imported products can be considered to be like.

7.3.2.1.4 Whether imported products are accorded "treatment less favourable" than that accorded to like domestic products

7.209. The last step of a panel's analysis under Article III:4 of the GATT 1994 is to determine whether imported products are accorded "treatment no less favourable" than that accorded to like domestic products pursuant to the measure in question. The Appellate Body has explained that this examination must be founded on a careful analysis of the measure and its implications in the marketplace. This does not mean, however, that the determination must be based on the *actual effects* of the measure in the marketplace.[615]

7.210. The Appellate Body has clarified that it is for the complaining party to establish that the measure accords to the group of like *imported* products less favourable treatment than it accords to the group of like *domestic* products.[616] In this regard, the Appellate Body has concluded that in order to determine whether there exists "treatment less favourable" for imported products, panels must analyse whether the measure at issue modifies the conditions of competition in the relevant market to the detriment of imported products:

> A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated 'less favourably' than like domestic products should be

[612] European Union's first written submission, paras. 626-627, 792-794, 945-946 and 1087-1088 (DS472) and 341, 408, 466 and 521 (DS497).
[613] Brazil's first written submission, paras. 234-237, 340, 397 and 489 (DS472) and 187-190, 290, 334 and 425 (DS497).
[614] Appellate Body Report, *EC – Asbestos*, para. 99.
[615] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 215.
[616] Appellate Body Report, *EC – Asbestos*, para. 100.

> assessed instead by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products.[617]

7.211. In *US – Clove Cigarettes*, the Appellate Body explained:

> In *Thailand – Cigarettes (Philippines)*, the Appellate Body further clarified that for a finding of less favourable treatment under Article III:4 "there must be in every case a genuine relationship between the measure at issue and its adverse impact on competitive opportunities for imported versus like domestic products to support a finding that imported products are treated less favourably".[618]

7.212. Finally, a demonstration of less favourable treatment can be made on a *de jure* or *de facto* basis. The Appellate Body in *US – COOL* stated:

> As under Article III:4, the national treatment obligation of Article 2.1 [of the TBT Agreement] prohibits both *de jure* and *de facto* less favourable treatment. That is, "*a measure may be* de facto *inconsistent with Article 2.1 even when it is origin-neutral on its face*." In such a case, the panel must take into consideration "the totality of facts and circumstances before it", and assess any "implications" for competitive conditions "discernible from the design, structure, and expected operation of the measure". Such an examination must take account of all the relevant features of the market, which may include the particular characteristics of the industry at issue, the relative market shares in a given industry, consumer preferences, and historical trade patterns. That is, a panel must examine the operation of the particular technical regulation at issue in the particular market in which it is applied.[619]

7.213. The Panel proceeds with its analysis by assessing the cited aspects of the ICT programmes alleged to be inconsistent with Article III:4 of the GATT 1994.

7.3.2.1.4.1 The conditions for accreditation

7.214. The complaining parties challenge as inconsistent with Article III:4 the accreditation requirements – i.e., the conditions that companies must fulfil in respect of particular incentivized products to become accredited producers of, and thus eligible for the tax incentives on, those products. Accreditation is product-by-product, rather than to a company as a whole. Thus, a company producing a range of different products each of which is covered by a challenged scheme must become accredited in respect of each of those products individually, by fulfilling the accreditation requirements applicable to each.

7.215. The European Union argues that in order for a product to enjoy the tax exemptions and reductions under the ICT programmes, that product must be produced by companies complying with the conditions for accreditation, namely producing the product in accordance with the applicable PPB or similar production step requirements, or demonstrating that the product is "developed in Brazil"; and spending a prescribed amount on specified kinds of R&D. The European Union adds that a requirement that certain production steps be carried out in Brazil, or alternatively that a product be "developed in Brazil", in order for the product to benefit from a tax incentive is not origin-neutral, because imported products that are like the domestic products have not undergone the same production steps in Brazil or will not have been "developed in Brazil", and thus by definition will be excluded from the incentive. The European Union further submits that purchasers of ICT products will have an incentive to acquire the domestic products that carry the lower tax burden. Hence, according to the European Union, the ICT programmes, access to which is obtained by compliance with the accreditation requirements, modify the equality of competitive

[617] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137 (emphasis original); see also the 1958 GATT Panel Report, *Italy – Agricultural Machinery* which stipulates that the scope of Article III is not only limited to laws and regulations that *directly relate to conditions* of sale, purchase and use of products but that "the drafters of the Article intended to cover in paragraph 4 […] any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market." GATT Panel Report, *Italy – Agricultural Machinery*, para. 12.

[618] Appellate Body Report, *US – Clove Cigarettes*, fn 96.

[619] Appellate Body Report, *US – COOL*, para. 269. (emphasis added)

conditions between imported and like domestic products.[620] The European Union makes the same argument with regard to the other accreditation requirements for access to the tax incentives, i.e., the R&D investment requirements. In particular, according to the European Union imported products manufactured by a company that has not invested in R&D in Brazil will not qualify for the tax incentives. Also, for the European Union, insofar as the R&D investment requirement is linked to improving the incentivised products, it should be concluded that such a requirement "affects" the sale of those products in Brazil (by giving them a qualitative technology advantage).[621]

7.216. Japan argues that the ICT programmes reduce tax burdens on domestic ICT products, thereby enabling companies to produce and market such products in Brazil at reduced prices using the tax benefit, while imported ICT products are not eligible for the benefits under the ICT programmes, and thus are subject to higher tax burdens. Accordingly, the ICT programmes deny equality of competitive opportunities for imported and domestic goods, thereby modifying the conditions of competition in the relevant market to the detriment of imported products.[622]

7.217. Japan submits that the ICT programmes are inconsistent with Article III:4, because the programmes draw origin-based distinctions with respect to covered ICT products. Japan maintains that the requirement that covered ICT products be produced in accordance with PPBs can only be satisfied if the final products are domestic.[623]

7.218. Brazil counters that Article III:4 of the GATT 1994 only applies to measures that affect a product once it has been produced and enters the domestic market, i.e. it refers only to market operations.[624] According to Brazil, the requirements under the ICT programmes are not designed or structured, nor do they operate in a manner, to affect the conditions of competition to the detriment of imported products, mainly because they are not related to products, but aimed at stimulating technology development and capacity-building.[625]

7.219. Brazil also argues, for the Informatics and PADIS programmes, that, in the case of intermediate goods produced by the accredited companies, the indirect tax suspensions or exemptions applied under the challenged programmes do not generate a difference in the effective tax burden due between imported and domestic products.[626]

7.220. The Panel notes that the aspects challenged by the complaining parties under Article III:4 are different from, albeit related to, the differential tax treatment of like domestic and imported products that they challenge under Article III:2. In respect of Article III:4, the complaining parties challenge the laws, regulations and requirements, namely the accreditation requirements for gaining access to the tax incentives, which then in turn allegedly distort the conditions of competition for imported products *vis-à-vis* like domestic products, through that differential tax burden.

7.221. The Panel recalls that in order to determine whether there exists "treatment less favourable" for imported products, panels must analyse whether the measures at issue modify the conditions of competition in the relevant market to the detriment of imported products.[627]

7.222. The Panel recalls that in order to be eligible for the tax exemptions, reductions and suspensions granted under the ICT programmes, companies must obtain accreditation[628], and in

[620] European Union's first written submission, paras. 622-625, 644-647, 788-792, 809-813, 940-944 and 963-969, 1082-1086 and 1103-1109. See also European Union's opening statement at the first meeting, paras. 133-135.

[621] European Union's second written submission, paras. 309-311, 425, 463 and 493.

[622] Japan's first written submission, paras. 339-341, 405-409, 463-467 and 519-522.

[623] Japan's second written submission, para. 151.

[624] Brazil's first written submissions, paras. 224-227 (DS472) and paras. 177-180 (DS497)

[625] Brazil's first written submission, paras. 252-259, 338-341, 395-398 and 487-490 (DS472) and 205-208, 291 and 333-336 (DS497); Brazil's second written submission, paras. 55, 79, 110 and 137.

[626] Brazil's first written submissions, paras. 185, 218 and 336 (DS472) and paras. 144, 173 and 286 (DS497).

[627] See for example, Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

[628] In respect of the Digital Inclusion programme, the Panel notes that in order for retailers to receive the relevant tax treatment available under the programme, it is not necessary for the retailers to be "accredited" under the programme. However, in order to be eligible for the relevant tax treatment, the products must have been produced in accordance with certain production step requirements. In other words

order to obtain accreditation companies must comply with the requirements imposed by each programme.

7.223. The Panel concluded in paragraphs 7.135 to 7.140 above that only products produced in Brazil can satisfy the conditions or requirements for accreditation of satisfying the PPBs or similar production step requirements, and only products developed in Brazil can satisfy the requirement of being "developed in Brazil". Imported like products cannot satisfy those requirements, and thus can never qualify for the tax exemptions, reductions or suspensions granted under the relevant ICT programmes. This is because imported products are never manufactured in Brazil in accordance with the relevant production-step requirements, nor can imported products developed outside Brazil satisfy the requirement of being "developed in Brazil". Consequently, imported like products are not able to obtain the tax exemptions, reductions and suspensions that are available to domestic products produced by accredited companies and developed in Brazil.

7.224. The Panel also concluded in paragraphs 7.154 and 7.172 above that, as a consequence of these accreditation requirements contained in the challenged programmes, imported *finished* and *intermediate* products bear a higher tax burden than like domestic *finished* and *intermediate* products. Specifically, because imported products cannot satisfy these requirements (a) imported *finished* products cannot benefit from the tax exemptions and reductions established in the ICT programmes; and (b) imported *intermediate* products face a tax payment that incentivized like domestic *intermediate* products do not face or face to a lesser extent, resulting, for the purchasers of imported *intermediate* products, in a reduced cash availability and a loss in the value of the tax credit derived from the purchase.

7.225. In the Panel's view, it is clear that the conditions for accreditation, which when fulfilled create a lower internal tax burden on domestic products than on like imported products, modify the conditions of competition to the detriment of the imported products.[629] Therefore, the Panel concludes that the accreditation requirements of the ICT programmes, by restricting access to the tax incentives only to domestic products, result in less favourable treatment being accorded to imported products than to like domestic products.

7.226. The Panel notes that it reached this conclusion based on the fact, as explained in paragraph 7.135 above, that only a product manufactured in Brazil can meet the production-step requirements imposed by the PPBs, or similar requirements, imposed by the ICT programmes. The Panel also concluded in paragraph 7.136 above that imported products that have been "developed" outside Brazil could never meet the requirement of being developed in Brazil.

7.227. The Panel notes that the European Union and Japan request the Panel to find that all of the conditions for accreditation taken altogether, including the production steps or manufacturing requirements, the R&D requirements and the requirement of being developed in Brazil, are inconsistent with Article III:4 of the GATT 1994. The Panel has made its findings in paragraph 7.173 above, with respect to only two of those conditions, the production step requirements under the PPBs or similar requirements, and the requirements to be "developed" in Brazil, and not with respect to the requirements to invest in R&D.

7.228. The European Union argues that the same conclusions can be reached with regard to the R&D investment requirements, because imported products manufactured by a company that has not invested in R&D in Brazil will not qualify for the tax incentives.

7.229. The Panel is not convinced that the European Union has met its burden of making a *prima facie* demonstration with respect to the R&D requirements. The European Union has not explained how the requirement to invest in R&D *alone* creates an origin-based discrimination, and how that requirement *alone* could disqualify imported products from the tax incentives. In particular, the

such requirements perform the same function in respect of the Digital Inclusion programme, as the accreditation requirements for the Informatics, PADIS and PATVD programmes. The Panel therefore uses the term "accreditation requirements" in this context to refer not only to accreditation of producers under the Informatics, PADIS and PATVD programmes, but also the eligibility of retailers under the Digital Inclusion programme, to receive the relevant tax treatment available under each programme.

[629] Those conditions for accreditation, themselves, are inconsistent with Article III:4 of the GATT 1994. Indeed, if there was no tax advantage attached to the conditions for accreditation, and such requirements were made mandatory, they would be, in and of themselves, inconsistent with Article III:4 of the GATT 1994.

European Union has not demonstrated that it would be impossible for foreign producers to comply with the R&D requirements, or even that compliance with such requirements are more onerous for foreign producers than domestic producers. Nor has the European Union indicated how these R&D requirements, taken *together with* the production-step requirements and the requirement for a product to be "developed in Brazil", create origin-based discrimination that is separable from the origin-based discrimination arising only from those other requirements.

7.230. The Panel concludes that the ICT programmes are inconsistent with Article III:4 of the GATT 1994, because the requirements to produce in accordance with the PPBs, or similar production-step requirements, and the requirement for a product to be developed in Brazil, in order to obtain accreditation and thereby access to the tax incentives under the programmes, accord to imported products treatment less favourable than that accorded to like domestic products.

7.3.2.1.4.2 The mechanism for the calculation of the amount of resources required to be invested in R&D under the Informatics and PADIS programmes

7.231. The Panel recalls that, among the requirements for accreditation under the Informatics programme, companies must invest annually in R&D activities in Brazil a percentage[630] of their gross sales on the internal market resulting from the commercialization of the incentivised products, after deduction of taxes levied in connection with those sales, *as well as deduction of the value of the purchases of products incentivised under the Informatics programme* (or produced in the Manaus Free Trade Zone in Brazil).[631]

7.232. The Panel also recalls that, among the requirements for accreditation under the PADIS programme, companies must invest annually in R&D activities in Brazil at least 5% of their gross sales on the internal market resulting from the commercialization of the incentivised products, after deduction of taxes levied in connection with those sales, *as well as deduction of the value of the purchases of products incentivised under the PADIS programme*.[632]

7.233. The latter means that if companies accredited under the Informatics or PADIS programmes buy products, *finished* or *intermediate*, incentivised under the same programme, the value of those purchases will be deducted from the calculation of the percentage of their gross sales required to be invested in R&D.

7.234. The European Union and Japan argue that the way the minimum investment requirement is calculated gives an incentive to companies accredited under the Informatics and PADIS programmes to purchase domestic products incentivised under the same programme, in order to reduce the amount of resources that they are compelled to invest in R&D in Brazil. In their view, this incentive to purchase domestic products alters the conditions of competition between domestic and imported products, to the detriment of the latter.[633]

7.235. The European Union further asserts that the higher a company's purchases are of products incentivised under the Informatics programme (or manufactured in the Manaus Free Trade Zone) or under the PADIS programme, the lower the amount of resources it will need to invest in R&D in Brazil in order comply with the R&D accreditation. The European Union maintains that accredited companies have an incentive to acquire products benefitting from these programmes, because the cost of those products will help them reduce the amount of resources that they have to invest in compulsory R&D in Brazil.[634]

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[630] At the time of establishment of the Panel, accredited companies have to invest at least 4% of their gross revenue in R&D, and at least 4.35% if investments are related to the sales of ICT products produced in the Mid-west, North (SUDAM) and Northeast (SUDENE) regions. See paragraph 2.54 above.

[631] Law 8,248/1991, (Exhibit JE-1), Article 11; and Decree 5,906/2006, (Exhibit JE-7), Article 8.

[632] Law 11,484/2007, (Exhibit JE-71), Article 6; and Decree 6,233/2007, (Exhibit JE-73), Article 8, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1.

[633] European Union's first written submission, paras. 649 and 811; European Union's second written submission, para. 323; European Union's response to Panel question No. 72; Japan's first written submission, para. 346; and Japan's response to Panel's question No. 72.

[634] European Union's opening statement in the first substantive meeting, paras. 150-152.

7.236. Brazil, in turn, submits that companies can offset from the amount required to be invested in R&D the value of their purchases of covered (incentivized) inputs, in order to prevent double counting. Brazil maintains in particular that this investment requirement works in much the same way as a value-added tax and that the deduction is made so that the investment requirement falls only on the added value of the covered product. Brazil adds that if this were not the case, accredited companies purchasing products from other accredited companies would have to bear the investment burden already borne by the previous company.[635]

7.237. The European Union contends that there is no risk of double counting, because what one company has invested in R&D in order to obtain a tax reduction on product A, has nothing to do with what another company has to invest in R&D in order to obtain a tax reduction on product B, which incorporates product A as an input.[636]

7.238. The Panel recalls that in order to determine whether there exists for the purpose of Article III:4 of the GATT 1994 "treatment less favourable" for imported products, panels must analyse whether the measures at issue modify the conditions of competition in the relevant market to the detriment of imported products.[637]

7.239. It is an undisputed fact that companies can deduct the value of purchases of products incentivised under the Informatics programme (or produced in the Manaus Free Trade Zone in Brazil) or under the PADIS programme from the percentage of their gross sales that must be invested in R&D in order be accredited under the respective programme.

7.240. It is clear for the Panel that companies can reduce the amount of resources required to be invested in R&D by purchasing incentivised products, which in turn creates an incentive to purchase products (usually *intermediate* products) incentivised by the programme under which the company is accredited, either the Informatics or the PADIS programme.

7.241. As explained in paragraphs 7.136 and 7.138 above, like imported products can never be incentivised by the Informatics or the PADIS programme, so this incentive to purchase incentivised products modifies the conditions of competition between domestic and like imported products, to the detriment of the imported products.

7.242. As described in paragraph 7.236 above, Brazil argues that the purpose of this deduction is to prevent double counting of R&D expenditures. However, in the Panel's view, the purchases of incentivised products by one company have nothing to do with the sales of incentivised products by another company. The *sale* of product A by one accredited company will be counted in its percentage required to be invested in R&D, but the *purchase* of that product A by another accredited company will not be counted in its percentage required to be invested in R&D. Thus, the Panel rejects Brazil's argument. In any event, what matters to the purchasing company is that the amount that it must spend on R&D is lower when it purchases an incentivized, and thus by definition domestic, product than when it purchases an imported (and thus by definition non-incentivized) product, even if the two products are sold for exactly the same price. Thus, the Panel rejects Brazil's argument.

7.243. For the reasons explained above, the Panel finds that the mechanisms under the Informatics and PADIS programmes for the calculation of the amount of resources required to be invested in R&D accord to imported products treatment less favourable than that accorded to like domestic products, and thus are inconsistent with Article III:4 of the GATT 1994.

7.3.2.1.4.3 The lower administrative burden on companies purchasing domestic incentivised intermediate products

7.244. The European Union argues that whenever a product benefits from an exemption or suspension of an indirect tax (or at least a very low tax rate), this implies a lower administrative burden for the purchaser of that product compared to the burden faced by the purchaser when it

[635] Brazil's first written submission, fn 45 (DS497); and Brazil's second written submission, para. 70.
[636] European Union's opening statement in the first substantive meeting, paras. 153-155.
[637] See e.g. Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

buys products subject to the tax (or subject to the full rate).[638] On this basis, the European Union argues that the exemptions under the ICT programmes entail a lower administrative burden in relation to the IPI tax and the PIS/PASEP and COFINS contributions when accredited companies sell the incentivised products, granting those products a competitive advantage over like imported products.[639]

7.245. The European Union submits that the lower administrative burden creates an incentive in the Brazilian market in favour of domestic products incentivised under the programmes, and in particular with respect to the incentivised *intermediate* products that are purchased by other producers. According to the European Union, this is because, first, purchasers will not need to anticipate the amount of those taxes when purchasing the products; and second, purchasers will not have to undergo the administrative procedure to claim a tax credit in relation to those taxes and obtain compensation with the same or other taxes (or they will have very low tax credit to compensate), or to ask for reimbursement.[640]

7.246. The European Union adds that Brazil has explained that the reimbursement of tax credits that cannot be compensated is a lengthy and time-consuming procedure that can take years, which confirms that the advantage received by the companies that benefit from the exemptions or suspensions of indirect taxes on their purchases is very significant, both in terms of positive cash flow as well as avoidance of administrative burden, and is not abstract and irrelevant, but instead is a concrete advantage recognised by Brazil itself.[641]

7.247. Brazil argues that the complaining parties want the Panel to make findings of *de facto* discrimination against imported products and domestic contingency without presenting any evidence to support those findings. Brazil adds that the complaining parties urge this Panel to draw unwarranted inferences regardless of whether those inferences have any basis in either the text of the measures, or evidence on the record. Brazil submits that the highly inferential nature of the complaining parties' case under Article III is illustrated by the fact that they are forced to refer to "unspecified administrative burdens".[642]

7.248. With respect to the *intermediate* incentivised products, the Panel has found in paragraphs 7.136 and 7.138 above, that imported *intermediate* products, which are not incentivised, face a tax payment that incentivized like domestic *intermediate* products do not face or face to a lesser extent, and that this tax payment results, for purchasers of imported *intermediate* products, in a limit to the cash availability as well as a loss in the value of the tax credit derived from the transaction. Consequently, the Panel found that the ICT programmes result in imported *intermediate* products being treated less favourably than like domestic products, notwithstanding the fact that the sales of *intermediate* products are subject to the mechanism of credits and debits, so that the purchaser will obtain a credit in the same amount as the tax paid.

7.249. The European Union's claim with respect to the alleged lower administrative burden on firms purchasing domestic intermediate products entitled to a tax suspension or exemption seems to merely add to the reasons for concluding that the tax exemptions and suspensions accorded to imported *intermediate* products result in less favourable treatment than that accorded to like domestic products, rather than to be a stand-alone claim. Nevertheless, the Panel will assess the European Union's claim.

7.250. The Panel recalls that in order to determine whether there exists "treatment less favourable" for imported products in the sense of Article III:4 of the GATT 1994, panels must

[638] European Union's first written submission, paras. 647, 807, 812, 960, 966, 1100 and 1105; European Union's second written submission, paras. 324 and 433; European Union's response to Panel questions No. 2 and 72.

[639] European Union's first written submission, paras. 647, 807, 812, 960, 966, 1100 and 1105; European Union's second written submission, paras. 324 and 433; European Union's response to Panel questions No. 2 and 72.

[640] European Union's first written submission, para. 647, 807, 812, 960, 966, 1100 and 1105; European Union's second written submission, paras. 324 and 433; European Union's response to Panel questions No. 2 and 72.

[641] European Union's first written submission, paras. 647, 807, 812, 960, 966, 1100 and 1105; European Union's second written submission, paras. 324 and 433; European Union's response to Panel questions No. 2 and 72.

[642] Brazil's opening statement in the second substantive meeting, paras. 4-5.

analyse whether the measures at issue modify the conditions of competition in the relevant market to the detriment of imported products.[643]

7.251. As a factual matter, purchasers of non-incentivised *intermediate* products will always have to pay the IPI tax and the PIS/PASEP and COFINS contributions when they purchase the product. It is also a fact that taxes paid on *intermediate* products generate a tax credit in the amount of the tax or contribution paid, in favour of the purchaser – a tax credit that can be offset with other debits on their IPI tax, or PIS/PASEP and COFINS contribution' debits.[644] Similarly, it is undisputed that, if the tax credit cannot be offset by debits after three taxation periods, the company can request that the tax credit is compensated with other Federal taxes, or reimbursed. It is accepted by Brazil that the process of compensation and reimbursement can be burdensome for companies, and can take years.[645]

7.252. The Panel notes that, while a purchaser of an incentivised *intermediate* product subject to a tax exemption or reduction will not need to anticipate any tax, or will only need to anticipate a reduced amount of tax, to the Brazilian Government, the purchaser of a non-incentivised *intermediate* product will need to anticipate the full amount of those taxes when purchasing the products, and will have to undergo the administrative procedure to claim a tax credit in relation to those taxes, to request compensation with the same or other taxes, or to ask for reimbursement.

7.253. The Panel agrees with the European Union that this difference in treatment creates an incentive to purchase incentivised *intermediate* products, produced by accredited companies, over non-incentivised products. In the view of the Panel, when faced with a decision to choose from either a product whose purchase will entail no payment of taxes, or a product whose purchase will entail the payment of the tax and the administrative burden that comes with the procedure of offsetting the tax with other debits (or requesting compensation or reimbursement), a purchaser, under normal circumstances, will prefer to avoid the administrative burden that comes with the payment of the tax.

7.254. Since an imported product will never be eligible for the tax reductions or exemptions, the incentive to avoid the administrative burden, by purchasing incentivised *intermediate* products, modifies the conditions of competition between domestic and like imported products, to the detriment of the imported products.

7.255. Thus, the ICT programmes are inconsistent with Article III:4 of the GATT 1994, because they accord to imported *intermediate* products treatment less favourable than that accorded to like domestic *intermediate* products, due to the lower administrative burden imposed on firms purchasing incentivised *intermediate* products.

7.3.2.2 Claims with respect to the alleged imposition, under the terms of the PPBs, or similar requirements, of an obligation to use domestic inputs in the production of the incentivized products under the ICT programmes

7.3.2.2.1 Introduction

7.256. The complaining parties argue that the production step requirements with which manufacturers must comply to receive the tax incentives under the four ICT programmes involve requirements to use domestic inputs in the production of the incentivized products. This allegation is relevant for the remaining element of the complaining parties' claims under Article III:4 of the GATT 1994 as well as their claims under Article 3.1(b) of the SCM Agreement.[646]

7.257. The Panel notes that it already has found the accreditation requirements of the ICT programmes – which include the production step requirements – to be inconsistent with Article III:4 of the GATT 1994. That said, however, the question of whether the production step requirements of the ICT programmes require the use of domestic inputs is different from the basis

[643] See for example, Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.
[644] See paragraph 2.11 above.
[645] See, for example, Brazil's first written submission, para. 702 (DS497).
[646] In limiting its discussion in this section to issues related to Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement, the Panel does not consider that this discussion is not also relevant to the claims under Article 2.1 of the TRIMs Agreement, addressed below.

for the Panel's ruling on the other aspects of the ICT programmes. In addition, this issue is raised in, and is central to, the complaining parties' claims that the ICT programmes provide subsidies that are contingent on the use of domestic over imported goods, inconsistent with Article 3.1(b) of the SCM Agreement.[647] Given this latter consideration, the Panel will proceed to analyse this issue.

7.258. If the Panel finds that the alleged requirement to use domestic goods exists, the Panel considers that this will lead *ipso facto* to the further finding of inconsistency with Article III:4 of the GATT 1994 that the complaining parties claim. This is because, while Article III:4 itself does not refer to such requirements, it is well settled on the basis of a considerable line of jurisprudence that such requirements are inconsistent with Article III:4 by operating to the disadvantage of imported products, including where the use of domestic goods is only one of the options for complying with the requirements of a law or regulation (or for obtaining an advantage).[648]

7.259. In addition, such a finding of a requirement to use domestic goods, if made, will also constitute a finding by the Panel that the contingency element of the claims under Article 3.1(b) of the SCM Agreement has been satisfied, i.e., that to the extent the programmes provide subsidies, any such subsidies would be contingent on the use of domestic over imported goods.

7.260. In this respect, pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement, subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods are prohibited, and shall not be granted or maintained.[649]

7.261. The Panel notes that the ordinary meaning of the word "contingent" is "conditional: dependent *on, upon*"[650], so a subsidy is "contingent upon the use of domestic over imported goods", and thus, prohibited under Article 3.1(b) of the SCM Agreement, if the use of domestic goods is *required* or *necessary* in order to receive the subsidy.[651]

7.262. If the Panel finds that such requirement to use domestic goods over imported goods exists, it will proceed with the further analysis of whether the ICT programmes provide subsidies. If, however, the Panel finds no requirement to use domestic goods over imported goods, that will dispose of the claims under Article 3.1(b) of the SCM Agreement and the Panel will stop its analysis of those claims at that point.

7.263. The Panel recalls that that for an inconsistency with Article III:4 of the GATT 1994 to be established, three elements must be satisfied: (a) that the measure at issue be a "law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use" of products; (b) that the imported and domestic products at issue be "like products"; and

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[647] See section 7.3.5.2 below.

[648] See, *e.g.*, Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 220, where the Appellate Body held that the local content requirements operated to provide a disincentive to the use of imports, notwithstanding the possibility to obtain the benefits in question without using domestic inputs, and thus constituted less favourable treatment of imports under Article III:4 of the GATT 1994. See also *Canada – FIRA*, (GATT Panel Report, *Canada – FIRA,* paras. 5.7 – 5.11), where undertakings to purchase goods of Canadian origin and undertakings to buy from Canadian suppliers both were found to be inconsistent with Article III:4. See for a similar finding GATT Panel Report, *Italy – Agricultural Machinery*, para. 13.

[649] Article 3.1(b) of the SCM Agreement states in relevant parts that: "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: … (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." Article 3.2, in turn, states that "[a] Member shall neither grant nor maintain subsidies referred to in paragraph 1.

[650] Shorter Oxford English Dictionary (6th ed., 2007)

[651] Indeed, such an interpretation was confirmed by the Appellate Body in Canada – Autos, where the Appellate Body recalled its discussion of Article 3.1(a) and explained as follows:

> In our discussion of Article 3.1(a) in Section VI of this Report, we recalled that in *Canada – Aircraft* we stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'." Thus, a subsidy is prohibited under Article 3.1(a) if it is "conditional" upon export performance, that is, if it is "dependent for its existence on" export performance. In addition, in *Canada – Aircraft*, we stated that contingency "in law" is demonstrated "on the basis of the words of the relevant legislation, regulation or other legal instrument." (emphasis added) As we have already explained, such conditionality can be derived by necessary implication from the words actually used in the measure. We believe that this legal standard applies not only to "contingency" under Article 3.1(a), but also to "contingency" under Article 3.1(b) of the SCM Agreement. Appellate Body Report, *Canada – Autos*, para. 123.

(c) that imported products be accorded "treatment less favourable" than that accorded to like domestic products.[652] The Panel examines the challenged measures on the basis of these three elements.

7.3.2.2.2 Whether the measures at issue are laws, regulations, or requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of domestic and imported products

7.264. The Panel recalls its analysis in section 7.3.2.1.2 above with respect to whether the measures at issue are laws, regulations, or requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of domestic and imported products. The Panel will not repeat its analysis, as it applies equally to this claim.

7.3.2.2.3 Whether the relevant imported and domestic products are "like products"

7.265. First, the Panel recalls its finding in paragraph 7.117 above in the context of Article III:2 of the GATT 1994 that the incentivised products receiving the relevant tax treatment are Brazilian domestic products within the meaning of Article III:2. This is also true for Article III:4.

7.266. As explained, in addition to their allegations of inconsistency with Article III:4 in respect of *finished* and *intermediate* products, the complaining parties also allege that the ICT programmes are inconsistent with Article III:4 in respect of components and subassemblies. The European Union explains that imported components and subassemblies that can be used in the production of *finished* and *intermediate* products are like products, and that those components and subassemblies "are defined essentially by their inherent technological features. Thus, components and subassemblies manufactured in Brazil and imported are in a directly competitive relationship in the market."[653] Both complaining parties consider that the challenged programmes distinguish "between imported and domestic products that are identical in all respects except for their origins, and there is no need to carry out a detailed case-by-case analysis of the 'like[ness]' element under Article III:4."[654]

7.267. Brazil argues that the challenged programmes do not make an origin distinction between imported and domestic products, and that the complaining parties have therefore not met their burden of proof.[655] Brazil did not contest the likeness of the products under the traditional criteria of likeness, as argued by the complaining parties.[656]

7.268. As stated above, previous panels used "hypothetical" likeness with respect to Articles III:4, under which approach "a complainant may establish 'likeness' by demonstrating that the measure at issue makes a distinction based exclusively on the origin of the product".[657] Under this approach, a complaining party must make a *prima facie* case that a measure draws a distinction based exclusively on origin.[658]

7.269. The Panel notes that the complaining parties' argument is that the relevant programmes require the use of domestically produced components and subassemblies in the production of a *finished* or *intermediate* product in order for that *finished* or *intermediate* product to receive

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[652] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

[653] European Union's first written submission, para. 627. See also European Union's first written submission, paras. 794, 695 and 1087.

[654] European Union's first written submission, paras. 626-628, 793-795, 945-946 and 1087-1088; Japan's first written submission, para. 59; Japan's first written submission, paras. 341-342, 411 and 412, 465-466, and 523.

[655] Brazil's first written submissions, paras. 234-237, 397 and 489 (DS472) and 188-190, 290, 335 and 426 (DS497).

[656] See paragraph 7.119 above.

[657] Appellate Body Report, *Argentina – Financial Services*, para. 6.36. See also Appellate Body Reports, *Argentina – Financial Services*, para. 6.36 (referring to Panel Reports, *Argentina – Hides and Leather*, para. 11.168; *China – Auto Parts*, para. 7.216; *Argentina – Import Measures*, para. 6.274; *Canada – Autos*, para. 10.74; *Canada – Wheat Exports and Grain Imports*, para. 6.164; *China – Publications and Audiovisual Products*, para. 7.1447; *India – Autos*, para. 7.174; *Thailand – Cigarettes (Philippines)*, para. 7.661; *Turkey – Rice*, paras. 7.214-7.216; *US – FSC (Article 21.5 – EC)*, paras. 8.132-8.135; *Colombia – Ports of Entry*, paras. 7.355-7.356; and *US – Poultry (China)*, paras. 7.424-7.432).

[658] Appellate Body Report, *Argentina – Financial Services*, para. 6.45.

certain tax benefits. Such regulatory distinction is clearly based on the origin of the products traded. The Panel does not prejudge at this point of its analysis the issue of whether the imported products identified by the complaining parties are indeed treated less favourably than the domestic like products. The Panel does consider, however, that the products alleged by the complaining parties to be disadvantaged are *like* the products that are allegedly favoured. The Panel addresses below whether the measures function as local content requirements that require the use of domestic over imported goods.

7.270. The Panel therefore concludes that domestically produced *components and subassemblies* and imported *components and subassemblies* are like products, within the meaning of Article III:4 of the GATT 1994.

7.3.2.2.4 Whether imported products are accorded "treatment less favourable" than that accorded to like domestic products

7.271. To recall, the complaining parties argue that to receive the relevant tax benefits under the ICT programmes, manufacturers must comply with certain production-step requirements that modify the conditions of competition for imported *inputs* in favour of domestic like *inputs*. The complaining parties consider this to be the case because the process of complying with each required production step specified in a basic production process (PPB) (or specified otherwise) results in the creation of an "input" good that then must be "used" in an ensuing step or steps in the production of the incentivized finished or intermediate product (i.e. the product receiving the advantageous tax treatment). They make this argument without regard for whether a single company itself performs all of the production steps and thus itself creates the "inputs" in question (so-called "in-house" production), or instead outsources some production steps to third parties, by acquiring from them the outputs of those production steps, which it then incorporates as "inputs" into its production of the incentivized product.

7.272. Thus, for the complaining parties, "the requirement to perform certain manufacturing steps in Brazil [in all cases] is tantamount to requiring the incorporation of domestic content into the finished product", whenever the performance of those manufacturing steps results in the creation of a product.[659] They argue in this regard that such conditions for receiving the tax benefit on an incentivized product require that "specific inputs of particular products, and/or specific amounts or proportions of such inputs, be sourced domestically", such that "the use of imported inputs can disqualify a final product for eligibility" under the ICT programmes.[660] In the view of the complaining parties, this alleged obligation to use local inputs in the production of ICT products, as a condition to receive the tax benefits under the ICT programmes, affords less favourable treatment to imported inputs than that accorded to like domestic inputs.[661]

7.273. Brazil disagrees with the complaining parties' characterization of the production step requirements, arguing that the PPBs (or the analogous production step requirements) are not related to either domestic or foreign products, as they are not related to products in the first place. Rather, Brazil asserts, PPBs aim at ensuring technological and industrial development along various steps of the production chain for the industry to "dominate the production cycle", and are origin-neutral.[662] Brazil considers that the complaining parties have erroneously conflated production steps with products, and manufacturing requirements with local content requirements.[663] Concerning the individual ICT programmes, Brazil argues that the Informatics, PATVD and Digital Inclusion programmes all refer to production processes (the so-called PPBs), while the PADIS programme describes the types of product design and productive steps with which accredited companies must comply, and that none of these requirements may be presumed to relate to the origin of the inputs and products used in the production process, or to affect the

[659] Japan's first written submission, para. 296. See also European Union's first written submission, para. 600 ("PPBs may not only require that certain stages in the production or processing operations of the information technology product take place in Brazil … PPBs also require that the company accredited under the programme itself carries out the production of certain inputs or intermediate products or that a percentage or quantum of locally sourced inputs or intermediate products (produced locally, often in accordance with their own respective PPB) must be incorporated into the end-product.").

[660] Japan's first written submission, para. 342.

[661] European Union's first written submission, para. 652,

[662] Brazil's first written submission, para. 73 (DS472). See also Brazil's first written submission, para. 42 (DS497).

[663] Brazil's first written submission, para. 78 (DS472).

conditions of competition of any product at the market.[664] According to Brazil, the ICT programmes do not require, in law or in fact, that a certain level of local components be used; to the contrary, in most cases imported inputs, parts and components constitute the large majority of the total cost of production covered by those programmes.[665]

7.274. The parties' arguments reveal fundamental differences both as to whether as a matter of fact the PPBs and other production step requirements under the ICT programmes consist of or contain requirements to use domestic inputs; and whether as a matter of law requirements to perform a series of production steps domestically constitute, without more, requirements to use domestic inputs. The Panel turns first to an analysis of the factual questions, on the basis of the details of the PPBs and other production step requirements themselves. The Panel conducts this factual analysis programme-by-programme, for the Informatics, PATVD, PADIS, and Digital Inclusion programmes.

7.3.2.2.4.1 The operation of the PPBs and other production step requirements in the ICT programmes

7.275. The Panel notes that in order for a company to become accredited and then to obtain the tax benefits under the Informatics programme, it must produce the relevant technology and automation goods in accordance with the terms of particular product-specific PPBs.[666]

7.276. Under the PADIS programme, in order to become accredited and then to obtain the relevant tax benefits, a company must comply with different requirements depending upon the products for which it seeks the tax benefits. Specifically, with respect to "semiconductor electronic devices", the company must perform the "concept, development and design", *or* "diffusion or physical-chemical processing", *or* "cutting, encapsulation and testing".[667] With respect to "information displays", the company must either perform the "concept, development and design", *or* the "manufacturing of photosensitive, photo or electroluminescent elements and light emitting diodes", *or* the "final assembly of displays and electrical and optical testing".[668] None of the requirements for these products include PPBs. They do, however, specify production-step details. Finally, with respect to "supplies and equipment intended for the manufacture of electronic semiconductor devices and information displays", the company must manufacture those products in accordance with the relevant PPBs.[669]

7.277. Under the PATVD programme, in order to obtain accreditation and then to obtain the relevant tax benefits, a company must either comply with the relevant PPB or alternatively meet the criteria for a product to be considered "developed in Brazil".[670]

7.278. Under the Digital Inclusion programme, retailers can obtain certain tax benefits on their sales in Brazil of certain digital consumer goods produced in accordance with their relevant PPBs.[671]

7.279. The Panel notes that all four programmes refer to production-step requirements contained in so-called PPBs or in other legal instruments.[672] The Panel has scrutinized the evidence submitted by the parties, including all PPBs submitted to the Panel as evidence (further detailed in the Appendix attached to this Report). Based on that examination, the Panel makes the following observations about the functioning of the PPBs themselves.

7.280. A PPB is defined as "the minimum set of operations, in a manufacturing establishment, which characterizes the effective industrialization of given product".[673] Indeed, a PPB is essentially a set of product-specific production steps that must be performed in Brazil, in order for a company

[664] Brazil's opening statement at the first meeting of the Panel, para. 45.
[665] Brazil's opening statement at the second meeting of the Panel, para. 34.
[666] See section 2.2.1.5 above.
[667] See section 2.2.2.5 above.
[668] See section 2.2.2.5 above.
[669] See section 2.2.2.5 above.
[670] See section 2.2.3.5 above.
[671] See section 2.2.4.4 above.
[672] See section 2.2.2.5 above.
[673] Decree 5,906/2006, (Exhibit JE-7), Article 16.

to benefit from the tax incentives in respect of that product under the relevant programme(s). The specific requirements within each product-specific PPB vary, depending on the nature of the production process for that particular product.[674]

7.281. Certain PPB production-step requirements must be performed by the company accredited as the producer of the incentivised *finished* or *intermediate* product that is the subject of the PPB, while other production-step requirements may be performed by "third parties" based in Brazil.[675] This varies by PPB.

7.282. The Panel further notes that not all production step requirements are contained in PPBs. This is the case, as noted above, for some of the products covered by PADIS. In addition, under PATVD, the tax benefits can be obtained either by complying with the production steps in the PPBs, or by meeting the criteria for the product to be considered "developed in Brazil".

7.283. Finally, the Panel notes that not all PPBs or other production step requirements are relevant under all of the ICT programmes. In particular, a large number of PPBs are relevant under the Informatics programme, and a subset of these is relevant under the Digital Inclusion programme. Other PPBs are relevant, respectively, under the PADIS and PATVD programmes. In addition, only PADIS has production step requirements that are not contained in separate PPBs.

7.284. In this regard, the Panel notes that while it presents its analysis in respect of the PPBs and other production step requirements overall, the Panel has scrutinized all of the PPBs and the other production step requirements, the analysis of which can be found in the Appendix attached to this Report. That Annex describes in detail, for each PPB or set of production step requirements, the specific instances of the types of provisions referred to herein.

7.285. Turning to the specific provisions of the PPBs, the Panel notes that all of them are titled as "basic production processes" for the specified, incentivized product in question "produced in Brazil". These titles, and the underlying legal instruments, make clear that all of the operations described in the PPBs must be carried out in Brazil. In terms of their content, all of the PPBs consist of a collection of production steps, most of which involve the conversion through a manufacturing process of basic raw materials in completely disaggregated form into a component or set of components or subassemblies, with the final step or steps involving the integration of all of these components or subassemblies into the final product along with, in some cases, testing and other final steps.

7.286. To illustrate this point, the Panel examines by way of example two PPBs under that programme, for Optical Splice Closures[676] and for Speed Alarms, Tracking and Control[677], which are broadly representative of how the PPBs as a whole operate.

7.287. The operational language of the PPB for Optical Splice Closures reads as follows:

> Article 1. Establishes the following Basic Production Process for **OPTICAL SPLICE CLOSURES:**
>
> I - manufacture of the moulds for the injection of the plastic parts;
> II - injection of the plastic parts;
> III - stamping of the metal parts;
> IV - assembly of the air valve and closure kit sub-assemblies and base items;
> V - final integration of the product; and
> VI - product impermeability test.

[674] The PPBs are further described in general in section 2.2.1.5.2 above.

[675] As a simple example, the PPB for "flexible organic drum assemblies" requires that the "cutting of the substrate", "soldering", and "assembly of all the parts and pieces, totally separated, at a basic component level" must be performed in Brazil. The cutting of the substrate and soldering may be performed by the entity producing the flexible drum assembly *or* by a third party in Brazil, and the assembly of the parts and pieces at a basic component level must be performed exclusively by the entity producing the flexible organic drum assembly itself. See Interministerial Implementing Order 268/2013, (Exhibit JE-37), Article 7.

[676] Interministerial Implementing Order 93/2013, (Exhibit JE-31).

[677] Interministerial Implementing Order 103/2013, (Exhibit JE-32).

> Sole Paragraph. Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties in Brazil, except with regard to stages V and VI which may not be conducted by third parties.
>
> Article 2. Whenever duly corroborated technical or economic factors so determine, any stage of the Basic Production Process may be temporarily suspended or changed through a joint Implementing Order issued by the Ministers of State for Development, Industry and Foreign Trade and Science, Technology and Innovation.
>
> Article 3. This Implementing Order shall come into force on the date of its publication.

7.288. As shown by Article 1 of this PPB, for an optical splice closure to be eligible for the tax benefits under the Informatics programme, all of the steps outlined in that Article must be undertaken in Brazil. Thus, the moulds for plastic injection must be made in Brazil, the plastic parts must be injected in Brazil, the metal parts must be stamped in Brazil, and so forth. This demonstrates that the production processes envisaged, all of which must be performed in Brazil, consist of fundamental manufacturing from basic inputs. In other words, a product produced through simple assembly of components and subassemblies would not satisfy the conditions of the PPB. This is consistent with how Brazil describes the PPBs.[678]

7.289. The PPB for Speed Alarms, Tracking and Control functions similarly, albeit with some additional features. Its operational language reads as follows:

> Article 1. The Basic Production Process for **PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL** industrialized in Brazil, as set out in the Annex to Interministerial Implementing Order MDIC/MCT No 14 of 22 January 2007, shall now read as follows:
>
> I - stamping, cutting, folding and surface treatment of metal parts, when applicable;
> II - injection of the housing's plastic parts, when applicable;
> III - manufacture of the printed circuits from laminate;
> IV - assembly and soldering, or equivalent process, of all components on the printed circuit boards;
> V - assembly of the electrical and mechanical parts, totally separated, at a basic component level; and
> VI - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, in accordance with indents I to V above.
>
> § 1 Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent VI which may not be conducted by third parties.
>
> § 2 Liquid crystal, plasma and other display technologies are temporarily exempted from assembly.
>
> § 3 The following assembled modules and sub-assemblies are temporarily exempted from compliance with the stages set out in indents III and IV, of the header paragraph to this Article:
>
> I - Frequency Modulation (FM) communication modules;
> II - Pager communication modules;
> III - Global Positioning System (GPS) communication modules;
> IV - satellite communication modules;
> V - thermal printer mechanisms; and
> VI - Code Division Multiple Access (CDMA) communication modules.
>
> Article 2. 90% of the total number of Global System for Mobile Communications (GSM) communication modules used in the production of PRODUCTS FOR SPEED

[678] Brazil's first written submissions, paras. 128-155 (DS472) and 85-104 (DS497).

ALARMS, TRACKING AND CONTROL as set out in the Annex to this Implementing Order shall be produced in accordance with their respective Basic Production Process in the calendar year.

§ 1 Should the percentage set out in the header paragraph not be achieved, the company shall be required to make up the difference in units produced, before 31 December of the following year, without prejudice to current obligations in that calendar year.

§ 2 The difference referred to in § 1 may not exceed 5% with regard to the production in the year in which it was not possible to achieve the set limit.

Article 3 The stage established in Article 1, indent III (manufacture of the printed circuits from laminate) shall be exempted with regard to printed circuits manufactured with 'via in pad' technology and an amount of 'blind' points greater than 500 holes per square decimetre to be used exclusively in TRACKERS.

Sole paragraph The exemption set out in this Article is conditioned to the additional investment of at least 1.5% by the manufacturer in R&D of its gross turnover in the domestic market resulting from the sale with tax benefit, less the corresponding contributions on such sales, as well as the value of acquisitions of goods with the same incentive, in the calendar year.

Article 4 Whenever duly corroborated technical or economic factors so determine, any stage of the Basic Production Process may be temporarily suspended or changed through a joint Implementing Order issued by the Ministers of State for Development, Industry and Foreign Trade and Science, Technology and Innovation.

Article 5 Interministerial Implementing Order MDIC/MCT No 14 of 22 January 2007 is hereby repealed.

Article 6 This Implementing Order shall come into force on the date of its publication.

ANNEX
PRODUCTS
Automobile immobiliser with transponder
Automobile immobiliser by FM
Automobile immobiliser by pager
Automobile immobiliser with/without remote control
Vehicle tracker without GPS and communication via satellite
Vehicle tracker with GPS and communication via satellite
Vehicle tracker without GPS and communication via satellite with flat antenna
Vehicle tracker with GPS positioning and communication via GSM/GPRS [Global System for Mobile Communication/General Packet Radio Service]
Vehicle tracker with Location Based Service (LBS) positioning and communication via GSM/GPRS
Vehicle tracker/immobiliser with GPS and communication via mobile phone
Vehicle tracker/immobiliser with GPS and communication via radio
Vehicle tracker/immobiliser with GPS and communication via satellite
Vehicle tracker/immobiliser with GPS and communication via radio frequency
Electronic tacograph
Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via mobile phone
Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via radio
Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via satellite
Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via radio frequency
Electronic tacograph with automobile tracker/immobiliser, by triangulation and communication via radio frequency
Electronic tacograph immobiliser by pager

Electronic tacograph immobiliser by FM

7.290. As shown by Article 1 of this PPB, for speed alarms, tracking and control to be eligible for the tax benefits under the Informatics programme, all of the steps outlined in that Article must be undertaken in Brazil. Thus, the stamping, cutting, folding and surface treatment of metal parts; injection of any plastic parts of the housing; manufacture of the printed circuits from laminate; assembly and soldering, or equivalent process, of all components on the printed circuit boards; assembly of the electrical and mechanical parts, totally separated, at a basic component level; and the integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, all must be undertaken in Brazil. Here again, these are not mere assembly operations but fundamental manufacturing processes from basic inputs.

7.291. The PPB for speed alarms, tracking and control has one additional aspect that the PPB for optical splice closures lacks, namely a PPB within a PPB (a so-called "nested PPB"[679]). In particular, Article 2 provides that at least 90% of the GSM modules used to produce any of the products for speed alarms, tracking and control listed in the Annex to the PPB must be produced in compliance with their own PPB. In other words, this means that a separate PPB exists for GSM modules, and that this separate PPB must be complied with for at least 90% of the GSM modules used in production of the products for speed alarms, tracking and control products listed in the Annex. The Panel notes that Brazil has accepted that all nested PPBs can be outsourced to a third party in Brazil.[680]

7.292. The Panel notes that by virtue of being accredited, a producer of a given incentivized product takes responsibility for all of the production steps required in the respective PPB, and correspondingly it alone receives the tax advantages in respect of that incentivized product. As noted above, however, this does not mean that that one company must perform all of the production steps itself in order to retain its accreditation. To the contrary, in every case[681] the PPBs allow the accredited company to outsource at least some of the required production steps to third parties, so long as those third parties themselves comply with the requirements of the PPB in respect of the steps they perform.

7.293. Starting with the example of the PPB for optical splice closures, an accredited producer can outsource steps I-IV, meaning that another company or companies can produce the injection moulds, inject the plastic parts, stamp the metal parts, and assemble the air valve and closure kit sub-assemblies and base items. Similarly, concerning speed alarms, tracking and control, an accredited producer can outsource all of the production steps other than the final step of integrating the printed circuit boards and all of the electrical and mechanical parts to form the final product. Thus, the accredited producer can outsource to another company or companies any stamping, cutting, folding or surface treatment of metal parts; any injection of the housing's plastic parts; the manufacture of the printed circuits from laminate; the assembly and soldering, or equivalent process, of all components on the printed circuit boards; and the assembly of the electrical and mechanical parts, totally separated, at a basic component level. The underlying condition for all of this outsourcing is, as indicated, that all of the third parties involved must comply with the requirements of the PPB for the respective steps that they are performing.

7.294. To put this in concrete terms, if a producer of optical splice closures wishes to outsource a stamped metal part, it must assure itself that the part was stamped in Brazil, either by the company from which it obtains the part or by another company in Brazil. Similarly, if a producer of a speed alarm wishes to outsource a printed circuit board, it must assure itself both that the printed circuits themselves were manufactured in Brazil from laminate, and that all of the components of the printed circuit boards were assembled and soldered or similarly attached to the boards in Brazil (whether by one or multiple companies). In this sense, each of the steps, in a PPB

[679] The term "nested PPBs" was first used by the United States in its third party submission, and continued to be used throughout the dispute. See United States third party submission, para. 15. See also, e.g., European Union's second written submission, para. 239; and European Union's response to Panel question No. 79.

[680] In Brazil's response to Panel question No. 67, it explained as follows: "[W]ith respect to PPBs that include requirements that a specific input or component be produced in accordance with its own PPB, the specific input or component can be produced by third parties in Brazil. The production of a specific input by third parties, in accordance with its own PPB, is still subject to verification by the authorities." See also the parties' responses to Panel Question No. 56.

[681] The details are set forth in the Appendix attached to this report.

for the creation of a manufactured component or subassembly for the incentivized product can be considered a "mini-PPB" for the component or subassembly that is produced in that step; and the principal requirements of these mini-PPBs (as for the main PPBs as a whole) are basic manufacturing processes that must be performed in Brazil.

7.295. The situation of "nested PPBs" is analytically similar to that of the production step requirements, with the main difference being what appears to be an implicit presumption that the products that are subject to the nested PPBs will be outsourced[682]. In any case, whoever makes the GSM modules in a specific instance, the fact that those products are subject to their own PPB implies that they are subject to their own production step requirements that must be carried out in Brazil and presumably their own outsourcing provisions for some of those production steps.

7.296. With this in mind, the Panel proceeds to evaluate each of the claims in respect of each of the challenged programmes.

7.3.2.2.4.2 The Panel's analysis of the Informatics programme

7.297. The Panel recalls that in the context of their claims under both Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement, the complaining parties argue that the production step requirements on their own constitute requirements to use domestic goods in the production of incentivized products, without regard to whether those requirements are met "in-house" with the accredited producer performing all of the required steps itself, or through outsourcing some of those steps. Brazil argues that the production step requirements have exclusively to do with production and in no case require the use of domestic goods, and thus are not covered either by Article III:4 of the GATT 1994 or by Article 3.1(b) of the SCM Agreement.[683] That said, there seems to be no theoretical disagreement among the parties that at least in the case in which a company is required, when it acquires a product from an outside source, to only acquire a domestic product, there would be a requirement to use domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

7.298. Given these views of the parties, in its analysis of whether, as alleged, the PPBs under the Informatics programme contain or constitute requirements to use domestic goods, the Panel considers it useful to separately analyse the two possible scenarios for compliance with the PPBs as just described: the in-house scenario and the outsourcing scenario. The Panel will first consider the outsourcing scenario.

7.299. In assessing this issue the Panel considers first the case of "main" PPBs that contain nested PPBs (such as the PPB for speed alarms, tracking and control, with its own nested PPB for GSM modules). The Panel recalls its finding in paragraph 7.117 above that all products produced in accordance with a PPB are, as such, Brazilian domestic products, by virtue of having been produced in Brazil from basic raw materials and other inputs through a specified mandatory manufacturing process. On this basis, the Panel considers that the incentivized products produced in accordance with the nested PPBs, which are used as components and subassemblies in the production of the products covered by the main PPBs, constitute Brazilian domestic products in their own right. The Panel further recalls that the main PPBs that contain nested PPBs require that at least some minimum proportion of the components and subassemblies of the type covered by the nested PPBs must have been produced in accordance with those nested PPBs. (As discussed above, the nested PPB for GSM modules contained in the main PPB for speed alarms, tracking and control requires that at least 90% of the GSM modules used be produced in accordance with the separate PPB for GSM modules.) As also discussed in paragraph 7.295 above, the Panel considers that in most cases, the components and subassemblies that are the subject of the nested PPBs will be outsourced, rather than produced, by the producer of the product covered by the main PPB; and in any case, as noted, Brazil has acknowledged that outsourcing is permitted for items subject to nested PPBs.[684] Therefore, where products subject to nested PPBs are outsourced, the requirements that (at least a certain proportion of) such products comply with their respective PPBs thus constitute explicit requirements to use domestic goods – the components and subassemblies covered by the nested PPBs – in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

[682] See footnote 680 above.
[683] The Panel has already rejected these arguments in section 7.2 above.
[684] See footnote 680 above.

7.300. Put another way, whenever a producer of a product covered by a main PPB obtains components or subassemblies covered by their own nested PPB it is obtaining domestic goods. Because the nested PPB imposes a mandatory minimum amount of such domestic goods to be used in producing the product subject to the main PPB, the only way to satisfy this requirement, when outsourcing, is by acquiring and using domestic goods. Thus, every PPB with a nested PPB inside contains an explicit requirement to use domestic goods in the cases where the goods covered by the nested PPB are outsourced.

7.301. This analysis also holds true for the basic production step requirements of all PPBs under the Informatics programme, which typically are set forth in the PPBs' Article 1. All PPBs, as discussed, contain outsourcing provisions that require that outsourced production steps comply with the respective requirements of the PPBs, and in every case at least some of those outsourcing provisions apply to production steps for the creation of manufactured components or subassemblies from basic components and raw materials which, as the Panel has found, are for that reason domestic products. The Panel further considers that, similarly to the case of the outsourcing of products produced in accordance with nested PPBs, the outsourcing of production steps for the manufacture in Brazil of components and subassemblies from basic components and raw materials gives rise to a requirement to use domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement. In particular, when an accredited company outsources components and subassemblies it can only comply with the PPB in question if the production step requirements for those components and subassemblies are respected, and respecting those requirements in turn means that those components and subassemblies must be Brazilian domestic goods.

7.302. Thus, under the Informatics programme, regarding the outsourcing requirements in respect of the production step requirements for components and subassemblies used in the production of an incentivized product, the PPBs require the use of domestic goods, in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

7.303. The Panel notes that certain PPBs contain alternative options to compliance with certain production-steps in the PPBs, in order for a company to obtain the concerned tax treatment. As discussed in paragraph 7.258, the Panel considers that the mere existence of options for compliance that are potentially WTO-consistent could not preclude a finding of inconsistency in respect of the PPBs as a whole. The Panel highlights that were it otherwise, Members could circumvent WTO rules, such as the fundamental principle of non-discrimination, by imposing measures that condition advantages on several alternative options, some of which are WTO-consistent, and others WTO-inconsistent. In short, the Panel does not consider that the existence of alternative, potentially WTO-consistent options, alters the inconsistency with Article III:4 of an option that requires the use of domestic products over imported products.[685]

7.304. This is also applicable to Article 3.1(b) of the SCM Agreement. In this respect, the Panel considers that where a particular requirement *can* be achieved by a number of means, and one of those means entails a contingency upon the use of domestic over imported goods, that particular aspect of the requirement is inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement. The Panel considers that the mere existence of options for compliance that are potentially WTO-consistent could not preclude a finding of inconsistency in respect of the measure as a whole. Were it otherwise, Members could circumvent the prohibition of subsidies contained in Article 3.1 of the SCM Agreement by conditioning the grant of such subsidies on several alternative options, and so long as one of them is WTO-consistent, the measure could not be found to be inconsistent with Article 3.1(b) of the SCM Agreement. In this context as well, the Panel does not consider that the existence of alternative, potentially WTO-consistent options, alters the inconsistency with Article 3.1(b) and 3.2 of the SCM Agreement of an option that entails a contingency upon the use of domestic over imported goods.[686]

7.305. The Panel recalls from paragraph 2.63 above that multiple PPBs require specific percentages of specific input goods be assembled in Brazil. In the view of the Panel, these specific percentages do not alter the Panel's conclusion that the production-step requirements within the PPBs favour the use of domestic like products, to the detriment of like imported products, inconsistently with Article III:4 of the GATT 1994. The Panel also notes that multiple PPBs also

[685] See footnote 648 above.
[686] See also Panel Report, *Canada – Autos*, paras. 10.84-10.87.

contain exemptions or alternative options that are time-specific. Additionally, certain PPBs contain time-limited exemptions of products or production-steps, including time-limited exemptions that apply to the percentages discussed in paragraph 2.63 above. In the Panel's view, such exemptions confirm the Panel's conclusion that generally the production-step requirements within the PPBs require the use of domestic over imported goods. In particular, the Panel notes the statement of the panel in *Russia – Tariff Treatment* that "a panel can in principle find an existing measure to be inconsistent as such … even if that measure mandates WTO-inconsistent action that will take place only in the future."[687] In this respect, the fact that a PPB explicitly provides for a future date at which an exemption will cease to apply, is sufficient for the Panel to conclude that the measure is inconsistent with Article III:4. However, to the extent that a product, entity or production-step, is fully exempted (with no defined time-limit), the Panel recognizes that there would be no inconsistency with Article III:4 of the GATT 1994 of Article 3.1(b) of the SCM Agreement arising therefrom.

7.306. The Panel now applies this analysis to each of the other ICT programmes: PATVD, PADIS and the Digital Inclusion programme.

7.3.2.2.4.3 The Panel's analysis of the PATVD programme

7.307. The Panel recalls that under the PATVD programme, in order to obtain accreditation and obtain the relevant tax benefits, companies must either comply with the relevant PPB or alternatively meet the criteria for a product to be considered "developed in Brazil".[688]

7.308. For the same reasons given above in respect of the Informatics programme, the Panel considers that with respect to the outsourcing provisions in the PPBs in respect of components and subassemblies, which require that when such components and subassemblies are outsourced they must be Brazilian domestic products, the PPBs in the PATVD programme require the use of domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement. Additionally, for the reasons described in paragraphs 7.303 and 7.304 above, the Panel does not consider that the existence of a potentially WTO-consistent alternative option for compliance (i.e., that the incentivized product be "developed in Brazil"), alters this conclusion. As noted above, the Panel's analysis of the PPBs in question is set forth in the Appendix attached to this Report.

7.3.2.2.4.4 The Panel's analysis of the PADIS programme

7.309. The Panel recalls that under the PADIS programme, for an accredited company to obtain the relevant tax benefits, it must comply with different requirements depending on the products for which it is seeking the tax benefits. Specifically, with respect to "semiconductor electronic devices", the company must perform the "concept, development and design", *or* "diffusion or physical-chemical processing", *or* "cutting, encapsulation and testing".[689] With respect to "information displays", the company must either perform the "concept, development and design", *or* the "manufacturing of photosensitive, photo or electroluminescent elements and light emitting diodes", *or* the "final assembly of displays and electrical and optical testing".[690] Finally, with respect to supplies and equipment intended for the manufacture of electronic semiconductor devices and information displays, the company must manufacture those products in accordance with the relevant production-step requirements imposed through PPBs.[691]

7.310. In respect of the production step requirements for semiconductor electronic devices, and information displays, accredited companies must comply with *one* of the several possible production steps referred to above. Any of these steps can be outsourced and some of them

[687] Panel Report, *Russia – Tariff Treatment*, para. 7.103. See also Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 82.

[688] See section 2.2.3.5 above.

[689] See section 2.2.2.5 above.

[690] See section 2.2.2.5 above.

[691] See section 2.2.2.5 above. Specifically, such "dedicated inputs and equipment intended for the manufacture of" semiconductor electronic devices and information displays must be "manufactured according to the Basic Production Process established by the Ministries of Development, Industry and Foreign Trade and of Science, Technology and Innovation". See Law 11,484/2007, (Exhibit JE-71), Article 2 §3, as amended by Law 12,715/2012, (Exhibit JE-95), Article 57; and Decree 6,233/2007, (Exhibit JE-73), Article 6 §3, as amended by Decree 8,247/2014, (Exhibit JE-75), Article 1.

involve the manufacturing of components or subassemblies from basic components and raw materials.[692]

7.311. For the same reasons given above in respect of the Informatics programme, the Panel considers that with respect to the outsourcing provisions in the production step requirements in respect of components and subassemblies, which require that when such components and subassemblies are outsourced they must be Brazilian domestic products, the production step requirements in the PADIS programme require the use of domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement. Additionally, for the reasons described in paragraphs 7.303 and 7.304 above, the Panel does not consider that the existence of a potentially WTO-consistent alternative option for compliance (i.e., "concept, development and design"), alters this conclusion.

7.312. In respect of supplies and equipment intended for the manufacture of electronic semiconductor devices and information displays, the Panel notes that the relevant legal instruments provide that the production-step requirements are contained in product-specific PPBs. However, in reviewing the evidence before the Panel, the Panel finds that no PPBs have as yet been adopted in respect of these particular products. Although the PADIS programme contemplates the adoption of PPBs in the future, the Panel cannot make findings in respect of production-step requirements that do not (yet) exist. At this point in time, it suffices for the Panel to note that, in accordance with its findings above, to the extent that any future PPBs adopted under the PADIS programme contain outsourcing provisions or nested PPBs in respect of manufactured components and subassemblies that operate in the same manner as those in the Informatics and PATVD programmes, such PPBs would require the use of domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

7.313. On the basis of the foregoing considerations, the Panel concludes that with respect to the outsourcing provisions, and where applicable, the nested PPBs, the PPBs and other production step requirements, under the Informatics, PATVD and PADIS programmes are explicitly contingent on the use of domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the Agreement. As a consequence, the Panel concludes that those aspects of the challenged programmes that include the PPBs are inconsistent with Article III:4, and that they also constitute a contingency on the use of domestic over imported goods for purposes of the claims under Article 3.1(b) of the SCM Agreement.

7.314. In light of these conclusions and the parties' divergent views in respect of the in-house scenario for complying with the PPBs, the Panel again recalls that the WTO-inconsistency of a requirement for compliance with a law or regulation cannot be cured by the existence of an alternative, potentially WTO-consistent, option for compliance with that law or regulation. Given this, the Panel considers it unnecessary to address the in-house scenario. In particular, were the Panel to find, as Brazil implies, that that scenario does not involve a requirement to use domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement, this would not alter the Panel's finding in respect of the outsourcing scenario that such measures are inconsistent with Article III:4 and constitute a contingency on the use of domestic over imported goods for purposes of the claims under Article 3.1(b) of the SCM Agreement. Thus, the Panel makes no finding in respect of the in-house scenario.

7.3.2.2.4.5 The Panel's analysis of the Digital Inclusion programme

7.315. Under the Digital Inclusion programme, retailers that sell in Brazil certain digital consumer goods produced in accordance with their respective PPBs[693] qualify for certain tax benefits.

7.316. The Panel's analysis of the role of PPBs under the Digital Inclusion programme departs from that under the other ICT programmes. This is because under this programme the tax benefits are in respect of sales of certain products by retailers, rather than in respect of production of

[692] As Brazil has indicated, a company seeking accreditation under the PADIS programme "has to select one of the set of activities to the development of the covered products. The company may perform all of the activities in the set or may outsource some of the activities to other companies … [T]here is no requirement that all set of activities for a specific product be conducted by one single company. The only requirement is that the activities be carried out in Brazil." Brazil's first written submission, fn 179 (DS497).

[693] See section 2.2.4.4.

certain products by producers. In this respect, the Panel recalls its finding above at paragraph 7.299 that all products produced in accordance with PPBs are, by definition, Brazilian domestic products. This means that the only goods eligible for the tax benefits under the Digital Inclusion programme are domestic goods (i.e., the goods produced in accordance with the specified PPBs), and the retailers in turn only obtain the tax benefits to the extent that they have purchased these domestic goods (for resale), instead of like imported goods.

7.317. The Panel therefore finds that this is a straightforward situation of incentives that are provided in respect of a preference (in this case by retailers) for domestic over imported goods, as discussed above in section 7.3.2.2.4.1. On this basis, and for the same reasons as outlined in that discussion, the Panel finds that the Digital Inclusion programme is inconsistent with Article III:4 of the GATT 1994. Furthermore, the Panel finds that for the same reasons, this programme involves a contingency on the use of domestic over imported goods in the sense covered by Article 3.1(b) of the SCM Agreement.

7.3.2.3 Conclusion

7.318. In light of the foregoing, the Panel concludes that (a) the production-step requirements and the requirement for products to obtain the status of "developed" in Brazil under the Informatics, PADIS, and PATVD programmes, and certain eligibility requirements under the Digital Inclusion programme; (b) the aspect of the mechanism for the calculation of the amount of resources required to be invested in R&D under the Informatics and PADIS programmes, where the amounts paid when purchasing incentivised products are deducted from the calculation; and (c) the lower administrative burden on companies purchasing domestic incentivised intermediate products under the Informatics and PADIS programmes; accord to imported products treatment less favourable than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994.

7.319. The Panel also concludes that the PPBs and other production step requirements of the Informatics, Digital Inclusion, PATVD and PADIS programmes accord to imported products treatment less favourable than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994. The Panel further concludes that the same aspects of these programmes give rise to contingency on the use of domestic over imported goods in the sense of Article 3.1(b) of the SCM Agreement. The Panel will incorporate this finding in its analysis of the claims under that provision.

7.3.3 Claims under Article III:5 of the GATT 1994

7.3.3.1 Introduction

7.320. The European Union and Japan present claims under both the first and second sentence of Article III:5 of the GATT 1994.

7.321. The Panel recalls that, as one of the requirements to be accredited under the ICT programmes, companies must commit to produce their incentivized goods in accordance with the PPBs, or similar requirements, which indicate the minimum stages or steps of the manufacturing process of a product that must be performed in Brazil.[694] The Panel recalls, as well, that some PPBs also require that specific components, parts and pieces used in the production of the ICT products be produced, in a specific percentage, in accordance with their own respective PPBs, and other require a percentage of local assembly for specific components, parts and pieces.[695]

7.322. The European Union and Japan submit that the ICT programmes are inconsistent with Article III:5, first sentence, of the GATT 1994, because the conditions under the terms of the PPBs (a) to perform a minimum number of processing activities or manufacturing steps in Brazil, and (b) to use a proportion of local inputs to manufacture ICT products in Brazil, in order to benefit from the exemptions or reductions, amount to an internal quantitative regulation relating to the

[694] See sections 2.2.1.5.2, 2.2.2.5, 2.2.3.5, and 2.2.4.4.
[695] See section 2.2.1.5.2 above.

processing or use of products, which requires a specified amount or proportion of the products to be supplied from domestic sources.[696]

7.323. The European Union and Japan submit that the ICT programmes are also inconsistent with Article III:5, second sentence, of the GATT 1994, because, in any event, the conditions relating to the minimum processing activities that must be carried out in Brazil amount to an internal quantitative regulation that is applied so as to afford protection to domestic production.[697]

7.324. Brazil submits that the ICT programmes do not establish requirements relating to products within the meaning of Article III:5 of the GATT 1994. Brazil submits that the production-step requirements are related to workforce and technology and not to the mixture, processing or use of products in specified amounts or proportions. Brazil also argues that the production-step requirements do not establish an obligation to source goods domestically, as they only require that certain stages of production be performed in Brazil. Brazil submits, as well, that the ICT programmes are not designed, structured or applied so as to afford protection to domestic production.[698]

7.3.3.2 The legal standard

7.325. Article III:5 of the GATT 1994, first sentence, provides as follows:

> No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources.

7.326. According to an early GATT panel in *US – Tobacco*, in order to find inconsistency with Article III:5 of the GATT 1994, first sentence, the challenged measure must meet two criteria: (a) that it be an "internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions"; and (b) that it "requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources".[699]

7.327. Article III:5 of the GATT 1994, second sentence, provides, in turn, as follows:

> Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.[700]

7.328. A regulation infringes Article III:5 of the GATT 1994, second sentence if two conditions are met: (a) it is an internal quantitative regulation; and (b) it is applied "so as to afford protection to domestic production".[701]

7.329. Article III:5 of GATT 1994, second sentence, is further clarified by the Ad Note to this paragraph, which provides that:

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[696] European Union's first written submission, paras. 662-675, 822-836, 981-992 and 1111-1113; Japan's first written submission, paras. 348-352, 414-418, 470-475 and 525-530; and European Union and Japan's responses to Panel question No. 79.

[697] European Union's first written submission, paras. 676-688, 836-840, 993-997, and 1114-1117; and Japan's first written submission, paras. 353-355, 419-421, 476-478 and 531-532.

[698] Brazil's first written submissions, paras. 265-285, 342-345, 399-400, and 491-493 (DS472) and 220-236, 292-295, 337-338 and 428-430 (DS497).

[699] GATT Panel Report, *US –Tobacco*, paras. 67 – 68.

[700] Article III:1 of the GATT 1994 provides as follows: The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

[701] Article III:1 of the GATT 1994; GATT Panel Report, *Spain- Soybean Oil*, para. 4.4 (not adopted); see also GATT Panel Report, *EEC – Animal Feed Proteins*, paras 4.5 and 4.6 and Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 18, DSR 1996:I, 97, at p. 111 ("Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production").

> Regulations consistent with the provisions of the first sentence of paragraph 5 shall not be considered to be contrary to the provisions of the second sentence in any case in which all of the products subject to the regulations are produced domestically in substantial quantities. A regulation cannot be justified as being consistent with the provisions of the second sentence on the ground that the proportion or amount allocated to each of the products which are the subject of the regulation constitutes an equitable relationship between imported and domestic products.

7.3.3.3 Analysis by the Panel

7.330. The Panel has already dealt with the conditions under the terms of the challenged PPBs, both to perform a minimum number of processing activities or manufacturing steps in Brazil, and to use a proportion of local inputs to manufacture ICT products in Brazil, in the context of the complaining parties' claims under Article III:4 of the GATT 1994.[702]

7.331. The Panel has concluded, in paragraph 7.319 above, that the conditions under the terms of the PPBs to perform certain processing activities or manufacturing steps in Brazil, and to use a proportion of local inputs to manufacture ICT products in Brazil, are inconsistent with Article III:4 of the GATT 1994, as they accord less favourable treatment to imported products (inputs for the production of incentivized goods) than that accorded to domestic like products.

7.332. Given the fact that the Panel has already dealt with the conditions under the terms of the corresponding PPBs challenged by the complaining parties, in the context of its analysis under Article III:4 of the GATT 1994, the Panel will assess whether it is appropriate to apply the principle of judicial economy in the context of the claims under Article III:5 of the GATT 1994.

7.333. In this respect, the European Union considers that its claim under Article III:5 of the GATT 1994 should be distinguished from its claim under Article III:4 and that the Panel should make findings on both provisions. The European Union submits that Article III:5 of the GATT 1994 contains a set of obligations which speak directly to certain elements in the programmes at issue and, in turn, the obligation under Article III:4 of the GATT 1994 is broader in scope. The European Union adds that under its claim pursuant to Article III:4 of the GATT 1994, it challenges the conditions for accreditation under the programmes, which, in the European Union's view, are different to the specific features contested under Article III:5 of the GATT 1994.[703]

7.334. The European Union maintains that although Article III:4 of the GATT 1994 is meant to cover more situations in practice when compared to Article III:5, this reason alone should not be used to exercise judicial economy, as Article III:5 has a very precise meaning and was meant to clarify that imposing local content requirements when regulating the processing of products internally would run against the national treatment principle enshrined in Article III.[704]

7.335. Japan argues that Articles III:4 and III:5 of the GATT 1994 have distinct scopes and focus on different aspects of discrimination, although they overlap with one another to a certain extent. Japan maintains that Article III:4 concerns discrimination between domestic and imported products and Article III:5 covers internal quantitative regulations which require that any specified amount or proportion of any product must be supplied from domestic sources, so those provisions focus on different aspects of discrimination and findings of inconsistency under Article III:5 would differ from findings under Article III:4.[705]

7.336. Brazil submits, in turn, that the scope of Article III:5 is significantly narrower than that of Article III:4 of GATT 1994, and if inconsistency with Article III:4 were to be found, there would probably be no further reason to analyse the claims under the narrower provision.[706]

7.337. The United States, as a third party, is of the view that if the Panel determines that the disputed programmes are inconsistent with Articles III:2 and III:4 of the GATT 1994, there would not seem to be value in addressing additional claims under Article III:5.[707]

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[702] See section 7.3.2.2 above.
[703] European Union's response to Panel question No. 2.
[704] European Union's response to Panel question No. 79.
[705] Japan's response to Panel questions No. 2 and 79.
[706] Brazil's response to Panel question No. 2.

7.338. As explained in paragraphs 7.177 to 7.179 above, panels are not obliged to rule on each of the claims put forth by the complaining parties. Panels have the discretion to exercise the principle of judicial economy and assess only the claims that they consider necessary to secure a positive solution to a dispute.

7.339. The Panel notes that the specific features challenged under Article III:5 of the GATT 1994 (namely the conditions under the terms of the corresponding PPBs (a) to perform a minimum number of processing activities or manufacturing steps in Brazil, and (b) to use a proportion of local inputs to manufacture ICT products in Brazil) were also specifically challenged by the complaining parties in their claims under Article III:4 of the GATT 1994.

7.340. In this respect, the European Union specifically challenged, under Article III:4 of the GATT 1994: (a) for the Informatics programme, the imposition under the terms of the relevant PPBs of an obligation to use locally-produced inputs in the production of ICT products, as a condition to benefit from the exemptions or reductions[708]; (b) for the PADIS programme, the requirement to use locally-produced inputs resulting from the list of processing activities to be carried out in Brazil, as a condition to benefit from the exemptions[709]; (c) for the PATVD programme, the imposition under the terms of Implementing Order 62/2014 of an obligation to use locally-produced components in the production of radio frequency signal transmission equipment for digital television, as a condition to benefit from the exemptions[710]; and (d) for the Digital Inclusion programme, the conditions necessary for consumer electronics to benefit from the exemptions (including those on inputs).[711]

7.341. Japan, in turn, specifically challenged under Article III:4 of the GATT 1994: (a) for the Informatics programme, the requirement that specific inputs of particular products, and/or specific amounts or proportions of such inputs, be sourced domestically[712]; (b) for the PADIS programme, the requirement that in order for the manufacturer of a particular product to be accredited, specific manufacturing steps must be performed by accredited legal entities[713]; (c) for the PATVD programme, the requirement as one of the conditions for accreditation to produce specific goods in accordance with the relevant PPBs, which in turn specify that particular inputs must be of Brazilian origin[714]; and (d) for the Digital Inclusion programme, the requirements to carry out a specific set of manufacturing steps in Brazil in accordance with the relevant PPBs, and that specific inputs and/or specific amounts or proportions of such inputs be manufactured domestically.[715]

7.342. The Panel recalls that it assessed those exact same features under Article III:4 of the GATT 1994 and found, in paragraph 7.319 above, that those features were inconsistent with Article III:4 of the GATT 1994. The Panel sees no difference in the features of the ICT programmes covered by the complaining parties in their claims under Article III:4 and the features covered by the complaining parties in their claims under Article III:5.

7.343. Moreover, both the European Union and Japan have explained that, as in the case of their claims under Article III:4 of the GATT 1994, they have challenged under Article III:5 of the GATT 1994 all the PPBs as one of the requirements under the conditions for accreditation.[716]

7.344. The Panel is fully aware of its task of securing a positive solution to this dispute. However, the Panel sees no reason why it would need to assess two claims under two different provisions of Article III of the GATT of 1994, covering the same features of the ICT programmes, in order to secure a positive solution to the dispute. This is because the same aspects that lead to the finding of inconsistency with Article III:4 of the GATT 1994 (specifically the finding of discrimination against imported inputs through the imposition of local content requirements), are the same aspects that the complaining parties allege to be inconsistent with Article III:5 of the GATT 1994.

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[707] United States' third party statement, para. 9.
[708] European Union's first written submission, para. 620.
[709] European Union's first written submission, para. 815.
[710] European Union's first written submission, para. 971.
[711] European Union's first written submission, para. 1081.
[712] Japan's first written submission, para. 342.
[713] Japan's first written submission, para. 410.
[714] Japan's first written submission, para. 468.
[715] Japan's first written submission, para. 523.
[716] European Union's and Japan's response to Panel question No. 76.

7.345. Even if Article III:5 of the GATT 1994 has a more precise meaning and refers to local content requirements when regulating the processing of products internally, in the context of this dispute, the complaining parties have framed their claims under Article III:4 and III:5 of the GATT 1994 in such a way so as to cover the exact same features.

7.346. The Panel therefore considers that, in the specific context of this dispute, if Brazil brings its measures into conformity with Article III:4 of the GATT of 1994, it will also bring its measures into conformity with Article III:5 of the GATT of 1994. In particular, the *reasons* for the alleged inconsistency in respect of Article III:5 are, in the Panel's view, fully resolved by the Panel's findings in respect of Article III:4. In this respect the Panel also emphasizes that all factual findings relevant to an assessment of the complaining parties' claims under Article III:5 have already been made in respect of the complaining parties' claims under Article III:4.

7.3.3.4 Conclusion

7.347. The Panel concludes that it is not necessary to make findings with respect to the complaining parties' claims under Article III:5 of the GATT 1994 in order to secure a positive solution to this dispute, and therefore exercises judicial economy with respect to these claims.

7.3.4 Claims under Article 2.1 of the TRIMs Agreement

7.3.4.1 Introduction

7.348. The complaining parties submit that the ICT programmes (i.e. the Informatics, PADIS, PATVD and Digital Inclusion programmes) are inconsistent with Article 2.1 of the TRIMs Agreement, both independently and in conjunction with Article 2.2 and paragraph 1(a) of the Agreement's Illustrative List, because they are inconsistent with Article III of the GATT 1994.[717]

7.349. The complaining parties claim that the ICT programmes constitute trade-related investment measures and are therefore within the scope of the TRIMs Agreement. The complaining parties further submit that the ICT programmes are inconsistent with Article III:2, III:4 and III:5 of the GATT 1994. Therefore, in their view, the ICT programmes also violate Article 2.1 of the TRIMs Agreement.[718]

7.350. Additionally, the complaining parties contend that the ICT programmes are TRIMs that fall under paragraph 1(a) of the Annex to the TRIMs Agreement because they require that accredited companies purchase or use products of domestic origin or from domestic sources in terms of particular inputs or a proportion of volume of its local production in order to obtain tax reductions and exemptions.[719]

7.351. Brazil agrees with the complaining parties that the ICT programmes are investment measures. However, it submits that they do not relate to trade in goods because they deal with research, development and production.[720] Brazil argues that the ICT programmes do not impose local content requirements inconsistent with the covered agreements.[721] Brazil submits that the ICT programmes fall outside the scope of Article III of the GATT 1994 by virtue of Article III:8(b) of the GATT 1994 and, therefore, do not violate either the GATT 1994 or the TRIMs Agreement.[722]

7.352. With respect to Brazil's arguments that the ICT programmes are outside the scope of Article III of the GATT 1994, because they relate to pre-market requirements rather products, and additionally by virtue of Article III:8(b) of the GATT, the Panel has addressed both of these

[717] European Union's first written submission, paras. 690, 841, 998 and 1118; Japan's first written submission, paras. 371, 437, 479-496 and 533-548.

[718] European Union's first written submission, paras. 702-703, 848-849, 1007-1008 and 1128-1129; and Japan's first written submission, paras. 366, 431, 490 and 542.

[719] European Union's first written submission, paras. 705-707, 851-852, 1010-1011 and 1131; and Japan's first written submission, paras. 370, 435-436, 494-495 and 546-547.

[720] Brazil's first written submissions, paras. 237 and 296 (DS472) and 431 (DS497).

[721] Brazil's first written submissions, paras. 287-288 (DS472) and 239 (DS497).

[722] Brazil's first written submissions, paras. 290-292, 346-347, 460-461 and 494-495 (DS472) and 240, 296, 397 and 431 (DS497).

arguments above and found that the challenged measures are subject to the disciplines of Article III.[723]

7.353. The Panel notes that Article 2.1 of the TRIMs Agreement states as follows:

> Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.

7.354. Additionally, the Panel in *Indonesia – Autos* indicated that two elements must be shown in order to demonstrate inconsistency with Article 2.1: first, that the challenged measure is a TRIM; second, that the TRIM is inconsistent with Article III or Article XI of GATT.[724] Additionally, the Panel in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* indicated that Article 2.1 of the TRIMs Agreement imposes an obligation on Members not to apply any TRIM that is inconsistent with the national treatment provisions of Article III of the GATT, including Articles III:2, III:4 and III:5. It follows that any measure found to be inconsistent with Article III of the GATT, that is also a TRIM, will be incompatible with Article 2.1 of the TRIMs Agreement.[725]

7.355. The Panel notes that in order for a measure to be found to be inconsistent with Article 2.1 of the TRIMs Agreement, it must be a trade-related investment measure, within the meaning of the TRIMs Agreement, and it must be found to be inconsistent with Article III of the GATT 1994. The Panel proceeds by assessing these two steps in turn.

7.3.4.2 Whether the ICT programmes are trade-related investment measures within the meaning of the TRIMs Agreement

7.356. The complaining parties submit that the Informatics programme is a trade-related investment measure for six reasons. First, it contains an obligation for all companies seeking accreditation to invest a minimum percentage of their gross revenue in R&D in the ICT sector in Brazil. Second, the requirement established in the PPBs that certain processing operations or production steps take place in Brazil in order to benefit from the tax reductions and exemptions incentivizes investment and local production. Third, Brazil admits that in the establishment of a PPB it is guided by the amount of investments to be carried out in Brazil by the company in order to produce the product in question. Fourth, Brazil has further acknowledged that the Informatics programme is an instrument for companies to relocate to Brazil and attract foreign investment. Fifth, the PPBs establish local content requirements expressed in terms of minimum percentages of locally-produced parts or components (sometimes produced in accordance with their own PPBs) that the accredited company must purchase or manufacture itself in Brazil in order to be used in the manufacturing processes in order to obtain the tax reductions and exemptions. Finally, the Informatics programme provides for domestic content requirements that are "related to trade in goods" since they affect ICT products marketed in Brazil.[726]

7.357. The complaining parties submit that the PADIS programme is a trade-related investment measure for five reasons. First, it contains an obligation for all companies seeking accreditation to invest a minimum percentage of their gross revenue in R&D in Brazil. Second, the declared objective of the PADIS programme is to attract investment in the area of semiconductors and displays, and it is advertised as a fiscal incentive scheme to attract foreign investment. Third, the requirement that certain processing operations or production steps take place in Brazil in order to benefit from the tax reductions and exemptions incentivizes investment and local production. Fourth, by its structure and design, the PADIS programme promotes productive investments in Brazil. Finally, the PADIS programme "relates to goods" because it relates to semiconductors, displays and strategic input, as well as all the production means and inputs necessary to

[723] See sections 7.2.1 and 7.2.2 above.
[724] Panel Report, *Indonesia – Autos*, para. 14.64.
[725] Panel Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 7.117.
[726] European Union's first written submission, paras. 695-700; Japan's first written submission, paras. 359-364.

manufacture them, and the tax exemption it provides applies on the domestic sale or import of those products.[727]

7.358. The complaining parties submit that the PATVD programme is a trade-related investment measure for four reasons. First, it contains an obligation for all companies seeking accreditation to invest a minimum percentage of their gross revenue in R&D in Brazil. Second, by its structure and design, PATVD promotes productive investments in Brazil in the field of radio frequency signal transmission equipment for digital television. The Brazilian government has acknowledged that one of the aims of the programme is to attract foreign investment. This idea is reinforced by the Explanatory Memorandum of the provisional measure that became Law 11,484/2007, which provides that one of the objectives of the programme is to promote the localisation in Brazil of companies developing and manufacturing radio frequency signal transmission equipment for digital television. Third, the PATVD programme incentivises local production and investment by requiring, through PPBs, that certain processing operations or production-steps take place in Brazil, and that some components are made in Brazil. In fact, Implementing Order 62/2014 requires PATVD beneficiaries to exclusively use printed circuit boards and other electric and mechanical parts made in Brazil in the production of radio frequency signal transmission equipment for digital television. Similar local content requirements have been found to be "necessarily … 'trade-related' because such requirements, by definition, always favour the use of domestic over imported products, and therefore affect trade. Finally, the PATVD programme "relates to goods" because it relates to radio frequency signal transmission equipment for digital television, as well as all the production means and inputs necessary to manufacture them, and the tax exemption it provides applies on the domestic sale or import of those products.[728]

7.359. The complaining parties submit that the Digital Inclusion programme is a trade-related investment measure for five reasons. First, it incentivises local production and investment by requiring, through the PPBs, that certain processing operations or production steps take place in Brazil in order to benefit from the tax exemptions. In this respect, the complaining parties recall that what guides the establishment of PPBs by the Brazilian government is, *inter alia*, the level of investment in Brazil in the manufacturing process by the accredited company. Second, the Brazilian government has admitted that one of the objectives of Digital Inclusion is to promote investment in order to promote production of consumers' electronics in Brazil. Third, the complaining parties argue that this programme has been conceived to operate with other tax incentive programmes that constitute investment measures, such as the Informatics programme. Finally, the Digital Inclusion programme "relates to goods" because it relates to consumer electronic products and their components, which are goods.[729]

7.360. In the view of the Panel, the ICT programmes affect, and indeed are aimed at promoting, investment. The programmes also have an impact on trade, by affecting the sale and purchase of imported products, including the inputs used in the production of incentivized *finished* and *intermediate* products. In this regard, it is important to note that, if a measure contains local content requirements, it would necessarily be a "trade-related" measure, because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade.[730]

7.361. The Panel therefore concludes that the ICT programmes are trade-related investment measures within the meaning of the TRIMs Agreement.

7.3.4.3 Whether the ICT programmes are TRIMs that are inconsistent with Article III of the GATT 1994, and therefore inconsistent Article 2.1 of the TRIMs Agreement

7.362. In order to make a finding of inconsistency in respect of Article 2.1 of the TRIMs Agreement, the relevant TRIMs must be found to be inconsistent with Article III of the GATT 1994.

[727] European Union's first written submission, paras. 843-847; Japan's first written submission, paras. 425-429.

[728] European Union's first written submission, paras. 1000-1006; Japan's first written submission, paras. 482-488.

[729] European Union's first written submission, paras. 1121-1127; Japan's first written submission, paras. 537-540.

[730] Panel Report, *Indonesia – Autos*, para. 14.82.

7.363. The Panel has concluded in paragraphs 7.174, 7.318, and 7.319 above, that certain aspects of the ICT programmes are inconsistent with Article III:2 and III:4 of the GATT 1994. In light of its finding above that the programmes constitute trade-related investment measures, the Panel therefore considers that those aspects of the ICT programmes found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement.

7.364. Additionally, the Panel notes that the local content requirements identified and discussed in section 7.3.2.2 above "require the purchase or use by an enterprise of products of domestic origin or from any domestic source", as referred to in paragraph 1(a) of the Illustrative List annexed to the TRIMs Agreement. Pursuant to Article 2.2 of the TRIMs Agreement, a TRIM on the Illustrative List is *per se* inconsistent with Article III:4 of the GATT 1994, and therefore inconsistent with Article 2.1 of the TRIMs Agreement. This further confirms the Panel's findings in that section that the local content requirements are inconsistent with Article III:4 and, as indicated in paragraphs 7.362 and 7.363 above, consequentially inconsistent with Article 2.1 of the TRIMs Agreement).

7.3.4.4 Conclusion

7.365. In light of the foregoing, the Panel concludes that the Informatics, Digital Inclusion, PATVD and PADIS programmes constitute trade-related investment measures, and that the aspects of these programmes found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement.

7.3.5 Claims under Article 3.1(b) of the SCM Agreement

7.3.5.1 Introduction

7.366. The complaining parties have raised claims under Article 3.1(b) of the SCM Agreement with respect to the ICT programmes.

7.367. As will be explained in detail below, Article 3.1(b) of the SCM Agreement prohibits subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

7.368. The Panel recalls that companies accredited under the Informatics programme are entitled to IPI tax exemptions or reductions on the sales of incentivized products, and IPI tax suspensions on the purchase of raw materials, intermediate goods and packaging materials.[731]

7.369. Companies accredited under the PADIS programme are entitled to exemptions (through zero rates) of the IPI tax and the PIS/PASEP and COFINS contributions, and 100% reduction of the corporate income tax and the duties on profits from exploitation of patents, all arising from the sales of finished products and their projects (design). Accredited companies are also entitled to exemptions (through zero rates) of ordinary customs duties, the IPI tax and the PIS/PASEP, COFINS, PIS/PASEP-importation, COFINS-importation and CIDE contributions on purchases of new machinery, apparatus, instruments, equipment, computational tools and inputs.[732]

7.370. Companies accredited under the PATVD programme are entitled to exemptions (through zero rates) of the IPI tax and the PIS/PASEP and COFINS contributions arising from the sales of incentivized products. Accredited companies are also entitled to zero rates of the IPI tax and the PIS/PASEP, COFINS, PIS/PASEP-importation, COFINS-importation and CIDE contributions on purchases of new machinery, apparatus, instruments, equipment, computational tools and inputs.[733]

[731] See paragraphs 2.41 to 2.45 above.
[732] See paragraph 2.73 above.
[733] See paragraph 2.84 above.

7.371. Companies accredited under the Digital Inclusion programme are entitled to exemptions (through zero rates) of the PIS/PASEP and COFINS contributions arising from the sales of incentivized products.[734]

7.372. The Panel also recalls that, as one of the requirements to be accredited under the ICT programmes, companies must commit to produce their incentivized goods in accordance with the PPBs, or similar requirements, which indicate the minimum stages or steps of the manufacturing process of a product that must be performed in Brazil.[735]

7.373. The European Union and Japan argue that the different exemptions, reductions and suspensions granted to accredited companies under the Informatics, PADIS, PATVD and Digital Inclusion programmes (hereinafter ICT programmes) are subsidies within the meaning of the SCM Agreement, as they constitute financial contributions in the form of government revenue otherwise due that is foregone or not collected, through which a benefit is conferred.[736]

7.374. The European Union and Japan also argue that the alleged subsidies granted under the ICT programmes are contingent upon the use of domestic over imported goods and are, thus, prohibited under Article 3.1(b) of the SCM Agreement, because those PPBs or similar requirements provide that certain inputs, parts and components incorporated in the product must be produced in Brazil.[737]

7.375. Brazil presents three lines of argumentation, depending on whether the challenged tax treatment is: (i) on the sales of incentivized goods which can be considered to be *finished goods* (as they will not undergo further manufacturing); (ii) on the sales of incentivized goods which can be considered to be *intermediate goods* (as they will undergo further manufacturing); and (iii) on the purchases of *raw materials, intermediate goods*, *new machinery, apparatus, instruments, equipment, computational tools* and *inputs* used by accredited companies to produce their incentivized goods.

7.376. With respect to the tax exemptions and reductions granted to accredited companies on the sales of the incentivized *finished goods* that they produce (under the Informatics, PATVD and Digital Inclusion programmes), Brazil accepts that there is a financial contribution in the form of "government revenue that is otherwise due is forgone or not collected", which confers a benefit.[738]

7.377. With respect to the tax exemptions and reductions granted to accredited companies on the sales of the incentivized *intermediate goods* that they produce (under Informatics and PADIS), Brazil contends that there is neither revenue foregone nor any benefit conferred. Brazil argues that, according to the principle of non-accumulation in the Brazilian tax system, the payments of taxes on the sales of *intermediate goods* are neutral in terms of tax collection. Brazil argues that, according to the mechanism of credits and debits under the principle of non-accumulation, the companies that purchase *intermediate goods* generate tax credits when they pay the IPI tax and the PIS/PASEP and COFINS contributions (under the non-cumulative regime) to the seller. These purchasing companies can later offset the credits generated by the taxes and contributions (that have been paid) with debits from the same taxes and contributions, or ask for compensation with other taxes or reimbursement.[739]

7.378. With respect to the tax suspensions on the purchases of *raw materials, intermediate goods* and *packaging materials* used by the accredited companies to produce their incentivized goods (under Informatics) and the tax exemptions on the purchase of *new machinery, apparatus, instruments, equipment, computational tools* and *inputs* used by the accredited companies to produce their incentivized goods (PADIS and PATVD), Brazil contends that there is neither revenue foregone nor any benefit conferred. Brazil argues that, according to the principle of non-

[734] See paragraph 2.93 above.

[735] See sections 2.2.1.5.2, 2.2.2.5, 2.2.3.5 and 2.2.4.4 above.

[736] European Union's first written submission, paras. 709-722, 856-871, 1015-1022 and 1135-1143; Japan's first written submission, paras. 372-377, 438-442, 497-501 and 549-553.

[737] European Union's first written submission, paras. 723-727, 872-878, 1023-1025 and 1144-1147; Japan's first written submission, paras. 372-377, 438-442, 497-501 and 549-553.

[738] Brazil's first written submissions, fn 120 and paras. 462 and 496 (DS472) and fn 111 and paras. 399 and 433 (DS497); and Brazil's response to Panel question No. 25.

[739] Brazil's first written submissions, paras. 294-295 and 349-351 (DS472) and 244-245 and 299-301 (DS497).

accumulation in the Brazilian tax system, the payments of taxes and contributions on the sales of *raw materials, inputs, intermediate goods, packaging materials, new machinery, apparatus, instruments, equipment and computational tools* are neutral in terms of tax collection. Brazil argues that, according to the mechanism of credits and debits under the principle of non-accumulation, the companies that purchase *raw materials, intermediate goods, packaging materials, new machinery, apparatus, instruments, equipment, computational tools and inputs* generate tax credits when they pay the IPI tax (if applicable[740]) and the PIS/PASEP and COFINS contributions to the seller. These companies can later offset the credits generated by the taxes and contributions paid, against debits from the same taxes and contributions. If the companies do not generate enough tax debits to fully offset the credits, they can ask for compensation or reimbursement. Brazil submits, however, that asking for compensation or reimbursement is burdensome for both the government and the taxpayers. Brazil explains that the tax exemptions or suspensions are, thus, a tax administration measure to prevent the accumulation of tax credits by companies whose final products are exempted or subject to low taxation, and that are unable to generate enough tax debits to offset the tax credits generated.[741]

7.379. Brazil also submits that the requirements to be accredited under the different programmes do not reflect contingency upon the use of domestic over imported goods, because the requirements are not related to products, but to production.[742] Brazil argues that the tax exemptions, reductions or suspensions granted under the ICT programmes are "payments of subsidies exclusively to domestic producers" covered by GATT Article III:8(b).

7.380. In order to determine whether the tax exemptions, reductions and suspensions granted under the ICT programmes are inconsistent with Article 3.1(b) of the SCM Agreement, the Panel must assess:

a. Whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute subsidies, i.e., whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute financial contributions by the Brazilian Government, in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred; and

b. Whether the tax exemptions, reductions and suspensions granted under the ICT programmes are contingent upon the use of domestic over imported goods and thus prohibited.[743]

7.3.5.2 Whether the tax exemptions, reductions and suspensions granted under the ICT programmes are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement and thus prohibited

7.381. The European Union and Japan argue that the subsidies conferred under the ICT programmes are contingent upon the use of domestic over imported, because they are only granted to ICT goods produced in accordance with the PPB or similar production-step requirements, which contain requirements that the components and subassemblies incorporated in the product are produced locally, sometimes by the accredited company, sometimes by other domestic companies.[744]

7.382. Brazil rejects the complaining parties' claims and argues that the measures at issue are not related to products, but to production, and that the production-step requirements under the

[740] The IPI tax is not applicable to the sales of capital goods.

[741] Brazil's first written submission, paras. 296-298, 352-353 and fn 302 (DS472) and 246-248, 302-303 and fn 273 (DS497).

[742] Brazil's first written submission paras. 299-304, 354, 463 and 497 (DS472) and 249-254, 304, 400 and 434 (DS497).

[743] As explained in paragraphs 7.496 to 7.498 below, pursuant to Article 2.3 of the SCM Agreement, consideration of the question of contingency also will address whether the subsidies are specific in the sense argued by the complaining parties. (The complaining parties make no claims or arguments in respect of any other mode of specificity.)

[744] European Union's first written submission, paras. 723-727, 872-877, 1023-1026 and 1144-1148; Japan's first written submission, paras. 375, 441, 500 and 554.

programmes do not require directly or indirectly the use of domestic over imported goods.[745] Brazil also argues that a product produced according to a PPB cannot be equated with a domestic product within the meaning of WTO law, because a product produced according to a PPB is simply a product produced according to specific production step requirements.[746]

7.383. Canada and the United States argue as third parties that Article 3.1(b) of the SCM Agreement does not prohibit subsidies where the receipt of the subsidy is conditioned on the recipient of the subsidy performing certain production steps that may result in the creation of intermediate products.[747] In the view of these third parties, neither the GATT 1994 nor the SCM Agreement "limit a subsidizing Member's ability to define the level of production required for subsidy eligibility purposes" and that a "Member's ability to condition the provision of a subsidy on a production requirement would be significantly curtailed if a Member could not require the production of an intermediate good. A production requirement would then have to be limited to simple assembly operations."[748]

7.384. Article 3 of the SCM Agreement states in relevant parts that:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> …
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.
>
> 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

7.385. Thus, pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement, subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods are prohibited, and shall not be granted or maintained. The ordinary meaning of the word "contingent" is "conditional: dependent *on, upon*"[749], so a subsidy is "contingent upon the use of domestic over imported goods", and thus, prohibited under Article 3.1(b) of the SCM Agreement, if the use of domestic goods is *required* or *necessary* in order to receive the subsidy.[750]

7.386. The Panel recalls its finding in paragraph 7.313 above that the tax exemptions, reductions and suspensions granted under the ICT programmes, through the PPBs and other production step requirements, are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b). Thus, if the Panel finds that the ICT programmes constitute subsidies within the meaning of the SCM Agreement, it will as a consequence conclude that these subsidies are inconsistent with SCM Article 3.1(b).

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[745] Brazil's first written submission, paras. 299-304, 354, 463 and 497 (DS472) and 249-254, 304, 400 and 434 (DS497).

[746] Brazil's second written submission, paras. 28-37.

[747] Canada's third party submission, paras. 4-5; United States' response to Panel question No. 6.

[748] Canada's third party submission, para. 7.

[749] Shorter Oxford English Dictionary (6th ed., 2007)

[750] Indeed, such an interpretation was confirmed by the Appellate Body in *Canada – Autos*, where the Appellate Body recalled its discussion of Article 3.1(a) and explained as follows:

> In our discussion of Article 3.1(a) in Section VI of this Report, we recalled that in *Canada – Aircraft* we stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'." Thus, a subsidy is prohibited under Article 3.1(a) if it is "conditional" upon export performance, that is, if it is "dependent for its existence on" export performance. In addition, in *Canada – Aircraft*, we stated that contingency "in law" is demonstrated "on the basis of the words of the relevant legislation, regulation or other legal instrument." (emphasis added) As we have already explained, such conditionality can be derived by necessary implication from the words actually used in the measure. We believe that this legal standard applies not only to "contingency" under Article 3.1(a), but also to "contingency" under Article 3.1(b) of the SCM Agreement. Appellate Body Report, *Canada – Autos*, para. 123.

7.3.5.3 Whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute subsidies within the meaning of the SCM Agreement

7.387. The SCM Agreement defines subsidies as consisting of a "financial contribution" by a government or any public body, which confers a benefit. With respect to the term financial contribution, Article 1.1(a)(1) of the SCM Agreement defines and identifies the government conduct that constitutes a financial contribution for purposes of the Agreement, and subparagraphs (i)-(iv) exhaust the types of government conduct deemed to constitute a financial contribution.[751]

7.388. The only type of financial contribution argued by the complaining parties is subparagraph (ii), namely "government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)".

7.389. Thus, Article 1.1 of the SCM Agreement, in its relevant part, defines a "subsidy" of the type alleged in this dispute as follows:

> 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
>
> …
>
> (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)[1];
>
> …
>
> and
>
> (b) a benefit is thereby conferred.

[1] In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, 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.

7.390. Therefore, with respect to the claims under the SCM Agreement regarding the ICT programmes, the Panel must consider whether:

a. There is a financial contribution by a government, in the form of government revenue otherwise due that is foregone or not collected; and

b. A benefit is thereby conferred.

7.3.5.3.1 The legal framework for financial contribution in the form of "government revenue that is otherwise due is foregone or not collected

7.391. The question of financial contribution in the form of "government revenue that is otherwise due is foregone or not collected" has been examined in a number of prior disputes. The Panel notes the following particularly relevant explanations of this form of financial contribution.

7.392. In *US – Large Civil Aircraft (2nd complaint)*, the Appellate Body summarized its interpretation of the concept of "government revenue that is otherwise due is foregone or not collected", as developed previously in *US – FSC* and *US – FSC (Article 21.5 – EC)*:

[751] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 613.

> The Appellate Body observed that the foregoing of revenue otherwise due implies that less revenue has been raised by the government than would have been raised in a different situation, and that the word "foregone" suggests that the government has given up an entitlement to raise revenue that it could "otherwise" have raised. This purported entitlement, however, cannot exist in the abstract. There must be "some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised 'otherwise'".[752] Moreover, the basis of comparison must be the "prevailing domestic standard" established by the tax rules applied by the Member in question, because "{w}hat is 'otherwise due' … depends on the rules of taxation that each Member, by its own choice, establishes for itself".[753]
>
> …
>
> The Appellate Body underscored that a financial contribution does not arise under Article 1.1(a)(1)(ii) simply because a government does not raise revenue that it could have raised. Although a government might be said to "forego" revenue when it chooses not to tax certain income, this alone is not determinative of whether the revenue foregone is "otherwise due".
>
> …
>
> The Appellate Body remarked that, because Members, in principle, have the sovereign authority to determine their own rules of taxation, the comparison under Article 1.1(a)(1)(ii) must necessarily be between the rules of taxation contained in the challenged measure and other rules of taxation of the Member concerned.
>
> …
>
> The Appellate Body further recognized that it may be difficult to identify the appropriate benchmark for comparison under Article 1.1(a)(1)(ii), because domestic rules of taxation are varied and complex. The Appellate Body stated that, "{i}n identifying the appropriate benchmark for comparison, panels must obviously ensure that they identify and examine fiscal situations which it is legitimate to compare"[754], and that this will be the case when there is "a rational basis for comparing the fiscal treatment of the income subject to the contested measure and the fiscal treatment of certain other income".[755] The Appellate Body added that, in general terms, "like will be compared with like"[756], and that it is important to ensure that the examination under Article 1.1(a)(1)(ii) "involves a comparison of the fiscal treatment of the relevant income for taxpayers in comparable situations".[757] [758]

7.393. The Appellate Body in *US – Large Civil Aircraft (2nd complaint)* also explained the rationale behind the inclusion of "government revenue that is otherwise due is foregone or not collected" in the SCM Agreement, as a form of financial contribution:

> [T]he *SCM Agreement* recognizes that WTO Members are sovereign in determining the structure and rates of their domestic tax regimes. Also, because tax systems are not static, Members must have some flexibility to make adjustments to their systems. At the same time, the *SCM Agreement* recognizes that tax regimes may be used to achieve outcomes equivalent to the results that are achieved where a government

[752] (footnote original) Appellate Body Report, *US – FSC*, para. 90.
[753] (footnote original) Appellate Body Report, *US – FSC*, para. 90.
[754] (footnote original) Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 90.
[755] (footnote original) Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 90.
[756] (footnote original) Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 90. By way of example, the Appellate Body indicated that, if the measure at issue involves income earned in sales transactions, it might not be appropriate to compare the treatment of this income with employment income.
[757](footnote original) Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 92. By way of further example, the Appellate Body stated that, if the measure at issue is concerned with the taxation of foreign-source income in the hands of a domestic corporation, it might not be appropriate to compare the measure with the fiscal treatment of such income in the hands of a foreign corporation.
[758] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 806-810.

> provides a direct payment. This explains why the Agreement includes the foregoing of government revenue otherwise due among the measures that constitute financial contributions under Article 1.1(a)(1).[759]

7.394. Finally, the Appellate Body in *US – Large Civil Aircraft (2nd complaint)* enunciated a three-step legal test for assessing whether a measure constitutes the foregoing of government revenue otherwise due, as follows:

> The identification of circumstances in which government revenue that is otherwise due is foregone requires a comparison between the tax treatment that applies to the alleged subsidy recipients and the tax treatment of comparable income of comparably situated taxpayers. Accordingly, a panel examining a claim under Article 1.1(a)(1)(ii) of the *SCM Agreement* should first identify the tax treatment that applies to the income of the alleged recipients. Identifying such tax treatment will entail consideration of the objective reasons behind that treatment and, where it involves a change in a Member's tax rules, an assessment of the reasons underlying that change.
>
> As a second step, the panel should identify a benchmark for comparison—that is, the tax treatment of comparable income of comparably situated taxpayers.[760] We recognize that this is not always a straightforward exercise, and may in some circumstances be exceedingly difficult. Identifying a benchmark involves an examination of the structure of the domestic tax regime and its organizing principles. In some cases, the principles will be ones well recognized in the tax regimes of Members; in other cases, they will be unique to the particular domestic regime. It may be that disparate tax measures, implemented over time, do not easily offer up coherent principles serving as a benchmark. In any event, the task of the panel is to develop an understanding of the tax structure and principles that best explains that Member's tax regime, and to provide a reasoned basis for identifying what constitutes comparable income of comparably situated taxpayers. Evidence relied upon in such an analysis must be located in the "rules of taxation that each Member, by its own choice, establishes for itself".[761] In doing so, a Member will be held to account for the tax structure and principles that it itself employs. This is akin to the approach undertaken in the field of public finance for purposes of estimating what are known as "tax expenditures".[762]
>
> Finally, as a third step, the panel should compare the reasons for the challenged tax treatment with the benchmark tax treatment it has identified after scrutinizing a Member's tax regime. Such a comparison will enable a panel to determine whether, in the light of the treatment of the comparable income of comparably situated taxpayers, the government is foregoing revenue that is otherwise due in relation to the income of the alleged recipients.[763]

7.395. In sum, in order to assess whether "government revenue that is otherwise due is foregone or not collected", the Panel must:

a. First, identify the tax treatment that applies to the income of the alleged recipients, considering the objective reasons behind that treatment;

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[759] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 811.

[760] (footnote original) Although the Appellate Body has previously referred to the tax treatment of "comparable income", we understand that the same approach would apply to identifying any comparable taxable activity, transaction, or property of comparably situated taxpayers. (See *Revenue Statistics, 1965-2010, Annex A, The OECD Classification of Taxes and Interpretative Guide* (OECD, 2011) (referring to the following categories of taxation: taxes on income, profits, and capital gains; social security contributions; taxes on payroll and workforce; taxes on property; taxes on goods and services; and other taxes))

[761] (footnote original) Appellate Body Report, *US – FSC*, para. 90.

[762] (footnote original) The Organisation for Economic Co-operation and Development ("OECD") describes tax expenditures as tax laws, regulations, or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax. (*Tax Expenditures in OECD Countries* (OECD, 2010), p. 12 (referring to B. Anderson, PowerPoint presentation at the 5th Annual Meeting of OECD-Asia Senior Budget Officials held on 10-11 January 2008 in Bangkok, available at <www.oecd.org/dataoecd/40/6/39944419.pdf>))

[763] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 812-815.

b. Second, identify a benchmark for comparison, i.e. the tax treatment of comparable income of comparably situated taxpayers. This involves an examination of the structure of the Member's domestic tax regime and its organizing principles; and

c. Third, compare the challenged tax treatment, and its reasons, with the identified benchmark tax treatment. Such a comparison will enable a panel to determine whether the government is foregoing revenue that is otherwise due in relation to the income of the alleged recipients.

7.3.5.3.2 The legal test for determining the existence of a benefit from a financial contribution in the form of *revenue foregone*

7.396. With respect to the concept of benefit, as explained by the Appellate Body in *US – Softwood Lumber IV*, "a financial contribution will confer a benefit upon a recipient within the meaning of Article 1.1(b) of the SCM Agreement when it provides an advantage to its recipient."[764] The Appellate Body Report in *Canada – Aircraft* explained that the existence of any such advantage is to be determined by comparing the position of the recipient with and without the financial contribution, and that the marketplace provides an appropriate basis for making this comparison.[765] In other words, a panel must assess whether the recipient receives a financial contribution on terms more favourable than those available to the recipient in the market.[766]

7.397. However, as the panel in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* noted, the marketplace has not been explicitly used as a benchmark to determine whether financial contributions taking the form of "government revenue that is otherwise due is foregone or not collected" confer a benefit.[767]

7.398. In fact, as recognized by the panel in *US – Large Civil Aircraft (2nd complaint)*, "[i]n those cases where a financial contribution has been found to exist in the form of the foregoing of revenue otherwise due, the conclusion that a benefit exists has been made with little difficulty."[768] In the panel's view, a tax break "[i]s essentially a gift from the government, or a waiver of obligations due, and it is clear that the market does not give such gifts."[769] Thus, when a panel finds that a tax measure constitutes a financial contribution in the form of foregone revenue, it will be able to readily conclude, that a benefit is conferred.

7.399. For example, the panel in *US – FSC (Article 21.5 – EC)* stated that the recipient was "'better off' than it would have been absent the contribution, that is, if it had been in another situation, where the conditions for obtaining the tax treatment under the Act were not fulfilled and it was therefore subject to otherwise applicable … taxation rules." [770]

7.400. Based on the above, the Panel will start its analysis of the existence of a subsidy by assessing whether the tax treatment granted under the ICT programmes constitute financial contributions in the form of government revenue otherwise due that is foregone or not collected. If the Panel concluded that the treatment granted under the ICT programmes involves revenue foregone and thus provides a financial contribution, the Panel will then address whether the financial contribution confers a benefit.

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[764] Appellate Body Report, *US – Softwood Lumber IV*, para. 51. See also Panel Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 7.271.

[765] Appellate Body Report, *Canada – Aircraft*, para. 157. See also: Panel Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 7.271.

[766] Appellate Body Report, *Canada – Aircraft,* para. 158.

[767] Panel Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, footnote 509. See also: Panel Reports, *US – FSC*, para. 7.103; and *US – FSC (Article 21.5 – EC)*, paras. 8.44-8.48; and Appellate Body Reports, *US – FSC*, para. 140; and *US – FSC (Article 21.5 – EC)*, para. 198.

[768] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, para. 7.169.

[769] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, para. 7.171.

[770] Panel Report, *US – FSC (Article 21.5 – EC)*, para. 8.46.

7.3.5.3.3 Whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected"

7.401. As explained in paragraph 7.395 above, in order to assess whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", it will respond the following questions: (a) what is the challenged tax treatment that applies to the income of the alleged recipients, and what are the objective reasons behind this treatment; (b) what is the benchmark treatment or tax treatment of comparable income of comparably situated taxpayers; and (c) what is the difference between the challenged tax treatment, and its reasons, with the identified benchmark tax treatment?[771]

7.3.5.3.3.1 The tax treatment that applies to the income of the alleged recipients, and the objective reasons behind this treatment

7.402. As described in paragraphs 7.368 to 7.371 above, the tax treatment applicable to accredited companies under the Informatics programme consists of:

a. IPI tax exemptions or reductions on the sales of incentivized goods; and

b. IPI tax suspensions on purchases of raw materials, intermediate goods and packaging materials.[772]

7.403. The tax treatment applicable to accredited companies under the PADIS programme consists of:

a. Zero rates (exemptions) of the IPI tax and PIS/PASEP and COFINS contributions on the sales of incentivized goods;

b. 100% reduction of the corporate income tax and duties on profits from exploitation of patents, arising from the sales of incentivized goods and their projects (design); and

c. Zero rates (exemptions) of ordinary customs duties, IPI tax and PIS/PASEP, COFINS, PIS/PASEP-importation, COFINS-importation on purchases of certain capital goods, inputs and computational tools and of the CIDE contributions on remittances sent abroad for payment of contracts related to the manufacturing of the incentivized goods.[773]

7.404. The tax treatment applicable to accredited companies under the PATVD programme consists of:

a. Zero rates (exemptions) of IPI tax and PIS/PASEP and COFINS contributions on the sales of incentivized goods (digital TV transmitters); and

b. Zero rates (exemptions) of IPI tax and PIS/PASEP, COFINS, PIS/PASEP-importation, COFINS-importation and on purchases of certain capital goods, inputs and computational tools and of the CIDE contributions on remittances sent abroad for payment of contracts related to the manufacturing of the incentivized goods.[774]

7.405. The tax treatment applicable to accredited companies under the Digital Inclusion programme consists of:

a. Zero rates (exemptions) of PIS/PASEP and COFINS contributions on the sales of incentivized goods.[775]

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[771] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 812-815.
[772] See paragraphs 2.41 to 2.45 above.
[773] See paragraph 2.73 above.
[774] See paragraph 2.84 above.
[775] See paragraph 2.93 above.

7.406. The Panel notes that the case at issue involves a range of different taxes and different tax treatments. In particular, each of the examined programmes provides a different package of exemptions, reductions, and/or suspensions from one or more particular types of tax. In the Panel's view, these different tax treatments can be best classified and identified for purposes of determining whether revenue that is otherwise due is foregone or not collected and a benefit thereby is conferred on the basis of (i) the tax at issue, (ii) whether the tax treatment is on the purchase of products by accredited companies or on their sale of incentivized products, and (iii) the degree of transformation of the incentivized products. Based on these criteria, the Panel has grouped the tax treatments into the following categories:

a. The IPI tax exemptions (including through zero rates) and reductions granted to accredited companies on their sales of the incentivized finished goods that they produce (for purposes of Informatics and PATVD);

b. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions granted to accredited companies on their sales of the incentivized finished goods that they produce (for purposes of PATVD and Digital Inclusion);

c. The 100% reduction granted to accredited companies of the corporate income tax and the duties on profits from exploitation of patents arising from their sales of incentivized finished goods and their projects (design) (for purposes of PADIS);

d. The IPI tax exemptions (including through zero rates) and reductions granted to accredited companies on their sales of the incentivized intermediate goods that they produce (for purposes of Informatics and PADIS);

e. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions granted to accredited companies on their sales of the incentivized intermediate goods that they produce (for purposes of PADIS);

f. The IPI tax suspensions on purchases of raw materials, intermediate goods and packaging materials (for purposes of Informatics) and IPI tax exemptions (through zero rates) on purchases of inputs (for purposes of PADIS and PATVD) used to manufacture the incentivized products;

g. The exemptions (though zero rates) of the PIS/PASEP and COFINS contributions or PIS/PASEP-importation and COFINS-importation contributions on purchases of inputs (for purposes of PADIS and PATVD) used to manufacture the incentivized products;

h. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions or PIS/PASEP-importation and COFINS-importation contributions on purchases of certain capital goods and computational tools (for purposes of PADIS and PATVD) used to manufacture the incentivized products, that will be incorporated into the fixed assets of the accredited company;

i. The exemptions (through zero rates) of the CIDE contributions on remittances sent abroad for payment of contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of incentivized products (for purposes of PADIS and PATVD); and

j. The exemptions (through zero rates) of ordinary customs duties on purchases of certain capital goods, inputs and computational tools used in the manufacture of incentivized products (for purposes of PADIS).

7.407. The Panel recalls that the Appellate Body in *US – Large Civil Aircraft (2nd complaint)* explained that the identification of the tax treatment that applies to the income of the alleged recipients will entail consideration of the objective reasons behind that treatment and, where it

involves a change in a Member's tax rules, an assessment of the reasons underlying that change.[776]

7.408. With respect the Informatics programme, Brazil argues as follows:

> The Informatics Law was established as part of Brazil's new national policy and was aimed at fostering technology and know-how in the Brazilian IT sector. The goal of the legislation is to develop technology-based industries, to expand the country's scientific infrastructure and to leverage its high-skilled human resources.[777]

7.409. With respect to PADIS, as explained earlier in this Report, Interministerial Explanatory Memorandum No 00008/2007 describes the aim of the programme as follows:

> The aim of establishing PADIS is to encourage the setting-up in Brazil of companies involved in the conception, development, design and manufacturing of electronic semiconductor devices and displays…[778]

7.410. With respect to PATVD, Interministerial Explanatory Memorandum No 00008/2007 describes the aim of the programme as follows:

> The aim of establishing PATVD is to encourage the setting-up in Brazil of companies involved in the development and manufacturing of radio-frequency transmitter equipment for digital television.[779]

7.411. Brazil also argues that the tax exemptions or suspensions on purchases of inputs and capital goods under the Informatics, PADIS and PATVD programmes are a tax administration measure to prevent the accumulation of tax credits by companies whose final products are exempted or subject to low taxation, and that would not able to generate enough tax debits to offset the tax credits generated.[780]

7.412. Finally, with respect to Digital Inclusion, Brazil argues that the programme "aims at increasing the access of the Brazilian population to computers and information technology products…".[781]

7.413. The Panel will address later the evidence before it in respect of these arguments, and whether the alleged reasons affect the comparison between the challenged tax treatment and the benchmark treatment.

7.3.5.3.3.2 The relevant benchmark treatments and the difference between each of the challenged tax treatments and the identified benchmark tax treatments

7.414. The Panel will address separately the specific benchmark for each of the categories of tax treatments previously identified. In so doing, the Panel notes that the challenged tax treatments are "exemptions", "reductions" or "suspensions" of economy-wide taxes that apply, in principle, to all transactions by all businesses. As explained in detail below, on the basis of the evidence before the Panel and the analytical framework set forth above, in every instance the Panel finds that the benchmarks to be applied are the economy-wide tax treatments from which the exemptions, reductions and suspensions are taken.

a. The IPI tax exemptions (including through zero tax rates) and reductions granted to accredited companies on their sales of the incentivized finished goods that they produce (for purposes of Informatics and PATVD).

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[776] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 812.
[777] Brazil's first written submission, paras. 107 (DS472) and 79 (DS497).
[778] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 2.
[779] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 7.
[780] Brazil's first written submissions, paras. 296-298, 352-353 and fn 302 (DS472) and paras. 246-248, 302-303 and fn 273 (DS497).
[781] Brazil's first written submission, paras. 469 (DS472) and 405 (DS497).

The benchmark treatment

7.415. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to sales of products covered by the Informatics and PATVD programmes by non-accredited companies, i.e. the obligation to pay the full amount of the applicable IPI tax rate on the sales of non-incentivized products. In particular, the accredited and non-accredited companies producing and selling the products covered by the Informatics and PATVD programmes are identically situated, except for the fact of accreditation. Brazil has provided no evidence demonstrating any other difference that could explain the differential IPI tax treatment of these products. Thus, the treatment applicable to sales by non-accredited companies of non-incentivized products can be considered the benchmark treatment or normal rule of general application.

Comparison

7.416. The Panel now compares the IPI tax exemptions and reductions granted to accredited companies on the sales of the incentivized finished goods that they produce, under the Informatics and PATVD programmes, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to sales by non-accredited companies of non-incentivized products.

7.417. The Panel notes that under the benchmark treatment the non-accredited company selling the non-incentivized finished product will always charge the IPI tax to the company buying the non-incentivized finished product, at the moment of the sale. The non-accredited company selling the non-incentivized product then will remit to the Federal Revenue Service the amount of IPI tax charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. Thus, the Brazilian Government will receive the full amount of IPI tax due from the non-accredited company selling the non-incentivized product.

7.418. In contrast, pursuant to the challenged treatment under the Informatics and PATVD programmes, whereby the tax is exempted or reduced, the accredited company selling the incentivized product will not have to remit any amount of tax, or will only have to remit part of the tax, to the Brazilian Government.

7.419. If the Panel compares the challenged treatment, where the Brazilian Government receives either none, or only part, of the IPI tax that otherwise would have been due, with the benchmark treatment, where the Brazilian Government receives the full amount of IPI tax due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due. Thus, the Panel finds that, with respect to the IPI tax exemptions and reductions granted to companies accredited under the Informatics and PATVD programmes on the sales of the incentivized finished goods that they produce, "government revenue that is otherwise due is foregone or not collected". The Panel notes that Brazil does not contest this finding.[782]

b. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions granted to accredited companies on their sales of the incentivized finished goods that they produce (for purposes of PATVD and Digital Inclusion).

The benchmark treatment

7.420. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to sales of products covered by the PATVD and Digital Inclusion programmes by non-accredited companies, i.e. the obligation to pay the full amount of the applicable PIS/PASEP and COFINS contributions rates on the sales of non-incentivized products. In particular, the accredited and non-accredited companies producing and selling the products covered by the PATVD and Digital Inclusion programmes are identically situated, except for the fact of accreditation. Brazil has provided no evidence demonstrating any other difference that could explain the differential PIS/PASEP and COFINS contributions treatment of these products. Thus, the treatment applicable to sales by non-accredited companies of non-incentivized products can be considered the benchmark treatment or normal rule of general application.

[782] Brazil's first written submission, fn 120 and para. 462 (DS472) and fn 111 and para. 399 (DS497); and Brazil's response to Panel question No. 25.

Comparison

7.421. The Panel now compares the exemptions of the PIS/PASEP and COFINS contributions granted to accredited companies on the sales of the incentivized finished goods that they produce, under the PATVD and Digital Inclusion programmes, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to sales by non-accredited companies of non-incentivized products.

7.422. The Panel notes that under the benchmark treatment the non-accredited company selling the non-incentivized finished product will always charge the PIS/PASEP and COFINS contributions to the company buying the non-incentivized finished product, at the moment of the sale. The non-accredited company selling the non-incentivized product then will remit to the Federal Revenue Service the amount of PIS/PASEP and COFINS contributions charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. From the Brazilian Government's standpoint, the Government will receive the full amount of PIS/PASEP and COFINS contributions due from the non-accredited company selling the non-incentivized product.

7.423. In contrast, pursuant to the challenged treatment under the PATVD programmes and Digital Inclusion programmes, whereby the contributions are exempted, the accredited company selling the incentivized product will not have to remit any amount of contributions to the Brazilian Government.

7.424. If the Panel compares the challenged treatment, where the Brazilian Government receives none of the PIS/PASEP and COFINS contributions that otherwise would have been due, with the benchmark treatment, where the Brazilian Government receives the full amount of PIS/PASEP and COFINS contributions due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due. Thus, the Panel finds that, with respect to the exemptions of the PIS/PASEP and COFINS contributions granted to companies accredited under the PATVD and Digital Inclusion programmes on the sales of the incentivized finished goods that they produce, "government revenue that is otherwise due is foregone or not collected". The Panel notes that Brazil does not contest this finding.[783]

c. The 100% reduction granted to accredited companies of the corporate income tax and the duties on profits from exploitation of patents arising from their sales of incentivized finished goods and their projects (design) (for purposes of PADIS).

The benchmark treatment

7.425. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to sales of products covered by the PADIS programme by non-accredited companies, i.e. the obligation to pay the full amount of the applicable corporate income tax and duties on profits from exploitation of patents rates on the sales of non-incentivized products. In particular, the accredited and non-accredited companies producing the products covered by the PADIS programme are identically situated, except for the fact of accreditation. Brazil has provided no evidence demonstrating any other difference that could explain the differential income tax and duties on profits treatment of these products. Thus, the treatment applicable to sales by non-accredited companies of non-incentivized products can be considered the benchmark treatment or normal rule of general application.

Comparison

7.426. The Panel now compares the 100% reduction granted to accredited companies of the corporate income tax and the duties on profits from exploitation of patents arising from their sales of incentivized finished goods that they produce and their projects, under the PADIS programme, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to sales by non-accredited companies of non-incentivized products.

7.427. The Panel notes that under the benchmark treatment the non-accredited company selling the non-incentivized finished product will always have to pay to the Federal Revenue Service the

[783] Brazil's first written submission, paras. 462 and 496 (DS472) and 399 and 433 (DS497).

corporate income tax and the duties on profits from exploitation of patents arising from their sales of the non-incentivized finished goods that they produce and their projects. The Government will receive the full amount of corporate income tax and duties on profits from exploitation of patents due from the non-accredited company selling the non-incentivized product.

7.428. In contrast, pursuant to the challenged treatment under the PADIS programme, whereby the taxes and duties are exempted, the accredited company selling the incentivized product will not have to remit any amount of taxes and duties to the Brazilian Government.

7.429. If the Panel compares the challenged treatment, where the Brazilian Government receives none of the corporate income tax and duties on profits from exploitation of patents that otherwise would have been due, with the benchmark treatment, where the Brazilian Government receives the full amount of corporate income tax and duties on profits from exploitation of patents due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due. Thus, the Panel finds that, with respect to the 100% reductions granted to accredited companies under the PADIS programme of the corporate income tax and the duties on profits from exploitation of patents, arising from the sales of incentivized finished goods that they produce and their projects "government revenue that is otherwise due is foregone or not collected". The Panel notes that Brazil does not contest this finding.[784]

d. The IPI tax exemptions (including through zero rates) and reductions granted to accredited companies on their sales of the incentivized intermediate goods that they produce (for purposes of Informatics and PADIS).

The benchmark treatment

7.430. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to sales of products covered by the Informatics and PADIS programmes by non-accredited companies, i.e. the obligation to pay the full amount of the applicable IPI tax rate on the sales of the non-incentivized intermediate goods that they produce, subject to the mechanism of credits and debits under the principle of non-accumulation. In particular, the accredited and non-accredited companies producing and selling the products covered by the Informatics and PADIS programmes are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential IPI tax treatment of these products. Thus, the treatment applicable to sales by non-accredited companies of non-incentivized products can be considered the benchmark treatment or normal rule of general application.

Comparison

7.431. The Panel now compares the IPI tax exemptions and reductions granted to accredited companies on their sales of the incentivized intermediate goods that they produce, under the Informatics and PADIS programmes, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to sales by non-accredited companies of non-incentivized intermediate products.

7.432. The Panel notes that under the benchmark treatment, the non-accredited company selling the non-incentivized intermediate goods will always charge the IPI tax to the buyer of the products, at the moment of the sale, and the buyer of the products will accrue a tax credit in the amount of the IPI tax paid. The non-accredited company selling the non-incentivized intermediate products then will remit to the Federal Revenue Service the amount of IPI tax charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the buyer of the non-incentivized intermediate products will be allowed to use the credit it has accrued to offset its IPI tax debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the non-accredited company selling the non-incentivized intermediate products pays the tax to the Brazilian Government.[785] However, if the buyer of the non-incentivized intermediate products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during

[784] Brazil's first written submission, paras. 348 (DS472) and 298 (DS497).
[785] See paragraphs 2.16 to 2.17 above.

subsequent taxation periods.[786] If the buyer of the non-incentivized products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement.[787] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the buyer of the non-incentivized intermediate products will be entitled to receive the compensation or reimbursement from the Government, as well as the interest generated.[788] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[789]

7.433. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the buyer of the non-incentivized intermediate products, the Government will receive the full amount of IPI tax due from the non-accredited company selling the non-incentivized intermediate products and the buyer of the non-incentivized products will be able to offset the amount of IPI tax paid during the same taxation period. However, if the buyer of the non-incentivized intermediate products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the non-accredited company selling the non-incentivized intermediate product until the buyer of the non-incentivized products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the buyer of the non-incentivized products (within 360 days of the date of the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[790] This cash availability and associated implicit interest can last from one taxation period[791] (if the buyer is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the buyer has to request it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to buyer of the non-incentivized products within 360 days after the request, the Brazilian Government will not have to pay the buyer of the non-incentivized products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the buyer of the non-incentivized products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[792]

[786] See paragraphs 2.19 to 2.20 above.

[787] See paragraph 2.20 above.

[788] See paragraph 2.20 above, and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6), (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submission, para. 780 (DS472) and fn 451 (DS497).

[789] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, para. 758 (DS472) and para. 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). See Exporters_2012 study on Brazilian exports – delays in refunds, (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

[790] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[791] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[792] See footnote 788 above.

7.434. In contrast, pursuant to the challenged treatment under the Informatics and PADIS programmes, whereby the IPI tax is exempted or reduced, the accredited company selling the incentivized products will not have to charge the IPI tax to the buyer of the incentivized products and will not have to remit any amount of tax, or will only have to remit part of the tax, to the Brazilian Government. The buyer of the incentivized products, in turn, will not accrue any credit, or will accrue a lower amount of credit.[793]

7.435. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction. By the same token, it also will not have to allow the buyer of the incentivized products to offset the amount of tax paid.[794]

7.436. If the Panel compares the challenged treatment with the best case scenario for the buyer of the non-incentivized products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period, there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the buyer of the non–incentivized products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from one taxation period[795] to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used.

7.437. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17 above, when the buyer of the incentivized intermediate products sells its finished goods incorporating those products, under normal circumstances[796] the Brazilian Government ultimately will collect the full amount of IPI tax corresponding to both the value added by the accredited company selling the incentivized product and the value added by the buyer of the incentivized products, i.e., the same nominal amount of IPI tax that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the buyer of the incentivized intermediate products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the accredited company selling the incentivized products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

e. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions granted to accredited companies on their sales of the incentivized intermediate goods that they produce (for purposes of PADIS).

The benchmark treatment

7.438. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to sales of products covered by the PADIS programme by non-accredited companies, i.e. the obligation to pay the full amount of the applicable PIS/PASEP and COFINS contributions rates on the sales of the non-incentivized intermediate goods that they produce, subject to the mechanism of credits and debits under the non-cumulative regime. In particular, the accredited and non-accredited companies producing and selling the products covered by the PADIS programme are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential PIS/PASEP and COFINS contributions treatment of these products. Thus, the treatment applicable to sales by non-accredited companies of non-incentivized products can be considered the benchmark treatment or normal rule of general application.

[793] See paragraph 2.18 above.

[794] See paragraph 2.13 above.

[795] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[796] The Panel notes that normal circumstances might not exist when the incentivized intermediate products are incorporated into finished products that are also incentivized under the Informatics or Digital Inclusion programmes, in which case those finished products pay no or a very low IPI tax.

Comparison

7.439. The Panel now compares the exemptions of the PIS/PASEP and COFINS contributions granted to accredited companies on their sales of the incentivized intermediate goods that they produce, under the PADIS programme, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to sales by non-accredited companies of non-incentivized intermediate products.

7.440. The Panel notes that under the benchmark treatment, the non-accredited company selling the non-incentivized intermediate goods will always charge the PIS/PASEP and COFINS contributions to the buyer of the products, at the moment of the sale, and the buyer of the products will accrue a tax credit in the amount of the PIS/PASEP and COFINS contributions paid. The non-accredited company selling the non-incentivized intermediate products then will remit to the Federal Revenue Service the amount of PIS/PASEP and COFINS contributions charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the buyer of the non-incentivized intermediate products will be allowed to use the credit it has accrued to offset its PIS/PASEP and COFINS contributions debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the non-accredited company selling the non-incentivized intermediate products pays the tax to the Brazilian Government.[797] However, if the buyer of the non-incentivized intermediate products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods.[798] If the buyer of the non-incentivized products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement.[799] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the buyer of the non-incentivized intermediate products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[800] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[801]

7.441. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the buyer of the non-incentivized intermediate products, the Government will receive the full amount of PIS/PASEP and COFINS contributions due from the non-accredited company selling the non-incentivized intermediate products and the buyer of the non-incentivized products will be able to offset the amount of PIS/PASEP and COFINS contributions paid during the same taxation period. However, if the buyer of the non-incentivized intermediate products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the non-accredited company selling the non-incentivized intermediate product until the buyer of the non-incentivized products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the buyer of the non-incentivized products (within 360 days of the date of the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from

[797] See paragraphs 2.16 to 2.17 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[798] See paragraphs 2.19 to 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions)

[799] See paragraph 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[800] See paragraph 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[801] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, paras. 758 (DS472) and 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). See Exporters_2012 study on Brazilian exports – delays in refunds, (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

the seller.[802] This cash availability and associated implicit interest can last from one taxation period[803] (if the buyer is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the buyer has to request it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to buyer of the non-incentivized products within 360 days after the request, the Brazilian Government will not have to pay the buyer of the non-incentivized products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the buyer of the non-incentivized products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[804]

7.442. In contrast, pursuant to the challenged treatment under the PADIS programme, whereby the PIS/PASEP and COFINS contributions are exempted, the accredited company selling the incentivized products will not have to charge the PIS/PASEP and COFINS contributions to the buyer of the incentivized products and will not have to remit any amount of tax to the Brazilian Government. The buyer of the incentivized products, in turn, will not accrue any credit.[805]

7.443. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction. By the same token, it also will not have to allow the buyer of the incentivized products to offset the amount of tax paid.[806]

7.444. If the Panel compares the challenged treatment with the best case scenario for the buyer of the non-incentivized products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period, there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the buyer of the non–incentivized products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from one taxation period[807] to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used.

7.445. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17 above[808], when the buyer of the incentivized intermediate products sells its finished goods incorporating those products, under normal circumstances the Brazilian Government ultimately will collect the full

[802] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[803] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[804] See paragraph 2.20 above (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions) and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6), (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submissions, paras. 780 (DS472) and fn 451 (DS497).

[805] See paragraph 2.18 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[806] See paragraph 2.13 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[807] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[808] Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.

amount of PIS/PASEP and COFINS contributions corresponding to both the value added by the accredited company selling the incentivized product and the value added by the buyer of the incentivized products, i.e., the same nominal amount of PIS/PASEP and COFINS contributions that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the buyer of the incentivized intermediate products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the accredited company selling the incentivized products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

7.446. Also, although the non-cumulative regime is the general rule for the PIS/PASEP and COFINS contributions[809], to the extent that the sales of the intermediate goods at issue could be subject to the cumulative regime, there would be no mechanism of credits and debits. In this case, if the Panel compares the challenged treatment, where the Brazilian Government receives none of the PIS/PASEP and COFINS contributions that otherwise would have been due, with the treatment under the cumulative regime, where the Brazilian Government receives the full amount of PIS/PASEP and COFINS contributions due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due under the cumulative regime.

f. The IPI tax suspensions on purchases of raw materials, intermediate goods and packaging materials (for purposes of Informatics) and IPI tax exemptions (through zero rates) on purchases of inputs (for purposes of PADIS and PATVD) used to manufacture the incentivized products.

The benchmark treatment

7.447. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods, packaging materials and inputs that will be used by those companies to manufacture products covered by the Informatics and PADIS programmes, i.e. the obligation to pay the full amount of the applicable IPI tax rate on the purchases of raw materials, intermediate goods, packaging materials and inputs used to manufacture products, subject to the mechanism of credits and debits under the principle of non-accumulation. In particular, the accredited and non-accredited companies purchasing the raw materials, intermediate goods, packaging materials and inputs used to manufacture their products are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential IPI tax treatment of these products. Thus, the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods, packaging materials and inputs used in the manufacture of their products can be considered as the benchmark treatment or normal rule of general application.

Comparison

7.448. The Panel now compares the IPI tax suspensions or exemptions granted to accredited companies on their purchases of raw materials, intermediate goods and packaging materials, under the Informatics programme, and inputs, under the PADIS and PATVD programmes, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods, packaging materials and inputs.

7.449. The Panel notes that under the benchmark treatment, the seller of the raw materials, intermediate goods, packaging materials and inputs will always charge the IPI tax to the non-accredited company buying the products, at the moment of the sale, and the non-accredited company buying the products will accrue a tax credit in the amount of the IPI tax paid. The seller then will remit to the Federal Revenue Service the amount of IPI tax charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the non-accredited company buying the products will be allowed to use the credit it has accrued to offset its IPI tax debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the seller pays the tax to the Brazilian Government.[810] However, if the non-accredited company buying the products is not able to offset

[809] See paragraph 2.22 above
[810] See paragraphs 2.17 and 2.18 above.

the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods.[811] If the non-accredited company buying the products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement.[812] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the non-accredited company buying the products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[813] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[814]

7.450. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the non-accredited company buying the products, the Government will receive the full amount of IPI tax due from the seller and the non-accredited company buying the products will be able to offset the amount of IPI tax paid during the same taxation period. However, if the non-accredited company buying the products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the seller until the non-accredited company buying the products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the non-accredited company buying the products (within 360 days of the date of the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[815] This cash availability and associated implicit interest can last from one taxation period[816] (if the non-accredited company is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the non-accredited company requests it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to the non-accredited company buying the products within 360 days after the request, the Brazilian Government will not have to pay the non-accredited company buying the products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the non-accredited company buying the products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[817]

[811] See paragraphs 2.19 and 2.20 above.

[812] See paragraph 2.20 above.

[813] See paragraph 2.20 above.

[814] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, para. 758 (DS472) and para. 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). See Exporters_2012 study on Brazilian exports – delays in refunds, (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

[815] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[816] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[817] See paragraph 2.20 above and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6) (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submission, paras. 780 (DS472) and fn 451 (DS497).

7.451. With respect to imported raw materials, intermediate goods, packaging materials and inputs, the Panel notes that the IPI tax is collected by the customs authorities from the importer during the customs clearance process.[818] Therefore, the Government will enjoy the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that is collected, from the moment the product is imported until the moment the non-accredited company buying the product is able to offset the credit, or receives compensation or reimbursement (within 360 days of the request).

7.452. In contrast, pursuant to the challenged treatment under the Informatics, PADIS and PATVD programmes, whereby the IPI tax is suspended or exempted, the seller will not have to charge the IPI tax to the accredited company buying the products and will not have to remit any amount of tax to the Brazilian Government. The accredited company buying the products, in turn, will not accrue any credit.[819]

7.453. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction, in the case of domestic products, or on the date of importation (in the case of imported products). By the same token, it also will not have to allow the accredited company buying the products to offset the amount of tax paid.[820]

7.454. If the Panel compares the challenged treatment with the best case scenario for the non-accredited company buying domestic products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period, there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the non-accredited company buying the products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from the moment of importation (in the case of imported products) or from one taxation period[821] (in the case of domestic products) to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used.

7.455. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17 above, when the accredited company buying the raw materials, intermediate goods, packaging materials and inputs sells its finished goods incorporating those products, under normal circumstances[822] the Brazilian Government ultimately will collect the full amount of IPI tax corresponding to both the value added by the seller and the value added by the accredited company buying the products, i.e., the same nominal amount of IPI tax that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the accredited company buying the products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the seller of the products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

g. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions or PIS/PASEP-importation and COFINS-importation contributions on purchases of inputs (for purposes of PADIS and PATVD) used to manufacture the incentivized products.

[818] See paragraph 2.8 above.
[819] See paragraph 2.18 above.
[820] See paragraph 2.13 above.
[821] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.
[822] The Panel notes that normal circumstances might not exist in the case at issue, because under the Informatics, PADIS and PATVD programmes, the finished products manufactured with the raw materials, intermediate goods, inputs and packaging materials with the IPI tax exempted or suspended, will also have the IPI tax exempted or reduced.

The benchmark treatment

7.456. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to purchases by non-accredited companies of inputs that will be used by those companies to manufacture the products covered by the PADIS and the PATVD programmes, i.e. the obligation to pay the full amount of the applicable PIS/PASEP and COFINS, or PIS/PASEP-importation and COFINS-importation contributions, on the purchase of inputs, subject to the mechanism of credits and debits under non-cumulative regime. In particular, the accredited and non-accredited companies purchasing the inputs used to manufacture products are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential tax treatment with respect to the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, of these products. Thus, the treatment applicable to purchases by non-accredited companies can be considered as the benchmark treatment or normal rule of general application.

Comparison

7.457. The Panel now compares the suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, granted to accredited companies on the purchases of inputs, under the PADIS and PATVD programmes, with the treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies of inputs.

7.458. The Panel notes that under the benchmark treatment, the seller of the inputs will always charge the PIS/PASEP and COFINS contributions to the non-accredited company buying the products, at the moment of the sale, and the non-accredited company buying the products will accrue a tax credit in the amount of the PIS/PASEP and COFINS contributions paid. The seller then will remit to the Federal Revenue Service the amount of PIS/PASEP and COFINS contributions charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the non-accredited company buying the products will be allowed to use the credit it has accrued to offset its PIS/PASEP and COFINS contributions debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the seller pays the tax to the Brazilian Government.[823] However, if the non-accredited company buying the products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods.[824] If the non-accredited company buying the products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement.[825] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the non-accredited company buying the products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[826] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[827]

7.459. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the non-accredited company buying the products, the Government will receive the full amount of

[823] See paragraphs 2.16 to 2.17 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[824] See paragraphs 2.19 and 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[825] See paragraph 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[826] See paragraph 2.20 above.

[827] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, paras. 758 (DS472) and 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). See Exporters_2012 study on Brazilian exports – delays in refunds, (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

PIS/PASEP and COFINS contributions due from the seller and the non-accredited company buying the products will be able to offset the amount of PIS/PASEP and COFINS contributions paid during the same taxation period. However, if the non-accredited company buying the products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the seller until the non-accredited company buying the products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the non-accredited company buying the products (within 360 days of the date for the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[828] This cash availability and associated implicit interest can last from one taxation period[829] (if the non-accredited company is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the non-accredited company requests it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to the non-accredited company buying the products within 360 days after the request, the Brazilian Government will not have to pay the non-accredited company buying the products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the non-accredited company buying the products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[830]

7.460. With respect to imported inputs, the Panel notes that the PIS/PASEP-importation and COFINS-importation contributions are collected by the customs authorities from the importer during the customs clearance process.[831] Therefore, the Government will enjoy the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that is collected, from the moment the product is imported until the moment the non-accredited company buying the product is able to offset the credit, or receives compensation or reimbursement (within 360 days of the request). Moreover, the Brazilian Government will enjoy the advantage of having charged the additional 1% of COFINS-importation contribution that does not generate a tax credit.[832]

7.461. In contrast, pursuant to the challenged treatment under the PADIS and PATVD programmes, whereby the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions are suspended, the seller will not have to charge the contributions to the accredited company buying the products and will not have to remit any amount of tax to the Brazilian Government. The accredited company buying the products, in turn, will not accrue any credit.[833]

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[828] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[829] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[830] See paragraph 2.20 above and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6), (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submission (DS472), paras. 780 and fn 451 (DS497).

[831] See paragraph 2.32 above.

[832] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, paras. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[833] See paragraph 2.18 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

7.462. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction (in the case of domestic products), or on the date of importation (in the case of imported products). By the same token, it also will not have to allow the accredited company buying the products to offset the amount of tax paid.[834]

7.463. If the Panel compares the challenged treatment with the best case scenario for the non-accredited company buying domestic products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period (in the case of domestic products), there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the non-accredited company buying the products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from the moment of importation (in the case of imported products) or from one taxation period[835] (in the case of domestic products) to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used. Moreover, in the case of imported products, the Brazilian Government is foregoing the advantage of the additional 1% of COFINS-importation contribution that does not generate a tax credit.[836]

7.464. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17[837] above, when the accredited company buying the inputs sells its finished goods incorporating those products, under normal circumstances[838] the Brazilian Government ultimately will collect the full amount of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, corresponding to both the value added by the seller and the value added by the accredited company buying the products, i.e., the same nominal amount of contributions that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the accredited company buying the products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the seller of the products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

7.465. Also, although the non-cumulative regime is the general rule for the PIS/PASEP and COFINS contributions[839], to the extent that the purchases of the inputs at issue could be subject to the cumulative regime, there would be no mechanism of credits and debits. In this case, if the Panel compares the challenged treatment, where the Brazilian Government receives none of the PIS/PASEP and COFINS contributions that otherwise would have been due, with the treatment under the cumulative regime, where the Brazilian Government receives the full amount of PIS/PASEP and COFINS contributions due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due under the cumulative regime.

h. The exemptions (through zero rates) of the PIS/PASEP and COFINS contributions or PIS/PASEP-importation and COFINS-importation contributions on purchases of certain capital goods and computational tools (for purposes of PADIS and PATVD) used to

[834] See paragraph 2.13 above.

[835] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[836] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, paras. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[837] Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.

[838] The Panel notes that normal circumstances might not exist in the case at issue, because under the Informatics, PADIS and PATVD programmes, the finished products manufactured with the raw materials, intermediate goods, inputs and packaging materials with the IPI tax exempted or suspended, will also have the IPI tax exempted or reduced.

[839] See paragraph 2.22 above

manufacture the incentivized products, that will be incorporated into the fixed assets of the accredited company.

The benchmark treatment

7.466. The Panel considers that the appropriate benchmark treatment is the treatment applicable to purchases by non-accredited companies of certain capital goods and computational tools that will be used by those companies to manufacture the products covered by PADIS and PATVD, i.e. the obligation to pay the full amount of the applicable PIS/PASEP and COFINS, or PIS/PASEP-importation and COFINS-importation contributions, on the purchase of certain capital goods and computational tools, subject to the mechanism of credits and debits under the non-cumulative regime.[840] In particular, the accredited and non-accredited companies purchasing the capital goods and computational tools used to manufacture products are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential tax treatment with respect to the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, of these products. Thus, the treatment applicable to purchases by non-accredited companies can be considered as the benchmark treatment or normal rule of general application.

Comparison

7.467. The Panel now compares the suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, granted to accredited companies on the purchases of certain capital goods and computational tools, under the PADIS and PATVD programmes, with the treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies.

7.468. The Panel notes that under the benchmark treatment, the seller of the capital goods and computational tools will always charge the PIS/PASEP and COFINS contributions to the non-accredited company buying the products, at the moment of the sale, and the non-accredited company buying the products will accrue a tax credit in the amount of the PIS/PASEP and COFINS contributions paid. The seller then will remit to the Federal Revenue Service the amount of PIS/PASEP and COFINS contributions charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the non-accredited company buying the products will be allowed to use the credit it has accrued to offset its PIS/PASEP and COFINS contributions debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the seller pays the tax to the Brazilian Government.[841] However, if the non-accredited company buying the products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods.[842] If the non-accredited company buying the products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement.[843] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the non-accredited company buying the products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[844] It is fairly common that companies are not able to offset the full

[840] The Panel notes that Law 11,774/2008, art. 1, as amended by Law 12.546/2011, explicitly allows for the immediate utilization of credits on purchases of capital goods. The Law states as follows: "The legal entities, in case of acquisition in the domestic market or of importation of machines and equipment intended for the production of goods and the provision of services, may opt for the discount of credits of the 'Contribuição para o Programa de Integração Social/Programa de Formação do Patrimônio do Servidor Público (PIS/Pasep)' and of the 'Contribuição para Financiamento da Seguridade Social (Cofins)' addressed in item III of § 1 of art. 3 of Law 10,637, of December 30, 2002, item III of § 1 of art. 3 of Law 10833, of December 29, 2003, and § 4 of art. 15 of Law 10,865, of April 30, 2004, in the following way: …XII - immediately, in the case of acquisitions occurred as of July, 2012." See Brazil's response to Panel's question 23.

[841] See paragraphs. 2.16 to 2.17 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[842] See paragraphs 2.19 to 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[843] See paragraph 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[844] See paragraph 2.20 above.

amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[845]

7.469. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the non-accredited company buying the products, the Government will receive the full amount of PIS/PASEP and COFINS contributions due from the seller and the non-accredited company buying the products will be able to offset the amount of PIS/PASEP and COFINS contributions paid during the same taxation period. However, if the non-accredited company buying the products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the seller until the non-accredited company buying the products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the non-accredited company buying the products (within 360 days of the date for the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[846] This cash availability and associated implicit interest can last from one taxation period[847] (if the non-accredited company is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the non-accredited company requests it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to the non-accredited company buying the products within 360 days after the request, the Brazilian Government will not have to pay the non-accredited company buying the products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the non-accredited company buying the products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[848]

7.470. With respect to imported capital goods and computational tools, the Panel notes that the PIS/PASEP-importation and COFINS-importation contributions are collected by the customs authorities from the importer during the customs clearance process.[849] Therefore, the Government will enjoy the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that is collected, from the moment the product is imported until the moment the non-accredited company buying the product is able to offset the credit, or receives compensation or reimbursement (within 360 days of the

[845] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, paras. 758 (DS472) and 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). See Exporters_2012 study on Brazilian exports – delays in refunds, (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

[846] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[847] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[848] See paragraph 2.20 and footnote 29 above. See also Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6) (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submissions, paras. 780 (DS472) and fn 451 (DS497).

[849] See paragraph 2.32 above.

request). Moreover, the Brazilian Government will enjoy the advantage of having charged the additional 1% of COFINS-importation contribution that does not generate a tax credit.[850]

7.471. In contrast, pursuant to the challenged treatment under the PADIS and PATVD programmes, whereby the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions are suspended, the seller will not have to charge the contributions to the accredited company buying the products and will not have to remit any amount of tax to the Brazilian Government. The accredited company buying the products, in turn, will not accrue any credit.[851]

7.472. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction (in the case of domestic products), or on the date of importation (in the case of imported products). By the same token, it also will not have to allow the accredited company buying the products to offset the amount of tax paid.[852]

7.473. If the Panel compares the challenged treatment with the best case scenario for the non-accredited company buying domestic products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period (in the case of domestic products), there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the non-accredited company buying the products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from the moment of importation (in the case of imported products) or from one taxation period[853] (in the case of domestic products) to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used. Moreover, in the case of imported products, the Brazilian Government is foregoing the advantage of the additional 1% of COFINS-importation contribution that does not generate a tax credit.[854]

7.474. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17[855] above, when the accredited company buying the capital goods and computational tools sells its finished goods that were produced using the capital goods and computational tools, under normal circumstances[856] the Brazilian Government ultimately will collect the full amount of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, corresponding to both the value added by the seller and the value added by the accredited company buying the products, i.e., the same nominal amount of contributions that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the accredited company buying the products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the

[850] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submissions, para. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[851] See paragraph 2.18 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[852] See paragraph 2.13 above.

[853] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[854] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, paras. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[855] Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.

[856] The Panel notes that normal circumstances might not exist in the case at issue, because under the PADIS and PATVD programmes, the finished products manufactured with exempted capital goods and computational tools will themselves be exempted from the payment of the PIS/PASEP and COFINS contributions.

tax to the seller of the products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

7.475. Also, although the non-cumulative regime is the general rule for the PIS/PASEP and COFINS contributions[857], to the extent that the purchases of the capital goods and computational tools at issue could be subject to the cumulative regime, there would be no mechanism of credits and debits. In this case, if the Panel compares the challenged treatment, where the Brazilian Government receives none of the PIS/PASEP and COFINS contributions that otherwise would have been due, with the treatment under the cumulative regime, where the Brazilian Government receives the full amount of PIS/PASEP and COFINS contributions due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due under the cumulative regime.

i. The exemptions (through zero rates) of the CIDE contributions on remittances sent abroad for payment of contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of incentivized products (for purposes of PADIS and PATVD).

The benchmark treatment

7.476. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to the remittances sent abroad for payment of contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of products covered by the PADIS and PATVD programmes by non-accredited companies, i.e. the obligation to pay the full amount of the applicable CIDE contributions on remittances sent abroad for the payment of contracts related to the manufacturing of the non-incentivized products. In particular, the accredited and non-accredited companies entering into contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of their products are identically situated, except for the fact of accreditation. Brazil has provided no evidence demonstrating any other difference that could explain the differential CIDE contributions treatment. Thus, the treatment applicable to remittances sent abroad for the payment of contacts entered into by non-accredited companies can be considered the benchmark treatment or normal rule of general application.

Comparison

7.477. The Panel now compares the exemptions granted to accredited companies of the CIDE contributions on remittances sent abroad for payment of contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of incentivized products, under the PADIS and PATVD programmes, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to remittances sent abroad for the payment of contracts entered into by non-accredited companies.

7.478. The Panel notes that under the benchmark treatment the non-accredited company entering into contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of their products will always have to pay the CIDE contributions arising from the remittances sent abroad for the payment of those contracts. The Brazilian Government will receive the full amount of CIDE contributions from the non-accredited company entering into contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of their products.

7.479. In contrast, pursuant to the challenged treatment under the PADIS and PATVD programmes, whereby the contributions are exempted, the non-accredited company entering into contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of their products will not have to pay any amount of contributions to the Brazilian Government.

[857] See paragraph 2.22 above

7.480. If the Panel compares the challenged treatment, where the Brazilian Government receives none of the CIDE contributions that otherwise would have been due, with the benchmark treatment, where the Brazilian Government receives the full amount of CIDE contributions, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due. Thus, the Panel finds that, with respect to the exemptions of the CIDE contributions granted to accredited companies under the PADIS and PATVD programmes on remittances sent abroad for payment of contracts for the exploitation of patents or use of trademarks and for the provision of technology and technical assistance for the manufacturing of incentivized products, "government revenue that is otherwise due is foregone or not collected".

j. The exemptions (through zero rates) of ordinary customs duties on purchases of certain capital goods, inputs and computational tools used in the manufacture of incentivized products (for purposes of PADIS).

The benchmark treatment

7.481. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to the purchases of certain inputs, capital goods and computational tools used in the manufacture of products covered by the PADIS programme by non-accredited companies, i.e. the obligation to pay the full amount of the applicable ordinary customs duties on purchases of certain inputs, capital goods and computational tools. In particular, the accredited and non-accredited companies purchasing the inputs, capital goods and computational tools are identically situated, except for the fact of accreditation. Brazil has provided no evidence demonstrating any other difference that could explain the differential CIDE contributions treatment. Thus, the treatment applicable to purchases by non-accredited companies can be considered the benchmark treatment or normal rule of general application.

Comparison

7.482. The Panel now compares the exemptions granted to accredited companies of the ordinary customs duties on purchases of certain inputs, capital goods and computational tools used in the manufacture of incentivized products, under the PADIS programme, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies.

7.483. The Panel notes that under the benchmark treatment the non-accredited company purchasing the inputs, capital goods and computational tools will always have to pay the ordinary customs duties on purchases of certain inputs, capital goods and computational tools used in the manufacture of incentivized products. The Brazilian Government will receive the full amount of ordinary customs duties from the non-accredited company purchasing the inputs, capital goods and computational tools.

7.484. In contrast, pursuant to the challenged treatment under the PADIS programme, whereby the ordinary customs duties are exempted, the non-accredited company purchasing the inputs, capital goods and computational tools will not have to pay any amount of duties to the Brazilian Government.

7.485. If the Panel compares the challenged treatment, where the Brazilian Government receives none of the ordinary customs duties that otherwise would have been due, with the benchmark treatment, where the Brazilian Government receives the full amount of ordinary customs duties, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due. Thus, the Panel finds that, with respect to the exemptions of ordinary customs duties granted to accredited companies under the programme on the purchases of inputs, capital goods and computational tools used in the manufacture of incentivized products, "government revenue that is otherwise due is foregone or not collected".

Reasons for the difference in tax treatment

7.486. Finally, with respect to the Panel's obligation to take into consideration the reasons for the difference in tax treatment, the Panel recalls that, according to Brazil and the relevant Explanatory

Memoranda, the stated aim of the Informatics programme[858] is to develop technology-based industries in Brazil. In the case of PADIS[859], the stated aim is to encourage the setting-up in Brazil of companies involved in the conception, development, design and manufacturing of electronic semiconductor devices and displays. In the case of PATVD[860], it is to encourage the setting-up in Brazil of companies involved in the development and manufacturing of radio-frequency transmitter equipment for digital television. In the case of Digital Inclusion[861], the stated aim is to increase the access of the Brazilian population to computers and information technology products. Brazil also argues in this dispute that the tax suspensions and exemptions on the purchases of inputs and capital goods under the Informatics, PADIS and PATVD programmes are a tax administration measure to prevent the accumulation of tax credits by companies whose final products are exempted or subject to low taxation, and that would not able to generate enough tax debits to offset the tax credits generated. Even if such consideration may appear reasonable, at least in principle, there is no evidence on the record, including in all the legal instruments examined, indicating that the policy basis for such tax treatment in the challenged programmes is, in fact, the prevention of the accumulation of tax credits. Moreover, other companies that are credit-accumulating companies cannot qualify for the suspensions, while other companies that might qualify for the suspensions are not credit-accumulating companies.[862]

7.487. The Panel notes that the alleged reasons relate to objectives of setting up and developing technology-based industries in Brazil, and giving access to those products to the population. The Panel does not see any reason why these alleged reasons could impact the Panel's findings with respect to the comparison between the challenged tax treatment and the benchmark treatment.

7.3.5.3.3.3 Conclusion on whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected"

7.488. In light of the above, the Panel concludes that each of the challenged tax reductions and exemptions granted to accredited companies on the sales of the *finished goods that they produce* (under the Informatics, PATVD and Digital Inclusion programmes) constitute financial contributions where "government revenue that is otherwise due is foregone or not collected".

7.489. The Panel also concludes that each of the challenged tax exemptions and reductions granted to accredited companies on the sales of the *intermediate goods that they produce* (under the Informatics and PADIS programmes) constitute financial contributions where "government revenue that is otherwise due is foregone or not collected".

7.490. The Panel concludes, as well, that each of the challenged tax suspensions and exemptions granted to accredited companies on its purchases of *raw materials, intermediate goods and packaging materials* (under the Informatics programme) and *inputs, capital goods and computational tools* (under the PADIS and PATVD programmes) constitute financial contributions where "government revenue that is otherwise due is foregone or not collected".

7.3.5.3.4 Whether the financial contributions granted under the ICT programmes confer a benefit

7.491. Several panels have concluded that, whenever there is revenue foregone by the government, a benefit is conferred.[863] Having concluded that the tax treatments at issue constitute financial contributions where "government revenue that is otherwise due is foregone or not collected", the Panel concludes that the subsidies at issue confer a benefit.

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[858] Brazil's first written submission, paras. 107 (DS472) and 79 (DS497).
[859] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 2.
[860] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 7.
[861] Brazil's first written submission, paras. 469 (DS472) and 405 (DS497).
[862] See paragraphs 7.1168 and 7.1169 below.
[863] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 7.169-7.171. See also: Panel Reports, Canada – Renewable Energy / Canada – Feed-in Tariff Program, fn 509; *US – FSC*, para. 7.103; and *US – FSC (Article 21.5 – EC)*, paras. 8.44-8.48; and Appellate Body Reports, *US – FSC*, para. 140; and *US – FSC (Article 21.5 – EC)*, para. 198.

7.492. With respect to the tax reductions and exemptions granted to accredited companies on the sales of the *finished goods* that they produce, it is clear that, by not having to pay the full amount of taxes and contributions concerned, the buyers of the incentivized products under the Informatics, PATVD and Digital Inclusion programmes are better off with the exemptions and reductions than in the benchmark scenario of having to pay the full amount of taxes or contributions concerned on their purchases on non-incentivized products.

7.493. With respect to the tax exemptions and reductions granted to accredited companies on the sales of the *intermediate goods* that they produce, it is also clear that, by retaining the advantage of cash availability, the buyers of the incentivized products under the Informatics and PADIS programmes are better off with the exemptions than in the benchmark scenario of having to pay the full amount of taxes or contributions on their purchases of non-incentivized products.

7.494. Finally, with respect to the tax suspensions and exemptions granted to accredited companies on purchases of raw materials, inputs, intermediate goods, packaging materials, capital goods and computational tools, it is clear that, by retaining the advantage of cash availability, the accredited companies under the Informatics, PADIS and PATVD programmes buying the inputs, capital goods and computational tools are better off with the exemptions and suspensions than in the benchmark scenario of having to pay the full amount of taxes or contributions on their purchases of raw materials, inputs, intermediate goods, packaging materials, capital goods and computational tools.

7.3.5.3.5 Conclusion on whether the tax exemptions, reductions and suspensions granted under the ICT programmes constitute subsidies within the meaning of Article 1 of the SCM Agreement

7.495. Having concluded that the tax exemptions, reductions and suspensions granted under the ICT programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred, the Panel concludes that the measures at issue constitute subsidies within the meaning of Article 1 of the SCM Agreement.

7.3.5.4 Whether the subsidies granted under the ICT programmes are specific within the meaning of Article 2 of the SCM Agreement

7.496. Article 1.2 of the SCM Agreement states as follows:

> A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

7.497. Article 2.3 of the SCM Agreement states as follows:

> Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

7.498. Pursuant to these provisions, a subsidy falling within the meaning of Article 1.1 of the SCM Agreement will be subject to the provisions of Part II (prohibited subsidies) if such a subsidy is specific, and a subsidy that is prohibited under the provisions of Article 3 shall be deemed to be specific

7.499. Because the Panel has already concluded that the conditions for receiving the subsidies granted under the ICT programmes involve contingency upon the use of domestic over imported goods in the sense of Article 3.1(b) of the SCM Agreement, the Panel also concludes, *ipso facto,* that pursuant to Article 2.3, the subsidies granted under the ICT programmes are specific, and thus subject to the provisions of Part II of the SCM Agreement.

7.3.5.5 Conclusion

7.500. In light of the foregoing, the Panel concludes that the exemptions, reductions and suspensions granted under the Informatics, PADIS, PATVD and Digital Inclusion programmes are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon the use of

domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement[864], and thus are prohibited subsidies, inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement.

7.501. The Panel would like to clarify that it has concluded that the subsidies at issue are prohibited because, based on the specific facts of this dispute, these subsidies are contingent upon the use of domestic over imported goods. However, the Panel is not saying with this that Brazil, or any other WTO Member, is not allowed to grant subsidies exclusively to their domestic producers with the aim of fostering the development of their industries.

7.502. In fact, the SCM Agreement prohibits (only) subsidies contingent upon the use of domestic over imported goods, or upon export performance, because those types of subsidies are particularly trade-distorting.

7.503. This means that Members are allowed to grant non-prohibited specific subsidies, exclusively to their domestic producers, without implicating the national treatment obligation contained in Article III of the GATT 1994. While as a general matter such non-prohibited subsidies are subject to the disciplines in Part III of the SCM Agreement in respect of the adverse effects[865] that those subsidies may cause to the interests of other Members, and subject as well to the possibility of countervailing action by other Members pursuant to Part V of that Agreement, they remain permitted. As the specificity provisions of Article 2 of the SCM Agreement make clear, it is permissible to aim such subsidies at an enterprise or industry, or a group of enterprises or industries, such as the ICT and the automotive sectors (again subject to the disciplines regarding adverse effects and a potential countervailing action).

7.504. In the context of this dispute involving subsidies of a developing Member, it is particularly worth recalling that while the prohibitions in Part II of the SCM Agreement, and the provisions concerning countervailing measures in Part V of that Agreement, are fully applicable to developing Members, the applicability of the adverse effects disciplines in Part III is considerably limited by the special and differential treatment provisions of the SCM Agreement. In particular, claims of serious prejudice cannot be brought in respect of developing Members' subsidies.[866] This provides developing Members with a considerably expanded scope of possibilities for providing subsidies, due to the considerably reduced possible repercussions.

7.505. Thus, a developing Member can provide subsidies for the development of such domestic industries, and without concern for whether those subsidies may cause serious prejudice to other Members' interests, so long as it does not condition those subsidies on the use of domestic goods, or on exportation. For example, a subsidy could be given separately to domestic producers of parts and components and to domestic producers of final products that use those parts and components, so long as the latter subsidy is not conditioned on the use of the domestic parts and components (or other domestic goods, or on exportation) in the production of the subsidized final products. If the subsidy to the producers of parts and components improved the price competitiveness of those products *vis-à-vis* imported products, any serious prejudice resulting from this situation could not be challenged.

7.506. Of course, all Members also are free to provide non-specific subsidies, which are not covered by the SCM Agreement at all. In this regard, Article 2.1(b) establishes that subject to certain requirements, subsidies provided pursuant to objective conditions and criteria, such as number of employees or size of enterprise, are non-specific.[867] Thus, in principle, subsidies for small and medium enterprises could be designed in such a way as to fall outside the scope of the SCM Agreement entirely.

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[864] See paragraphs 7.259 to 7.261 above.

[865] I.e. injury to domestic industry of another signatory, nullification or impairment of benefits accruing directly or indirectly to other Members under the GATT 1994, or serious prejudice to the interests of another member. See Article 5 of the SCM Agreement.

[866] Article 27.9 of the SCM Agreement. This special and differential treatment provision underscores that the drafters of the rules wished to allow considerable flexibility to developing Members to provide subsidies.

[867] So long as eligibility is automatic and the criteria and conditions are strictly adhered to. Objective criteria or conditions are conditions that are neutral, do not favour certain enterprises over others, and are economic in nature and horizontal in application.

7.507. In sum, the SCM Agreement leaves policy space for WTO Members – particularly developing Members – to devise WTO-consistent programmes to grant subsidies exclusively to their domestic producers, to foster, through those subsidies, the development of their industries and to pursue other policy goals.

7.3.6 Brazil's invocation of Article XX(a) of the GATT 1994 to justify certain inconsistencies in respect of the PATVD programme

7.3.6.1 Introduction

7.508. In respect of the PATVD programme, Brazil argues that there is no inconsistency with any provisions of the GATT 1994 or the TRIMs Agreement. Brazil also argues that, in the event the Panel does make any findings of inconsistency, such inconsistency is nevertheless justified under subparagraph (a) of Article XX of the GATT 1994, which refers to measures "necessary to protect public morals".

7.509. Additionally, Brazil argues that in the event the Panel does make any findings of inconsistency under Article 2.1 of the TRIMs Agreement, resulting from findings of inconsistency in respect of Article III of the GATT 1994, since the Article III inconsistencies are "justified under Article XX(a) … there would … be no violation of the TRIMs Agreement".[868] Brazil has not raised any Article XX defence with regard to alleged inconsistencies with the SCM Agreement.

7.510. As an initial matter, the Panel highlights the Appellate Body's statements that "the aspects of a measure to be justified under the subparagraphs of Article XX are those that give rise to the finding of inconsistency under the GATT 1994".[869] The Appellate Body has further clarified in the context of Article XIV of the GATS, governing the general exceptions applicable in the context of the GATS, that:

> [I]n order for a panel properly to conduct its assessment under Article XIV of the GATS, it should be clear from the panel's analysis that, with respect to each individual measure, the aspects of the measure addressed are the same as those that gave rise to its earlier finding of inconsistency. This is because a respondent may not justify the inconsistency of a measure by basing its defence on aspects of that measure different from those that were found by the panel to be inconsistent with a provision of the GATS.[870]

7.511. Therefore the aspects of the PATVD programme to be justified under Article XX(a) are those that the Panel found to be inconsistent with Article III of the GATT 1994, namely:

a. Those aspects of the PATVD programme that have been found to discriminate against imported finished products in favour of like domestic finished products, inconsistently with Articles III:2 and III:4; and

b. Those aspects of the PPB under the PATVD programme that have been found to discriminate by incentivising the use of domestic input products over like imported input products, in the production of finished products that receive the tax treatment available under the programme, inconsistently with Article III:4.

7.3.6.2 Description of the legal test

7.512. Article XX(a) of the GATT 1994 provides as follows:

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[868] Brazil's first written submissions, para. 461 (DS472) and para. 398 (DS497).

[869] Appellate Body Report, *EC – Seal Products*, para. 5.185. Additionally, in *Thailand – Cigarettes (Philippines)*, the Appellate Body observed that:

> [W]hen Article XX(d) is invoked to justify an inconsistency with Article III:4, what must be shown to be "necessary" is the treatment giving rise to the finding of less favourable treatment. Thus, when less favourable treatment is found based on differences in the regulation of imports and of like domestic products, the analysis of an Article XX(d) defence should focus on whether those regulatory differences are "necessary". Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 177.

[870] Appellate Body Report, *Argentina – Financial Services*, para. 6.169.

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> (a) necessary to protect public morals;

7.513. The Appellate Body has explained that:

> [T]he assessment of a claim of justification under Article XX involves a two-tiered analysis in which a measure must first be provisionally justified under one of the subparagraphs of Article XX, before it is subsequently appraised under the chapeau of Article XX.[871]

7.514. According to the Appellate Body, the burden of proving that a measure is justified under Article XX rests on the party invoking that defence.[872] Specifically, the party invoking the defence bears the burden of proving not only that a measure is provisionally justified under a subparagraph of Article XX, but that the measure is consistent with the requirements of the chapeau of Article XX.[873] The Appellate Body has indicated, however, that

> [T]he nature and scope of arguments and evidence required to establish a *prima facie* case will necessarily vary according to the facts of the case, and from measure to measure, provision to provision, and case-to-case. Moreover, these rules and principles of WTO jurisprudence must not be applied in an unduly formalistic or mechanistic fashion, nor inhibit the substantive analysis that must be undertaken by a panel.[874]

7.515. Article XX of the GATT 1994 therefore involves a two-tiered analysis. First, a panel must assess whether the measure at issue is provisionally justified under the subparagraph of Article XX invoked. Second, if the panel finds that the measure is provisionally justified, it must examine whether the application of the measure satisfies the requirements of the chapeau of Article XX.

7.3.6.2.1 Provisional justification under Article XX(a)

7.516. The Appellate Body in *Colombia – Textiles* recalled from previous jurisprudence that, generally speaking:

> [P]rovisional justification under one of the paragraphs of Article XX requires that a challenged measure "address the particular interest specified in that paragraph", and that "there be a sufficient nexus between the measure and the interest protected". "The required nexus – or 'degree of connection' – between the measure and the interest is specified in the language of the paragraphs themselves, through the use of terms such as 'relating to' and 'necessary to'" in Article XX.[875]

7.517. Specifically with respect to Article XX(a), the Appellate Body stated in *Colombia – Textiles* that "[i]n order to establish whether a measure is justified under Article XX(a), the analysis proceeds in two steps. First the measure must be 'designed' to protect public morals. Second, the measure must be 'necessary' to protect such public morals."[876]

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[871] Appellate Body Report, *EC – Seal Products*, para. 5.169. (footnotes omitted) This sequence of steps, as the Appellate Body had previously noted, does not reflect "inadvertence or random choice but rather the fundamental structure and logic of Article XX of the GATT 1994". Appellate Body Report, *China – Rare Earths*, para. 5.86 (referring to Appellate Body Report, *US – Shrimp*, para. 119).

[872] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:I, 323, at p. 335.

[873] Appellate Body Report, *US – Gasoline*, pp. 22-23, DSR 1996:I, 3, at pp. 21-23.

[874] Appellate Body Report, *US – Tuna II (Article 21.5 - Mexico)*, para. 7.33.

[875] Appellate Body Report, *Colombia – Textiles*, para. 5.67 (referring to Appellate Body Reports, *EC – Seal Products*, para. 5.169; *US – Gambling*, para. 292).

[876] Appellate Body Report, *Colombia – Textiles*, para. 5.67. (footnotes omitted)

7.518. In order to determine whether a particular measure is "designed" to protect public morals, the Appellate Body in *Colombia – Textiles* explained that:

> With respect to the analysis of the "design" of the measure, the phrase "to protect public morals" calls for an initial, threshold examination in order to determine whether there is a relationship between an otherwise GATT-inconsistent measure and the protection of public morals. If this initial, threshold examination reveals that the measure is incapable of protecting public morals, there is not a relationship between the measure and the protection of public morals that meets the requirements of the "design" step. In this situation, further examination with regard to whether this measure is "necessary" to protect such public morals would not be required. This is because there can be no justification under Article XX(a) for a measure that is not "designed" to protect public morals. However, if the measure is not incapable of protecting public morals, this indicates the existence of a relationship between the measure and the protection of public morals. In this situation, further examination of whether the measure is "necessary" is required under Article XX(a).[877]

7.519. In performing this "threshold examination", a panel must therefore assess whether the claimed objective is a "public morals" objective within the meaning of Article XX(a), and whether the measure is "designed" to protect that objective (in other words, whether the measure is not incapable of contributing to that objective).

7.520. The concept of "public morals" has been addressed by WTO panels in the past. The panel in *Colombia – Textiles*, in a finding that was not appealed regarding the determination of whether a particular objective is a "public morals" objective or not, summarised the jurisprudence as follows:

> In interpreting the concept of "public morals" for the first time, [the panel in *US – Gambling*] pointed out that the expression "denotes standards of right and wrong conduct maintained by or on behalf of a community or nation", and that its content for Members "can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values". The panel also noted that Members, in applying similar societal concepts, have the right to determine the level of protection that they consider appropriate and added that Members should be given some scope to define and apply for themselves the concept of "public morals" in their respective territories, according to their own systems and scales of values.
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> The panel in *China – Publications and Audiovisual Products*, in interpreting Article XX(a) of the GATT 1994 for the first time, adopted the interpretation of "public morals" proposed by the panel in *US – Gambling*. The panel considered that Article XX(a) of the GATT 1994 and Article XIV(a) of the GATS use the same concept and saw no reason to depart from the interpretation proposed in *US – Gambling*.
>
> The panel in *EC – Seal Products* also interpreted the term "public morals" within the meaning of Article XX (a) of the GATT 1994. The panel pointed out that the assessment of the scope of the expression suggests that "WTO Members are afforded a certain degree of discretion in defining the scope of 'public morals' with respect to various values prevailing in their societies at a given time." The panel added that:
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>> [T]he question of whether a measure aims to address public morals relating to a particular concern in the society of a regulating Member requires ... an assessment of two issues: first, whether the concern in question indeed exists in that society; and, second, whether such concern falls within the scope of "public morals" as "defined and applied" by a regulating Member "in its territory, according to its own systems and scales of values".
>
> However, the Appellate Body in *EC – Seal Products* made it clear that it did not consider that the term "to protect", when used in relation to "public morals" under

[877] Appellate Body Report, *Colombia – Textiles*, para. 5.68. (footnotes omitted)

> Article XX(a), required the panel to identify the existence of a risk to public moral concerns, and that it had difficulty in accepting that a panel is required to identify the exact content of the public morals standard at issue.[878]

7.521. Policies covered under the public morals exception in past disputes have addressed issues such as money laundering, organized crime, fraud, underage gambling, and pathological gambling[879]; content review to prevent the dissemination of cultural goods with a content that has a negative impact on a Member's public morals[880]; and public concerns related to seal welfare.[881]

7.522. If a panel determines that a particular claimed objective is indeed a public morals objective within the meaning of Article XX(a), the panel must determine whether the measure is *designed* to achieve that objective. As described above, the Appellate Body has explained that the standard for whether or not a measure is "designed to protect" public morals is whether the measure is "not incapable" of protecting that objective.[882] The Appellate Body has further explained that "[i]n order to determine whether such a relationship exists, a panel must examine evidence regarding the design of the measure at issue, including its content, structure, and expected operation."[883] Furthermore, the Appellate Body explained that "in the context of the 'design' step of the analysis, a panel is not precluded from taking into account evidence and considerations that may also be relevant to the examination of the contribution of the measure in the context of the 'necessity' analysis".[884]

7.523. Nevertheless, the Appellate Body also explained that it does "not see the examination of the 'design' of the measure as a particularly demanding step … By contrast, the assessment of the 'necessity' of a measure involves a more in-depth, holistic analysis".[885] Additionally, the Appellate Body explained that:

> [O]nce an analysis of the "design" of a measure reveals that the measure is not incapable of protecting public morals, such that there is a relationship between the measure and the protection of public morals, a panel may not refrain from conducting the "necessity" step of the analysis. The Appellate Body has emphasized that "[a] panel must not … structure its analysis of the ["design" step] in such a way as to lead it to truncate its analysis prematurely and thereby foreclose consideration of crucial aspects of the respondent's defence relating to the 'necessity' analysis."[886]

7.524. Thus, if a measure is found to be designed to protect a public morals objective, the panel must assess whether or not the measure is "necessary" to protect public morals. The analysis of the term "necessary" in the context of the general exceptions has evolved in the WTO jurisprudence over time. The Appellate Body in *EC – Seal Products* found that the analysis of necessity under Article XX of the GATT 1994 consists of the following:

> [A] necessity analysis involves a process of "weighing and balancing" a series of factors, including the importance of the objective, the contribution of the measure to that objective, and the trade-restrictiveness of the measure. The Appellate Body has

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[878] Panel Report, *Colombia – Textiles*, paras. 7.299-7.302 (referring to Appellate Body Reports, *EC – Seal Products*, paras. 5.198-5.199; and Panel Reports, *US – Gambling*, paras. 6.465 and 6.461; *China – Publications and Audiovisual Products*, para. 7.759; *EC – Seal Products*, paras. 7.380-7.381 and 7.383).

[879] Panel Report, *US – Gambling*, paras. 6.481-6.487.

[880] Appellate Body Report, *China – Publications and Audiovisual Products*, paras. 206-233.

[881] Panel Report, *EC – Seal Product*s, paras. 7.415-7.421 and 7.631.

[882] Appellate Body Report, *Colombia – Textiles*, para. 5.68.

[883] Appellate Body Report, *Colombia – Textiles*, para. 5.69 (referring to Appellate Body Reports, *US – Shrimp*, paras. 135-142; and *EC – Seal Products*, para. 5.144).

[884] Appellate Body Report, *Colombia – Textiles*, para. 5.76. The Panel notes that in *EC – Seal Products* the Appellate Body followed (and upheld) the panel's approach of determining the precise objective of the relevant measure. See Appellate Body Report, *EC – Seal Products*, paras. 5.133-5.167. See also Panel Report, *EC – Seal Products*, paras. 7.357-7.411. However, in light of the Appellate Body's decision in *Colombia – Textiles*, the Panel understands that a comprehensive analysis of the precise objectives of the measure is *not* required, and that a panel need only assess whether the discriminatory aspects of the measure are "not incapable" of contributing to the stated objective claimed by the responding party invoking Article XX. Appellate Body Report, *Colombia – Textiles*, paras. 5.70 and 5.76.

[885] Appellate Body Report, *Colombia – Textiles*, para. 5.70.

[886] Appellate Body Report, *Colombia – Textiles*, para. 5.77 (referring to Appellate Body Report, *Argentina – Financial Services*, para. 6.203).

> further explained that, in most cases, a comparison between the challenged measure and possible alternatives should then be undertaken. As the Appellate Body has stated, "[i]t is on the basis of this 'weighing and balancing' and comparison of measures, taking into account the interests or values at stake, that a panel determines whether a measure is 'necessary' or, alternatively, whether another, WTO-consistent measure is 'reasonably available'". Such an analysis, the Appellate Body has observed, involves a "holistic" weighing and balancing exercise "that involves putting all the variables of the equation together and evaluating them in relation to each other after having examined them individually, in order to reach an overall judgement".[887]

7.525. Therefore, the first element that a panel should consider when analysing whether a measure is "necessary" to protect public morals is the importance of the interests or values that the measure is intended to protect. The Appellate Body in *Korea – Various Measures on Beef*, in the context of interpreting the "necessity" test in Article XX(d), concluded that the more vital or important those interests or values are, the easier it would be to accept as "necessary" a measure otherwise found to be inconsistent with the GATT 1994.[888]

7.526. A second element to be "weighed and balanced" is the contribution of the measure to the objective pursued. A panel's assessment of the contribution shall be guided by the particular circumstances of the case and the evidence at issue.[889] In *Brazil – Retreaded Tyres*, the Appellate Body stated that "a contribution exists when there is a genuine relationship of ends and means between the objective pursued and the measure at issue".[890]

7.527. As regards the existence of a particular methodology that a panel should follow to assess the contribution of a measure, the Appellate Body stated as follows:

> The selection of a methodology to assess a measure's contribution is a function of the nature of the risk, the objective pursued, and the level of protection sought. It ultimately also depends on the nature, quantity, and quality of evidence existing at the time the analysis is made. Because the Panel, as the trier of the facts, is in a position to evaluate these circumstances, it should enjoy a certain latitude in designing the appropriate methodology to use and deciding how to structure or organize the analysis of the contribution of the measure at issue to the realization of the ends pursued by it. This latitude is not, however, boundless. Indeed, a panel must analyze the contribution of the measure at issue to the realization of the ends pursued by it in accordance with the requirements of Article XX of the GATT 1994 and Article 11 of the DSU.[891]

7.528. The Appellate Body also clarified that there is not a "generally applicable standard requiring the use of a pre-determined threshold of contribution in analysing the necessity of a measure under Article XX of the GATT 1994".[892] However, "the greater the contribution, the more easily a measure might be considered to be 'necessary'."[893] The Appellate Body further confirmed that a panel's contribution analysis "can be done either in quantitative or in qualitative terms".[894] In this connection, the Appellate Body noted that, in cases where a measure is part of a broader policy, it might be difficult in the short term to isolate the contribution of that specific measure to the objective pursued, from that attributable to other measures that are part of the same policy. It further added that the contribution of a measure might not be perceived immediately but only over

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[887] Appellate Body Report, *EC – Seal Products*, para. 5.214 (referring to Appellate Body Reports, *EC – Seal Products*, para. 5.169; *Brazil – Retreaded Tyres*, para. 182; and *US – Gambling*, para. 307 (referring to Appellate Body Report, *Korea – Various Measures on Beef*, para. 166)). See also Appellate Body Report, *Colombia – Textiles*, paras. 5.70-5.75.

[888] Appellate Body Report, *Korea - Various Measures on Beef*, para. 162.

[889] Appellate Body Report, *EC – Seal Products*, para. 5.211.

[890] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 145.

[891] Appellate Body Report, *EC – Seal Products*, para. 5.210 (referring to Appellate Body Report, *Brazil – Retreaded Tyres*, para. 145).

[892] Appellate Body Report, *EC – Seal Products*, para. 5.213.

[893] Appellate Body Report, *Korea- Various Measures on Beef*, para. 163.

[894] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 146.

time, and that an estimation of a measure's contribution can be made in terms of how "apt" the measure is to contribute to the relevant objective.[895]

7.529. A third element to be "weighed and balanced" is the level of trade-restrictiveness of the measure. The Appellate Body in *China – Publications and Audiovisual Products* stated that "[t]he less restrictive the effects of the measure, the more likely it is to be characterized as 'necessary'".[896] It further added that if a Member decides to adopt a highly trade-restrictive measure, "it will have to ensure that the measure is carefully designed so that the other elements to be taken into account in weighing and balancing the factors relevant to an assessment of the 'necessity' of the measure will 'outweigh' such restrictive effect."[897]

7.530. The Appellate Body has indicated that "in principle a panel must assess the restrictive effect of a measure on international commerce".[898] However, the Appellate Body did not dismiss the possibility that this assessment could extend beyond the restrictive effects on imported products given that "this assessment must be undertaken in the light of the measure at issue, the specific obligation of the covered agreements that the measure infringes, and the defence being invoked."[899]

7.531. Finally, the necessity analysis typically requires a determination as to "whether a WTO-consistent alternative measure which the Member concerned could 'reasonably be expected to employ' is available, or whether a less WTO-inconsistent measure is 'reasonably available'".[900] The Appellate Body has indicated that "whether a measure is 'necessary' cannot be determined by the level of contribution alone, but will depend on the manner in which the other factors of the necessity analysis, including a consideration of potential alternative measures, inform the analysis."[901] The Appellate Body has also clarified that:

> While there may be circumstances in which a weighing and balancing exercise would not require that a panel proceed to evaluate alternative measures …, we also do not consider that such an exercise mandates a preliminary determination of the necessity of the challenged measure before proceeding to assess those alternatives … We therefore disagree with [the] assertion that a preliminary determination of necessity is required before proceeding to compare the challenged measure with possible alternatives.[902]

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[895] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 151. See also Appellate Body Report, *EC – Seal Products*, para. 5.213.

[896] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 310. See also Appellate Body Reports, *Korea- Various Measures on Beef*, para. 163; and *Brazil – Retreaded Tyres*, para. 150.

[897] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 310.

[898] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 306.

[899] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 306. In that dispute, the panel took into consideration not just the restrictive effect of the Chinese measures on imports but also on beneficiaries of the right to trade. The Appellate Body upheld the panel's findings in this regard.

[900] Appellate Body Report, *Korea – Various Measures on Beef*, para. 166.

[901] Appellate Body Report, *EC – Seal Products*, para. 5.215.

[902] Appellate Body Report, *EC – Seal Products*, fn 1299. (referring to Appellate Body Reports, *US – Gambling*, paras. 306 and 307; *Brazil – Retreaded Tyres*, paras. 156 and 178; and *China – Publications and Audiovisual Products*, para. 241 (stating that if a panel reaches a preliminary conclusion that a measure is necessary, this result must be confirmed by comparing the measure with possible alternatives)). See also Appellate Body Reports, *US – COOL (Article 21.5 – Canada and Mexico)*, para. 5.229, stating in respect of an analysis of the "necessity" of a particular measure that:

> [T]he particular manner of sequencing the steps of this analysis is adaptable, and may be tailored to the specific claims, measures, facts, and arguments at issue in a given case. Accordingly, panels are afforded a certain degree of latitude to tailor the sequence and order of analysis in a given case when assessing the relevant factors and conducting the overall weighing and balancing under Article 2.2 [of the TBT Agreement]. This latitude, however, is not boundless. Rather, it is informed by the specific claims, measures, facts, and arguments at issue, as mentioned above. For instance, while the particular circumstances of a given case may call for "preliminary conclusions" on the necessity of the trade-restrictiveness of the challenged measure before proceeding to a comparison with an alternative, such preliminary determinations are not mandatory, and may not be appropriate in the circumstances of other cases. (footnotes omitted)

The Panel considers this guidance relevant for an assessment of necessity under Article XX. The Panel notes that prior to making its statement above in the context of Article 2.2 of the TBT Agreement, the Appellate Body reviewed its jurisprudence in respect of the necessity test under Article XX. See Appellate Body Reports, *US –*

7.532. The Appellate Body established that it rests upon the complaining party to identify possible reasonably available alternatives to the measure at issue that the responding Member could have adopted.[903] The Appellate Body explained that "in order to qualify as an alternative, a measure proposed by the complaining Member must be not only less trade-restrictive than the measure at issue, but should also 'preserve for the responding Member its right to achieve its desired level of protection with respect to the objective pursued'."[904] The Panel understands that the burden on the complaining party of "identifying" an alternative measure does not require simply suggesting an alternative without any substantiation; a complaining party must also demonstrate that the proposed alternative is less trade-restrictive, and contributes to the achievement of the pursued objective to an equal or greater extent than the challenged measure.[905]

7.533. Once the complainant has identified such alternative measures, it is for the responding party to demonstrate that the proposed alternatives are not reasonably available alternatives that could achieve the same desired level of protection.[906] The Appellate Body has stated that "[a]n alternative measure may be found not to be 'reasonably available' … where it is merely theoretical in nature, for instance, where the responding Member is not capable of taking it, or where the measure imposes an undue burden on that Member, such as prohibitive costs or substantial technical difficulties."[907] Furthermore, the alternative measure must not only be WTO-consistent or less trade-restrictive; it must also achieve at least the same level of protection as the challenged measure.[908] In this regard, the Appellate Body has accepted as a basic principle the right of a Member to determine the level of protection it deems appropriate.[909]

7.534. Having considered these four elements of the necessity analysis independently, a panel must assess them holistically in order to come to a conclusion on whether or not a particular measure is "necessary". As stated by the Appellate Body in *Colombia – Textiles*:

> The Appellate Body has noted that "the very utility of examining the interaction between the various factors of the necessity analysis, and conducting a comparison with potential alternative measures, is that it provides a means of testing these factors as part of a holistic weighing and balancing exercise". In this respect, the weighing and balancing exercise can be understood as "a holistic operation that involves putting all the variables of the equation together and evaluating them in

COOL (Article 21.5 – Canada and Mexico), paras. 5.205 and 5.228. The Appellate Body indicated that in *EC – Seal Products*, in the context of the necessity analysis under Article XX of the GATT 1994, a "'preliminary conclusion' was not considered to be a requisite aspect of the sequence and order of analysis". Appellate Body Reports, *US – COOL (Article 21.5 – Canada and Mexico)* (referring to Appellate Body Report, *EC – Seal Products*, fn 1299).

[903] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156.

[904] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156.

[905] Although the Appellate Body has not explicitly indicated this, a number of Appellate Body reports tend to indicate that the burden on the complainant is greater than merely "suggesting" or "stating" a possible alternative. See Appellate Body Reports, *Brazil – Retreaded Tyres*, para. 156; and *US – Gambling*, paras. 310-311. The Panel is wary of assigning weight to the Appellate Body's allocation of burden of proof in respect of an analysis under Article 2.2 of the TBT Agreement, in light of the "differences between, on the one hand the burden on the respondent under Article XX of the GATT 1994 to prove that an alternative measures proposed by the complainant would impose an undue burden … and that this alternative is therefore *not* reasonably available and, on the other hand, the burden on the complainant under Article 2.2 of the TBT Agreement to make a *prima facie* case that the alternative measure it proposes would be reasonably available." Appellate Body Reports, *US – COOL (Article 21.5 – Canada and Mexico)*, para. 5.337. Nevertheless, that statement by the Appellate Body suggests that if the burden under an Article XX analysis is on the respondent to demonstrate that the measure is not reasonably available because of an "undue burden", then the burden must be on the complainant to demonstrate that the alternative is less trade-restrictive, and would make at least an equivalent contribution to the objective, as the challenged measure. Appellate Body Reports, *US – COOL (Article 21.5 – Canada and Mexico)*, para. 5.327. Additionally, the Appellate Body has indicated in the context of Article 5.6 of the SPS Agreement, that it is for the complaining party to establish a *prima facie* case that an alternative measure is reasonably available, achieves the appropriate level of protection, and is less trade-restrictive than the challenged measure. See Appellate Body Reports, *Japan – Agricultural Products II*, paras. 123 and 126; *India – Agricultural Products*, para. 5.220.

[906] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156.

[907] Appellate Body Report, *US – Gambling*, para. 308. See also Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156.

[908] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 156.

[909] Appellate Body Reports, *Korea – Various Measures on Beef*, para. 157; *Brazil – Retreaded Tyres*, para. 210.

relation to each other after having examined them individually, in order to reach an overall judgment."[910]

7.535. On the basis of this holistic analysis, a panel can conclude whether a measure is necessary, and therefore provisionally justified under subparagraph (a) of Article XX.

7.3.6.2.2 The chapeau of Article XX of the GATT 1994

7.536. Once a measure has been found to be provisionally justified under one of the subparagraphs of Article XX of the GATT 1994, a panel must assess whether the measure has been "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade". As stated by the Appellate Body, the function of the chapeau is to "prevent the abuse or misuse of a Member's right to invoke [Article XX] exceptions".[911] The Appellate Body further clarified that "the chapeau operates to preserve the balance between a Member's right to invoke the exceptions of Article XX, and the rights of other Members to be protected from conduct proscribed under the GATT 1994."[912] The Appellate Body has stated that the manner in which the measure is applied "can most often be discerned from the design, the architecture, and the revealing structure of a measure".[913] The burden of demonstrating that a provisionally justified measure meets the requirements of the chapeau rests upon the party invoking the exception.

7.537. With respect to "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", the Appellate Body has explained that the standard of discrimination under GATT obligations is not the same as under Article XX exceptions. In particular, the Appellate Body stated that "the nature and quality of this discrimination is different from the discrimination in the treatment of products which was already found to be inconsistent with one of the substantive obligations of the GATT 1994".[914] In *EC – Seal Products*, the Appellate Body clarified that "[t]his does not mean, however, that the *circumstances* that bring about the discrimination that is to be examined under the chapeau cannot be the same as those that led to the finding of a violation of a substantive provision of the GATT 1994."[915]

7.538. As to the interpretation of the phrase "between countries where the same conditions prevail", the Appellate Body considered that "only 'conditions' that are relevant for the purpose of establishing arbitrary or unjustifiable discrimination in the light of the specific character of the measure at issue and the circumstances of a particular case should be considered under the chapeau."[916] The Appellate Body also stated that "the identification of the relevant 'conditions' under the chapeau should be understood by reference to the applicable subparagraph of Article XX under which the measure was provisionally justified and the substantive obligations under the GATT 1994 with which a violation has been found."[917] A respondent arguing that conditions in the compared countries are not the same bears the burden of proving its claim.[918]

7.539. In the event that a panel finds that the measure discriminates by treating differently countries where the same conditions prevail, it shall continue its analysis by examining whether this discrimination is "arbitrary or unjustifiable". In this connection, the Appellate Body explained that the analysis of whether discrimination is arbitrary or unjustifiable within the meaning of the chapeau "should focus on the cause of the discrimination, or the rationale put forward to explain its existence".[919] As indicated by the Appellate Body in *EC – Seal Products*, "one of the most

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[910] Appellate Body Report, *Colombia – Textiles*, para. 5.75 (referring to Appellate Body Reports, *EC – Seal Products*, para. 5.215; and *Brazil – Retreaded Tyres*, para. 182).

[911] Appellate Body Report, *EC – Seal Products*, para. 5.297.

[912] Appellate Body Report, *EC – Seal Products*, para. 5.297 (referring to Appellate Body Report, *US – Shrimp*, para. 156).

[913] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, 97, at p. 120.

[914] Appellate Body Report, *US – Shrimp*, para. 150 (referring to Appellate Body Report, *US – Gasoline*, p. 23, DSR 1996:I, 3, at p. 21).

[915] Appellate Body Report, *EC – Seal Products*, para. 5.298. (emphasis added)

[916] Appellate Body Report, *EC – Seal Products*, para. 5.299.

[917] Appellate Body Report, *EC – Seal Products*, para. 5.301.

[918] Appellate Body Report, *EC – Seal Products*, para. 5.301.

[919] Appellate Body Report, *Brazil – Retreaded Tyres*, paras. 225-226 (referring to Appellate Body Reports, *US – Gasoline*, pp. 25-26 and 29, DSR 1996:I, 3, at pp. 23-24 and 27; *US – Shrimp*, paras. 163-166, 172 and 177; and *US – Shrimp (Article 21.5 – Malaysia)*, paras. 144 and 147).

important factors in the assessment of arbitrary or unjustifiable discrimination is the question of whether the discrimination can be reconciled with, or is rationally related to, the policy objective with respect to which the measure has been provisionally justified under one of the subparagraphs of Article XX."[920]

7.540. In respect of whether the measure constitutes a "disguised restriction on international trade", the Appellate Body in *US – Gasoline* clarified that:

> "Arbitrary discrimination", "unjustifiable discrimination" and "disguised restriction" on international trade may, accordingly, be read side-by-side; they impart meaning to one another. It is clear to us that "disguised restriction" includes disguised *discrimination* in international trade. It is equally clear that *concealed* or *unannounced* restriction or discrimination in international trade does *not* exhaust the meaning of "disguised restriction." We consider that "disguised restriction", whatever else it covers, may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX. Put in a somewhat different manner, the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to "arbitrary or unjustifiable discrimination", may also be taken into account in determining the presence of a "disguised restriction" on international trade. The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.[921]

7.541. On the basis of this analysis, a panel can conclude whether a measure satisfies the requirements of the chapeau of Article XX. If a measure is provisionally justified under a subparagraph of Article XX, and satisfies the requirements of the chapeau of Article XX, such a measure is justified under Article XX.

7.542. As indicated above, Article XX of the GATT 1994 involves a two-tiered analysis. First, the Panel must assess whether the measure at issue is provisionally justified under a subparagraph of Article XX. Second, if the Panel finds that the measure is provisionally justified, it must examine whether the application of the measure satisfies the requirements of the chapeau of Article XX. The Panel proceeds with its analysis in this order.

7.3.6.3 Whether the discriminatory aspects of the PATVD programme are provisionally justified under Article XX(a)

7.543. Brazil argues that any aspects of the PATVD programme found to be inconsistent with the GATT 1994 are justified under Article XX(a) of the GATT 1994.

7.544. According to Brazil, there is a "gap between demographics and regions that have access to modern information and telecommunications technology and those that do not have access or have restricted access".[922] This "digital divide" is a particular problem in developing countries, and due to increasing services "such as video on demand, video conferencing and virtual classrooms that require access to high-speed, high-quality connections" that are otherwise inaccessible and unaffordable, "closing the 'digital divide' would improve literacy, democracy, social mobility, economic quality, and growth."[923]

7.545. Brazil states that it has chosen digital television as a means to bridge this digital divide and promote social inclusion. It contends that "proper and timely access of the Brazilian population to information and education is a matter of public interest in Brazil", that television is the Brazilian population's "predominant source of information", and that digital television will "enable a universal network of distance learning, encourage R&D, [and] foster the expansion of Brazilian technologies so as to guarantee access to information at costs compatible with viewers' income."[924] Brazil argues that "[s]ince television remains the population's predominant source of

[920] Appellate Body Report, *EC – Seal Products*, para. 5.306.
[921] Appellate Body Report, *US – Gasoline*, p. 23, DSR 1996:I, 3, at p. 23.
[922] Brazil's first written submissions, paras. 408 (DS472) and 346 (DS497.
[923] Brazil's first written submissions, paras. 410 (DS 472) and 348 (DS497).
[924] Brazil's first written submissions, paras. 411-412 (DS472) and 349-350 (DS497).

information, ensuring appropriate conditions to the implementation of the digital television system, falls squarely within the range of policies necessary to protect public morals."[925]

7.546. Brazil therefore adopted a "specific and unique digital television standard that answers to Brazil's reality and needs".[926] To this end, Brazil argues that:

> A vital part of implementing the digital system all over the country was to ensure the supply of digital TV transmitting equipment and the capacity to develop and manufacture this equipment in Brazilian order [*sic*] to comply with the schedule established for the transition from analogue to digital transmission. Consequently, PATVD was created in 2007 to facilitate the integration and operation of the new technology in the country and therefore is justified under paragraph (a) of Article XX of GATT 1994.[927]

7.547. Brazil further elaborates that "in light of the objectives of the programme, from the very beginning there has been an interest in fomenting the local capacity to develop and manufacture this equipment, so as to ensure that there would be no risk of discontinuity in the supply of the transmitting equipment required to carry out the transition as planned."[928]

7.548. The European Union argues that the social and economic development objectives claimed by Brazil characterise any governmental action, and that if objectives such as "access to information and education" were protected under Article XX, then any governmental action taken in the public interest could be justifiable under Article XX.[929] The European Union emphasizes that although Brazil argues that it set up the PATVD programme because "'it was not certain that foreign suppliers would develop and manufacture compatible digital television transmitters' … the Explanatory Memorandum of the provisional measure that then became the law setting up the PATVD programme makes clear that it was urgent to set up the PATVD programme *because of the risk that transmitters in question would be imported in Brazil*".[930] Furthermore, the European Union argues that the PATVD programme does not aim to protect Brazil's public morals, but rather pursues an industrial policy objective of Brazil.[931] According to the European Union, there is "no

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[925] Brazil's second written submission, para. 116.

[926] Brazil's first written submissions, paras. 411 (DS472) and 349 (DS497); Brazil's second written submission, para. 114. Brazil explains that:

> [T]here are three main digital television standards in the world: i) the Advanced Television Standard Committee – ATSC (American system); ii) the Digital Video Broadcasting – BVD (European system); and iii) the Integrated Service Digital Broadcasting – ISDB (Japanese system). These standards were established by major developed economies and were tailored towards their needs and interests. Each standard has its own specificities that does not necessarily fit or comply with the needs of different countries.
>
> Taking that into consideration, and the importance of television broadcasting in Brazil as a vector of social inclusion and cultural diversity, Brazil decided to adopt a specific and unique standard of digital television based upon the Japanese model (ISDB) with added technological innovations, such as video codification H.264 and the middleware developed in Brazil. The Brazilian Digital Television System (SBTVD) preserved the characteristics of the Brazilian TV, open and free for all, but introduced the possibility of being received by portable and mobile receivers, in addition to allowing the interactivity of the viewer with the program. Brazil's second written submission, paras. 113-114.

[927] Brazil's second written submission, para. 117.

[928] Brazil's second written submission, para. 118.

[929] European Union's second written submission, para. 467. The European Union claims that the objective advanced by Brazil is not a public moral objective within the meaning of Article XX(a), because it "is just a general social and economic development objective which characterise [*sic*] nearly any governmental action", and that "[p]ublic policy objectives that ultimately refer to the social and economic development of a country (like access to information and education) are part and parcel of the objectives pursued by any government that strives to improve the social and economic condition of its community". European Union's second written submission, para. 467. The European Union states that if such an objective were within the meaning of Article XX, then Article XX would be "virtually available to justify any governmental action which is taken in the public interest". European Union's second written submission, para. 467. See also European Union's opening statement at the first meeting of the Panel, paras. 159-160.

[930] European Union's opening statement at the first meeting of the Panel, para. 162-163 (quoting Brazil's first written submission, para. 424 (DS472)).

[931] European Union's second written submission, para. 466.

genuine relationship of ends and means between the public morals allegedly protected by Brazil and the PATVD programme".[932]

7.549. Additionally, both the European Union and Japan argue that Brazil has not met its burden of demonstrating that the discriminatory aspects of the PATVD programme are "necessary" within the meaning of Article XX(a). According to Japan, "if the components of printed circuit boards used in digital TV equipment were manufactured in a country other than Brazil, this would not diminish the Brazilian public's access to information and education. Indeed it could possibly increase it, because it would be easier for domestic producers to receive the tax advantages under PATVD."[933] Similarly, the European Union argues that "Brazil did not even argue (let alone demonstrate) that equivalent digital TV transmitters could not be imported in [*sic*] Brazil" and that "if the components of printed circuit boards used in digital TV equipment were manufactured in a country other than Brazil, or if the equipment were developed by technicians who are not resident in Brazil or in facilities outside Brazil this would not diminish the Brazilian public's access to digital TV."[934] The United States as a third party makes a similar argument.[935] Both complaining parties and the United States as a third party have proposed certain alternative measures that they claim are WTO-consistent, less trade-restrictive, reasonably available to Brazil, and that would contribute to the objective of increasing access to digital TV to an equivalent or greater extent than the discriminatory aspects of the PATVD programme.[936]

7.550. Both complaining parties also argue that Brazil has failed to demonstrate that the discriminatory aspects of the PATVD programme satisfy the requirements of the chapeau of Article XX.

7.3.6.3.1 Whether the discriminatory aspects of the PATVD programme are designed to protect public morals

7.551. As discussed above, the Panel must address as a threshold issue whether the discriminatory aspects of the measure are designed to protect public morals. This entails first determining whether the claimed objective of the measure is indeed a "public morals" objective, within the meaning of Article XX(a) of the GATT 1994. If the Panel finds that the claimed objective is a "public morals" objective, the Panel will then address whether the measure is "designed to" achieve that objective (in other words, whether the measure is "not incapable" of contributing to that objective).

7.3.6.3.1.1 Whether the claimed objective of the measure is a "public moral" objective within the meaning of Article XX(a)

7.552. The Panel understands from Brazil's multiple submissions, statements and responses, that the alleged objective of the PATVD programme is to ensure supply of digital television equipment in accordance with the Brazilian digital television standard (the SBTVD), "so as to ensure that there would be no risk of discontinuity in the supply of the transmitting equipment required to

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[932] European Union's opening statement at the first meeting of the Panel, para. 164.

[933] Japan's second written submission, para. 166.

[934] European Union's second written submission, paras. 479 and 488.

[935] The United States argues that:

> Brazil fails to explain why digital TV transmitters must be developed and manufactured in Brazil in order to accomplish the objective of providing access to information and education via digital television. Making sure digital TV transmitters are available to Brazilians may be relevant to this objective, but there would not seem to be any reason why those transmitters must be developed or made in Brazil to provide such access. The public would have as much access to information and education if it were conveyed by imported transmitters as by domestic transmitters. Thus, there does not appear to be a genuine relationship between the provision of tax benefits to domestic producers of digital TV transmitters via PATVD and the goal of making digital television accessible in Brazil. United States' third party submission, para. 26

[936] These alternatives are: tax exemptions (or suspensions) on all sales of digital TV transmitters that comply with Brazil's digital TV standards, regardless of whether they are imported or domestically produced; the elimination of tariffs on the importation of digital TV transmitters; and the provision of subsidies directly to producers of digital TV transmitters, without imposing discrimination between products. See European Union's opening statement at the first meeting of the Panel, para. 165; European Union's response to Panel question No. 5; Japan's opening statement at the first meeting of the Panel, para. 19; Japan's response to Panel question No. 5; and Japan's second written submission, para. 167. See also United States' third party submission, para. 28.

carry out the transition [from analogue to digital television] as planned."[937] In particular, Brazil indicates that:

> [A]t the time the decision to adopt the SBTVD was taken, although imports were expected, there was no guarantee at all that the transmitting equipment, compliant with Brazil's standards, would be produced worldwide and made available in the Brazilian market in the necessary scale. Moreover, even if imports occurred as expected, there was a risk of discontinuity that could affect the transition schedule. Depending solely on the possibility of importation was accordingly not an option.[938]

7.553. That this was the objective of the PATVD programme is further evidenced, in Brazil's view, by the Explanatory Memorandum for the Provisional Measure implementing the PATVD, which indicates that implementation of the provisional measure was urgent, due to:

> [T]he fact that the timeframe for designing and building factories manufacturing transmitters is around 24 months, and that in accordance with Decree No []5.820 of 29 June 2006, laying down the technological standards to be adopted for the transmission of digital broadcasting signals of sounds and images, if the incentives set out in this proposal are not adopted swiftly, there is a risk that these products will be imported, thus undermining the creation of an industrial base for the sector.[939]

7.554. According to Brazil, this *continuity of supply* would ensure "appropriate conditions to the implementation of the digital television system", which is "within the range of policies necessary to protect public morals … justified under paragraph (a) of Article XX of GATT 1994."[940]

7.555. However, Brazil has also stated that:

> The PATVD has objectives other than just providing the Brazilian population with access to digital television, and one goal should not prevail over the other … the PATVD also aims at promoting local capability and investments in R&D of such technologies in Brazil …
>
> In this sense, PATVD's concept of requiring annual investments in R&D activities by the accredited companies, and requiring the development and manufacture of digital transmitters in Brazil, serves to encourage research and development and foster the expansion of Brazilian technologies and of a national industry related to communication and information technology, which are all goals pursued by the SBTVD.[941]

7.556. The Panel recalls the statement of the panel in *EC – Seal Products* that:

> [T]he question of whether a measure aims to address public morals relating to a particular concern in the society of a regulating Member requires, in our view, an assessment of two issues: first, whether the concern in question indeed exists in that society; and, second, whether such concern falls within the scope of 'public morals' as

[937] Brazil's second written submission, para. 118.

[938] Brazil's second written submission, para. 120.

[939] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), paragraph 19. The Panel notes that this passage was quoted in Brazil's second written submission and translated by Brazil slightly differently to the European Union and Japan. These differences in translation are not substantive in the Panel's view. Specifically, according to Brazil, the Explanatory Memorandum refers to "[t]he time necessary to project and set up manufacturing plants for transmitting equipment, approximately 24 months, and the publication of Decree n. 5,820, of June 29, 2006, that defined the set of technological standards to be adopted for the broadcast of digital sounds and images, if the incentives indicated in this draft are not adopted quickly, there is a risk that these products be imported to the detriment of the creation of an industrial park for the sector." Brazil's second written submission, para. 118. The Panel notes that Brazil's translation correctly refers to Decree 5,820, whereas the original European Union translation incorrectly refers to Decree 25,820.

[940] Brazil's second written submission, para. 116.

[941] Brazil's second written submission, para. 125-126.

> 'defined and applied' by a regulating Member "in its territory, according to its own systems and scales of values'.[942]

7.557. The panel in *EC – Seal Products* further explained that such an assessment, in the context of that dispute, required the panel to:

> [E]xamine whether the evidence as a whole show[ed] (a) the existence of the EU public's concerns on seal welfare and/or any other concerns or issues that the European Union [sought] to address; and, (b) the connection between such concerns, if proven to exist, and the "public morals" (i.e. standards of right or wrong) as defined and applied within the European Union.

7.558. In this respect, the Panel notes that, although Members have "some scope to define and apply for themselves the concept of 'public morals' in their respective territories, according to their own systems and scales of values"[943], this latitude does not excuse a responding party in dispute settlement from its burden of establishing that the alleged public policy objective at issue is indeed a public moral objective according to its value system.

7.559. In the Panel's view, Brazil has identified at least two objectives of the PATVD programme. First, according to Brazil, the objective of the PATVD programme itself was to establish and promote a domestic Brazilian industry capable of supplying digital television equipment to the domestic market. However, this objective was merely intermediate to an overarching objective contained in the legislation establishing the SBTVD standard, namely bridging the so-called "digital divide" and promoting social inclusion. Thus, according to Brazil, the attainment of the intermediate objective is merely a precondition to the attainment of the second objective.

7.560. Brazil has not argued that the intermediate objective of promoting its domestic industry is in and of itself a public moral objective. The Panel therefore limits its analysis to the overarching objective claimed by Brazil, namely bridging the digital divide and promoting social inclusion.

7.561. Regarding the second, overarching objective, namely bridging the digital divide and promoting social inclusion, the Panel recalls the following aspects of Brazil's argument. Brazil argues that there is a gap between certain "demographics and regions that have access to modern information and telecommunications technology and those that do not have access or have restricted access", in developing countries.[944] Additionally, Brazil argues that "[t]he transition to the digital television system is considered a key element in the access to information and education … The proper and timely access of the Brazilian population to information and education is a matter of highest public interest in Brazil as it ensures a better means of social inclusion."[945] Brazil argues that closing the digital divide would improve literacy, democracy, social mobility, economic equality, growth, and generally people's standard of living.[946]

7.562. In support of this, Brazil has submitted into evidence an excerpt from a report from the Office of Social Communication of the Presidency of the Republic entitled *Brazilian Media Research 2015*. That report indicates that "television continues to reign as the prevailing means of communication" and that 79% of people polled indicated that they "watch TV mainly to get informed".[947] In terms of access to television, the report indicated that "26% of Brazilian homes are served by a cable TV service, 23% have a parabolic dish installed, and 72% have access to open TV."[948] On the distribution of access, the report notes that "[w]hereas cable TV is present in large urban centers and is accessible to the richer and more educated portions of the population, the parabolic dish is more commonly found in the countryside".[949] Further evidence of the existence of a digital divide is provided in the form of a 2013 National Survey through Household Sampling, carried out by the Brazilian Institute of Statistics and Geography, which indicates that

[942] Panel Report, *EC – Seal Products*, para. 7.383.
[943] Panel Report, *US – Gambling*, para. 6.461 (referred to by Panel Reports, *EC – Seal Products*, para. 7.380; and *Colombia – Textiles*, para. 7.334).
[944] Brazil's first written submissions, para. 408 (DS472) and para. 346 (DS497).
[945] Brazil's first written submissions, para. 410 (DS472) and para. 348 (DS497).
[946] Brazil's first written submissions, para. 410 (DS472) and para. 348 (DS497).
[947] Brazilian Media Research 2015 (Pesquisa Brasileira de Mídia 2015), (Exhibit BRA-38), pp. 3 and 5.
[948] Brazilian Media Research 2015 (Pesquisa Brasileira de Mídia 2015), (Exhibit BRA-38), p. 5.
[949] Brazilian Media Research 2015 (Pesquisa Brasileira de Mídia 2015), (Exhibit BRA-38), p. 5.

42.4% of households in Brazil have internet access, 49.4% of residents have internet access, and 48.9% of households in Brazil have computer access.[950]

7.563. The Panel further notes that Brazil has submitted as evidence the United Nations Millennium Development Goals Report 2015 (UN MDG Report)[951], as well as a United Nations Educational, Scientific and Cultural Organization (UNESCO) press release regarding a UNESCO session to discuss open and inclusive access to information.[952] According to the UN MDG Report, Goal 8 of the Millennium Development Goals (MDGs) is to "develop a global partnership for development".[953] Target 8.F of the MDGs is to, "[i]n cooperation with the private sector, make available the benefits of new technologies, especially information and communications."[954] The UN MDG Report elaborates that "[i]nformation and communication technologies (ICTs) have completely transformed the way people live, work and communicate. Their role and importance continue to expand thanks to technological progress, expanding networks, falling prices and growth in applications and content."[955] The UN MDG Report states, however, that "ICT access and use are unequally distributed within and between countries" and that "it will be essential to address the widening digital divide. Only then will the transformative power of ICTs and the data revolution be harnessed to deliver sustainable development for all".[956]

7.564. Finally, the Panel notes that Brazil has submitted as evidence two decrees respectively establishing and implementing the SBTVD.[957] Article 1(I) of Decree 4,901 of 26 November, 2003, establishing the SBTVD, indicates that one objective of the SBTVD is "to promote social inclusion, cultural diversity in the country and the native language by means of access to digital technology, aiming at the democratization of information."[958] Additionally, Article 4 of Decree 5,820 of 29 June, 2006, implementing the SBTVD, states that "[a]ccess to SBTVD-T shall be assured [to] the public in general, in a manner free of charge, for the purpose of guaranteeing the adequate performance of the conditions for the exploitation [of] the object of the grants."[959]

7.565. In reviewing the arguments and evidence submitted by Brazil, the Panel considers that Brazil has demonstrated that there is a problem of a "digital divide" in Brazil, and that the problem of the digital divide has implications for people's standards of living. As noted by Brazil, the Preamble to the WTO Agreement explicitly states that the WTO Members "[r]ecogniz[e] that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living". The Panel highlights that this concern is internationally recognised as an issue confronting developing countries. Furthermore, and taking into account that Brazil has indicated that access to information and bridging the digital divide have an educational component, the Panel recalls the panel's statement in *EC – Seal Products*, in a finding that was not appealed, that "WTO Members are afforded a certain degree of discretion in defining the scope of 'public morals' with respect to various values prevailing in their societies at a given time."[960] Although this "degree of discretion" is not boundless, in light of the above the Panel is inclined to defer to Brazil.

7.566. The Panel notes the European Union's concern that the objective identified by Brazil is:

> [P]art and parcel of the objectives pursued by any government that strives to improve the social and economic condition of its community … [and that] accepting that such general objectives may fall within public morals within the meaning of Article XX,

[950] National Survey through Household Sampling (*Pesquisa Nacional por Amostragem de Domicílios - PNAD*), (Exhibit BRA-44). The Panel notes that although Brazil submitted this evidence in the context of the programme for Digital Inclusion, and not the PATVD programme, the Panel nevertheless considers this evidence to be relevant in the context of Brazil's Article XX(a) defence in respect of the PATVD programme.

[951] The Millennium Development Goals Report 2015, (Exhibit BRA-43).

[952] "UNESCO convenes session to discuss open and inclusive access to information", (Exhibit BRA-42).

[953] The Millennium Development Goals Report 2015, (Exhibit BRA-43), p. 7.

[954] The Millennium Development Goals Report 2015, (Exhibit BRA-43), p. 67.

[955] The Millennium Development Goals Report 2015, (Exhibit BRA-43), p. 67.

[956] The Millennium Development Goals Report 2015, (Exhibit BRA-43), p. 67. The Panel also notes that Brazil has submitted as evidence an article from the website www.internetworldstats.com which describes the problem of the digital divide. See The Digital Divide, ICT, and Broadband Internet, (Exhibit BRA-39).

[957] Decree No. 4,901, of 26 November 2003, (Exhibit BRA-40); and Decree No. 5,820, of 29 June 2006 (Exhibit BRA-41).

[958] Decree 4,901/2003, (Exhibit BRA-40), Article 1(I).

[959] Decree 5,820/2006, (Exhibit BRA-41), Article 4.

[960] Panel Report, *EC – Seal Products*, para. 7.381.

> would in practice tantamount [*sic*] to say that Article XX is virtually available to justify any governmental action which is taken in the public interest.[961]

7.567. In this respect, the Panel does not consider that including the objective of "bridging the digital divide and promoting social inclusion" in the specific context of Brazil at the present moment is "tantamount to say that Article XX is virtually available to justify any governmental action which is taken in the public interest". Indeed, conditions and circumstances vary from WTO Member to Member. In the Panel's view, in order for a Member to rely on the defence of Article XX(a), it must be demonstrated that the particular objective is a public moral objective *for that Member,* in its particular context. As the panel stated in *US – Gambling*, the content of public morals "for Members can vary in time and space, depending upon a range of factors".[962]

7.568. The Panel therefore finds that Brazil has demonstrated that a concern exists in Brazilian society with respect to the need to bridge the digital divide and promote social inclusion, and that such concern is within the scope of "public morals" as defined and applied by Brazil.

7.3.6.3.1.2 Whether the discriminatory aspects of the measure are "designed to protect" public morals, within the meaning of Article XX(a) of the GATT 1994

7.569. In light of the Panel's finding that "bridging the digital divide and promoting social inclusion" constitute a public morals objective within the meaning of Article XX(a) of the GATT 1994, the Panel must determine whether Brazil has demonstrated that the aspects of the PATVD programme found to be inconsistent with Article III of the GATT 1994 are designed to achieve this objective.

7.570. The Panel recalls that the standard adopted by the Appellate Body for determining whether a measure is "designed" to achieve a particular objective is whether that measure "is not incapable" of contributing to that objective.[963] The Panel further recalls the Appellate Body's instructions that "[i]n order to determine whether such a relationship exists, a panel must examine evidence regarding the design of the measure at issue, including its content, structure, and expected operation".[964] Furthermore, the Appellate Body explained that it does "not see the examination of the 'design' of the measure as a particularly demanding step."[965]

7.571. Applying this standard in the present dispute, the Panel notes at the outset that the discriminatory aspects of the PATVD programme do not, on their face, bear any relation to bridging the digital divide, or social inclusion. Furthermore, the Panel is not fully convinced by Brazil's argument that the PATVD programme is designed to contribute to closing the digital divide by establishing and promoting a domestic industry.

7.572. As described above, Brazil argues that the PATVD programme contributes to bridging the digital divide and promoting social inclusion, by ensuring "appropriate conditions to the implementation of the digital television system", and more specifically, ensuring "the supply of digital TV transmitting equipment and the capacity to develop and manufacture this equipment in Brazilian order [*sic*] to comply with the schedule established for the transition from analogue to digital transmission".[966] Brazil also argues that "at the time the decision to adopt the SBTVD was taken, although imports were expected, there was no guarantee at all that the transmitting equipment, compliant with Brazil's standards, would be produced worldwide and made available in the Brazilian market in the necessary scale".[967]

7.573. The Panel first notes that Brazil has not provided any evidence to indicate that transmitting equipment would not be made available in the Brazilian market in the necessary scale.

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[961] European Union's second written submission, para. 467. See also European Union's opening statement at the first meeting of the Panel, paras. 159-160.

[962] Panel Report, *US – Gambling*, para. 6.461.

[963] Appellate Body Report, *Colombia – Textiles*, paras. 5.68 and 5.77.

[964] Appellate Body Report, *Colombia – Textiles*, para. 5.69 (referring to Appellate Body Reports, *US – Shrimp*, paras. 135-142; and *EC – Seal Products*, para. 5.144).

[965] Appellate Body Report, *Colombia – Textiles*, para. 5.70.

[966] Brazil's second written submission, paras. 116-117.

[967] Brazil's second written submission, para. 120.

Additionally, the Explanatory Memorandum for the provisional measure implementing the PATVD programme indicates that there was some urgency to adopt the implementing measures due to:

> The time necessary to project and set up manufacturing plants for transmitting equipment, approximately 24 months, and the publication of Decree n. 5,820, of June 29, 2006, that defined the set of technological standards to be adopted for the broadcast of digital sounds and images, if the incentives indicated in this draft are not adopted quickly, there is a risk that these products be imported to the detriment of the creation of an industrial park for the sector.[968]

7.574. A plain reading of the Explanatory Memorandum suggests that the motivation for adopting the PATVD programme was *not*, as claimed by Brazil[969], because there were concerns over whether there would be a sufficient quantity of imported products to adequately supply the market. To the contrary, the Explanatory Memorandum suggests that the motivation to implement the programme was precisely because there were concerns that the market *could be supplied* by imported products, "to the detriment of the creation of an industrial park for the sector".[970]

7.575. Furthermore, notwithstanding the Explanatory Memorandum, there is a certain inherent tension to Brazil's argument. Brazil claims that because there were concerns that foreign suppliers would not or could not affordably and sufficiently supply the market, it adopted the PATVD in order to incentivise domestic industry to produce relevant digital television equipment, to ensure access to digital television. Yet the mechanism adopted in order to incentivise and promote local production was in the form of tax incentives and local content requirements that discriminated against foreign products that could have supplied the market. In other words, Brazil basically argues that the discrimination against imported products was adopted because of concerns that there may not be a sufficient quantity of imported products in the market.

7.576. This tension becomes more marked when one takes into account that the laws and decrees establishing and implementing PATVD do not even mention the digital divide or social inclusion, or any related objectives. To the contrary, the relevant Interministerial Explanatory Memorandum explicitly states that "[t]he aim of establishing PATVD is to encourage the setting-up in Brazil of companies involved in the development and manufacturing of radio-frequency transmitter equipment for digital television".[971] Furthermore, the Explanatory Memorandum does not identify this as an intermediate objective, but rather tends to indicate that the overarching objective (if there is any) is to achieve "rapid economic growth":

> [I]t should be noted that, by increasing economic efficiency and stimulating productive investment, the newly adopted measures create conditions for more rapid economic growth over the coming years, having a positive impact on tax collection in the long term, even if the tax burden as a proportion of the GDP falls below the current level.[972]

7.577. Brazil argues, however, that the PATVD programme is merely implementing the objectives of the SBTVD, and that the decrees establishing the SBTVD sets out the objectives of the PATVD, namely bridging the digital divide and achieving social inclusion.[973]

7.578. It is true that Decree 4,901/2003, establishing the SBTVD, does state that the SBTVD has the objectives "(I) to promote social inclusion, cultural diversity in the country and the native language by means of access to digital technology, aiming at the democratization of information; (II) to enable the creation of a universal network of distance education; … [and] (IV) to plan and

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[968] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), paragraph 19.

[969] Brazil states that:

[A]t the time the decision to adopt the SBTVD was taken, although imports were expected, there was no guarantee at all that the transmitting equipment, compliant with Brazil's standards, would be produced worldwide and made available in the Brazilian market in the necessary scale. Moreover, even if imports occurred as expected, there was a risk of discontinuity that could affect the transition schedule. Depending solely on the possibility of importation was accordingly not an option. Brazil's second written submission, para. 120.

[970] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), paragraph 19.

[971] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 7.

[972] Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), para. 16.

[973] Brazil's second written submission, paras. 114-115 (referring to Exhibits BRA-40 and BRA-41).

process the transition from analogue to digital television, in a manner which ensures the gradual accession of users at costs compatible with their incomes."[974] However, that same decree *also* states that the objectives of the SBTVD include "to encourage research and development and to foster the expansion of Brazilian Technologies and national industry related to information technology and communication; … [and] to promote the regional and local production of digital instruments and services."[975]

7.579. Indeed, in assessing the design and structure of the PATVD programme, it is apparent that the discriminatory aspects of the programme were indeed intended to foster Brazilian technology and industry, and to promote Brazilian production of instruments and services. However, where Brazil argues that these objectives were merely a means to an overarching end (namely bridging the digital divide), the SBTVD legislation appears to identify these objectives as ends *in and of themselves*. Recalling the inherent tension described above, the design, structure, operation, and stated objectives of the measure all support the notion that the measure was adopted for the objective of promoting domestic production as an end in and of itself.

7.580. Brazil itself concedes that:

> The PATVD has objectives other than just providing the Brazilian population with access to digital television, and one goal should not prevail over the other … the PATVD also aims at promoting local capability and investments in R&D of such technologies in Brazil …
>
> In this sense, PATVD's concept of requiring annual investments in R&D activities by the accredited companies, and requiring the development and manufacture of digital transmitters in Brazil, serves to encourage research and development and foster the expansion of Brazilian technologies and of a national industry related to communication and information technology, which are all goals pursued by the SBTVD.[976]

7.581. The Panel notes that the standard adopted by the Appellate Body for determining whether a particular measure is "designed to" protect public morals, is whether the measure is not "incapable of contributing to the objective". Notwithstanding its deep reservations regarding the design of the measure, the Panel does not consider that it is in a position to make a finding in the negative, to the effect that the PATVD programme is *incapable* of contributing to bridging the digital divide and promoting social inclusion. Indeed, it is not inconceivable to the Panel that under certain circumstances, discriminatory measures could indeed contribute to the claimed objectives in a manner similar to that explained by Brazil.

7.582. Although the functioning of the measure appears to contradict its *raison d'être*, the Panel considers that in a situation where domestic producers could not compete with foreign imports absent government protection, it is conceivable that the protection afforded to domestic producers could allow such producers to develop their industry. The development of the industry could enable an otherwise uncompetitive domestic industry to become competitive to such an extent that it could supply the market alongside foreign imports in an open, competitive market, resulting in a lower price for consumers and therefore a net welfare benefit in terms of "social inclusion" and "access to information". In other words, more people could afford digital television, meaning more social inclusion and access to information. The Panel recognizes that this is a scenario that has not been shown to exist (nor has it been shown that such a scenario is even likely). Indeed, Brazil has not presented any evidence in support of its assertions that domestic producers required protecting, nor has it taken into account the capacity of foreign producers to supply the Brazilian market in order to secure access to digital television equipment, at least in the present circumstances. Nevertheless, the Panel agrees with Brazil that this is one way in which the discriminatory aspects of the measure at issue could *potentially* contribute to the protection of public morals. The Panel is therefore not in a position to conclude that PATVD is "incapable" of contributing to the bridging the digital divide and promoting social inclusion.

[974] Decree 4,901/2003, (Exhibit BRA-40), Article 1.
[975] Decree 4,901/2003, (Exhibit BRA-40), Article 1.
[976] Brazil's second written submission, para. 125-126.

7.583. The Panel therefore finds that, notwithstanding its significant reservations regarding the design, structure, and expected operation, Brazil demonstrated that the measure is not incapable of contributing to the objective of bridging the digital divide and promoting social inclusion. In light of its finding above that these objectives have been shown to be "public moral" objectives within the meaning of Article XX(a) of the GATT 1994, the Panel consequently finds that Brazil has demonstrated that the measure is designed to protect public morals within the meaning of Article XX(a).

7.3.6.3.2 Whether the discriminatory aspects of the measure are "necessary" to achieve the claimed objectives

7.584. Since the Panel has found that the discriminatory aspects of the measure are designed to protect a public moral objective, the Panel must consequently assess whether Brazil has demonstrated that the discriminatory aspects of the measure are necessary to achieve that public moral objective. The Panel recalls that this is a holistic analysis, involving weighing and balancing the importance of the interest being protected, the contribution of the measure to the protection of that interest, and the trade-restrictiveness of the measure, in light of any WTO-consistent less trade-restrictive reasonably-available alternatives that could achieve the same level of protection.

7.585. As a preliminary point, the Panel notes the Appellate Body's expectation that panels somewhat precisely define the level of "contribution" that the challenged measure makes to the objective, as well as the level of "trade-restrictiveness" of the measure.[977] As a general matter, the Panel notes that it can only make its assessment of the precise degree of the importance of the interest being protected, the contribution to the objective, and the trade-restrictiveness of the measure, on the basis of the parties' arguments and evidence. Furthermore, the Panel understands that a lack of precision from the parties in defining these levels does not relieve the Panel of its duty to perform a weighing and balancing analysis, regardless of methodological difficulties arising from imprecision on the part of the parties.[978]

7.3.6.3.2.1 The importance of the objective

7.586. The Panel begins its analysis of the necessity of the discriminatory aspects of the PATVD programme by assessing the importance of the interest being protected. According to the Appellate Body, the more "vital or important" the interest being protected, the easier it would be to accept as "necessary" a measure designed to protect that interest.[979]

7.587. Brazil argues that the objective of the discriminatory aspects of the PATVD programme, namely to bridge the digital divide and promote social inclusion, is an interest of the highest degree.[980] Brazil has asserted that "[f]ew interests are more 'vital' and 'important' than protecting public morals."[981] Brazil quotes the panel report in *China – Publications and Audiovisual Products*, where the panel stated that:

> In our view, it is undoubtedly the case that the protection of public morals ranks among the most important values or interests pursued by Members as a matter of public policy. We do not consider it simply accidental that the exception relating to 'public morals' is the first exception identified in the ten sub-paragraphs of Article XX. We therefore concur that the protection of public morals is a highly important value or interest.[982]

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[977] Appellate Body Report, *Colombia – Textiles*, paras. 5.107-5.113.

[978] The Panel recalls the Appellate Body's statement that "once an analysis of the 'design' of a measure reveals that the measure is not incapable of protecting public morals, such that there is a relationship between the measure and the protection of public morals, a panel may not refrain from conducting the 'necessity' step of the analysis." Appellate Body Report, *Colombia – Textiles*, para. 5.77 (referring to Appellate Body Report, *Argentina – Financial Services*, para. 6.203)

[979] Appellate Body Report, *Korea – Various Measures on Beef*, para. 162.

[980] Brazil's first written submissions, para. 420 (DS472) and para. 358 (DS497).

[981] Brazil's first written submissions, para. 417 (DS472) and para. 355 (DS497).

[982] Brazil's first written submissions, para. 417 (DS472) and para. 355 (DS497) (quoting Panel Report, *China – Publications and Audiovisual Products*, para. 7.817). The Panel notes that Brazil mistakenly indicated that this quote was from the Appellate Body report in that dispute, and not the panel report.

7.588. The Panel notes that in *US – Gambling*, the panel (in a finding upheld by the Appellate Body) assessed the importance of the public moral objective at issue by examining the specific "interests and values protected by the [measure]", namely "the threat of money laundering, organized crime, fraud and risks to children (i.e. underage gambling) and to health (i.e. pathological gambling)".[983] The panel noted that those specific "societal interests" could be "characterized as 'vital and important in the highest degree' in a similar way to the characterization of the protection of human life and health against a life-threatening health risk by the Appellate Body in *EC – Asbestos*".[984]

7.589. Similarly, the panel in *EC – Seal Products* noted the claim by the responding party in that dispute that the specific "'moral concern with regard to the protection of animals' is regarded as a value of high importance in the European Union."[985] The panel found that "the protection of *such* public moral concerns is indeed an important value or interest".[986]

7.590. In *Colombia – Textiles* the Appellate Body indicated that:

> [I]n a finding that is not contested on appeal, the Panel held that, in Colombia, the objective of combating money laundering reflects societal interests that can be described as vital and important in the highest degree. We also observe that, before the Panel and on appeal, Panama has not denied that, for Colombia, the fight against money laundering is a societal interest that could be described as vital and important in the highest degree.[987]

7.591. In light of this jurisprudence, the Panel considers that in determining the importance of a particular objective, it is more pertinent to assess the importance of the *particular* societal interest being protected, rather than assuming that by virtue of its status as a "public moral" objective the interest is *per se* vital or important to the highest degree.

7.592. In assessing the importance of the particular public moral objective at issue in this dispute, namely bridging the digital divide and promoting social inclusion, the Panel notes that this objective is internationally recognized as an important policy objective, and indeed is recognized as a target of the UN MDGs. The importance of the MDGs should not be understated. This is true in any developing country, but in the Panel's view the specific MDG target at issue here is particularly important in Brazil, where the percentage of households and individuals with internet access or computer access is low. Overall, the Panel considers that the objective of bridging the digital divide and social inclusion and access to information is a reasonably important policy objective.

7.3.6.3.2.2 The contribution to the objective

7.593. The Panel now turns to assess the contribution that the PATVD programme makes to the objective of bridging the digital divide and promoting social inclusion.

7.594. Brazil explains that the PATVD programme contributes to the protection of public morals because it is essential to the development and manufacture of digital transmitters in Brazil. According to Brazil, the fact that it has adopted "a unique and tailor-made standard for digital TV" requires that the government adopts measures to guarantee the provision of compatible transmitters.[988] Brazil argues that "[w]hen the standard was adopted, it was not certain that foreign suppliers would develop and manufacture compatible digital television transmitters. Brazil then decided to facilitate to the maximum extent possible the development of the technological and industrial capacity necessary for the Brazilian population to maintain their access to culture and information under the new technological paradigm."[989]

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[983] Panel Report, *US – Gambling*, para. 6.489. See also Appellate Body Report, *US – Gambling*, paras. 296-299.
[984] Panel Report, *US – Gambling*, para. 6.492
[985] Panel Report, *EC – Seal Products*, para. 7.632.
[986] Panel Report, *EC – Seal Products*, para. 7.632. (emphasis added)
[987] Appellate Body Report, *Colombia – Textiles*, para. 5.105.
[988] Brazil's first written submissions, paras. 422-426 (DS472) and paras. 360-366 (DS497).
[989] Brazil's first written submissions, para. 424 (DS472) and para. 362 (DS497).

7.595. Brazil states, however, that the "schedule of migration from analogue to digital transmission will begin in 2016 and expect to be concluded by the end of 2018."[990] Brazil has therefore not presented any statistics or data to demonstrate the extent to which the programme has successfully resulted in the Brazilian public achieving access to digital television. Nevertheless, Brazil argues that "the contribution does not have to be measurable immediately after the questioned measure is applied or enters into force. It is sufficient to demonstrate that it is '*capable* of making a contribution'."[991] Brazil also argues that:

> The Appellate Body has rightly said that "[t]he greater the contribution, the more easily a measure might be considered to be 'necessary'." The measure's contribution need not be absolute or infallible. It merely needs to 'contribute, *at least to some extent*, to addressing these concerns." The PATVD program contributes to protecting public morals far more than just 'to some extent' - no other practical alternative is as effective.[992]

7.596. Indeed, the Panel agrees with Brazil that no minimum level of contribution is required in order for a particular measure to be "necessary" within the meaning of Article XX. In this respect, the Panel recalls the Appellate Body's statements that "mandating in advance a pre-determined threshold level of contribution would [not] be instructive or warranted in a necessity analysis" and "whether a measure is 'necessary' cannot be determined by the level of contribution alone, but will depend on the manner in which the other factors of the necessity analysis, including a consideration of potential alternative measures, inform the analysis."[993] Furthermore, the Panel recalls that the Appellate Body has indicated that a panel's contribution analysis "can be done either in quantitative or in qualitative terms".[994]

7.597. At this stage of the analysis, in assessing the actual (or expected) contribution of the measure to that objective, the Panel recalls its concerns raised in paragraphs 7.571 to 7.580 above regarding the design, structure, operation, and objectives of the measure. The Panel does not consider it necessary to fully rearticulate each of these concerns in the context of its assessment of the contribution made by the discriminatory aspects of the measure to the claimed objective. It suffices for the Panel to recall the following: Brazil has not provided relevant evidence in support of its assertion that "at the time the decision to adopt the SBTVD was taken, although imports were expected, there was no guarantee at all that the transmitting equipment, compliant with Brazil's standards, would be produced worldwide and made available in the Brazilian market in the necessary scale"[995]; the evidence before the Panel indicates that Brazil's primary motivation for implementing the programme was because there were concerns that the market could be supplied by imported products, "to the detriment of the creation of an industrial park for the sector"[996]; the design and structure of the measure appears to contradict its own intended purpose, in that the measure discriminates against, and dis-incentivises the sale of, imported products that supply the market[997]; and the decree establishing the SBTVD states that an objective of the SBTVD was to promote domestic production of digital television equipment.[998]

7.598. In light of these concerns, the Panel considers that although it is *possible* that the PATVD programme will contribute to the objective of the bridging the digital divide and promoting social

[990] Brazil's first written submissions, para. 427 (DS472) and para. 365 (DS497). The Panel recalls that the European Union's request for establishment of a panel was circulated in November 2014, and Japan's request for establishment of a panel was circulated in September 2015.

[991] Brazil's first written submissions, para. 427 (DS472) and para. 366 (DS497). (emphasis original)

[992] Brazil's first written submissions, paras. 421-422 (DS472) and paras. 359-360 (DS497) (quoting Appellate Body Report, *Korea – Various Measures on Beef*, para. 163 (the Panel notes that Brazil mistakenly referred to paragraph 49); and Panel Report, *US – Gambling*, para. 6.494 (the Panel notes that Brazil mistakenly referred to the Appellate Body report instead of the panel report)).

[993] Appellate Body Report, *EC – Seal Products*, para. 5.215.

[994] Appellate Body Report, *Brazil – Retreaded Tyres*, para. 146.

[995] See paragraph 7.573 above; Brazil's second written submission, para. 120.

[996] See paragraph 7.574 above; Interministerial Explanatory Memorandum No. 00008/2007, (Exhibit JE-109), paragraph 19.

[997] See paragraph 7.575 above.

[998] See paragraph 7.578 above; Exhibit BRA-40, Article 1. The Panel also notes that Brazil has not fully articulated how or why the SBTVD itself is designed to contribute to the objective of bridging the digital divide.

inclusion[999], the evidence before the Panel indicates that the PATVD is unlikely to actually make much, if any, contribution to this objective. In particular, the Panel emphasizes the inherent contradiction of a measure that is designed to ensure that a particular market is supplied with particular products at affordable prices, by discriminating against imported products in that particular market. The Panel considers this contradiction to be evident both in the market for finished digital television equipment products, as well as the market for components to be used in the production of the finished digital television equipment products.

7.599. The Panel also considers it relevant at this point to recall the finding of the Appellate Body in *India – Solar Cells*, regarding an assessment in the context of Article XX(j) of the GATT 1994 as to whether products are "in general or local short supply". The Appellate Body stated that "an assessment of whether a Member has identified 'products in general or local short supply' requires a case-by-case analysis of the relationship between supply and demand based on a holistic consideration of all relevant factors."[1000] Although the Appellate Body made this comment in the context of Article XX(j), the Panel considers it to be relevant in light of Brazil's argument that the discriminatory aspects of the PATVD programme were necessary because of concerns that imported products could not adequately supply the market.[1001]

7.600. In the present dispute, Brazil has not undertaken any analysis, nor presented any evidence (quantitative or qualitative), in support of its contention that imported products could not supply the market. Indeed, Brazil has not substantiated its argument.

7.601. The Panel can therefore see no reason to conclude that the discriminatory aspects of the PATVD programme will necessarily lead to any increase in market supply, nor that the discriminatory aspects are likely, or apt, to lead to such an increase. The Panel recalls its finding above that the discrimination at issue here could potentially contribute to increased supply of digital television equipment in the market, thereby facilitating the closing of the digital divide and promotion of social inclusion. However, in the absence of evidence to the contrary, it is equally plausible that the decline in supply of imported like products as a result of the discrimination is either equivalent to, or less than, the increase in supply of domestically produced like products.

7.602. In the Panel's view, Brazil has not demonstrated that the manner in which the PATVD programme incentivises domestic production has led, will lead, or is apt to lead, to an increase in social inclusion or access to information. Thus, in the Panel's view, although it is possible that the PATVD programme *could*, in theory, contribute to social inclusion and access to information, Brazil has not demonstrated that the PATVD programme does, or will, in fact, contribute to the realisation of Brazil's policy goal. In the Panel's view, it is likely that the PATVD programme will not make much, if any, contribution to the objective of social inclusion and access to information. Nonetheless, the Panel continues its analysis.

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[999] The Panel recalls its finding above that the measure is "designed to" protect public morals, because it is not incapable of making a contribution to the objective of bridging the digital divide and promoting social inclusion.

[1000] Appellate Body Report, *India – Solar Cells*, para. 5.74. Some of these factors include:

> [T]he extent to which a particular product is 'available' for purchase in a particular geographical area or market, and whether this is sufficient to meet demand in the relevant area or market … the level of domestic production of a particular product and the nature of the products … the relevant product and geographic market, potential price fluctuations in the relevant market, the purchasing power of foreign and domestic consumers, and the role that foreign and domestic producers play in a particular market … [d]ue regard should be given to the total quantity of imports that may be 'available' to meet demand in a particular geographical area or market … the extent to which international supply of a product is stable and accessible. Appellate Body Report, *India – Solar Cells*, para. 5.71.

[1001] The Panel notes that Brazil did not argue that the PATVD programme was justified under Article XX(j) of the GATT 1994. The Panel does not consider that this has any bearing on the legitimacy of Brazil's defence under Article XX(a). However, in light of the fact that the intermediate objective of Brazil was to resolve a concern over the sufficiency of supply of digital television products to the market, in order to consequently achieve the overarching public moral objective, and considering that Article XX(j) explicitly refers to measures "essential to the acquisition or distribution of products in general or local short supply", the Panel considers Article XX(j) to be relevant context for determining whether or not Brazil has demonstrated that certain products could or would be in short supply in the Brazilian market. Specifically in this dispute, the Panel considers the guidance of the Appellate Body report in *India – Solar Cells* to be indicative of the type of evidence any Member should present in order to demonstrate that particular products are in short supply in a particular market.

7.3.6.3.2.3 The level of trade-restrictiveness

7.603. The Panel now turns to assess the trade-restrictiveness of the discriminatory aspects of the PATVD programme.

7.604. Brazil argues that the trade-restrictiveness of the measure is offset, or "countervail[ed]" by the investment costs of the PATVD programme.[1002] Brazil argues that the trade impact of the PATVD programme is low because tax incentives are granted to companies that have previously incurred expenditure in order to be eligible for the tax benefit. Thus, "investment costs countervail any financial impact on the relevant goods stemming from the tax reduction".[1003] Further, Brazil notes that it does not impose any ban on imports of digital television transmission equipment into Brazil.[1004]

7.605. The Panel fails to see the relevance of the investment requirements in respect of the trade-restrictiveness of the measure. The term trade-restrictiveness primarily relates to the impact of the measure on imports of like products into Brazil.[1005] In the Panel's view, the fact that companies must invest in R&D in Brazil in order to be accredited neither mitigates nor enhances the level of trade-restrictiveness of the challenged aspects of the programme.

7.606. However, the Panel does acknowledge Brazil's argument that "PATVD does not ban or prohibit imports of digital TV transmission equipment into Brazil".[1006] In the view of the Panel, while it is clear that the conditions of competition have been altered to the detriment of like imported products, PATVD does not exclude those like imported products from entering the market and being sold as finished products to end users, nor does it preclude like imported products from entering the market and being incorporated into finished products produced domestically.

7.607. The Panel recognises that a determination of the trade-restrictiveness of a particular measure should be as precise as possible. However, the Panel is not in a position to make a quantitative estimation of the level of trade-restrictiveness. In the present dispute, the discriminatory aspects of the PATVD programme result in a disincentive to purchase imported products (both finished products and the components used to produce those finished products), which in the view of the Panel will have a material impact on imports of those products. The Panel therefore considers that the actual and potential overall trade-restrictiveness of the PATVD programme is material.[1007]

7.3.6.3.2.4 Comparison with reasonably available alternative measures

7.608. The Panel recalls the Appellate Body's instructions in *EC – Seal Products* that "[w]hile there may be circumstances in which a weighing and balancing exercise would not require that a panel proceed to evaluate alternative measures …, we also do not consider that such an exercise mandates a preliminary determination of the necessity of the challenged measure before proceeding to assess those alternatives".[1008] In light of the findings above, and in particular the Panel's finding regarding the contribution made by the measure to the objective, the Panel does not consider it necessary to make a preliminary decision on whether the measure is "necessary" based on the three factors described above, but proceeds by considering whether the alternative measures proposed by the complaining parties are WTO-consistent measures that are reasonably available to Brazil, that are less trade-restrictive than the PATVD programme, and that could achieve an equal or higher level of contribution to the objective.

[1002] Brazil's first written submissions, para. 431 (DS472) and para. 369 (DS497).
[1003] Brazil's first written submissions, para. 431 (DS472) and para. 369 (DS497).
[1004] Brazil's first written submissions, para. 432 (DS472) and para. 370 (DS497).
[1005] Appellate Body Report, *China – Publications and Audiovisual Products*, para. 306.
[1006] Brazil's first written submissions, para. 432 (DS472) and para. 370 (DS497).
[1007] The Panel notes that in *Colombia – Textiles* the Appellate Body considered that there was insufficient clarity with respect to the degree of trade-restrictiveness, such that the Appellate Body saw "no basis to proceed with a comparison of the measure at issue with any possible alternative measures". See Appellate Body Report, *Colombia – Textiles*, para. 5.115. In the present dispute, the Panel considers that the Panel's determination of the level of trade-restrictiveness is sufficiently clear to engage in a comparison of the trade-restrictiveness of alternative measures reasonably available to Brazil, as discussed in section 7.3.6.3.2.4 below.
[1008] Appellate Body Report, *EC – Seal Products*, fn 1299. See also Appellate Body Reports, *US – COOL (Article 21.5 – Canada and Mexico)*, para. 5.235.

7.609. Both complaining parties have proposed certain WTO-consistent, less trade-restrictive alternative measures that they claim are reasonably available to Brazil and that would contribute to the objective of achieving access to digital TV to an equivalent or greater extent than the discriminatory aspects of the PATVD programme. These alternatives are: tax exemptions (or suspensions) on all sales of digital TV transmitters that comply with Brazil's digital TV standards, regardless of whether they are imported or domestically produced[1009]; the elimination of tariffs on the importation of digital TV transmitters[1010]; or the provision of subsidies directly to producers of digital TV transmitters, without imposing discrimination between products.[1011]

7.610. The Panel recalls that once a complainant has identified an alternative measure, and shown that such alternative measure is less trade-restrictive, and contributes to the achievement of the pursued objective to an equal or greater extent, than the challenged measure, it is then for the responding party to demonstrate why the proposed alternatives are not reasonably available.[1012]

7.611. Brazil has argued that the PATVD programme contributes to the objective of bridging the digital divide and promoting social inclusion, by ensuring continuity of supply of digital television equipment meeting the requirements of the SBTVD.[1013] The Panel recalls its finding above that Brazil has not demonstrated that the PATVD programme will make much contribution to this objective, if any. The Panel further recalls that it was able to conclude that the degree of actual and potential trade-restrictiveness was material.

7.612. The first alternative is for Brazil to exempt from IPI, PIS-PASEP, COFINS, PIS/PASEP-Importation, and COFINS-Importation contributions, the sales of all digital television transmitters that comply with Brazil's digital television standards, regardless of whether they are imported or domestically produced.[1014] In the view of the Panel, this alternative is WTO-consistent, would be trade-enhancing rather than trade-restrictive, and is likely to increase the supply of digital television equipment to the market and lower the price of digital television equipment for end consumers, thereby resulting in a greater contribution than the PATVD programme to the objective of bridging the digital divide and promoting social inclusion.

7.613. The second alternative is for Brazil to exempt from custom duties[1015] all digital television transmitters[1016] that are currently incentivised under the programme.[1017] In the view of the panel, this alternative is WTO-consistent, would be trade-enhancing rather than trade-restrictive, and is likely to increase the supply of digital television equipment to the market and lower the price of digital television equipment for end consumers, resulting in lower prices for consumers, thereby resulting in a greater contribution than the PATVD programme to the objective of bridging the digital divide and promoting social inclusion.

[1009] See European Union's opening statement at the first meeting of the Panel, para. 165; European Union's response to Panel question No. 5; Japan's opening statement at the first meeting of the Panel, para. 19; Japan's response to Panel question No. 5; and Japan's second written submission, para. 167. The Panel notes that the United States also suggested this as an alternative. See United States' third party submission, para. 28.

[1010] See European Union's opening statement at the first meeting of the Panel, para. 165; and European Union's response to Panel question No. 5. The Panel notes that the United States also suggested this as an alternative. See United States' third party submission, para. 28.

[1011] See European Union's opening statement at the first meeting of the Panel, para. 165; European Union's response to Panel question No. 5; Japan's opening statement at the first meeting of the Panel, para. 19; Japan's response to Panel question No. 5; and Japan's second written submission, para. 167. The Panel notes that the United States also suggested this as an alternative. See United States' third party submission, para. 28.

[1012] See paragraphs 7.532 to 7.533 above.

[1013] See paragraphs 7.545 to 7.547 above.

[1014] European Union's opening statement at the first meeting of the Panel, para. 165; European Union's response to Panel question No. 5; Japan's opening statement at the first meeting of the Panel, para. 19; Japan's response to Panel question No. 5; Japan's second written submission, para. 167.

[1015] The European Union explains that the current applied ad valorem duty for products falling within this tariff line is 12%. European Union's response to Panel question No. 5.

[1016] The European Union describes this as "'transmission apparatus (transmitters) for television, whether or not incorporating a reception apparatus or a sound recording or reproduction apparatus', falling within the MCN code 8525.59.2". European Union's response to Panel question No. 5.

[1017] See European Union's opening statement at the first meeting of the Panel, para. 165; European Union's response to Panel question No. 5.

7.614. The third alternative is for Brazil to provide subsidies directly to producers of digital television equipment, regardless of the origin of the manufactured products.[1018] In the view of the Panel, this alternative is WTO-consistent, would be trade-enhancing rather than trade-restrictive, and is likely to increase the supply of digital television equipment to the market and lower the price of digital television equipment for end consumers, resulting in lower prices for consumers, thereby resulting in a greater contribution than the PATVD programme to the objective of bridging the digital divide and promoting social inclusion.

7.615. Brazil argues that these alternative measures are not reasonably available because the PATVD programme has multiple objectives, one of which includes the promotion of "local capability and investments in R&D of [digital television] technologies in Brazil".[1019] In Brazil's view, the PATVD programme "serves to encourage research and development and foster the expansion of Brazilian technologies and of a national industry related to communication and information technology".[1020] Brazil argues that the alternative measures are not reasonably available because the proposed alternatives do not make a sufficient contribution to this objective.

7.616. Brazil has not argued that the objective of promoting its domestic industry is a public morals objective, nor has Brazil argued that this objective is covered by any other sub-paragraph of Article XX of the GATT 1994.

7.617. The Panel agrees with Brazil that a measure may have multiple goals, and that it is not necessary that one goal should prevail over another. However, in order for an aspect of a measure that is found to be GATT-inconsistent to be justified under Article XX, the objective being pursued must fit within one of the subparagraphs of Article XX. A panel cannot reject a reasonably available alternative that achieves the desired level of protection of an interest protected under Article XX, purely because that alternative does not achieve a certain level of protection of an interest *not* protected under Article XX.

7.618. The Panel therefore considers that any of the three proposed alternatives would be not only WTO-consistent and less trade-restrictive than the discriminatory aspects of the PATVD programme, but can make a more substantial contribution to the claimed objective than the discriminatory aspects of the PATVD programme. Furthermore, Brazil has not demonstrated that these alternatives are not "reasonably available" to Brazil.

7.619. In the view of the Panel, this finding also sheds light on the Panel's concerns regarding the nature and objective of the PATVD programme. Specifically, these alternative measures, which if adopted would make a clear contribution to the stated objective of bridging the digital divide through increased supply of more affordable digital television products to the market, stand in stark contrast to the PATVD programme.

7.620. Brazil has not demonstrated that the proposed alternatives are not financially, technically, or otherwise, reasonably available, nor has Brazil rebutted the complaining parties' demonstrations that such alternatives would be WTO-consistent, less trade-restrictive than the PATVD programme, and more likely to contribute to the objective than the PATVD programme.

7.621. The Panel therefore concludes that the alternative measures suggested by the complaining parties are reasonably available to Brazil, WTO-consistent, less trade-restrictive than the PATVD programme, and are likely to result in a greater contribution than the PATVD programme to the objective of bridging the digital divide and promoting social inclusion.

7.3.6.3.2.5 Conclusion on necessity under Article XX(a)

7.622. The Panel has conducted a holistic analysis, weighing and balancing the importance of the objective, the contribution made by the measure to that objective, and the trade-restrictiveness of the measure, in light of reasonably available alternative measures. In the Panel's view, and particularly in light of reasonably available alternatives that in the Panel's view are not only WTO-

[1018] See European Union's opening statement at the first meeting of the Panel, para. 165; European Union's response to Panel question No. 5; Japan's opening statement at the first meeting of the Panel, para. 19; Japan's response to Panel question No. 5; Japan's second written submission, para. 167.

[1019] Brazil's second written submission, para. 125.

[1020] Brazil's second written submission, para. 126.

consistent and less trade-restrictive but are likely to contribute to a greater extent than the discriminatory aspects of the PATVD programme to the objective, Brazil has not demonstrated that the aspects of the measure found to be inconsistent with provisions of the GATT 1994 are "necessary" to achieve social inclusion and access to information, within the meaning of Article XX(a) of the GATT 1994.

7.3.6.4 Whether the discriminatory aspects of the PATVD programme satisfy the requirements of the chapeau of Article XX

7.623. Brazil contends that the PATVD programme is not applied in a manner that constitutes an arbitrary or unjustifiable discrimination. Brazil considers that the PATVD programme is necessary to guarantee the development and manufacture of digital television transmitting equipment in Brazil, in order to achieve the implementation of Brazil's digital television system.[1021] Brazil notes that the conditions prevailing between the relevant countries are not the same since the Brazilian digital television system is unique.[1022] Brazil argues that the application of the PATVD programme does not constitute a disguised restriction to trade because the purpose of the programme is to guarantee investment in R&D, and the conditions necessary to implement the Brazilian Digital Television System.[1023]

7.624. The complaining parties argue that Brazil has failed to demonstrate that the discriminatory aspects of the PATVD programme satisfy the requirements of the chapeau of Article XX. In particular, the complaining parties argue that the PATVD programme, and particularly the local content requirements in PATVD, discriminate between countries where the same conditions prevail, in a manner that "runs counter to the purported objective of PATVD", inconsistently with the chapeau of Article XX.[1024] Additionally, both complaining parties allege that the discriminatory aspects of the PATVD programme comprise a "disguised restriction on trade", since "Brazil has introduced a measure that discriminates on the basis of national origin not only with respect to digital TV equipment, but also with respect to the components of such equipment."[1025]

7.625. In light of its findings above that the measure is not provisionally justified under Article XX(a) of the GATT 1994, the Panel does not consider it necessary to make findings on whether Brazil has demonstrated that its defence under Article XX(a) meets the requirements of the chapeau to Article XX.

7.3.6.5 Conclusion

7.626. In light of the foregoing, the Panel concludes that those aspects of the PATVD programme found to be inconsistent with Article III of the GATT 1994 and Article 2.1 of the TRIMs Agreement are not justified under Article XX(a) of the GATT 1994.[1026]

7.4 The INOVAR-AUTO programme

7.4.1 Claims under Article III:2 of the GATT 1994

7.4.1.1 Introduction

7.627. The European Union and Japan raise claims under Article III:2 of the GATT 1994, first sentence, with respect to certain aspects of the INOVAR-AUTO programme. Specifically, the

[1021] Brazil's first written submissions, para. 446 (DS472) and para. 384 (DS497).
[1022] Brazil's first written submissions, para. 450 (DS472) and para. 388 (DS497).
[1023] Brazil's first written submissions, para. 457 (DS472) and para. 395 (DS497).
[1024] European Union's second written submission, para. 470; Japan's second written submission, para. 168.
[1025] European Union's second written submission, para. 470; Japan's second written submission, para. 169.
[1026] The Panel notes that pursuant to Article 3 of the TRIMs Agreement, "[a]ll exceptions under GATT 1994 shall apply, as appropriate to the provisions of this Agreement".

complaining parties allege that Brazil imposes a tax burden on imported motor vehicles in excess of that imposed on domestic like motor vehicles.[1027]

7.628. Japan also raises claims under the second sentence of Article III:2 of the GATT 1994 with respect to certain aspects of the INOVAR-AUTO programme.[1028]

7.629. Brazil argues that the complaining parties have not provided sufficient evidence that the INOVAR-AUTO programme modifies the competitive conditions between imported and like domestic motor vehicles to the detriment of the former.[1029]

7.630. As developed in paragraphs 7.61 and 7.71 above, Brazil also argues that the challenged aspects of the programmes are not within the scope of Article III:2, because: (i) these aspects of the programmes are pre-market requirements that are not covered by Article III, and (ii) the programmes constitute subsidies paid exclusively to domestic producers within the meaning of Article III:8(b) of GATT.[1030]

7.631. The Panel has considered Brazil's threshold arguments in sections 7.2.1 and 7.2.2 above. With respect to Brazil's first argument, the Panel already found in paragraph 7.70 above that the fact of the measures' status as "pre-market" requirements does not have an impact on whether the measure is within the scope of Article III:2 of the GATT 1994. With regards to Brazil's second argument, i.e. that the programmes constitute subsidies to domestic producers within the meaning of Article III:8(b) of the GATT 1994, the Panel recalls its findings in paragraph 7.87 above that, as a general principle, Article III:8(b) does not exempt from the substantive disciplines of Article III components of such production subsidies that introduce tax discrimination on imported like products.

7.632. As noted above, in order to determine whether there is an inconsistency with the first sentence of Article III:2 of the GATT 1994, two questions need to be answered:

a. Whether imported and domestic products are like products; and

b. Whether the imported products are taxed in excess of the domestic products.[1031]

7.633. If the answers to both questions are affirmative, then the internal tax or charge shall be found to be inconsistent with the first sentence of Article III:2 of the GATT 1994.[1032]

7.634. As regards the second sentence of Article III:2 of the GATT 1994, three separate issues must be addressed:

a. Whether the imported products and the domestic products are "directly competitive or substitutable products";

b. Whether the directly competitive or substitutable imported and domestic products are "not similarly taxed"; and

c. Whether the dissimilar taxation of the directly competitive or substitutable imported and domestic products is "applied ... so as to afford protection to domestic production".

7.635. If the answers to these three questions are affirmative, then the internal tax or internal charge shall be found to be inconsistent with the second sentence of Article III:2 of the GATT 1994.

[1027] European Union's first written submission, paras. 320-345; Japan's first written submission, paras. 195-229.

[1028] Japan's first written submission, paras. 230-244.

[1029] Brazil's first written submissions, paras. 564-567 (DS472) and 501-504 (DS497).

[1030] Brazil's first written submissions, paras. 547 and 475-483 (DS472) and paras. 472 and 549-556 (DS497).

[1031] Appellate Body Report, *Canada –Periodicals*, pp. 22–23, DSR 1997:1, 449, at p. 468. See also Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 19–23, DSR 1996:I, 97, at pp. 111-115.

[1032] Appellate Body Report, *Canada –Periodicals*, pp. 22–23, DSR 1997:1, 449, at p. 468.

7.636. As noted above, in the present dispute the parties agree that the challenged measures are taxes.[1033] The relevant tax under this claim with respect to the INOVAR-AUTO programme is the IPI tax.[1034]

7.637. The complaining parties have identified two ways whereby companies can reduce their IPI tax burden under the INOVAR-AUTO programme: (i) through reduced IPI tax rates for certain motor vehicles; and (ii) through the use of presumed IPI tax credits with which to offset their IPI tax liabilities. The Panel shall address these two instances separately. As the Panel did with respect to the ICT programmes, it shall start its analysis by examining whether the products at issue are like. It shall then assess whether imported motor vehicles are taxed in excess of like domestic motor vehicles.

7.4.1.2 Reduced IPI tax rates

7.4.1.2.1 Whether imported and domestic motor vehicles are "like products", within the meaning of Article III:2, first sentence

7.638. First, the Panel recalls its finding in paragraph 7.117 above, in the context of Article III:2 of the GATT 1994 as applied to the ICT programmes, that incentivised products manufactured in Brazil are Brazilian domestic products within the meaning of Article III:2. The Panel similarly considers that motor vehicles manufactured in Brazil are domestic Brazilian products.

7.639. The complaining parties identify as an instance of special treatment the reduced IPI tax rates provided under the Additional Note NC 87-5 to the TIPI in Annex IX of Decree 7,819/2012 with respect to certain motor vehicles domestically produced.[1035]

7.640. Additional Note NC 87-5 to the TIPI reads as follows:

> From 1 January 2013 to 31 December 2017:
>
> NC (87-5). Tax rates shall be reduced to 45% for *vehicles manufactured nationally* with manual transmission, transfer case, chassis independent from the bodywork, minimum clear height from the ground of the front or rear axles of 200 mm, minimum clear height from the ground between the axles of 300 mm, minimum approach angle of 35º, minimum departure angle of 24º, minimum ramp angle of 28º, resurfacing capacity from 500 mm, combined total gross weight from 3 000 kg, maximum weight in running order of up to 2 100 kg, designed for military use or agro-industrial work, classified under codes 8703.32.10 and 8703.33.10.
>
> From 1 January 2018:
>
> NC (87-5). Tax rates shall be reduced to 15% for *vehicles manufactured nationally* with manual transmission, transfer case, chassis independent from the bodywork, minimum clear height from the ground of the front or rear axles of 200 mm, minimum clear height from the ground between the axles of 300 mm, minimum approach angle of 35º, minimum departure angle of 24º, minimum ramp angle of 28º, resurfacing capacity from 500 mm, combined total gross weight from 3 000 kg, maximum weight

[1033] See European Union's first written submission, paras. 771, 918 and 1059; Japan's first written submission, paras. 10-16; Brazil's first written submissions, para. 59 (DS472) and para. 23 (DS497). The European Union and Japan have raised an alternative claim under Article II:1(b) of the GATT 1994 with respect to the four ICT-related programmes (Informatics, PADIS, PATVD and Digital Inclusion) in the event that Brazil contends that PIS/PASEP-Importation and COFINS-Importation are not taxes but "other duties or charges" on imports within the meaning of Article II:1(b) of the GATT 1994. Since Brazil has not argued that PIS/PASEP-Importation and COFINS-Importation are "other duties and charges" within the meaning of Article II:1(b), the Panel shall not address these particular claims. See European Union's first written submission, para. 1149; and Japan's first written submission, fn 26 to para. 14.

[1034] See European Union's first written submission, para. 320.

[1035] European Union's first written submission, para. 341; Japan's first written submission, para 189.

in running order of up to 2 100 kg, designed for military use or agro-industrial work, classified under codes 8703.32.10 and 8703.33.10.[1036]

7.641. Thus, Additional Note NC 87-5 provides that from 1 January 2013 to 31 December 2017 tax rates shall be reduced to 45% for certain vehicles manufactured nationally. From 1 January 2018, tax rates shall be reduced to 15% for these same vehicles provided that they are manufactured domestically.

7.642. The Panel considers that the text of the Additional Note NC 87-5 clearly establishes an origin-based distinction given that it explicitly requires that the vehicles at issue be produced domestically in order to benefit from the reduced IPI tax rate.

7.643. Therefore, the Panel finds that the likeness of domestic and imported vehicles fulfilling the characteristics set out in Additional Note NC-87-5 can be presumed, for the purposes of the analysis under Article III:2, first sentence, of the GATT 1994.

7.4.1.2.2 Whether imported motor vehicles are "taxed in excess of" like domestic motor vehicles

7.644. The text of Additional Note NC 87-5 provides that the tax rates applicable to certain motor vehicles manufactured domestically "shall be reduced" to 45% from 1 January 2013 to 31 December 2017 and to 15% from 1 January 2018 onwards. Imported motor vehicles with these characteristics shall not benefit from this reduced tax rate.

7.4.1.2.3 Conclusion

7.645. The Panel therefore finds that the imported motor vehicles at issue are taxed in excess of domestic like motor vehicles given that the tax reduction only affects those motor vehicles manufactured domestically. Consequently, the Panel finds that imported motor vehicles are taxed in excess of like domestic motor vehicles within the meaning of Article III:2, first sentence, of the GATT 1994.

7.4.1.3 Presumed IPI tax credits

7.4.1.3.1 Whether imported and domestic motor vehicles are "like products"

7.646. First, the Panel recalls its finding in paragraph 7.117 above, in the context of Article III:2 of the GATT 1994 as applied to the ICT programmes, that incentivised products manufactured in Brazil are Brazilian domestic products within the meaning of Article III:2. The Panel similarly considers that motor vehicles manufactured in Brazil are domestic Brazilian products.

7.647. The European Union and Japan argue that the imported and domestic motor vehicles at issue are like because the INOVAR-AUTO programme provides for differential treatment based exclusively on the origin of the products.[1037] In this respect, the European Union argues that the distinctions are drawn based on the place of production of the products (or some production steps), the origin of the components and the obligations undertaken by companies to invest in R&D, and engineering and industrial technology and technological development in Brazil.[1038]

7.648. The European Union and Japan argue that the INOVAR-AUTO programme draws origin-based distinctions at three different stages: (i) conditions for accreditation; (ii) rules on accrual and calculation of presumed IPI tax credits; and (iii) rules on the use of such tax credits.[1039] Additionally, the European Union argues that the origin-based discrimination is reinforced by the fact that presumed IPI tax credits cannot be used to offset IPI tax liabilities at the point of import

[1036] Decree 7,819/2012, (Exhibit JE-132), Annex IX, TIPI Additional Note (NC) 87-5. (emphasis added)

[1037] European Union's first written submission, para. 326; and Japan's first written submission, para. 198.

[1038] European Union's first written submission, para. 333.

[1039] European Union's first written submission, para. 115; second written submission, paras. 329-334; and Japan's first written submission, paras. 196 and 198; second written submission, paras. 71-72.

and, therefore, the IPI tax levied on imported motor vehicles at the time of their importation is always the full rate.[1040]

7.649. As far as accreditation is concerned, Japan considers that it is more difficult for manufacturers of imported motor vehicles to get accredited under the INOVAR-AUTO programme compared to domestic manufacturers. In this respect, Japan argues that domestic manufacturers can easily satisfy the requirement of producing motor vehicles in Brazil because this is their regular activity, and also because it is easier for domestic manufacturers to comply with the requirements relating to domestic expenditure.[1041] Japan considers that, even though foreign manufacturers can potentially have access to the advantages under INOVAR-AUTO by opting for the importer/distributor accreditation type, such foreign manufacturers face a higher burden in getting accredited than domestic manufacturers, for instance by becoming established in the Brazilian market and incurring costs in Brazil which they would otherwise not incur given that they do not conduct manufacturing activities in Brazil.[1042]

7.650. As far as accrual and calculation of presumed IPI tax credits is concerned, the European Union and Japan argue that companies that import motor vehicles, and manufacturers of imported products, cannot accrue significant IPI tax credits compared to domestic manufacturers because such companies do not make expenditure in strategic inputs and tools in Brazil (since they do not perform manufacturing activities in Brazil). In the case of accredited importers/distributors, this limits their ability to import motor vehicles at a lower IPI tax rate. For its part, Japan argues that it is less likely that manufacturers of imported motor vehicles accrue presumed IPI tax credits, because such manufacturers do not carry out manufacturing activities in Brazil and consequently are unlikely to make expenditure in Brazil, especially on strategic inputs and tools, which are the items that generate higher presumed IPI tax credits.[1043]

7.651. As far as the use of presumed IPI tax credits is concerned, the European Union and Japan point out that the use of presumed IPI tax credits with respect to imported motor vehicles is limited for two reasons. First, the complaining parties state that any tax credits may only be applied to imported motor vehicles if there is any tax credit left after offsetting the IPI tax due on domestic products. Second, the complaining parties further add that there is a limit to the number of imported motor vehicles that can benefit from the tax reduction: 4,800 imported motor vehicles per year.[1044]

7.652. In the complaining parties' view, the fact that the differential treatment is exclusively based on the origin of the products precludes the need to examine the four traditional likeness criteria. In any event, the European Union argues that the examination of the four traditional likeness criteria confirms that the products at issue are like because the products (i) are identified based on the Mercosur Common Nomenclature (MCN);[1045] (ii) have similar physical characteristics, (iii) have the same end uses; and (iv) generally attract the same consumers.[1046]

7.653. Brazil contends that the level of presumed IPI tax credits is not related to the origin of the products but to the different levels of contribution that the accredited companies make to the objectives of the INOVAR-AUTO programme.[1047]

7.654. The Panel notes that, on its face, the IPI tax rates established in the TIPI are in principle the same for imported and like domestic products.[1048] The products covered under the INOVAR-AUTO programme are identified in Annex I of Decree 7,819/2012 on the basis of their TIPI tariff

[1040] European Union's second written submission, para. 338. The European Union notes that there are two exceptions to this situation: (i) the motor vehicles imported by companies accredited as "investors"; and (ii) the annual quota of 4,800 imported motor vehicles per accredited company established in Article 22(II) of Decree 7,819/2012.

[1041] Japan's first written submission, para. 199.

[1042] Japan's first written submission, para. 202.

[1043] European Union's second written submission, para. 339; Japan's first written submission, para. 209.

[1044] European Union's second written submission, para. 340; Japan's first written submission, para. 212.

[1045] European Union's first written submission, para. 608.

[1046] European Union's first written submission, para. 334.

[1047] Brazil's first written submissions, para. 560 (DS472) and 496 (DS497); second written submission, para. 146.

[1048] The exception being Additional Note 87-5 in Annex IX of Decree 7,819/2012, which explicitly provides for a reduced IPI tax rate for "vehicles manufactured nationally" that meet certain features.

code; no distinction between domestic and imported products is in principle established.[1049] However, a first glance at the structure and operation of the INOVAR-AUTO programme shows that companies that fulfil certain requirements obtain an accreditation that entitles them to accrue and use presumed IPI tax credits, thereby reducing their IPI tax burden up to 30 percentage points. This reduction of their IPI tax burden would result in a differential tax treatment for those companies that are accredited, compared to those that are not accredited.[1050]

7.655. The Panel will in turn conduct a thorough assessment of the design, structure and operation of the INOVAR-AUTO programme to determine, first, whether this differential tax treatment is based exclusively on the origin of the products, as argued by the complaining parties. If this is the case, the Panel will presume the likeness of imported and domestic products for the purpose of its analysis. In order to do so, the Panel shall assess in turn the three stages of allegedly origin-based discrimination identified by the complaining parties: (i) accreditation; (ii) accrual and calculation of presumed tax credits; and (iii) use of presumed tax credits. Second, the Panel will proceed to examine whether the differential tax treatment provided for in the INOVAR-AUTO programme results in imported motor vehicles being taxed in excess of domestic like motor vehicles.

Accreditation

7.656. As explained above, there are three types of accreditation that entitle companies to accrue and use presumed IPI tax credits: (i) accreditation for domestic manufacturers; (ii) accreditation for "importers/distributors", and (iii) accreditation for investors. All accredited companies must comply with two general requirements and with a series of specific requirements that differ depending on the type of accreditation.[1051]

7.657. The Panel notes in the first place that, in order for companies to obtain any sort of accreditation that entitles them to accruing and using presumed IPI tax credits, they must either be located and operate in Brazil[1052] (in the case of "domestic manufacturers" and "importers/ distributors") or in the process of establishing in the country as domestic manufacturers (in the case of "investors").[1053] This entails that foreign companies exclusively located outside Brazil that manufacture products imported into Brazil cannot, *per se*, get accredited and, consequently, cannot accrue and use presumed IPI tax credits. If foreign companies wish to obtain accreditation under the INOVAR-AUTO programme, they must establish themselves in Brazil as importers/distributors[1054], or as investors that will later become domestic manufacturers. The Panel considers that the fact that foreign companies cannot get accredited as such indicates that the origin of the company is indeed relevant for receiving differential tax treatment in the form of presumed IPI tax credits. In this respect, the Panel observes that accreditation is a pre-requisite for accruing and using the tax credits, and that foreign companies, which manufacture imported products, cannot obtain accreditation because they are not located in Brazil, and that their products therefore cannot benefit from the presumed IPI tax credits.

7.658. The Panel further notes that companies applying for a "domestic manufacturer" accreditation and those applying for an "importer/distributor" accreditation must fulfil different requirements. "Domestic manufacturers" shall comply with three out of four specific requirements, one of which must be the performance of a minimum number of defined manufacturing and engineering infrastructure activities in Brazil.[1055] "Importers/distributors" shall comply with the following three specific requirements: (i) investments in R&D in Brazil; (ii) expenditure on engineering, basic industrial technology and capacity-building of suppliers in Brazil; and

[1049] Decree 7,567/ 2011, (Exhibit JE-127). See also European Union's first written submission, para. 327.

[1050] See section 2.2.5.4 above.

[1051] See sections 2.2.5.5.1 and 2.2.5.5.2.1 above.

[1052] Brazil's response to Panel question No. 57.

[1053] Brazil has explained that the type of accreditation that relates to "investors" "is a temporary accreditation which eventually becomes an accreditation as a manufacturer in Brazil". See Brazil's response to Panel question No. 28.

[1054] This category of accreditation does not involve carrying out manufacturing activities in Brazil.

[1055] The other two requirements must be among these three: (i) investments in R&D in Brazil; (ii) expenditure on engineering, basic industrial technology and capacity-building of suppliers in Brazil; and (iii) participation in the vehicle labelling programme by the National Institute of Metrology, Quality and Technology (INMETRO). See paragraph 2.115 above.

(iii) participation in the vehicle labelling programme by the National Institute of Metrology, Quality and Technology (INMETRO).[1056] In light of the difference in the accreditation requirements to be fulfilled and the fact that the only way for foreign companies who exclusively manufacture their motor vehicles abroad to obtain accreditation is to become "importers/distributors" in Brazil, the Panel considers that foreign companies seeking accreditation under the INOVAR-AUTO programme must go through a more burdensome accreditation process than domestic manufacturers. The reason is twofold.

7.659. First, one of the specific requirements imposed on domestic manufacturers is that they perform a minimum number of manufacturing activities in Brazil. The Panel is of the view that this requirement is inherent to any domestic manufacturer, resulting in domestic manufacturers being subject *de facto* to only two other specific requirements. One of these requirements involves investing in R&D in Brazil, which is also linked to the development of their manufacturing activity in the country. In contrast, importers/distributors must fulfil three requirements that are not inherent to their activity in Brazil: (i) investing in R&D in Brazil; (ii) making expenditure in certain items such as engineering, basic industrial technology and capacity-building of suppliers in Brazil; and (iii) participating in a vehicle labelling programme. Therefore, the Panel considers that, in practice, the INOVAR-AUTO programme is designed in a manner that requires foreign manufacturers to comply with three specific requirements, whereas domestic manufacturers are required to meet only two specific requirements (the performance of a minimum number of defined manufacturing and engineering infrastructure activities in Brazil not constituting *per se* a requirement given that domestic manufacturers necessarily perform manufacturing activities in Brazil).

7.660. Second, the Panel is of the view that, even if it were to consider that the number of requirements imposed on domestic manufacturers and importers/distributors is the same, compliance with those requirements is more burdensome on foreign manufacturers than domestic manufacturers. A foreign manufacturer not planning to manufacture motor vehicles within Brazil can only be granted the presumed tax credits if that manufacturer obtains the importer/distributor accreditation. However, this accreditation also requires that the foreign manufacturers must be located and operate in Brazil.[1057] There is no possibility for foreign manufacturers as such (located outside Brazil) to obtain any accreditation under the INOVAR-AUTO programme, unless they are also established in Brazil. Thus, unlike for domestic manufacturers, for foreign manufacturers compliance with the accreditation criteria necessarily entails establishing in Brazil, with a corresponding administrative and economic burden. Domestic manufacturers do not face such a burden because they are already established in Brazil.

7.661. Therefore, the burden of obtaining accreditation is higher for foreign manufacturers than for domestic manufacturers. In light of the above, it is the Panel's view that the accreditation process[1058] under the INOVAR-AUTO programme treats imported motor vehicles, which are produced by foreign manufacturers outside Brazil, differently to identical domestic motor vehicles produced by accredited domestic manufacturers, based exclusively on the origin of the manufacturers, and consequently, the origin of the motor vehicles.

Accrual and calculation of presumed IPI tax credits

7.662. As explained above, companies accredited as "domestic manufacturers" and "importers/distributors" can accrue presumed IPI tax credits by making expenditure in the following items in Brazil: (i) strategic inputs; (ii) tools; (iii) research; (iv) technological development; (v) technological innovation; (vi) contributions to the FNDCT; (vii) capacity-building of suppliers; and, (viii) basic engineering and industrial technology.[1059]

[1056] There is a fourth specific requirement set out in Decree 7,819/2012 dealing with the performance in Brazil of certain manufacturing steps. Complying with this requirement is not an option for importers/distributors given that their accreditation type does not foresee their participation in manufacturing activities in Brazil.

[1057] Brazil's response to Panel question No. 57.

[1058] In particular, the specific accreditation requirements under the INOVAR-AUTO programme. No claim has been raised by the complaining parties with regard to the general accreditation requirements provided for in Article 4 of Decree 7,819/2012, (Exhibit JE-132).

[1059] See paragraph 2.122 above.

7.663. The Panel recalls that the calculation of presumed IPI tax credits differs depending on whether the accredited company makes expenditure in Brazil in strategic inputs and tools, on the one hand, or in the other six categories of expenditure mentioned in the paragraph above.

7.664. With respect to expenditure in Brazil in *strategic inputs and tools*, the Panel explained above that the method of calculation of the presumed tax credits changed in October 2014. Before 1 October 2014 the presumed IPI tax credit resulting from expenditure in strategic inputs and tools in Brazil was the result of multiplying the amount of expenditure by a coefficient that varied depending on the type of vehicle and the calendar year.[1060]Pursuant to Implementing Order MDIC 257/2014, from October 2014 the calculation of the presumed IPI tax credits resulting from expenditure in Brazil in strategic inputs and tools must take into account an additional element: the so-called "deductible part". The deductible part is deducted from the total value of expenditure in strategic inputs and tools made in Brazil, which constitutes the base to calculate the presumed IPI tax credit.

7.665. In the case of strategic inputs and tools from providers that supply to direct suppliers of accredited companies (i.e. Tier 2 supplies), the deductible part is calculated based on the Tax Situation Codes (CST) indicated in the tax invoices issued to the suppliers of the accredited companies:[1061]

a. If the strategic inputs and tools are (i) directly imported from abroad; (ii) imports purchased in the Brazilian market; or (iii) Brazilian products with a level of imported content higher than 70% (i.e. CST 1, 2, 6, 7 or 8), then 100% of the value shall be deducted from the expenditure used to calculate the presumed IPI tax credit.[1062]

b. If the strategic inputs and tools are Brazilian products (i) with a level of imported content higher than 40% but lower than or equal to 70%; or (ii) produced in accordance with certain PPBs (i.e. CST 3 or 4), then 50% of the value shall be deducted from the expenditure used to calculate the presumed IPI tax credit.[1063]

c. If the strategic inputs and tools are (i) domestic products other than those classified under CST 3, 4, 5 and 8; or (ii) domestic products with a level of imported content lower than or equal to 40% (i.e. CST 0 or 5), then the deductible part is 0, and therefore 100% of the expenditure incurred shall count towards calculating the presumed IPI tax credit.[1064]

7.666. In the case of strategic inputs and tools supplied directly to accredited companies (i.e. Tier 1 supplies), the deductible part is the actual value of direct imports (Cost, Insurance & Freight (CIF) value) plus the import tax plus the Tier 2 deductible part (i.e. imported content).[1065]

7.667. With respect to expenditure in Brazil in *research; technological development; technological innovation; and payments to the FNDCT*[1066], the Panel recalls that the presumed credit shall

[1060] Decree 7,819/2012, (Exhibit JE-132), Article 12 §3. See also Decree 7,819/2012, (Exhibit JE-132), Article 12 §5.

[1061] See E. da Matta, "*Valoração da parcela dedutível*", Sindipeças, September 2014, (Exhibit JE-105); and Implementing Order MDIC 257/2014, (Exhibit JE-158), Annex III, paragraph 5(b). In the event that no CST is indicated in the tax invoice issued to the supplier, it will be classified as CST 2. See Implementing Order MDIC 257/2014, (Exhibit JE-158), Annex III, paragraph 2(a).

[1062] CST 1 (Foreign – Direct import, except as indicated in CST 6), CST 2 (Foreign – Purchased in the internal market, except as indicated in code 7), CST 6 (Foreign – Direct import, without a national equivalent present in a list of a CAMEX Resolution and natural gas), CST 7 (Foreign- Purchased in the internal market, without a national equivalent present in a list of a CAMEX Resolution and natural gas) and CST 8 (National, merchandise or good with Imported Content higher than 70%). See Annex to SINIEF Convention, Un-numbered, of 15 December 1970, (Exhibit JE-159).

[1063] CST 3 (National, merchandise or good with Imported Content higher than 40% but lower than or equal to 70%) and CST 4 (National, produced in accordance with the basic productive processes which are dealt with in Decree-Law 288/67, and in Laws 8,248/91, 8,387/91, 10,176/01 and 11,484/07). See Annex to SINIEF Convention, Un-numbered, of 15 December 1970, (Exhibit JE-159).

[1064] CST 0 (National, except as indicated in codes 3, 4, 5 and 8) or CST 5 (National, merchandise or good with Imported Content lower than or equal to 40% (forty percent). See Annex to SINIEF Convention, Un-numbered, of 15 December 1970, (Exhibit JE-159).

[1065] See E. da Matta, "*Valoração da parcela dedutível*", Sindipeças, September 2014, (Exhibit JE-105); and Implementing Order MDIC 257/2014, (Exhibit JE-158), Annex III paragraph 5(a).

correspond to 50% of the expenditure, limited to 2% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit.[1067]

7.668. With respect to expenditure in Brazil in *payments to the FNDCT; capacity-building of suppliers; and engineering and basic industrial technology*[1068]; the presumed credit shall correspond to 50% of the expenditure which exceeds 0.75%, and up to a limit of 2.75%, of the total gross proceeds from sales of goods and services in the second month prior to the calculation of the credit.[1069]

7.669. The Panel observes that higher tax credits (and consequently, lower tax burdens) are obtained by making expenditure in strategic inputs and tools because the starting point (i.e. initial base) to calculate the presumed IPI tax credit is 100% of the expenditure, whereas when expenditure is made in the other items, the basis for the calculation is 50% of the expenditure.[1070] Furthermore, the only cap applicable to the accrual of presumed IPI tax credits in the case of expenditure in strategic inputs and tools is a reduction of 30 percentage points in the IPI tax rate, whereas more restrictive caps apply in the case of expenditure in other items.[1071] The Panel is of the view that the INOVAR-AUTO programme is designed to favour the accrual of presumed IPI tax credits by domestic manufacturers *vis-à-vis* the other two types of accredited companies, because domestic manufacturers' manufacturing activities in Brazil require that they make expenditure in Brazil in strategic inputs and tools, thereby generating higher presumed IPI tax credits. Foreign manufacturers who obtain accreditation as "importers/distributors" do not carry out manufacturing activities in Brazil[1072], so the Panel sees no reason why they should purchase in Brazil strategic inputs and tools that are used in manufacturing processes. The Panel's view is supported by the definition of "strategic inputs" and "tools" under the INOVAR-AUTO programme, which makes it clear that they are to be used in the manufacture of a vehicle:

> [S]trategic materials shall mean any raw materials, parts and components *used in the manufacture* of, and physically incorporated in, the vehicles referred to in Annex I to Decree No 7.819 of 2012.…[T]ools shall mean specific tools for each type of part, linked to a machine and used to stamp or inject automotive parts *intended for the manufacturing process* referred to in Article 1.[1073]

7.670. The same applies to the third category of accreditation, that of "investors" because they are in the process of establishing in the country. By the time they start making expenditure in strategic inputs and tools due to starting their manufacturing activities, they will be accredited as domestic manufacturers.[1074]

7.671. Furthermore, the Panel considers that if foreign manufacturers accredited as "importers/distributors" were to make any expenditure or investment in Brazil, it would be in the other categories of expenditure that are not so targeted towards manufacturing, such as: (i) research; (ii) technological development; (iii) technological innovation; (iv) contributions to the FNDCT; (v) capacity-building of suppliers; and, (vi) basic engineering and industrial technology. As

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[1066] Decree 7,819/2012, (Exhibit JE-132), Article 12(III) to (VI).

[1067] Taxes and contributions on sales are excluded. See Decree 7,819/2012, (Exhibit JE-132), Article 12 §9, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[1068] Decree 7,819/2012, (Exhibit JE-132), Article 12(VI) to (VIII).

[1069] Taxes and contributions on sales are excluded. See Decree 7,819/2012, (Exhibit JE-132), Article 12 §10, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[1070] See paragraph 2.127 above.

[1071] With respect to expenditure in Brazil in *research; technological development; technological innovation; and payments to the FNDCT*, the presumed IPI tax credit is capped at 2% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit. With respect to expenditure in Brazil in *payments to the FNDCT; capacity-building of suppliers; and engineering and basic industrial technology*; the presumed credit is capped at 2.75%, of the total gross proceeds from sales of goods and services in the second month prior to the calculation of the credit. See Decree 7,819/2012, (Exhibit JE-132), Articles 12 §9 and §10, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[1072] Subsection II of Decree 7,819/2012, which refers to the so-called "importer/distributor" type of accreditation is entitled "Of companies that do not produce but only market vehicles in the country".

[1073] Implementing Order MDIC 257/2014, (Exhibit JE-158), Articles 1 and 2 (emphasis added)

[1074] Brazil explained that the accreditation as "investor" "is a temporary accreditation which eventually becomes an accreditation as a manufacturer in Brazil". See Brazil's response to Panel question No. 28.

described above, expenditure in these items generates lower tax credits than expenditure in strategic inputs and tools.[1075]

7.672. Therefore, the Panel finds that the system of accrual and calculation of presumed IPI tax credits under the INOVAR-AUTO programme treats imported motor vehicles, which are produced by foreign manufacturers outside Brazil, differently to identical domestic motor vehicles produced by accredited domestic manufacturers, based exclusively on the origin of the manufacturers, and consequently, the origin of the motor vehicles.

Use of presumed IPI tax credits

7.673. As noted above, the use of presumed IPI tax credits resulting from expenditure made in Brazil in strategic inputs and tools is subject to two limits. First, the presumed IPI tax credits must be used by the accredited companies to first offset the IPI tax arising from the sales of domestic motor vehicles, and, only if there is any presumed credit left, can it be used to offset the IPI tax arising from the sales of imported motor vehicles.[1076] Second, the number of imported motor vehicles that can benefit from the reduction through presumed credits of the IPI tax arising from their sales is limited to 4,800 imported motor vehicles per calendar year.

7.674. The Panel therefore observes that there exists indeed a differential treatment between imported and domestic products as regards the use of presumed IPI tax credits resulting from expenditure made in Brazil in strategic inputs and tools. Priority in the use of these credits is given to offsetting the IPI tax due on *domestic* motor vehicles. The IPI tax due on imported motor vehicles shall only be offset if there is credit left after having used the credit with respect to domestic products. In addition, a numerical limit is imposed on the number of imported motor vehicles whose IPI tax can be offset, whereas no limit on the number of domestic motor vehicles applies. For these reasons, the Panel finds that the rules on the use of presumed IPI tax credits resulting from expenditure made in Brazil in strategic inputs and tools treat imported motor vehicles differently to identical domestic motor vehicles, within Brazil, based exclusively on the origin of the products.

7.675. In light of the foregoing, the Panel concludes that:

a. The complaining parties have successfully made a *prima facie* case that the differential treatments set out in the accreditation process[1077], the system of accrual and calculation of presumed IPI tax credits, and the rules on the use of presumed IPI tax credits resulting from expenditure made in Brazil in strategic inputs and tools under the INOVAR-AUTO programme, are based exclusively on the origin of the vehicles; and

b. Brazil has not successfully rebutted the *prima facie* case made by the complaining parties.

7.676. Consequently, the Panel finds that domestic and imported motor vehicles are presumed to be like for the purposes of the analysis under Article III:2, first sentence, of the GATT 1994.

[1075] The Panel additionally notes that the new method to calculate the presumed IPI tax credits derived from expenditure in strategic inputs and tools as from October 2014 favours domestic over imported content. As noted above, expenditure in imported strategic inputs and tools and Brazilian strategic inputs and tools with a level of imported content higher than 70% does not generate any tax credit. In addition, only half of the expenditure made in Brazil in domestic strategic inputs and tools with a level of imported content higher than 40% but lower than or equal to 70%, is taken into account to calculate the presumed IPI tax credit. The Panel observes that the only way for accredited companies to obtain the higher tax credits when making expenditure in Brazil in strategic inputs and tools is by purchasing domestic products (other than those classified under CST 3, 4, 5 and 8) or domestic products with a level of imported content lower than or equal to 40%. The Panel will discuss further this issue in the section dealing with Article III:4 of the GATT 1994.

[1076] This does not apply to the imported motor vehicles set out in Annex VI and the presumed IPI tax credit resulting from the acquisition of strategic inputs and tools used for manufacturing these motor vehicles. See Decree 7,819/2012, (Exhibit JE-132), Articles 14 §5 and §6, as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[1077] In particular, the specific accreditation requirements under the INOVAR-AUTO programme. No claim has been raised by the complaining parties with regard to the general accreditation requirements provided for in Article 4 of Decree 7,819/2012, (Exhibit JE-132).

7.4.1.3.2 Whether imported motor vehicles are "taxed in excess of" like domestic motor vehicles

7.677. The Panel has noted above that the TIPI provides for identical IPI tax rates for the motor vehicles falling under the scope of the INOVAR-AUTO programme, regardless of their origin. The Panel has also concluded above that the differential tax treatment provided to domestic and imported vehicles derives from the rules on accreditation, accrual and subsequent use of presumed IPI tax credits under the INOVAR-AUTO programme, which reduces the IPI tax burden up to 30 percentage points. The Panel has found that this differential treatment is based exclusively on the origin of the vehicles. As the Panel did with respect to the ICT programmes, the Panel shall in turn examine whether the differential tax treatment provided for in the INOVAR-AUTO programme results in imported vehicles being taxed in excess of domestic like vehicles. The Panel shall structure its reasoning following the three-stage analysis used to examine whether the vehicles at issue were like: (i) accreditation, (ii) accrual and calculation of the presumed IPI tax credits, and (iii) use of the presumed IPI tax credits.

Accreditation

7.678. In the previous section, the Panel found that imported vehicles are manufactured by foreign companies that cannot get accredited under the INOVAR-AUTO programme unless they establish and operate in Brazil. The Panel also found that the burden on foreign companies seeking accreditation was higher than for domestic manufacturers.

7.679. In the Panel's view, it is therefore clear that foreign companies *per se* cannot obtain accreditation under the INOVAR-AUTO programme because they are not located or operate in Brazil. Foreign companies seeking accreditation under the INOVAR-AUTO programme should opt for becoming "importers/distributors" by establishing in Brazil in order to carry out certain marketing and sale activities in the Brazilian market. The other two types of accreditation do not seem viable given that foreign manufacturers would effectively change their status from "foreign manufacturers" to become "domestic manufacturers" or "investors" (i.e. future domestic manufacturers), located in Brazil and conducting manufacturing activities (or planning to conduct manufacturing activities) in Brazil.

7.680. This results in a higher tax burden applied to imported vehicles manufactured by foreign manufacturers for two reasons. First, the IPI tax burden on imported vehicles manufactured by foreign companies located outside Brazil cannot be reduced through presumed IPI tax credits because foreign companies, which are not located in Brazil, can never obtain the accreditation that entitles them to accrue and use such credits. Second, foreign companies that opt for establishing in Brazil in order to get accredited as importers/distributors face more burdensome requirements to be entitled to accrue and use credits than domestic manufacturers. In this respect, foreign manufacturers must bear an economic and administrative burden that domestic manufacturers do not bear as a result of their need to establish in Brazil. Thus it is more burdensome to obtain presumed tax credits for foreign-produced vehicles, compared to like domestically-produced vehicles.

7.681. Therefore, the Panel concludes that the accreditation process[1078] under the INOVAR-AUTO programme is designed and operates in a manner that makes it more difficult for foreign manufacturers to reduce the IPI tax burden on imported vehicles compared to accredited domestic manufacturers and domestic vehicles, contrary to Article III:2 of the GATT 1994.

Accrual and calculation of presumed IPI tax credits

7.682. The Panel noted above that the method of calculating presumed IPI tax credits resulting from expenditure in Brazil in strategic inputs and tools favours domestic vehicles over imported vehicles because higher tax credits (and consequently, lower tax burdens) are obtained by making expenditure in strategic inputs and tools. This kind of expenditure is basically made by one of the three types of accredited companies, i.e. domestic manufacturers, which are the only accredited

[1078] In particular, the specific accreditation requirements under the INOVAR-AUTO programme. No claim has been raised by the complaining parties with regard to the general accreditation requirements provided for in Article 4 of Decree 7,819/2012, (Exhibit JE-132).

companies that conduct manufacturing activities in Brazil and, therefore, need strategic inputs and tools.

7.683. The Panel recalls its finding that higher tax credits are obtained by making expenditure in strategic inputs and tools because the starting point (i.e. initial base) to calculate the presumed IPI tax credit is 100% of the expenditure, whereas when expenditure is made in the other items, the basis for the calculation is 50% of the expenditure.[1079] The Panel further recalls that the only cap applicable to the accrual of presumed IPI tax credits in the case of expenditure in strategic inputs and tools is a reduction of 30 percentage points in the IPI tax rate, whereas more restrictive caps apply in the case of expenditure in other items.[1080] As explained above, the Panel considers that this design and structure of the INOVAR-AUTO programme favours the accrual of presumed IPI tax credits by domestic manufacturers *vis-à-vis* the other two types of accredited companies because their manufacturing activities in Brazil require that they make expenditure in Brazil in strategic inputs and tools, thereby generating higher presumed IPI tax credits. Foreign manufacturers who obtain accreditation as "importers/distributors" do not carry out manufacturing activities in Brazil[1081], so the Panel sees no reason why they should purchase strategic inputs and tools that are used in manufacturing processes. The same goes for "investors", who do not carry out manufacturing activities in Brazil.[1082]

7.684. The fact that domestic manufacturers benefit from the possibility of accruing higher presumed IPI tax credits by purchasing strategic inputs and tools necessary to conduct their manufacturing activities leads the Panel to the conclusion that the design and operation of the system of rules on accrual and calculation of presumed IPI tax credits under the INOVAR-AUTO programme necessarily leads to lower IPI tax burdens for vehicles produced by accredited domestic manufacturers *vis-à-vis* imported vehicles produced by foreign manufacturers, because domestic manufacturers can accrue higher tax credits.

7.685. Therefore, the Panel concludes that incentivized domestic motor vehicles manufactured by accredited domestic manufacturers benefit from a lower tax burden than like imported motor vehicles manufactured by foreign manufacturers as a result of the design and operation of the system of rules on accrual and calculation of presumed IPI tax credits, contrary to Article III:2 of the GATT 1994.

Use

7.686. The Panel recalls its finding in paragraph 7.673 above that the presumed IPI tax credits must be used by the accredited companies to first offset the IPI tax arising from the sales of domestic motor vehicles, and, only if there is any presumed credit left, to offset the IPI tax arising from the sales of imported motor vehicles. The Panel also recalls that the number of imported motor vehicles that can benefit from the presumed credits is limited to 4,800 imported motor vehicles per calendar year.

7.687. Based on the above, the Panel concludes that domestic motor vehicles are prioritized *vis-à-vis* imported like motor vehicles with respect to the use of presumed IPI tax credits. This prioritization of domestic over imported vehicles for the use of presumed IPI tax credits resulting from expenditure in strategic inputs in tools in Brazil results in imported motor vehicles being taxed in excess of like domestic motor vehicles, contrary to Article III:2 of the GATT 1994.

[1079] See paragraph 7.669 above.

[1080] With respect to expenditure in Brazil in *research; technological development; technological innovation; and payments to the FNDCT*, the presumed IPI tax credit is capped at 2% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit. With respect to expenditure in Brazil in *payments to the FNDCT; capacity-building of suppliers; and engineering and basic industrial technology*; the presumed credit is capped at 2.75%, of the total gross proceeds from sales of goods and services in the second month prior to the calculation of the credit. See Decree 7,819/2012, (Exhibit JE-132), Articles 12 §9 and §10, as amended by Decree 8,294/2014, (Exhibit JE-134), Article 1.

[1081] Subsection II of Decree 7,819/2012, which refers to the so-called "importer/distributor" type of accreditation is entitled "Of companies that do not produce but only market vehicles in the country".

[1082] Brazil's response to Panel question No. 28.

7.4.1.3.3 Conclusion

7.688. In light of the foregoing, the Panel concludes that under the INOVAR-AUTO programme, certain aspects of the accreditation process, the system of rules on accrual and calculation, and the use of presumed IPI tax credits resulting from expenditure in strategic inputs in tools in Brazil, result in a higher tax burden imposed on imported motor vehicles *vis-à-vis* like domestic motor vehicles. The Panel therefore concludes that these aspects of the INOVAR-AUTO programme programmes result in imported products being subject to internal taxes in excess of those applied to like domestic products, inconsistently with Article III:2, first sentence, of the GATT 1994.

7.4.1.4 Article III:2, second sentence, of the GATT 1994

7.689. Japan, the only complainant that has raised claims under this particular provision, argues that an objective review of the measure, taking into account the origin-based distinctions drawn at the accreditation, calculation and use of the presumed credits stages and the differential indirect taxation, cannot have any other policy rationale than providing protection to the domestic industry.[1083]

7.690. Brazil submits that "as INOVAR-AUTO conforms to the requirements of Article III:2, first sentence, it also conforms to [the] second sentence, as the products at issue are similarly taxed."[1084]

7.691. The Panel has addressed above whether the tax measures challenged by the complaining parties are inconsistent with Article III:2, first sentence, of the GATT 1994. Although Japan presents an additional and not an alternative claim under the second sentence of Article III:2, Japan has not indicated why such findings on the second sentence would be necessary or useful to secure a positive solution to the dispute if the Panel were to find the measures to be inconsistent with the first sentence of Article III:2. Indeed, the Panel, on its own motion, considers that, in light of the findings regarding Article III:2, first sentence, additional findings regarding the same measure under the second sentence of Article III:2 are not necessary or useful to secure a positive solution to the dispute. In particular, the Panel notes that its findings on the first sentence are made on the basis of hypothetical likeness, meaning that the analysis in respect of Article III:2, second sentence, would be similar to that under the first sentence. Accordingly, pursuant to the principle of judicial economy, the Panel refrains from making any findings with respect to this particular claim.

7.4.2 Claims under Article III:4 of the GATT 1994

7.4.2.1 Introduction

7.692. The European Union and Japan have raised claims under Article III:4 of the GATT 1994 with respect to the following aspects of the INOVAR-AUTO programme, which in their view accord less favourable treatment to imported products than that accorded to like domestic products:

a. In respect of finished motor vehicles, the conditions for accreditation in order for presumed tax credits to apply to motor vehicles, together with the rules on accrual and calculation of presumed IPI tax credits, and the rules on the use of presumed IPI tax credits[1085];

b. In respect of automotive components and equipment:

   i. The aspect of the accreditation requirements that requires the use of local inputs in the production of motor vehicles, through the imposition of manufacturing steps to be performed in Brazil; and

[1083] Japan's first written submission, para. 229.
[1084] Brazil's first written submission, para. 504 (DS497).
[1085] European Union's first written submission, paras. 368-396; Japan's first written submission, paras. 233-237.

ii. The aspect of the rules on accrual and calculation of presumed IPI tax credits that requires expenditure in strategic inputs and tools with a high level of Brazilian content.[1086]

7.693. The European Union[1087] also has one specific claim of inconsistency with Article III:4, in respect of that aspect of the rules on accreditation under the INOVAR-AUTO programme that incentivises the purchase of Brazilian laboratory equipment.[1088]

7.694. As developed in paragraphs 7.61 and 7.71 above, Brazil argues that these aspects of the challenged programmes are not within the scope of Article III:4, because (i) these aspects of the programmes are pre-market requirements that are not covered by Article III, and (ii) the programmes constitute subsidies paid exclusively to domestic producers within the meaning of Article III:8(b) of the GATT 1994.[1089] In the event that the Panel finds that Article III:4 of the GATT 1994 applies to the INOVAR-AUTO programme, Brazil contends that the challenged programme does not accord less favourable treatment to imported over domestic products because the regulatory differences are not based on the origin of the products.[1090]

7.695. The Panel has considered Brazil's threshold arguments in sections 7.2.1 and 7.2.2 above. With respect to Brazil's first argument, the Panel already found in paragraph 7.70 above that the fact of the measures' status as a "pre-market" requirement does not have an impact on whether the measure is within the scope of Article III:4 of the GATT 1994.

7.696. With regard to Brazil's second argument, that the programmes constitute subsidies to domestic producers within the meaning of Article III:8(b) of the GATT 1994, the Panel recalls its findings in paragraph 7.87 above that as a general principle Article III:8(b) does not exempt from the disciplines of Article III components of such production subsidies that introduce product discrimination in the form of less favourable treatment on imported like products.

7.697. Therefore, the Panel will analyse the complaining parties' claims under Article III:4 of the GATT 1994.

7.698. The Panel recalls that for an inconsistency with Article III:4 of the GATT 1994 to be established, three elements must be satisfied:

a. that the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use";

b. that the imported and domestic products at issue are "like products"; and

c. that imported products are accorded "treatment less favourable" than that accorded to like domestic products.[1091]

7.699. The Panel examines these three elements below.

[1086] European Union's first written submission, paras. 397-406; Japan's written submission, paras. 238-244.

[1087] Japan mentions this aspect of the INOVAR-AUTO programme in the factual section of its submission, and in its discussion of its claims under Article 2.1 of the TRIMs Agreement, but it does not explicitly raise claims under Article III:4 of the GATT 1994. See Japan's first written submission, para. 259. The Panel notes that in the context of its claims under Article 2.1 of the TRIMs Agreement, Japan refers to this particular aspect of the INOVAR-AUTO programme only as support for its assertion that the INOVAR-AUTO programme is a "trade-related investment measure" within the meaning of the TRIMs Agreement. Neither in the context of its claims under Article III:4 of the GATT 1994, nor in the context of its claims under Article 2.1 of the TRIMs Agreement, does Japan assert that this particular aspect of the programmes is inconsistent with Article III:4 of the GATT 1994. Furthermore, Japan does not refer to laboratory equipment in its response to Panel question 72 on the particular aspects of the measures challenged under Article III:4.

[1088] European Union's first written submission, para. 354.

[1089] See footnote 1030.

[1090] Brazil's first written submissions, paras. 584-589 (including misnumbered paragraphs) (DS472) and 508-523 (DS497).

[1091] Appellate Body Report, *Korea – Various Measures on Beef*, para. 133.

7.4.2.2 Whether the measures at issue are laws, regulations, or requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of domestic and imported products

7.700. The Panel recalls the legal standard for a determination of whether measures are "laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" of imported and domestic products, within the meaning of Article III:4, as explained in paragraphs 7.190 to 7.196 above.

7.701. The complaining parties argue that the aspects of the programmes challenged under Article III:4 are "requirements" that affect the internal use, purchase, and sale of domestic and imported goods, since compliance with such requirements results in a reduction of an indirect tax applied to motor vehicles.[1092] The complaining parties also argue that certain of these requirements function as local content requirements, either incentivising or requiring the use of domestically produced components, strategic inputs and tools, and laboratory equipment used in the production of those motor vehicles, over imported components, strategic inputs and tools, and laboratory equipment used in the production of those motor vehicles, and are therefore requirements affecting the use, purchase, and sale of those domestic and imported components, strategic inputs and tools, and laboratory equipment.[1093]

7.702. It is undisputed that the INOVAR-AUTO programme is enacted and implemented through laws and regulations, including laws, decrees and a number of binding legal acts, and contain a series of conditions for companies to obtain accreditation to be eligible for the presumed IPI tax credits, a set of rules for the accrual of presumed IPI tax credits, and a set of rules for the use of the presumed IPI tax credits.[1094]

7.703. As noted in paragraph 7.195 above, the Panel agrees with the panel in *India – Autos* that the term "requirement" within the meaning of Article III:4 of the GATT 1994 includes those requirements that an enterprise voluntarily accepts in order to obtain an advantage from the government.[1095] In the present dispute, the INOVAR-AUTO programme includes conditions or requirements that companies voluntarily accept to undertake in order to be accredited and hence, obtain the presumed IPI tax credits. The Panel therefore agrees with the complaining parties that the accreditation requirements constitute requirements within the meaning of Article III:4 of the GATT 1994.

7.704. Additionally, in respect of the rules on accrual and use of presumed IPI tax credits, the Panel understands that these rules are imposed through specific laws and decrees, as described in section 2.2.5 above. The Panel therefore considers that these rules are within the meaning of "laws" and "regulations" in the context of Article III:4 of the GATT 1994.

7.705. With respect to whether these laws, regulations and requirements "affect the internal sale, offering for sale, purchase, transportation, distribution or use" of products, the Panel recalls that the Appellate Body has explained that the word "affecting" has a broad scope of application.[1096]

7.706. The Panel notes that the purpose of complying with the requirements for accreditation is to obtain presumed IPI tax credits on the sale of products, so it is clear that the requirements at issue affect the sale and offering for sale of products. Furthermore, a tax reduction in respect of the sale of products, including through presumed tax credits, can create an incentive to buy the products subject to the tax reduction, over products that do not have the tax reduction. Thus, this confirms that the requirements at issue affect the sale, offering for sale or purchase of products.

[1092] European Union's first written submission, paras. 374-388; Japan's first written submission, para. 235.

[1093] European Union's first written submission, para. 404; Japan's first written submission, paras. 235 and 239-244.

[1094] See section 2.2.5 above.

[1095] Panel Report, *India – Autos*, para. 7.184. *See also* Panel Reports, *Canada – Autos*, para. 10.73; *Turkey – Rice*, para. 7.218; *China – Auto Parts*, para. 7.240; and GATT Panel Report, *EEC – Parts and Components*, para. 5.21.

[1096] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 208-210.

7.707. Additionally, in respect of the rules on accrual and use of presumed IPI tax credits, the Panel notes that these rules determine the extent of the tax benefit, and how that tax benefit is applied to certain products. The Panel therefore considers that these rules also affect the sale, offering for sale of products, and purchase, of products.

7.708. Based on the above, the Panel concludes that the INOVAR-AUTO programme is within the scope of "laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use" of products within the meaning of Article III:4 of the GATT 1994.

7.4.2.3 Whether the relevant imported and domestic products are "like products"

7.709. The Panel recalls the legal standard for a determination of whether products are "like products" within the meaning of Article III:4, as explained in paragraphs 7.199 to 7.202 above.

7.710. The complaining parties argue that the relevant domestic and imported products at issue – namely motor vehicles as well as components and equipment used in their production – are "like" because the INOVAR-AUTO programme discriminates based exclusively on the origin of the products. The complaining parties therefore argue that the Panel can apply a "hypothetical" likeness analysis.[1097] In particular, the complaining parties argue that domestic and imported motor vehicles listed in Annex I of Decree 7,819/2012 are like.[1098] Additionally, the complaining parties argue that components used in the production of those motor vehicles are like products, and that strategic inputs and tools manufactured in Brazil and imported strategic inputs and tools, are in a directly competitive relationship in the market and are like.[1099] Finally, according to the European Union, imported and domestically-produced laboratory equipment used in the pursuit of R&D in Brazil is "like".[1100]

7.711. Brazil argues that the legal presumption that the INOVAR-AUTO programme discriminates based on origin is flawed because the INOVAR-AUTO programme relates to requirements concerning production rather than products.[1101]

7.712. The Panel has already indicated generally in section 7.2.1 above, that the status of a particular law, regulation or requirement as a "pre-market" or "production-stage" requirement does not preclude the application of Article III:4 of the GATT 1994.

7.713. Similarly, in the context of "likeness", the Panel does not consider that the status of a particular requirement (or the "stage of production" in which that requirement operates), has any bearing on whether or not it applies to "like" domestic and imported products. In the Panel's view, and in light of the Panel's findings in paragraph 7.202 above, if a particular requirement applies to domestic and imported products, and discriminates between those imported and domestic products exclusively on the basis of the origin of the products, then those products may be presumed to be "like" within the meaning of Article III:4.

7.714. The Panel proceeds with its analysis by distinguishing between the distinct types of products in respect of which the complaining parties allege "likeness", namely finished motor vehicles, and automotive components and equipment used in the production of finished motor vehicles. Specifically, the Panel considers whether the relevant measures distinguish between imported and domestic products exclusively on the basis of origin.

[1097] European Union's first written submission, paras. 371-373; Japan's first written submission, paras. 234 and 241.

[1098] European Union's first written submission, para. 372; Japan's first written submission, paras. 234 and 243-244.

[1099] European Union's first written submission, para. 372; Japan's first written submission, paras. 234 and 243-244.

[1100] European Union's first written submission, para. 372.

[1101] Brazil's first written submissions, para. 508.

7.4.2.3.1 With respect to finished motor vehicles

7.715. The Panel notes that the product coverage under the INOVAR-AUTO programme with respect to finished motor vehicles is the same for the claims under Article III:2 of the GATT 1994 and the claims under Article III:4 of the GATT 1994.

7.716. The Panel concluded in paragraph 7.675 above that the complaining parties had made a *prima facie* case that there is a differential tax treatment between imported and like domestic products that is exclusively based on the origin of the products. The Panel found, for that reason, that domestic and imported products are presumed to be *like* for the purposes of the analysis under Article III:2, first sentence, of the GATT 1994.

7.717. The same reasoning applies to the likeness analysis under Article III:4 of the GATT 1994, i.e. that the INOVAR-AUTO programme introduces regulatory distinctions on the basis of the origin of the concerned products. Therefore, for the exact same reasons described in the assessment of likeness under Article III:2 of the GATT 1994, the Panel finds that domestic and imported products are presumed to be like for the purposes of the analysis of the claims under Article III:4 of the GATT 1994.

7.718. The Panel notes that this is consistent with the Appellate Body's explanation that the product scope in Article III:4 of the GATT 1994 is broader than that in the first sentence of Article III:2, but not broader than the combined scope of the first and second sentence of Article III:2 together.[1102] Therefore, if product likeness exists under Article III:2 of the GATT 1994, first sentence, product likeness will also exist under Article III:4 of the GATT 1994 for the same products at issue. Therefore, the Panel finds that imported and domestic finished motor vehicles are like for the purpose of Article III:4 of the GATT 1994.

7.4.2.3.2 With respect to automotive components and equipment used in the production of finished motor vehicles

7.719. As stated above, previous panels have applied "hypothetical" likeness in the context of Article III:4 of the GATT 1994, under which approach "a complainant may establish 'likeness' by demonstrating that the measure at issue makes a distinction based exclusively on the origin of the product".[1103] Under this approach, a complaining party must make a *prima facie* case that a measure draws a distinction based exclusively on origin.[1104]

7.720. The Panel notes that the complaining parties' argument is that the INOVAR-AUTO programme requires or incentivises the use of domestically produced components, strategic inputs and tools, and laboratory equipment, in the production of finished motor vehicles in order for those finished motor vehicles to receive certain tax benefits. Such regulatory distinction is clearly based on the origin of the products traded. The Panel does not prejudge at this point the issue of whether the imported products identified by the complaining parties are treated less favourably than the domestic like products. The Panel does consider, however, that the products alleged by the complaining parties to be disadvantaged are *like* the products that are allegedly favoured. The Panel addresses below whether the measures function as local content requirements that incentivise the use of domestically produced products, which by definition would differentiate against like imported products exclusively on the basis of the origin of the product.[1105]

7.721. The Panel therefore concludes that domestically produced components and imported components are like, domestically produced strategic inputs and tools and imported strategic inputs and tools are like, and domestically produced laboratory equipment and imported laboratory equipment are like, within the meaning of Article III:4 of the GATT 1994.

[1102] Appellate Body Report, *EC – Asbestos*, para. 99.

[1103] Appellate Body Report, *Argentina – Financial Services*, para. 6.36 (referring to Panel Reports, *Argentina – Hides and Leather*, para. 11.168; *China – Auto Parts*, para. 7.216; *Argentina – Import Measures*, para. 6.274; *Canada – Autos*, para. 10.74; *Canada – Wheat Exports and Grain Imports*, para. 6.164; *China – Publications and Audiovisual Products*, para. 7.1447; *India – Autos*, para. 7.174; *Thailand – Cigarettes (Philippines)*, para. 7.661; *Turkey – Rice*, paras. 7.214-7.216; and *US – FSC (Article 21.5 – EC)*, paras. 8.132-8.135, *Colombia – Ports of Entry*, paras. 7.355-7.356; and *US – Poultry (China)*, paras. 7.424-7.432).

[1104] Appellate Body Report, *Argentina – Financial Services*, para. 6.45.

[1105] See sections 7.4.2.4.2, 7.4.2.4.3 and 7.4.2.4.4 below.

7.4.2.4 Whether imported products are accorded "treatment less favourable" than that accorded to like domestic products

7.722. The Panel recalls that the last step of a panel's analysis under Article III:4 of the GATT 1994 is to determine whether imported products are accorded "treatment no less favourable" than that accorded to like domestic products pursuant to the measure in question. The Panel recalls the legal standard described in paragraphs 7.210 to 7.212 above.

7.723. The Panel recalls Brazil's threshold argument that "a production subsidy falling under the purview of Article III:8(b), such as the case of INOVAR-AUTO, may not necessarily allow 'the producer to sell a product at a lower price' or entail modifications in the conditions of competition."[1106] Brazil effectively argues that "the tax regime established by the [INOVAR-AUTO p]rogramme has imposed no adverse effects on the competitive opportunities for imported products."[1107] In support of this view, Brazil argues that "[t]he Brazilian automotive sector remains one of the largest importers of the country. Since 2012, when INOVAR-AUTO was established, the deficit in Brazil's balance of trade concerning the sector has continuously increased."[1108]

7.724. With respect to Brazil's first argument, the Panel initially notes its finding above that the relevant measures are not *per* se exempted from the disciplines of Article III of the GATT 1994, through Article III:8(b). The Panel also notes the well-established jurisprudence that no adverse trade effects need to be demonstrated in respect of a finding of inconsistency with Article III:4.[1109] The Panel therefore does not consider that a lack of adverse effects, or the deficit in Brazil's balance of trade in the sector, are relevant to a determination of whether the conditions of competition have been altered to the detriment of imported products and in favour of like domestic products.

7.725. The Panel also notes that Brazil does repeat in some detail its general argument, restating its view that the relevant requirements challenged under Article III:4 are "pre-market" requirements that do not affect the conditions of competition. The Panel takes note of Brazil's view that the relevant requirements do not modify the conditions of competition, but for the reasons indicated above[1110], does not consider that the status of the requirements as "pre-market" *per se* precludes a finding that the measures modify the conditions of competition. The Panel therefore proceeds with its analysis in order to determine to what extent the conditions of competition are altered by the challenged requirements.

7.4.2.4.1 Conditions for accreditation, and rules on accrual and use of presumed IPI tax credits, in respect of finished motor vehicles

7.726. The complaining parties argue that the accreditation requirements for obtaining the presumed IPI tax credits, the rules on accrual of presumed IPI tax credits, and the rules on use of presumed IPI tax credits, all modify the conditions of competition to the detriment of imported motor vehicles and in favour of like domestic motor vehicles.[1111] In the view of the complaining parties, these aspects of the INOVAR-AUTO programme favour domestic vehicles over imported vehicles, resulting in a level of taxation applied to imported motor vehicles that exceeds that applied to domestic motor vehicles.[1112] The complaining parties refer to their explanation of the accreditation requirements, and rules on accrual and use of presumed IPI tax credits in the context of their arguments under Article III:2 of the GATT 1994.[1113] The Panel recalls the specific arguments of the complaining parties in respect of Article III:2, as explained in paragraphs 7.627 to 7.628, and 7.646 to 7.648, above.

7.727. The Panel notes that the aspects challenged by the complaining parties under Article III:4 are different from the aspects challenged by the parties under Article III:2. Specifically, under

[1106] Brazil's first written submissions, para. 555 (DS472) and para. 481 (DS497).
[1107] Brazil's first written submissions, para. 556 (DS472) and para. 482 (DS497).
[1108] Brazil's first written submissions, para. 556 (DS472) and para. 482 (DS497).
[1109] Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 129.
[1110] See section 7.2.1above.
[1111] European Union's first written submission, para. 392; Japan's first written submission, para. 237.
[1112] European Union's first written submission, para. 392; Japan's first written submission, para. 237.
[1113] European Union's first written submission, paras. 399-400; Japan's first written submission, para. 237.

Article III:2 the complaining parties challenge the differential tax burden imposed on imported products as compared to like domestic products. In respect of Article III:4, the complaining parties challenge certain laws, regulations and requirements, relating in various ways to the implementation of the differential tax burden, which allegedly distort the conditions of competition for imported products in respect of like domestic products, through the operation of that differential tax burden.

7.728. The Panel recalls that in order to determine whether there exists "treatment less favourable" for imported products, panels must analyse whether the measures at issue modify the conditions of competition in the relevant market to the detriment of imported products.[1114]

7.729. The Panel will examine in turn whether the aspects of the INOVAR-AUTO programme identified by the complaining parties in the context of their Article III:4 claims (i.e. the accreditation requirements to get the presumed IPI tax credits, rules on accrual of presumed IPI tax credits, and rules on use of presumed IPI tax credits) do modify the conditions of competition to the detriment of imported motor vehicles.

Accreditation

7.730. The Panel recalls that in order to be eligible for the presumed IPI tax credits under the INOVAR-AUTO programme, companies must obtain accreditation, and in order to obtain accreditation companies must comply with the requirements imposed by the programme.

7.731. The Panel concluded in paragraphs 7.656 to 7.661 above that foreign manufacturers, as such, cannot obtain accreditation under the INOVAR-AUTO programme, because they are not located or do not operate in Brazil. Indeed, such foreign manufacturers would have to become accredited as importers/distributers, in order for their products to be eligible for the tax benefits. The Panel further found that this results in a higher tax burden on imported vehicles manufactured by foreign manufacturers, because foreign manufacturers are required to be legally established in Brazil in order to be accredited as importers/distributers, and foreign manufacturers seeking accreditation as importers/distributors are required to comply with more accreditation requirements than domestic manufacturers in order to obtain the tax benefits. Foreign manufacturers consequently bear a higher burden than domestic manufacturers in becoming accredited. In addition, motor vehicles produced by foreign manufacturers that are not established in Brazil are taxed higher than motor vehicles produced by Brazilian manufacturers within Brazil.

7.732. The Panel therefore considers that certain requirements for accreditation under the INOVAR-AUTO programme modify the conditions of competition to the detriment of imported motor vehicles and in favour of like domestic motor vehicles. Therefore, the Panel concludes that these requirements accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4.

Accrual and calculation of presumed IPI tax credits

7.733. The Panel concluded in paragraphs 7.662 to 7.672 above that the INOVAR-AUTO programme is designed to favour the accrual of presumed IPI tax credits by domestic manufacturers *vis-à-vis* the other types of accredited companies, because of the fact that domestic manufacturers performing their manufacturing activities in Brazil are required to make expenditure in Brazil on strategic inputs and tools, thereby generating higher presumed IPI tax credits. By contrast, foreign manufacturers that are accredited under the programme as importers/distributors and investors do not carry out manufacturing activities in Brazil, and the Panel sees no reason why they would purchase strategic inputs and tools in Brazil for the manufacture of motor vehicles. Therefore there is a greater burden on foreign manufacturers than domestic manufacturers when they seek to accrue presumed IPI tax credits to be used to offset taxes on the sale of motor vehicles.

7.734. The Panel considers that this aspect of the rules on accrual and calculation of presumed IPI tax credits modifies the conditions of competition to the detriment of imported motor vehicles and in favour of like domestic motor vehicles. Therefore, the Panel concludes that these rules on

[1114] See for example, Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

accrual and calculation accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4.

Use of presumed IPI tax credits

7.735. The Panel concluded in paragraphs 7.673 to 7.674 above that the rules on the use of presumed IPI tax credits resulting from expenditure in strategic inputs and tools in Brazil, require that such credits be used on the sale of domestically produced vehicles before being used to offset the IPI tax on imported motor vehicles. Additionally, the Panel concluded that there is a quantitative limit on the number of imported vehicles that can benefit from a reduction in the IPI tax through the use of presumed IPI tax credits, specifically 4,800 imported vehicles per calendar year. The Panel concluded that these two aspects of the rules on the use of presumed IPI tax credits result in a differential tax burden on imported motor vehicles *vis-à-vis* like domestic motor vehicles.

7.736. The Panel considers that these aspects of the rules on use of presumed IPI tax credits resulting from expenditure in strategic inputs and tools in Brazil modify the conditions of competition to the detriment of imported motor vehicles and in favour of like domestic motor vehicles. Therefore, the Panel concludes that these aspects of the rules on use of presumed IPI tax credits resulting from expenditure in strategic inputs and tools in Brazil under the INOVAR-AUTO programme accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4.

7.4.2.4.2 The accreditation requirement to perform a minimum number of manufacturing steps in Brazil, in respect of components used in the production of finished motor vehicles

7.737. The complaining parties challenge the accreditation requirement for gaining access to the presumed IPI tax benefits under which a company requesting accreditation as a "domestic manufacturer" must comply with a certain number of manufacturing steps in Brazil.[1115] In the view of the complaining parties, the requirement to comply with these manufacturing steps in Brazil effectively requires that certain components and inputs used in the manufacture of the motor vehicle must have been made or sourced locally.[1116] Thus, in the complaining parties' view, this requirement is effectively a "local content requirement" that requires the use of domestic products over imported products in the manufacture of motor vehicles, in order to gain certain tax benefits, thereby altering the conditions of competition to the detriment of imported products and in favour of like domestic products.[1117]

7.738. If the Panel finds that the alleged requirement to use domestic goods exists, the Panel considers that this will lead *ipso facto* to the further finding of inconsistency with Article III:4 of the GATT 1994 that the complaining parties claim. This is because, while Article III:4 itself does not refer to such requirements, it is well settled on the basis of a considerable line of jurisprudence that such requirements are inconsistent with Article III:4 by operating to the disadvantage of imported products, including where the use of domestic goods is only one of the options for complying with the requirements of a law or regulation (or for obtaining an advantage).[1118]

7.739. In addition, such a finding of a requirement to use domestic goods, if made, will also constitute a finding by the Panel that the contingency element of the claims under Article 3.1(b) of the SCM Agreement has been satisfied, i.e., that to the extent the programmes provide subsidies, any such subsidies would be contingent on the use of domestic over imported goods.

[1115] European Union's first written submission, para. 399; Japan's first written submission, para. 239.

[1116] European Union's first written submission, para. 399; Japan's first written submission, paras. 243-244.

[1117] European Union's first written submission, para. 399; Japan's first written submission, paras. 243-244.

[1118] See e.g. Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 220, where the Appellate Body held that the local content requirements operated to provide a disincentive to the use of imports, notwithstanding the possibility to obtain the benefits in question without using domestic inputs, and thus constituted less favourable treatment of imports under Article III:4 of the GATT 1994. See also *Canada – FIRA*, where undertakings to purchase goods of Canadian origin and undertakings to buy from Canadian suppliers both were found to be inconsistent with Article III:4. GATT Panel Report, Canada – FIRA, paras. 5.7 – 5.11. See for a similar finding GATT Panel Report, *Italy – Agricultural Machinery,* para. 13.

7.740. In this respect, pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement, and as noted above[1119], subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods are prohibited, and shall not be granted or maintained.[1120]

7.741. The Panel notes that the ordinary meaning of the word "contingent" is "conditional; dependent *on, upon*"[1121], so a subsidy is "contingent upon the use of domestic over imported goods", and thus, prohibited under Article 3.1(b) of the SCM Agreement, if the use of domestic goods is *required* or *necessary* in order to receive the subsidy.[1122]

7.742. If the Panel finds that such requirement to use domestic goods over imported goods exists, it will proceed with the further analysis of whether the INOVAR-AUTO programme provides subsidies. If, however, the Panel finds no requirement to use domestic goods over imported goods, that will dispose of the claims under Article 3.1(b) of the SCM Agreement and the Panel will stop its analysis of those claims at that point.

7.743. The Panel recalls from paragraph 2.122 above that Decree 7,819/2012 requires as a condition of accreditation to be eligible for the presumed IPI tax credits under the INOVAR-AUTO programme, that a company seeking accreditation as a "domestic manufacturer" must comply with a minimum number of defined manufacturing and engineering infrastructure activities specified in the law itself. Such activities must be performed in Brazil either by the accredited company or through third parties, must cover at least 80% of manufactured vehicles, and are subject to a schedule of the minimum number of activities to be performed, which varies by calendar year and type of vehicle manufactured.[1123]

7.744. This schedule is the following:

MINIMUM NUMBER OF MANUFACTURING AND ENGINEERING INFRASTRUCTURE ACTIVITIES TO BE PERFORMED IN BRAZIL[1124]				
Calendar year	Manufacture of passenger cars and light commercial vehicles	Manufacture of trucks	Manufacture of chassis fitted with engines	Manufacture of automobiles in the situation referred to in Article 12 §5(III)[1125]
2013	8	9	7	6
2014	9	10	8	6
2015	9	10	8	7

[1119] See paragraphs 7.259 to 7.261 above.

[1120] Article 3.1 of the SCM Agreement states in relevant parts that: "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: … (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." Article 3.2, in turn, states that "[a] Member shall neither grant nor maintain subsidies referred to in paragraph 1."

[1121] Shorter Oxford English Dictionary (6th ed., 2007)

[1122] Indeed, such an interpretation was confirmed by the Appellate Body in Canada – Autos, where the Appellate Body recalled its discussion of Article 3.1(a) and explained as follows:

> In our discussion of Article 3.1(a) in Section VI of this Report, we recalled that in *Canada – Aircraft* we stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'." Thus, a subsidy is prohibited under Article 3.1(a) if it is "conditional" upon export performance, that is, if it is "dependent for its existence on" export performance. In addition, in *Canada – Aircraft*, we stated that contingency "in law" is demonstrated "on the basis of the words of the relevant legislation, regulation or other legal instrument." (emphasis added) As we have already explained, such conditionality can be derived by necessary implication from the words actually used in the measure. We believe that this legal standard applies not only to "contingency" under Article 3.1(a), but also to "contingency" under Article 3.1(b) of the SCM Agreement. Appellate Body Report, *Canada – Autos*, para. 123.

[1123] See paragraph 2.122 above, referring to Decree 7,819/2012, (Exhibit JE-132), Article 7(I).

[1124] Decree 7,819/2012, (Exhibit JE-132), Article 7(I), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

[1125] Manufacture of automobiles by companies established in Brazil, that become accredited as domestic manufacturers, with an investment project relating to the installation of a single factory of vehicles classified in the tariff codes listed in Annex XIII of Decree 7,819/2012, whose maximum annual production capacity is 35,000 units and whose specific investments reach at least R$17,000 real. See Decree 7,819/2012, (Exhibit JE-132), Article 12 §5(III), as amended by Decree 8,015/2013, (Exhibit JE-133), Article 1.

2016	10	11	9	7
2017	10	11	9	8

7.745. The legal instruments specify the following manufacturing and engineering infrastructure activities performed in Brazil which can be used to satisfy the accreditation requirement for each specific type of vehicle:

MANUFACTURING AND ENGINEERING INFRASTRUCTURE ACTIVITIES THAT CAN BE PERFORMED IN BRAZIL TO SATISFY THE ACCREDITATION REQUIREMENT[1126]		
Manufacture of passenger cars and light commercial vehicles	Manufacture of trucks	Manufacture of chassis fitted with engines
Moulding	Moulding	N/A
Welding	Welding	Welding
Anti-corrosion treatment and painting	Anti-corrosion treatment and painting	Anti-corrosion treatment and painting
Plastic injection	Plastic injection	Plastic injection
Engine manufacture	Engine manufacture	Engine manufacture
Gearbox and transmission manufacture	Gearbox and transmission manufacture	Gearbox and transmission manufacture
Steering and suspension system manufacture	Steering and suspension system manufacture	Steering and suspension system manufacture
Electrical system assembly	Electrical system assembly	Electrical system assembly
Braking and axle systems assembly	Braking and axle systems assembly	Braking and axle systems assembly
Assembly, final inspection and compatibility tests	Assembly, final inspection and compatibility tests	Assembly, final inspection and compatibility tests
Manufacture of self-supporting body or assembly of chassis	Chassis and bodywork assembly	Chassis assembly
N/A	Final assembly of cabins or bodywork; installation of acoustic and heat insulation, carpets and finishing	N/A
N/A	Production of bodywork primarily from spare parts moulded in the region	N/A
Own laboratory infrastructure for product development and testing	Own laboratory infrastructure for product development and testing	Own laboratory infrastructure for product development and testing

7.746. The Panel recalls that in general these steps can be performed by the accredited motor vehicle manufacturer itself, or by third parties.[1127] Furthermore, based on their descriptions in the relevant legal instruments, in the view of the Panel, the performance of *certain* of these production-steps will result in the creation, in Brazil, of components or subassemblies that must be incorporated into at least 80% of finished motor vehicles manufactured by the company in order for that company to be accredited to receive certain tax benefits on the sale or transfer of a finished motor vehicle manufactured by that company, including: moulding; plastic injection; engine manufacture; gearbox and transmission manufacture; steering and suspension system manufacture; electrical system assembly; braking and axle systems assembly; manufacture of self-supporting body or assembly of chassis; chassis and bodywork assembly; chassis assembly; production of bodywork primarily from spare parts moulded in the region; and final assembly of cabins or bodywork, and potentially some of the other steps.[1128]

[1126] In respect of automobiles in the situation referred to in Article 12 §5(III) the Panel notes that such vehicles would still fit within one of the three basic categories, namely passenger cars and light commercial vehicles, trucks, or chassis fitted with engines. The only difference in respect of that particular category of motor vehicles is that they are subject to a different *number* of requirements.

[1127] Decree 7,819/2012 explicitly states that the relevant manufacturing and engineering infrastructure activities (which must be performed in Brazil to qualify under the accreditation requirements) must be performed either by the accredited company *or through third parties*. See paragraph 2.122 above.

[1128] Decree 7,819/2012, (Exhibit JE-132), Article 7(I).

7.747. The Panel recalls its analysis in paragraphs 7.290 to 7.302 and 7.307 to 7.313 above of the "outsourcing" scenario in the context of the ICT programmes. In the view of the Panel, these production step requirements under the INOVAR-AUTO programme operate in an analogous manner, and thus the same sort of analysis pursuant to Article III:4 of the GATT 1994 is applicable. First, for the same reasons explained above at paragraphs 7.290 to 7.295 and 7.299, in the view of the Panel, the components and subassemblies that are produced in the various production steps discussed in the previous paragraph are Brazilian domestic products. Second, in the cases where these production steps are outsourced, the only way that the accredited manufacturer can qualify for the tax benefits is by outsourcing to a Brazilian producer of the components or subassemblies in question. If instead it acquired and used imported components and subassemblies, it would not meet the conditions of accreditation and thus would not qualify for the tax benefits.[1129]

7.748. Thus, in the outsourcing scenario, the production step requirements under the INOVAR-AUTO programme require the use of domestic goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

7.749. For the same reasons as explained in respect of the ICT programme, having made this finding, the Panel does not need to consider whether under the "in-house" scenario the production step requirements also would constitute a requirement to use domestic goods.

7.750. Additionally, for the reasons described in paragraphs 7.303 to 7.304 above, the Panel does not consider that the existence of an alternative option for compliance, that may be WTO-consistent, alters the fact that the option that requires the use of domestic over imported goods is inconsistent with Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement.

7.751. Therefore, in the view of the Panel, with respect to the outsourcing provisions, the aspect of the accreditation requirements for domestic manufacturers that requires compliance with a minimum number of manufacturing steps in Brazil results in a requirement to use domestic over imported goods in the sense covered by Article III:4 of the GATT 1994 and Article 3.1(b) of the SCM Agreement. The Panel therefore concludes that this aspect of the INOVAR-AUTO programme is inconsistent with Article III:4 of the GATT 1994.

7.4.2.4.3 Rules on accrual of presumed IPI tax credits, in respect of strategic inputs and tools used in the production of finished motor vehicles

7.752. The complaining parties argue that the rules governing accrual of presumed IPI tax credits contain local content requirements in terms of purchases of strategic inputs and tools which must contain minimum percentages of domestic content, i.e. sourced in Brazil, in order for those inputs and tools be deemed "national" and result in the accrual of a tax credit.[1130] The complaining parties highlight firstly that on the face of the relevant law, expenditure on strategic inputs and tools in order to gain IPI tax credits requires that such expenditures be made on strategic inputs and tools of Brazilian origin.[1131] Secondly, the complaining parties explain that under the terms of an Implementing Order implementing the INOVAR-AUTO programme, "the value of expenditures on strategic inputs and tooling is offset by a 'deductible portion' that includes the value of imported sub-components, the value of sub-components with 0% Brazilian-origin content, and 50% of the value of sub-components with 30% to 60% of Brazilian-origin content."[1132]

7.753. The Panel notes as an initial matter that the term "strategic inputs" is defined as "raw materials, parts and components used in the manufacture of, and physically incorporated in" the finished motor vehicles that can receive certain tax benefits[1133], and "tools" or "tooling" is defined

[1129] Decree 7,819/2012, (Exhibit JE-132), Article 14-A, as amended by Decree No. 8,924/2014, (Exhibit JE-134), Article 1.

[1130] European Union's first written submission, para. 400; Japan's first written submission, paras. 240 and 243.

[1131] European Union's first written submission, para. 400; Japan's first written submission, paras. 240 and 243.

[1132] Japan's first written submission, para. 240. See also European Union's first written submission, para. 400; and Japan's first written submission, para. 243.

[1133] Implementing Order 257/2014, (Exhibit JE-158), Article 1.

as "specific tools for each type of part, linked to a machine and used to stamp or inject automotive parts intended for the manufacturing process" of those finished motor vehicles.[1134]

7.754. Turning to the complaining parties' first argument, that Article 41 of Law 12,715/2012 on its face refers to expenditure in Brazilian strategic inputs and tools and not to imported inputs and tools, the Panel notes that Article 41 of Law 12,715/2012[1135] does state that the presumed IPI credit may be calculated on the basis of "expenditure made in Brazil" or as Japan translates the provision, "expenditures made in the Country". However, the Panel does not consider that this indicates that those strategic inputs and tools must have been *made* in Brazil. In the Panel's view the plain terms of this provision require that certain items must be purchased within the borders of Brazil. However, that *in and of itself* does not imply that the precise products purchased within those borders must be of any particular origin.

7.755. Having said that, the Panel notes Japan's argument that the "'in the Country' requirement is construed to mean that both the buyer and the seller are located in Brazil."[1136] Japan supports this by arguing that this interpretation:

> [I]s confirmed by the explanatory text contained in a past version of Law 12,715/2012, which identified a special case where expenditures on imported goods/services were "deemed" to be carried out "in the Country". Specifically, the former Article 40 § 5-A stated that certain expenditures on imported software, equipment and replacement parts would be "deemed" (*considerados*) to have been carried out "in the Country" if there were no national items similar to the imported ones, and provided that they were used in laboratories. The existence of this provision in the previous version of the law suggests that only expenditures on specified kinds of imported inputs could be exceptionally considered as being made "in the Country" under certain prescribed circumstances, and the general rule was rather that expenditures on imported inputs are excluded from the expenditures "in the Country". A for[t]iori, the absence of any language setting out similar exceptions in the current text of Article 41 of Law 12,715, Article 12 of Decree 7,819, and other provisions governing the expenditures that result in the accrual of IPI tax credits, confirms that the phrase expenditures carried out "in the Country" in that Article should be interpreted as excluding expenditures on imported goods/services.[1137]

7.756. The Panel agrees with Japan that its interpretation of the previous iteration of the law is logical. However, the Panel does not consider that this is determinative of the *present* meaning of the law. In particular, the fact that the law *changed* must be meaningful. Indeed, contrary to Japan's proposed interpretation, the Panel considers that the absence of exceptions in the new version of the law tends to suggest that Article 41 does *not* in and of itself exclude the purchase of imported goods from eligibility for calculation of presumed IPI tax credits. The only requirement that Article 41 indicates on its face is that the purchase *must* occur within Brazilian borders.

7.757. The European Union also refers to a magazine article in support of its interpretation of Article 41.[1138] However, the Panel does not consider this magazine article to be particularly relevant in the context of interpreting Article 41 of Law 12,715/2012. The Panel considers that in light of the explicit change in the wording of the law, as identified by Japan, and considering the minimal evidence provided by the complaining parties, Article 41 of Law 12,715/2012 does not on its face indicate that only expenditure on *Brazilian* inputs and tools counts towards the accrual of IPI tax credits.

7.758. Turning to the second argument by the complaining parties, the Panel recalls that, as noted in paragraphs 2.126 to 2.127, as of 1 October 2014, the calculation of the presumed IPI tax credit accrued from expenditure on strategic inputs and tools in Brazil incorporates a new element introduced by Implementing Order MDIC 257/2014: the deductible part. The deductible part is the

[1134] Implementing Order 257/2014, (Exhibit JE-158), Article 2.

[1135] See also Decree 7,819/2012 (Exhibit JE-132), Article 12, as amended by Decree No. 8,924/2014, (Exhibit JE-134), Article 1.

[1136] Japan's first written submission, para. 141.

[1137] Japan's first written submission, para. 141 (referring to Law 12,715/2012, (Exhibit JE-95), Article 40 § 5-A, as amended by Law 12,996/2014). (footnotes omitted)

[1138] European Union's first written submission, fn 260.

sum of the value of imported inputs by Tier 1 and Tier 2 suppliers. Implementing Order MDIC 257/2014 establishes a traceability system whereby suppliers of strategic inputs and tools to accredited companies (Tier 1) (and their direct suppliers, i.e. Tier 2) are required to provide information to the purchasing accredited companies on the value and characteristics of the products supplied. Suppliers shall indicate not just the value of the invoices but also the value of the deductible part. This deductible part shall be deducted from the total value of expenditure on strategic inputs and tools made in Brazil, which constitutes the base to calculate the presumed IPI tax credit. The accredited companies will use this information when filing their tax returns.

7.759. The calculation of the deductible part differs depending on whether it is a Tier 1 or a Tier 2 automotive supplier. The deductible part of Tier 2 inputs is calculated based on the Tax Situation Codes (CST) indicated in the tax invoices issued to Tier 1 suppliers. If the CST indicated in the tax invoice is 1, 2, 6, 7 or 8, then 100% of the value is deducted from the expenditure used to calculate the presumed IPI tax credit. If the CST is 3 or 4, 50% of the value is deducted from the expenditure used to calculate the presumed IPI tax credit. If the CST is 0 or 5, no deduction is applied and 100% of the expenditure incurred counts towards calculating the presumed IPI tax credit. The deductible part of Tier 1 inputs is the actual value of direct imports (Cost, Insurance & Freight (CIF) value) plus the import tax (II) plus the Tier 2 deductible part (i.e. imported content).

7.760. Regarding expenditure made in Brazil (referred to as "made in the country" in the legal instruments) on research; technological development; technological innovation; and payments to the FNDCT, the presumed credit shall correspond to 50% of the expenditure, limited to 2% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit.

7.761. Regarding expenditure made in Brazil ("made in the country") on payments to the FNDCT pursuant to the specific legal instruments; capacity-building of suppliers; and engineering and basic industrial technology; the presumed credit shall correspond to 50% of the expenditure which exceeds 0.75%, up to a limit of 2.75% of the total gross proceeds from sales of goods and services of the second month prior to the calculation of the credit.

7.762. Expenditure on the acquisition of software, equipment and spare parts will be considered to be expenditure "made in the country" provided that the software, equipment and spare parts are used in the laboratories indicated in the Terms of Commitment.

7.763. The Panel further notes that in order to effectuate the deductible part, Brazil has also adopted a traceability system.[1139] Indeed, the Panel considers that the evidence presented by the complaining parties in respect of this traceability and monitoring system of products purchased for the purposes of calculating the presumed IPI tax credits does indeed suggest that the origin of the products is determinative of the amount of the deductible part and, consequently, the amount of the presumed IPI tax credit.

7.764. Additionally, the Panel notes that Brazil itself concedes that aspects of its rules on calculation of the presumed IPI tax credits may incentivise the purchase of domestic products over like imported products, and that Brazil even provides a policy justification as to *why* such incentives are in place. Brazil explains that "INOVAR-AUTO, through the method of calculation and use of presumed IPI credits, may favour certain domestic strategic inputs and machinery in order to ensure the effective supply and development of a domestic auto parts industry able to provide environmentally friendly and energy efficient auto parts for vehicles circulating in Brazil."[1140] Brazil argues that such "potential difference is, in any case, justified under paragraphs (b) and (g) of Article XX".[1141]

7.765. Based on its review of this evidence, the Panel considers that the calculation of the deductible part does, by the necessary implication of the wording of the measure, require the use of domestic over imported goods in order to accrue tax credits. As explained in 7.258 above, a requirement to use domestic over imported goods is inconsistent with Article III:4 of the GATT

[1139] See Implementing Order MDIC 113/2013, (Exhibit JE-154). See also CLEPA letter, correspondence between car maker and supplier on traceability, 24 February 2014, (Exhibit JE-104); and Sindipeças e-mail to members on traceability, 20 January 2014, (Exhibit JE-174).

[1140] Brazil's first written submission, para. 483 (DS497).

[1141] Brazil's first written submission, para. 483 (DS497).

1994. The Panel therefore concludes that this aspect of the INOVAR-AUTO programme is inconsistent with Article III:4 of the GATT 1994. Also, for the reasons indicated above in paragraph 7.259 to 7.262, the Panel considers that a finding of a requirement to use domestic goods also constitutes a finding by the Panel that the contingency element of the claims under Article 3.1(b) of the SCM Agreement has been satisfied.

7.4.2.4.4 The accreditation requirements to invest in R&D in Brazil and make expenditure in engineering, basic industrial technology and capacity-building of suppliers in Brazil, in respect of laboratory equipment used in performing R&D in Brazil

7.766. The European Union considers that one aspect of the rules on accreditation in order to receive presumed IPI tax credits contains an "explicit local content condition", requiring the use of Brazilian laboratory equipment as part of the purchases of strategic inputs and tools to be used in the required R&D activities, thus altering the conditions of competition for imported laboratory equipment in favour of domestic laboratory equipment, inconsistently with Article III:4 of the GATT 1994.[1142] Japan has not challenged this particular aspect of the INOVAR-AUTO programme.[1143]

7.767. The Panel recalls that in order to obtain accreditation under the INOVAR-AUTO programme, a company seeking accreditation must make expenditures on R&D activities, engineering, technology or capacity-building of suppliers, in Brazil.[1144] Additionally, the particular provision of the INOVAR-AUTO programme referred to by the European Union states that:

> [T]he following shall be regarded as product and process research and development (R&D) activities in Brazil: … V – design, planning, construction or modernisation of laboratories and infrastructure for their operation, and acquisition of national equipment, services and spare parts needed to carry out the activities set out in this paragraph.[1145]

7.768. The European Union also refers to the following provision with respect to expenditure in engineering, basic industrial technology and capacity-building of suppliers in Brazil:

> For the purposes of this Implementing Order, the following shall be regarded as product and process engineering, basic industrial technology activities and capacity-building of suppliers in Brazil: … V - design, planning, construction or modernisation of laboratories, applied research centres, test tracks and infrastructure for their operation, and acquisition of national equipment, services and spare parts needed to carry out the activities set out in subparagraph I, among others; VI - design, planning, construction or modernisation of laboratories, applied research centres and test tracks, in addition to all infrastructure for their operation, and acquisition of national equipment, services and spare parts needed to carry out the activities set out in subparagraph II.[1146]

7.769. In the view of the Panel, by the necessary implication of these provisions, the option to purchase "national" equipment and spare parts in order to satisfy the accreditation requirements for the INOVAR-AUTO programme, functions as a requirement to purchase Brazilian equipment and spare parts. In other words, purchasing like imported equipment and spare parts could not satisfy this requirement in order to be taken into account in calculating the amounts required to be invested and spent on R&D in Brazil.

7.770. Based on its review of this evidence, the Panel considers that the accreditation requirements to invest in R&D in Brazil and make expenditure in engineering, basic industrial technology and capacity-building of suppliers in Brazil, in respect of laboratory equipment used in performing R&D in Brazil, by the necessary implication of the wording of the measure, require the use of domestic over imported goods in order to be accredited and obtain the tax benefits. As

[1142] European Union's first written submission, para. 372. See also European Union's first written submission, para. 435 and fn 354; European Union's second written submission, paras. 90 and 186.

[1143] See footnote 1087 above.

[1144] This requirement is not compulsory for companies seeking accreditation as domestic manufacturers. See paragraph 2.115 above.

[1145] Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1 §1 (1)(V).

[1146] Implementing Order MCTI/MDIC 772/2013, (Exhibit JE-175), Article 1, §5(V)-(VI).

explained in paragraph 7.258 above, a requirement to use domestic over imported goods is inconsistent with Article III:4 of the GATT 1994. The Panel therefore concludes that the INOVAR-AUTO programme is inconsistent with Article III:4 of the GATT 1994. Also, for the reasons indicated above in paragraphs 7.259 to 7.260 above, the Panel considers that a finding of a requirement to use domestic goods also constitutes a finding by the Panel that the contingency element of the claims under Article 3.1(b) of the SCM Agreement has been satisfied. The Panel recalls its view, as stated in paragraph 7.258 above, that if a particular option to comply with a certain requirement alters the conditions of competition to the detriment of imported products and in favour of like domestic products, then that requirement is inconsistent with Article III:4 of the GATT 1994, notwithstanding the existence of alternative options that may be WTO-consistent.[1147]

7.771. The Panel therefore concludes that this aspect of the INOVAR-AUTO programme is inconsistent with Article III:4, because the accreditation requirements to invest in R&D in Brazil, and make expenditure in engineering, basic industrial technology and capacity-building of suppliers in Brazil, in respect of laboratory equipment, accord treatment less favourable to imported products than that accorded to like domestic products.

7.4.2.5 Conclusion

7.772. In light of the foregoing, the Panel concludes that under the INOVAR-AUTO programme, the conditions for accreditation in order to receive presumed tax credits, rules on accrual of presumed tax credits, and rules on use of presumed tax credits resulting from expenditure in strategic inputs and tools in Brazil accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994.

7.773. Additionally, the Panel concludes that (a) the accreditation requirement to perform a minimum number of manufacturing steps in Brazil; (b) the rules on accrual of presumed tax credits, with respect to purchases of strategic inputs an tools; and (c) that aspect of the accreditation requirements in respect of expenditure and investment in R&D in Brazil, pertaining to the purchase of Brazilian laboratory equipment; accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994. The Panel further concludes that these same three aspects of the INOVAR-AUTO programme give rise to contingency on the use of domestic over imported goods in the sense of Article 3.1(b) of the SCM Agreement. The Panel will incorporate this finding in its analysis of the claims under that provision.

7.4.3 Claims under Article III:5 of the GATT 1994

7.4.3.1 Introduction

7.774. The European Union and Japan present claims under both the first and second sentence of Article III:5 of the GATT 1994.

7.775. The Panel recalls that, as one of the requirements to be accredited under the INOVAR-AUTO programme, companies must perform a minimum number of defined manufacturing and engineering infrastructure activities in Brazil.[1148]

7.776. The Panel also recalls that accredited companies can earn more presumed IPI tax credits if they purchase automotive strategic inputs and tools with a higher level of local content than if they purchase strategic inputs and tools with a low level of local content.[1149]

7.777. The European Union and Japan submit that the INOVAR-AUTO programme is inconsistent with Article III:5, first sentence, of the GATT 1994, because the requirements (a) to perform a minimum number of processing activities or manufacturing steps in Brazil, and (b) to use domestically produced automotive components and equipment, in order to earn IPI tax credits, amount to an internal quantitative regulation relating to the processing or use of products, which

[1147] See paragraphs 7.258 and 7.303, and footnote 648 above.
[1148] See paragraph 2.115 above.
[1149] See paragraphs 2.126 to 2.127 above.

requires a specified amount or proportion of the products to be supplied from domestic sources.[1150]

7.778. The European Union and Japan submit that the INOVAR-AUTO programme is also inconsistent with Article III:5, second sentence, because, in any event, the above described requirements amount to an internal quantitative regulation that is applied so as to afford protection to domestic production.[1151]

7.779. Brazil submits that the production step requirements programmes do not establish requirements relating to products within the meaning of Article III:5 of the GATT 1994. Brazil submits that the production-step requirements are related to workforce and technology and not to the mixture, processing or use of products in specified amounts or proportions. Brazil also argues that the production-step requirements do not establish an obligation to source goods domestically, as they only require that certain stages of production be performed in Brazil. Brazil submits, as well, that the INOVAR-AUTO programme is not designed, structured or applied so as to afford protection to domestic production.[1152]

7.780. Brazil also submits that the tax credits associated with expenditures on inputs are outside the scope of Article III:5 of the GATT 1994 because there is no obligation regarding the "mixture, processing or use" of these inputs, but rather, they can be more closely associated to purchase obligations.[1153]

7.4.3.2 The legal standard

7.781. The Panel refers to the legal framework developed in section 7.3.3.2 above.

7.4.3.3 Analysis by the Panel

7.782. The Panel has already dealt with both the conditions to perform a minimum number of processing activities or manufacturing steps in Brazil, and to purchase domestically produced automotive strategic inputs and tools in order to earn IPI tax credits, in the context of the complaining parties' claims under Article III:4 of the GATT 1994.[1154]

7.783. The Panel has concluded, in paragraphs 7.751 and 7.765 above, that the conditions to perform a minimum number of processing activities or manufacturing steps in Brazil, and to use domestically produced automotive components and equipment, in order to earn presumed IPI tax credits, are inconsistent with Article III:4, as they accord less favourable treatment to imported products (inputs in the production of incentivized goods) than that accorded to domestic like products.

7.784. Given the fact that the Panel has already dealt with the two conditions, in the context of its analysis under Article III:4 of the GATT 1994, the Panel will assess whether it is appropriate to apply the principle of judicial economy in the context of the claims under Article III:5 of the GATT 1994.

7.785. In this respect, the Panel recalls the arguments of the European Union, Japan, and Brazil regarding whether the Panel should make findings on Article III:5 in addition to its findings on Article III:4, as described in section 7.3.3.3 above.

7.786. As explained in paragraphs 7.177 to 7.179 above, panels are not obliged to rule on each of the claims put forth by the complaining parties. Panels have the discretion to exercise the principle of judicial economy and assess only the claims that they consider necessary to secure a positive solution to a dispute.

[1150] European Union's first written submission, paras. 408-418; and Japan's first written submission, paras. 248-251.

[1151] European Union's first written submission, paras. 419-433; and Japan's first written submission, para. 252.

[1152] Brazil's first written submissions, paras. 591-594 (DS472) and 525-527 (DS497).

[1153] Brazil's first written submissions, paras. 595 (DS472) and 528 (DS497).

[1154] See sections 7.4.2.4.2 and 7.4.2.4.3 above.

7.787. The Panel notes that the specific features challenged under Article III:5 of the GATT 1994 (namely the conditions to perform a minimum number of processing activities or manufacturing steps in Brazil, and to use domestically produced automotive components and equipment, in order to earn IPI tax credits) were also specifically challenged by the complaining parties in their claims under Article III:4 of the GATT 1994.

7.788. The Panel recalls that it assessed the exact same features under Article III:4 of the GATT 1994 and found, in 7.4.2.4.2 and 7.4.2.4.3 above, that those features were inconsistent with Article III:4 of the GATT 1994. The Panel sees no difference in the features covered by the complaining parties in their claims under Article III:4 and the features covered by the complaining parties in their claims under Article III:5 of the GATT 1994.

7.789. The Panel is fully aware of its task of securing a positive solution to this dispute. However, the Panel sees no reason why it would need to assess two claims under two different provisions of Article III of the GATT of 1994, covering the same features of the INOVAR-AUTO programme, in order to secure a positive solution to the dispute. This is because the same aspects that lead to the finding of inconsistency with Article III:4 of the GATT 1994 (specifically the finding of discrimination against imported inputs through the imposition of local content requirements), are the same aspects that the complaining parties allege to be inconsistent with Article III:5 of the GATT 1994.

7.790. Even if Article III:5 of the GATT 1994 has a more precise meaning and refers to local content requirements when regulating the processing of products internally, in the context of this dispute, the complaining parties have framed their claims under Article III:4 and III:5 of the GATT 1994 in such a way so as to cover the exact same features.

7.791. As the Panel concluded with respect to the complaining parties' claims under Article III:5 for the ICT programmes, the Panel considers that, in the specific context of this dispute, if Brazil brings the aspects of the INOVAR-AUTO programme found to be inconsistent with Article III:4 of the GATT 1994 into conformity, it will also bring its measures into conformity with Article III:5 of the GATT 1994.[1155] In particular, the *reasons* for the alleged inconsistency in respect of Article III:5 are, in the Panel's view, fully resolved by the Panel's findings in respect of Article III:4. In this respect the Panel also emphasizes that all factual findings relevant to an assessment of the complaining parties' claims under Article III:5 have already been made in respect of the complaining parties' claims under Article III:4.

7.4.3.4 Conclusion

7.792. The Panel concludes that it is not necessary to make findings with respect to the complaining parties' claims under Article III:5 of the GATT 1994 in order to secure a positive solution to this dispute, and therefore exercises judicial economy with respect to these claims.

7.4.4 Claims under Article 2.1 of the TRIMs Agreement

7.4.4.1 Introduction

7.793. The complaining parties contend that the INOVAR-AUTO programme is inconsistent with Article 2.1 of the TRIMs Agreement, both independently and in conjunction with Article 2.2 and paragraph 1(a) of the Agreement's Illustrative List, because it is inconsistent with Article III of the GATT 1994.[1156] The complaining parties claim that the INOVAR-AUTO programme constitutes a trade-related investment measure and is therefore within the scope of the TRIMs Agreement. The complaining parties further submit that the INOVAR-AUTO programme is inconsistent with Article III:2, III:4 and III:5 of the GATT 1994. Therefore, in their view, the INOVAR-AUTO programme also violates Article 2.1 of the TRIMs Agreement.[1157]

[1155] See paragraph 7.347 above.

[1156] European Union's first written submission, paras. 435-451; Japan's first written submission, paras. 253-266.

[1157] European Union's first written submission, paras. 445-446; Japan's first written submission, para. 262.

7.794. Finally, the complaining parties contend that the INOVAR-AUTO programme is a TRIM that falls under paragraph 1(a) of the Annex to the TRIMs Agreement because it requires that accredited companies purchase or use products of domestic origin or from domestic sources in terms of particular inputs or a proportion of volume of its local production in order to obtain IPI tax reductions.[1158]

7.795. Brazil agrees with the complaining parties that the INOVAR-AUTO programme is an investment measure. However, it submits that it does not relate to trade in goods because it deals with research, development and production.[1159] Brazil submits that the INOVAR-AUTO programme falls outside the scope of Article III of the GATT 1994 by virtue of Article III:8(b) of the GATT 1994 and, therefore, does not violate either the GATT 1994 or the TRIMs Agreement.[1160]

7.796. With respect to Brazil's arguments that the INOVAR-AUTO programme is outside the scope of Article III of the GATT 1994, because they relate to pre-market requirements rather products, and additionally by virtue of Article III:8(b) of the GATT, the Panel has addressed both of these arguments above in sections 7.2.1 and 7.2.2 above and found that the challenged measures are not excluded from the disciplines of Article III.

7.797. The Panel notes that Article 2.1 of the TRIMs Agreement states as follows:

> Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.

7.798. The Panel in *Indonesia – Autos* indicated that two elements must be shown in order to demonstrate inconsistency with Article 2.1: first, that the challenged measure is a TRIM; second, that the TRIM is inconsistent with Article III or Article XI of GATT."[1161] Additionally, the Panel in *Canada – Renewable Energy / Canada – Feed-in Tariff Program* indicated that Article 2.1 of the TRIMs Agreement imposes an obligation on Members not to apply any TRIM that is inconsistent with the national treatment provisions of Article III of the GATT, including Articles III:2, III:4 and III:5. It follows that any measure found to be inconsistent with Article III of the GATT, that is also a TRIM, will be incompatible with Article 2.1 of the TRIMs Agreement.[1162]

7.799. The Panel notes that in order for a measure to be found to be inconsistent with Article 2.1 of the TRIMs Agreement, it must be a trade-related investment measure, within the meaning of the TRIMs Agreement, and it must be found to be inconsistent with Article III of the GATT 1994. The Panel proceeds by assessing these two steps in turn.

7.4.4.2 Whether the INOVAR-AUTO programme is a trade-related investment measure within the meaning of the TRIMs Agreement

7.800. The complaining parties submit that the INOVAR-AUTO programme is a trade-related investment measure for five reasons. First, INOVAR-AUTO contains a clear obligation to invest in R&D and/or engineering and basic industrial technology in the automotive sector in Brazil in order to get accredited. Second, domestic manufacturers seeking accreditation must perform a minimum number of manufacturing activities in Brazil, thereby incentivizing investment and local production. Third, the accreditation requirement relating to investment in design, planning, construction or modernisation of laboratories requires that the equipment, services and spare parts are sourced domestically. Fourth, the rules on accrual and calculation of presumed IPI tax credits provide that the higher the level of domestic content of strategic inputs and tools, the higher the IPI tax credits obtained. Finally, the European Union argues that the local content requirements under INOVAR-AUTO "relate to trade in goods" because they affect motor vehicles marketed in Brazil.[1163]

[1158] European Union's first written submission, paras. 447-449; Japan's first written submission, para. 264.

[1159] Brazil's first written submissions, para. 675 (DS497).

[1160] Brazil's first written submissions, paras. 676-677 (DS497).

[1161] Panel Report, *Indonesia – Autos*, para. 14.64.

[1162] Panel Report, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, para. 7.117.

[1163] European Union's first written submission, paras. 439 -443; Japan's first written submission, paras. 257-261.

7.801. In the view of the Panel, the INOVAR-AUTO programme affects, and indeed is aimed at promoting, investment. The programmes also have an impact on trade, by affecting the sale and purchase of imported products, including the inputs used in the production of incentivized *finished* and *intermediate* products. In this regard, as noted before, if a measure contains local content requirements, it would necessarily be a "trade-related" measure, because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade.[1164]

7.802. The Panel therefore concludes that the INOVAR-AUTO programme constitutes a trade-related investment measure within the meaning of the TRIMs Agreement.

7.4.4.3 Whether the INOVAR-AUTO programme is a TRIM that is inconsistent with Article III of the GATT 1994, and therefore inconsistent Article 2.1 of the TRIMs Agreement

7.803. In order to make a finding of inconsistency in respect of Article 2.1 of the TRIMs Agreement, the relevant TRIMs must be found to be inconsistent with Article III of the GATT 1994.

7.804. The Panel has found in paragraphs 7.645, 7.688, and 7.772 to 7.773[1165], above that the INOVAR-AUTO programme is inconsistent with Article III:2 and III:4 of the GATT 1994. In light of its finding above that the programmes constitute trade-related investment measures, the Panel therefore considers that those aspects of the INOVAR-AUTO programme found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement.

7.805. Additionally, the Panel notes that the local content requirements identified and discussed in sections 7.4.2.4.2, 7.4.2.4.3, and 7.4.2.4.4 above "require the purchase or use by an enterprise of products of domestic origin or from any domestic source", as referred to in paragraph 1(a) of the Illustrative List annexed to the TRIMs Agreement. Pursuant to Article 2.2 of the TRIMs Agreement, a TRIM on the Illustrative List is *per se* inconsistent with Article III:4 of the GATT 1994, and therefore inconsistent with Article 2.1 of the TRIMs Agreement. This further confirms the Panel's findings above that the local content requirements are inconsistent with Article III:4 (and, as indicated above, consequentially inconsistent with Article 2.1 of the TRIMs Agreement).

7.4.4.4 Conclusion

7.806. In light of the foregoing, the Panel concludes that the INOVAR-AUTO programme constitutes a trade-related investment measure, and that the aspects of the programme found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement.[1166]

7.4.5 Claims under Article 3.1(b) of the SCM Agreement

7.4.5.1 Introduction

7.807. The complaining parties have raised claims under Article 3.1(b) of the SCM Agreement with respect to the INOVAR-AUTO programme.

[1164] Panel Report, *Indonesia – Autos*, para. 14.82.

[1165] As noted in paragraph 7.766 and discussed in footnote 1087 above, Japan does not allege any inconsistency with Article III:4 of the particular aspect of the INOVAR-AUTO programme concerning laboratory equipment purchased for the purposes of the expenditure and investment accreditation requirements, as discussed in section 7.4.2.4.4 above.

[1166] The Panel notes that its finding of inconsistency with Article III:4 of the GATT 1994 in respect of that aspect of accreditation requirements to invest in R&D in Brazil and make expenditure in engineering, basic industrial technology and capacity-building of suppliers in Brazil, concerning laboratory equipment used in performing R&D in Brazil, as discussed in section 7.4.2.4.4 above, is only relevant to the European Union's request for findings (DS472) and not Japan (DS497). See footnotes 1087 and 1165 above. Consequently, the Panel's conclusion of inconsistency with Article 2.1 of the TRIMs Agreement in respect of this particular aspect of the INOVAR-AUTO programme is also limited to the dispute brought by the European Union (DS472) and not Japan (DS497).

7.808. Article 3.1(b) of the SCM Agreement prohibits subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

7.809. The Panel recalls that companies accredited under the INOVAR-AUTO programme are entitled to reductions of the IPI tax due on the sales of certain motor vehicles through presumed IPI tax credits that can be used to fully or partially offset the IPI tax paid, up to 30 percentage points.[1167]

7.810. The European Union and Japan argue that the reductions of the IPI tax due on certain motor vehicles through presumed IPI tax credits granted to accredited companies under the INOVAR-AUTO programme are subsidies within the meaning of the SCM Agreement, as they constitute financial contributions where "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred.[1168]

7.811. The European Union and Japan also argue that the alleged subsidies granted under the INOVAR-AUTO programme are contingent upon the use of domestic over imported goods and are, thus, prohibited under Article 3.1(b) of the SCM Agreement, because: (a) as one of the requirements to be accredited under the INOVAR-AUTO programme, companies must perform a number of specific manufacturing and engineering infrastructure activities in Brazil; (b) the highest amount of presumed credits can only be obtained by purchasing domestic strategic inputs and tools; and (c) if an accredited company chooses to comply with the R&D and technology investment requirements through the setting up or refurbishing of testing laboratories, it should rely on national equipment and spare parts.[1169]

7.812. Brazil states that the INOVAR-AUTO programme qualifies as a production subsidy aiming at promoting the quality of the vehicles and their energy efficiency. Brazil explains that, for that, the Program established a tax regime conceived to offset the cost of compliance incurred by the accredited companies in the implementation of the INOVAR-AUTO programme's goals.[1170]

7.813. Brazil also submits that the INOVAR-AUTO programme does not require, in law or in fact, domestic products to be used and the production-step requirements and investment requirements, do not impose any contingency upon the use of domestic over imported products. Brazil argues that labour, production-step and technology requirements do not affect products and fall outside the scope of both the GATT and Article 3 of the SCM Agreement.[1171]

7.814. Brazil also submits that the tax credits under the INOVAR-AUTO programme accrue from the purchase rather than the use of strategic inputs and tools, regardless of their origin, and that the method for calculating the tax credit is not related to the origin of products, but rather to the level of contribution of the respective expenditure to the programme´s goals.[1172]

7.815. Brazil adds that the generation of credits through the purchase of inputs and tools is only one of various manners of obtaining credits. They can be equally obtained through expenditures on research, development, innovation, payments to the FNDCT, supplier capacity building and engineering.[1173]

7.816. In order to determine whether the reductions through presumed tax credits granted under the INOVAR-AUTO programme are inconsistent with Article 3.1(b) of the SCM Agreement, the Panel must assess:

a. Whether the reductions through presumed tax credits granted under the INOVAR/AUTO programme constitute subsidies, i.e., whether the reductions through presumed tax credits granted under the INOVAR-AUTO programme constitute financial contributions by

[1167] See section 2.2.5.2 above.
[1168] European Union's first written submission, paras. 454-460; Japan's first written submission, paras. 268-271.
[1169] European Union's first written submission, paras. 461-465; Japan's first written submission, paras. 272-273. The item (c) is only argued by the European Union.
[1170] Brazil's first written submissions, paras. 746-749 (DS472) and paras. 678-681 (DS497).
[1171] Brazil's first written submissions, paras. 750-755 (DS472) and paras. 682-689 (DS497).
[1172] Brazil's first written submissions, paras. 750-755 (DS472) and paras. 682-689 (DS497).
[1173] Brazil's first written submissions, paras. 750-755 (DS472) and paras. 682-689 (DS497).

the Brazilian Government, in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred; and

b. Whether any such subsidies are contingent upon the use of domestic over imported goods and thus prohibited.[1174]

7.4.5.2 Whether the reductions through presumed tax credits granted under the INOVAR-AUTO programme are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement, and thus prohibited

7.817. The Panel recalls that the European Union and Japan argue that the subsidies granted under the INOVAR-AUTO programme are contingent upon the use of domestic over imported goods and are, thus, prohibited under Article 3.1(b) of the SCM Agreement, because: (a) as one of the requirements to be accredited under the INOVAR-AUTO programme, companies must perform a number of specific manufacturing and engineering infrastructure activities in Brazil; (b) the highest amount of presumed credits can only be obtained by purchasing domestic strategic inputs and tools; and (c) if an accredited company chooses to comply with the R&D and technology investment requirements through the setting up or refurbishing of testing laboratories, it should rely on national equipment and spare parts.[1175]

7.818. Brazil submits that the INOVAR-AUTO programme does not require, in law or in fact, domestic products to be used and the production-step requirements and investment requirements, do not impose any contingency upon the use of domestic over imported products. Brazil argues that labour, production-step and technology requirements do not affect products and fall outside the scope of both the GATT and Article 3.1(b) of the SCM Agreement.[1176]

7.819. Brazil also submits that the tax credits under the INOVAR-AUTO programme accrue from the purchase rather than the use of strategic inputs and tools, regardless of their origin and that the method for calculating the tax credit is not related to the origin of products, but rather to the level of contribution of the respective expenditure to the programme´s goals.[1177]

7.820. Brazil adds that the generation of credits through the purchase of inputs and tools is only one of various manners of obtaining credits. They can be equally obtained through expenditures on research, development, innovation, payments to the FNDCT, supplier capacity building and engineering.[1178]

7.821. Article 3 of the SCM Agreement states in relevant parts that:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> …
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.
>
> 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

7.822. Thus, pursuant to Articles 3.1(b) and 3.2 of the SCM Agreement, subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods are prohibited, and shall not be granted or maintained. The ordinary meaning of the word

[1174] As explained in paragraphs 7.497 to 7.498 above, pursuant to Article 2.3 of the SCM Agreement, consideration of the question of contingency also will address whether the subsidies are specific in the sense argued by the complaining parties. (The complaining parties make no claims or arguments in respect of any other mode of specificity.)

[1175] European Union's first written submission, paras. 461-465; Japan's first written submission, paras. 272-273. The item (c) is only argued by the European Union.

[1176] Brazil's first written submissions, paras. 750-755 (DS472) and paras. 682-689 (DS497).

[1177] Brazil's first written submissions, paras. 750-755 (DS472) and paras. 682-689 (DS497).

[1178] Brazil's first written submissions, paras. 750-755 (DS472) and paras. 682-689 (DS497).

"contingent" is "conditional: dependent *on, upon*"[1179], so a subsidy is "contingent upon the use of domestic over imported goods", and thus, prohibited under Article 3.1(b) of the SCM Agreement, if the use of domestic goods is *required* or *necessary* in order to receive the subsidy.[1180]

7.823. The Panel recalls its finding in paragraph 7.751 above that the accreditation requirement to perform a number of specific manufacturing and engineering infrastructure activities in Brazil constitutes a requirement to use domestic over imported goods to be eligible for the tax benefits under the programme, and thus, entails a contingency upon the use of domestic over imported goods.

7.824. The Panel also recalls its finding in paragraph 7.765 above that the calculation of the deductible part for the rules on accrual of presumed IPI tax credits resulting from expenditure in strategic inputs and tools requires the use of domestic over imported goods, and thus, entails a contingency upon the use of domestic over imported goods.

7.825. Finally, the Panel recalls its finding in paragraph 7.771 above that the accreditation requirement to make expenditure and invest in R&D in Brazil, in respect of laboratory equipment used in performing R&D in Brazil, results in a requirement to use domestic over imported goods, and thus, entails a contingency upon the use of domestic over imported goods.

7.826. Thus, if the Panel finds that the tax credits granted under the INOVAR-AUTO programme constitute subsidies within the meaning of the SCM Agreement, it will as a consequence conclude that these subsidies are inconsistent with Article 3.1(b) of the SCM Agreement.

7.4.5.3 Whether the reductions through presumed tax credits granted under the INOVAR-AUTO programme constitute subsidies within the meaning of the SCM Agreement

7.827. The Panel recalls from section 7.3.5.3 above that, pursuant to the relevant part of Article 1 of the SCM Agreement, a subsidy will exist in the case at issue, if:

a. there is a financial contribution by a government, in the form of government revenue otherwise due that is foregone or not collected; and

b. a benefit is thereby conferred.

7.828. With respect to the term financial contribution, the Panel recalls from section 7.3.5.3.1 above that, in order to assess whether "government revenue that is otherwise due is foregone or not collected", the panel must:

a. First, identify the tax treatment that applies to the income of the alleged recipients, considering the objective reasons behind that treatment.

b. Second, identify a benchmark for comparison, i.e. the tax treatment of comparable income of comparably situated taxpayers. This will involve an examination of the structure of the Member's domestic tax regime and its organizing principles.

[1179] Shorter Oxford English Dictionary (6th ed., 2007)

[1180] Indeed, such an interpretation was confirmed by the Appellate Body in Canada – Autos, where the Appellate Body recalled its discussion of Article 3.1(a) and explained as follows:

> In our discussion of Article 3.1(a) in Section VI of this Report, we recalled that in *Canada – Aircraft* we stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'." Thus, a subsidy is prohibited under Article 3.1(a) if it is "conditional" upon export performance, that is, if it is "dependent for its existence on" export performance. In addition, in *Canada – Aircraft*, we stated that contingency "in law" is demonstrated "on the basis of the words of the relevant legislation, regulation or other legal instrument." (emphasis added) As we have already explained, such conditionality can be derived by necessary implication from the words actually used in the measure. We believe that this legal standard applies not only to "contingency" under Article 3.1(a), but also to "contingency" under Article 3.1(b) of the SCM Agreement. Appellate Body Report, *Canada – Autos*, para. 123.

c. Third, compare the challenged tax treatment, and its reasons, with the identified benchmark tax treatment. Such a comparison will enable a panel to determine whether the government is foregoing revenue that is otherwise due in relation to the income of the alleged recipients.[1181]

7.829. With respect to the concept of benefit, the Panel also recalls that in those cases where a financial contribution has been found to exist in the form of the foregoing of revenue otherwise due, the conclusion that a benefit exists has been made with little difficulty because a tax break is essentially a gift from the government, or a waiver of obligations due, and it is clear that the market does not give such gifts.[1182]

7.4.5.3.1 Whether the reductions through presumed tax credits granted under the INOVAR-AUTO programme constitute financial contributions in the form of government revenue that is otherwise due foregone or not collected

7.830. As explained in paragraph 7.828 above, in order to assess whether the presumed tax credits granted under the INOVAR-AUTO programme constitute financial contributions where "government revenue that is otherwise due is foregone or not collected", the Panel needs to respond to the following questions: a) What is the challenged tax treatment that applies to the income of the alleged recipients, and what are the objective reasons behind this treatment? b) What is the benchmark treatment or tax treatment of comparable income of comparably situated taxpayers? And, c) What is the difference between the challenged tax treatment, and its reasons, with the identified benchmark tax treatment?[1183]

7.4.5.3.1.1 The tax treatment that applies to the income of the alleged recipients, and the objective reasons behind this treatment

7.831. As described in paragraph 7.809 above, the tax treatment applicable to accredited companies under the INOVAR-AUTO programme consists of reductions of the IPI tax due on the sales of certain motor vehicles through presumed IPI tax credits that can be used to fully or partially offset the IPI tax up to 30 percentage points.

7.832. The Panel recalls that the Appellate Body in *US – Large Civil Aircraft (2nd complaint)* explained that the identification of the tax treatment that applies to the income of the alleged recipients will entail consideration of the objective reasons behind that treatment and, where it involves a change in a Member's tax rules, an assessment of the reasons underlying that change.[1184]

7.833. Interministerial Explanatory Memorandum No 00025/2012 describes the aim of the INOVAR-AUTO programme as follows:

> [The INOVAR-AUTO programme] aims to strengthen the national automotive industry and create impulses [incentives] for an improvement of the technological content of the vehicles produced in the country.
>
> …
>
> The measure will promote the increase of the Brazilian vehicle fleet efficiency and allow the national automotive industry to meet the current production standards of the international automotive industry.[1185]

[1181] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 812-815.

[1182] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 7.169-7.171. See also: Panel Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, fn 509; *US – FSC*, para. 7.103; and *US – FSC (Article 21.5 – EC)*, paras. 8.44-8.48; and Appellate Body Reports, *US – FSC*, para. 140; and *US – FSC (Article 21.5 – EC)*, para. 198.

[1183] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 812-815.

[1184] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 812.

[1185] Interministerial Explanatory Memorandum No. 00025/2012, (Exhibits JE-183 and BRA-51), paras. 44-45.

7.834. The Panel will address below whether these stated reasons affect the comparison between the challenged tax treatment and the benchmark treatment.

7.4.5.3.1.2 The relevant benchmark treatment and the difference between the challenged tax treatment and the identified benchmark tax treatment

7.835. The Panel notes that the challenged tax treatment is a reduction of an economy-wide tax that applies, in principle, to all transactions by all businesses. As explained in detail below, on the basis of the evidence before the Panel and the analytical framework set forth above, the Panel finds that the benchmark to be applied is the economy-wide tax treatment from which the reduction is taken.

The benchmark treatment

7.836. The Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to sales of motor vehicles covered by the INOVAR-AUTO programme by non-accredited companies, i.e. the obligation to pay the full amount of the applicable IPI tax rate due on the sales of non-incentivized motor vehicles. In particular, the accredited and non-accredited companies producing and selling the motor vehicles covered by the INOVAR-AUTO programme are identically situated, except for the fact of accreditation. Brazil has provided no evidence demonstrating any other difference that could explain the differential IPI tax treatment of these products. Thus, the treatment applicable to sales by non-accredited companies of non-incentivized products can be considered the benchmark treatment or normal rule of general application.

Comparison

7.837. The Panel now compares the reductions granted to accredited companies of the IPI tax due on the sales of certain motor vehicles, through presumed IPI tax credits, under the INOVAR-AUTO programme, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to sales by non-accredited companies of non-incentivized products.

7.838. The Panel notes that under the benchmark treatment the non-accredited company selling the non-incentivized motor vehicle will always charge the IPI tax to the company buying the non-incentivized finished product, at the moment of the sale. The non-accredited company selling the non-incentivized product then will remit to the Federal Revenue Service the amount of IPI tax charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. Thus, the Brazilian Government will receive the full amount of IPI tax due from the non-accredited company selling the non-incentivized product.

7.839. In contrast, pursuant to the challenged treatment under the INOVAR-AUTO programme, whereby the tax is reduced, the accredited company selling the incentivized product will only have to remit part of the tax to the Brazilian Government.

7.840. If the Panel compares the challenged treatment, where the Brazilian Government receives only part of the IPI tax that otherwise would have been due, with the benchmark treatment, where the Brazilian Government receives the full amount of IPI tax due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due. Thus, the Panel finds that, with respect to the reductions of the IPI tax due on certain motor vehicles through presumed IPI tax credits that can be used to fully or partially offset the IPI tax, "government revenue that is otherwise due is foregone or not collected". The Panel notes that Brazil does not contest this finding.[1186]

Reasons for the difference in tax treatment

7.841. Finally, with respect to the Panel's obligation to take into consideration the reasons for the difference in tax treatment, the Panel recalls that, according to the relevant Explanatory Memoranda, the stated aim of the INOVAR-AUTO programme is to strengthen the national automotive industry and create incentives for an improvement of the technological content of the vehicles produced in the country, and promote the increase of the Brazilian vehicle fleet efficiency

[1186] Brazil's first written submissions, paras. 746-749 (DS472) and paras. 678-681 (DS497).

and allow the national automotive industry to meet the current production standards of the international automotive industry. The Panel does not see any reason why these alleged reasons could impact the Panel's findings with respect to the comparison between the challenged tax treatment and the benchmark treatment.

7.4.5.3.1.3 Conclusion on whether the tax reductions through presumed tax credits under the INOVAR-AUTO programme constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected"

7.842. In light of the above, the Panel concludes that the reductions of the IPI tax due on certain motor vehicles through presumed IPI tax credits under the INOVAR-AUTO programme constitute financial contributions where "government revenue that is otherwise due is foregone or not collected".

7.4.5.3.2 Whether the financial contributions granted under the INOVAR-AUTO programme confer a benefit

7.843. Several panels have concluded that, whenever there is revenue foregone by the government, a benefit is conferred.[1187] Having concluded that the tax treatments at issue constitute financial contributions where "government revenue that is otherwise due is foregone or not collected", the Panel concludes that the subsidies at issue confer a benefit.

7.844. With respect to the reductions of the IPI tax due on certain motor vehicles through presumed IPI tax credits, it is clear that, by not having to pay the full amount of taxes and contributions concerned, the buyers of the incentivized products are better off with the reductions than in the benchmark scenario of having to pay the full amount of taxes concerned on their purchases on non-incentivized products.

7.4.5.3.3 Conclusion on whether the reductions through presumed tax credits granted under the INOVAR-AUTO programme constitute subsidies within the meaning of Article 1 of the SCM Agreement

7.845. Having concluded that with the tax reductions granted under the INOVAR-AUTO programme, "government revenue that is otherwise due is foregone or not collected" and a benefit is thereby conferred, the Panel concludes that the IPI tax reductions on certain motor vehicles through presumed IPI tax credits constitute subsidies within the meaning of Article 1 of the SCM Agreement.

7.4.5.4 Whether the subsidies granted under the INOVAR-AUTO programme are specific within the meaning of Article 2 of the SCM Agreement

7.846. The Panel refers to the Panel's explanation on the concept of specificity in paragraphs 7.496 to 7.498 above. Based on that explanation, and because the case at issue involves claims of prohibited subsidies, if the Panel concludes, in its analysis below, that the subsidies granted under the INOVAR-AUTO programme are prohibited within the meaning of Article 3.1(b) of the SCM Agreement, the Panel will also be able to conclude *ipso facto* that, pursuant to Article 2.3, the subsidies granted under the INOVAR-AUTO programme are specific and thus subject to the provisions of Part II of the SCM Agreement.

7.4.5.5 Conclusion

7.847. In light of the foregoing, the Panel concludes that the reductions through presumed tax credits granted under the INOVAR-AUTO programme are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon the use of domestic over imported goods within

[1187] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 7.169-7.171. See also: Panel Reports, Canada – Renewable Energy / Canada – Feed-in Tariff Program, fn 509; *US – FSC*, para. 7.103; and *US – FSC (Article 21.5 – EC)*, paras. 8.44-8.48; and Appellate Body Reports, *US – FSC*, para. 140; and *US – FSC (Article 21.5 – EC)*, para. 198.

the meaning of Article 3.1(b) of the SCM Agreement[1188], and thus are prohibited subsidies, inconsistent with Article 3.1(b) and 3.2 of the SCM Agreement.

7.848. As explained in paragraphs 7.501 to 7.507 above, the SCM Agreement leaves policy space for WTO Members – particularly developing Members - to devise WTO consistent programmes to grant subsidies exclusively to their domestic producers, and to foster, through those subsidies, the development of their industries and to pursue other policy goals.

7.4.6 Brazil's invocation of Article XX of the GATT 1994 to justify certain inconsistencies in respect of the INOVAR-AUTO programme

7.4.6.1 Introduction

7.849. In respect of the INOVAR-AUTO programme, Brazil argues there is no inconsistency with any provisions of the GATT 1994 or the TRIMs Agreement. Brazil also argues that, in the event the Panel does make any findings of inconsistency in respect of Article III of the GATT 1994, such inconsistency is nevertheless justified under sub-paragraph (b) of Article XX, which refers to measures "necessary to protect human, animal or plant life or health", and sub-paragraph (g) of Article XX, which refers to measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption".

7.850. Additionally, Brazil argues that in the event the Panel does make any findings of inconsistency under Article 2.1 of the TRIMs Agreement, resulting from findings of inconsistency in respect of Article III of the GATT 1994, since the Article III inconsistencies are justified under Article XX(b) and XX(g), there would be no violation of the TRIMs Agreement.[1189] Brazil has not raised any Article XX defence with regard to alleged inconsistencies with the SCM Agreement.

7.851. As noted above, the Panel recalls the Appellate Body's statements that "the aspects of a measure to be justified under the subparagraphs of Article XX are those that give rise to the finding of inconsistency under the GATT 1994".[1190] The Appellate Body has further clarified in the context of Article XIV of the GATS, governing the general exceptions applicable in the context of GATS, that:

> [I]n order for a panel properly to conduct its assessment under Article XIV of the GATS, it should be clear from the panel's analysis that, with respect to each individual measure, the aspects of the measure addressed are the same as those that gave rise to its earlier finding of inconsistency. This is because a respondent may not justify the inconsistency of a measure by basing its defence on aspects of that measure different from those that were found by the panel to be inconsistent with a provision of the GATS.[1191]

7.852. Therefore the aspects of the INOVAR-AUTO programme to be justified under Article XX(b) and (g) are those that the Panel found to be inconsistent with Article III:2 and III:4 of the GATT 1994.[1192]

7.853. The Panel proceeds by assessing Brazil's affirmative defences under Article XX(b), before turning to its affirmative defence under Article XX(g).

[1188] See paragraphs 7.258 to 7.260 above.

[1189] Brazil's first written submissions, para. 744 (DS472) and para. 676 (DS497).

[1190] Appellate Body Report, *EC – Seal Products*, para. 5.185. Additionally, in *Thailand – Cigarettes (Philippines)*, the Appellate Body observed that:

> [W]hen Article XX(d) is invoked to justify an inconsistency with Article III:4, what must be shown to be "necessary" is the treatment giving rise to the finding of less favourable treatment. Thus, when less favourable treatment is found based on differences in the regulation of imports and of like domestic products, the analysis of an Article XX(d) defence should focus on whether those regulatory differences are "necessary". Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 177.

[1191] Appellate Body Report, *Argentina – Financial Services*, para. 6.169.

[1192] See sections 7.4.1 and 7.4.2 above.

7.4.6.2 Whether the discriminatory aspects of the INOVAR-AUTO programme are justified under Article XX(b) of the GATT 1994

7.4.6.2.1 Description of the legal test

7.854. Article XX(b) of the GATT 1994 provides as follows:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> …
>
> (b) necessary to protect human, animal or plant life or health

7.855. As noted above with respect to Article XX(a), the Appellate Body has explained that:

> [T]he assessment of a claim of justification under Article XX involves a two-tiered analysis in which a measure must first be provisionally justified under one of the subparagraphs of Article XX, before it is subsequently appraised under the chapeau of Article XX.[1193]

7.856. According to the Appellate Body, the burden of proving that a measure is justified under Article XX rests on the party invoking that defence.[1194] Specifically, the party invoking the defence bears the burden of proving not only that a measure is provisionally justified under a subparagraph of Article XX, but that the measure is consistent with the requirements of the chapeau of Article XX.[1195] The Appellate Body has indicated, however, that

> [T]he nature and scope of arguments and evidence required to establish a *prima facie* case will necessarily vary according to the facts of the case, and from measure to measure, provision to provision, and case-to-case. Moreover, these rules and principles of WTO jurisprudence must not be applied in an unduly formalistic or mechanistic fashion, nor inhibit the substantive analysis that must be undertaken by a panel.[1196]

7.857. Article XX of the GATT 1994 therefore involves a two-tiered analysis. First, a panel must assess whether the measure at issue is provisionally justified under the subparagraph of Article XX invoked. Second, if the panel finds that the measure is provisionally justified, it must examine whether the application of the measure satisfies the requirements of the chapeau of Article XX.

7.858. Similarly to the legal standard under Article XX(a) of the GATT 1994, as discussed above, the first step of the analysis requires that a panel examine two elements in order to determine whether a measure is provisionally justified under subparagraph (b) of Article XX: (i) whether the challenged measure addresses the particular interest specified in subparagraph (b) of Article XX, that is, whether the measure is "designed to" protect human life or health, and (ii) whether "there [is] a sufficient nexus between the [challenged] measure and the interest protected", that is, whether the challenged measure is "necessary" to protect human life or health.[1197]

7.859. In order to avoid repetition, the Panel refers to its statements above on the general legal standard in respect of whether a measure is "designed to" protect a particular interest.[1198] However, the Panel notes that in the specific case of subparagraph (b) of Article XX, which deals with the protection of human, animal and plant life or health, past panels and the Appellate Body

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[1193] Appellate Body Report, *EC – Seal Products*, para. 5.169. (footnotes omitted) See also footnote 871 above.

[1194] Appellate Body Report, *US – Gasoline*, pp. 22-23, DSR 1996:I, 3, at p. 21-23.

[1195] Appellate Body Report, *US – Gasoline*, pp. 22-23, DSR 1996:I, 3, at p. 21-23.

[1196] Appellate Body Report, *US – Tuna II (Article 21.5 - Mexico)*, para. 7.33.

[1197] Appellate Body Report, *Colombia – Textiles*, para. 5.67.

[1198] See paragraphs 7.518 and 7.522 to 7.523 above.

have explained that the existence of a risk to human, animal or plant life or health must be determined in the first place.[1199] In this regard, the Appellate Body recalled that a panel "enjoy[s] a margin of discretion in assessing the value of the evidence, and the weight to be ascribed to that evidence", including the use of experts.[1200] Once that risk is found to exist, the second step is to examine whether the policy underlying the measure aims to reduce such risk. In this connection, it is clearly established that Members have the right to determine the level of protection that they deem appropriate.[1201]

7.860. Once a measure is found to be "designed to" protect human, animal or plant life or health", a panel must determine whether the measure is "necessary" to achieve that objective. In order to avoid repetition, the Panel refers to its statements above on the general legal standard in respect of whether a measure is "necessary to" protect a particular interest.[1202]

7.861. In the event that the Panel finds the challenged measure to be provisionally justified under subparagraph (b) of Article XX of the GATT 1994, as being necessary for the protection of human life and health, the Panel shall proceed to the second step of its analysis, to determine whether the measure satisfies the requirements of the chapeau of Article XX.

7.862. Under this second step, the Panel shall assess whether the discriminatory aspects of the challenged measure have been "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade". In order to avoid repetition, the Panel refers to its statements above on the general legal standard in respect of whether a measure satisfies the requirements of the chapeau.[1203]

7.863. The Panel proceeds with the first step of the analysis.

7.4.6.2.2 Whether the discriminatory aspects of the INOVAR-AUTO programme are provisionally justified under Article XX(b)

7.864. Brazil argues that the INOVAR-AUTO programme is part of a set of Brazilian policies aimed at (i) improving vehicle safety and (ii) reducing CO_2 emissions. Therefore, Brazil considers that it falls within the range of policies designed to protect human, animal or plant life and health as well as the environment.[1204] Brazil refers to Law 12,715/2012 that enacted the INOVAR-AUTO programme, which explicitly states that the objective of this programme is to support "the technological development, the innovation, *the safety, the protection of the environment, the energy efficiency* and the quality of automobiles, trucks, buses and auto parts".[1205]

7.865. As far as the objective of increasing vehicle safety is concerned, Brazil submits that the INOVAR-AUTO programme aims to promote automotive safety and related social benefits, which include the safety of passengers and the reduction of accidents.[1206] Brazil argues that the INOVAR-AUTO programme is the tool by which it aims to achieve the standards established by the United Nations Economic Commission for Europe (UNECE) through the World Forum for Harmonisation of Vehicle Regulations.[1207] Brazil contends that the INOVAR-AUTO programme contributes to the objective of protecting human life and health by providing incentives for the production of safer vehicles.[1208]

[1199] Panel Report, *EC – Asbestos*, para. 8.170. The panel in that case said that "the use of the word 'protection' implies the existence of a risk." See Panel Report, *EC– Asbestos*, para. 8.184.

[1200] Appellate Body Report, *EC – Asbestos*, para. 161.

[1201] Appellate Body Report, *EC – Seal Products*, para. 5.200 (referring to Panel Report, *US – Gambling*, para. 6.461, referring to Appellate Body Reports, *Korea – Various Measures on Beef*, para. 176; and *EC – Asbestos*, para. 168).

[1202] See paragraphs 7.524 to 7.535 above.

[1203] See section 7.3.6.2.2 above.

[1204] Brazil's first written submissions, section 6.1.2.8.1.1 (DS472) and section 5.1.2.8.1.1. (DS497).

[1205] Brazil's first written submissions, para. 606 (DS472) and para. 539 (DS497), referring to Law 12,715/2012, (Exhibit BRA-85), Article 40. (emphasis added)

[1206] Brazil's first written submissions, para. 609 (DS472) and para. 542 (DS497).

[1207] Brazil's first written submissions, para. 612 (DS472) and para. 545 (DS497).

[1208] Brazil's first written submissions, para. 613 (DS472) and para. 546 (DS497).

7.866. With respect to the objective of reducing CO_2 emissions, Brazil argues that the INOVAR-AUTO programme is part of a set of policies aimed at progressively reducing CO_2 and pollutant emissions.[1209] In this regard, Brazil states that the INOVAR-AUTO programme is specifically mentioned in Brazil's Transport and Urban Mobility Sectorial Plan for Climate Change Mitigation and Adaptation as a measure that contributes to the reduction of greenhouse gases emissions in the transport sector.[1210] Brazil argues that its policies to increase energy efficiency in vehicles result in protection of the environment that leads to the protection of human, animal and plant life and health.[1211]

7.867. The European Union submits that Brazil has not demonstrated that the discriminatory aspects of INOVAR-AUTO have been adopted, enforced, or designed to protect human, animal or plant life or health.[1212] In the European Union's view, the energy efficiency and vehicle safety objectives claimed by Brazil are not aims in themselves but rather elements of the real objective pursued by Brazil, which is the protection and development of the domestic industry.[1213]

7.868. Japan considers that Brazil has not demonstrated the existence of a "genuine relationship" between the specific challenged features of the INOVAR-AUTO programme and the policy objective of protecting human, animal or plant life or health.[1214]

7.869. As noted above, the Appellate Body has explained in the context of Article XX(a) that, in order to determine whether a challenged measure is provisionally justified under the relevant subparagraph of Article XX of the GATT 1994, panels must assess two elements: (i) whether the challenged measure is "designed to" protect public morals, and (ii) whether the challenged measure is "necessary" to protect such public morals.[1215] Given the similarities between Article XX(a) and XX(b) as regards the required nexus between the challenged measure and the interest protected, the Panel considers that the approach taken by the Appellate Body with respect to the analysis under Article XX(a) is also applicable to the analysis under subparagraph (b) of Article XX.

7.4.6.2.2.1 Whether the discriminatory aspects of the INOVAR-AUTO programme are designed to protect human life or health

7.870. The Panel will now proceed to examine whether the aspects of the INOVAR-AUTO programme found to be GATT-inconsistent are designed to protect human life or health in two steps. First, it will examine whether the claimed policy objectives; i.e. increase vehicle safety and reduce CO_2 emissions, are objectives that fall within the range of policies aimed at protecting human life or health. Second, the Panel will analyse whether aspects of the INOVAR-AUTO programme found to be GATT-inconsistent are designed to increase vehicle safety and reduce CO_2 emissions.

Whether the claimed objectives of the measure are within the scope of Article XX(b) of the GATT 1994

7.871. As noted above, Brazil has identified two policy objectives pursued by the INOVAR-AUTO programme: (i) improving vehicle safety and (ii) reducing CO_2 emissions. Although the European Union acknowledges that, *in abstracto*, energy efficiency and road safety are objectives that may fall under Article XX(b) of the GATT 1994, it argues that the real objective of the INOVAR-AUTO programme is to develop the Brazilian car industry.[1216] Japan has not rebutted Brazil's characterization of its policy objectives.

7.872. Past panels have found that a broad range of policies are aimed at the protection of human, animal and plant life or health, including policies relating to the reduction of air pollution

[1209] Brazil's first written submissions, para. 614 (DS472) and para. 547 (DS497).

[1210] Brazil's first written submissions, para. 616 (DS472) and para. 549 (DS497), referring to Transport and Urban Mobility Sectorial Plan for Climate Change Mitigation and Adaptation (*Plano Setorial de Transporte e de Mobilidade Urbana para Mitigação e Adaptação à Mudança do Clima* (PSTM), (Exhibit BRA-71).

[1211] Brazil's first written submissions, para. 616 (DS472) and para. 549 (DS497).

[1212] European Union's second written submission, paras. 151-152 (referring to Appellate Body Report, *EC – Seal Products*, para. 5.185).

[1213] European Union's second written submission, para. 155.

[1214] Japan's second written submission, para. 95.

[1215] Appellate Body Report, *Colombia – Textiles*, paras. 5.67-5.68.

[1216] See paragraph 7.867 above, and European Union's second written submission, para. 157.

as a result of consumption of gasoline and the reduction of risks arising from the accumulation of waste tyres.[1217]

7.873. The Panel notes the importance of the existence of a risk for human, animal or plant life or health in the context of Article XX(b). In *EC – Asbestos*, the panel considered that the first step to determine whether a measure is provisionally justified under Article XX(b) of the GATT 1994 is to determine the existence of a risk to human, animal or plant life or health. In this regard, the Appellate Body recalled that a panel "enjoy[s] a margin of discretion in assessing the value of the evidence, and the weight to be ascribed to that evidence", including the use of experts.[1218] Once that risk is found to exist, the second step is to examine whether the policy underlying the measure aims at reducing such risk.

7.874. With respect to the first objective invoked by Brazil, i.e. increasing vehicle safety, the Panel notes that Brazil has provided evidence that higher vehicle safety standards have an impact on the reduction of the risk for human life or health in car accidents. A report by the World Health Organization establishing a Global Plan for the Decade of Action for Road Safety 2011-2020 identifies the risks that car accidents represent for human life and health by stating that "[r]oad traffic injuries are among the three leading causes of death for people between 5 and 44 years of age".[1219] According to this report:

> Each year nearly 1.3 million people die as a result of a road traffic collision—more than 3000 deaths each day… Twenty to fifty million more people sustain non-fatal injuries from a collision, and these injuries are an important cause of disability worldwide. Ninety percent of road traffic deaths occur in low- and middle-income countries... [R]oad traffic injuries are predicted to become the fifth leading cause of death in the world, resulting in an estimated 2.4 million deaths each year.[1220]

7.875. The Panel further notes that a report from the US Department of Transportation states that one of the developments that can have an impact on the fatality rate is the development of vehicle safety technologies such as seat belts, air bags and electronic stability control.[1221] Several reports referred to by Brazil also point to the fact that vehicle safety devices such as electronic stability control systems can prevent up to 33% of fatal accidents and reduce by 73% the number of accidents in which the vehicle may roll over. Such reports conclude that this technology might save up to 4,000 lives and avoid 100,000 accidents involving injuries, in Brazil.[1222]

7.876. The World Health Organization report establishing a Global Plan for the Decade of Action for Road Safety 2011-2020 lists the improvement of vehicle safety as one of the effective interventions to prevent road traffic injuries. In fact, the United Nations General Assembly resolution that proclaimed a Decade of Action for Road Safety 2011–2020 also calls upon UN member states to implement at the national level actions in five pillars, one such pillar being vehicle safety.[1223]

7.877. In light of the above, the Panel considers that Brazil has provided sufficient evidence to demonstrate that there is a risk for human life and health caused by car accidents and increasing vehicle safety contributes to protecting human life and health, by contributing to a lower number of casualties. Therefore, the Panel is of the view that increasing vehicle safety is one of the policies covered by subparagraph (b) of Article XX, given that it can fall within the range of policies that protect human life or health.

7.878. With respect to the second objective invoked by Brazil, i.e. the reduction of CO_2 emissions, Brazil states that its Transport and Urban Mobility Plan estimates that 78% of total national CO_2

[1217] Panel Reports, *China – Raw Materials*, para. 7.479 (referring to Panel Reports, *US – Gasoline*, para. 6.21 and *Brazil – Retreaded Tyres*, paras. 7.108 and 7.115).

[1218] Appellate Body Report, *EC – Asbestos*, para. 161.

[1219] WHO Article on road traffic injuries, (Exhibit BRA-52), p. 4.

[1220] WHO Article on road traffic injuries, (Exhibit BRA-52), p. 4.

[1221] "Lives Saved by Vehicle Safety Technologies and Associated Federal Motor Vehicle Safety Standard, 1960 to 2012", U.S. Department of Transportation, January 2015, (Exhibit BRA-82).

[1222] "Automotive safety: Brazil is still delayed" (*Segurança nos carros: o Brasil ainda está na rabeira*), (Exhibit BRA-83).

[1223] WHO Article on road traffic injuries, (Exhibit BRA-52), p. 11.

emissions associated with transportation derive from the use of individual vehicles.[1224] Brazil explains that the reduction in the CO_2 emissions obtained through the Motor Vehicle Air Pollution Control Program (PROCONVE) has a direct effect in improving air quality in the cities and reducing the risks of experiencing respiratory problems.[1225] Numerous resolutions issued by the Brazilian National Environmental Council (CONAMA) refer to the need to reduce the emission level of pollutants given that they contribute to the continuing deterioration of air quality.[1226] A study prepared by the Brazilian Ministry of the Environment shows that vehicle emissions of CO_2 in Brazil are increasing significantly. In the five years that preceded the INOVAR-AUTO programme, such emissions increased by 61.5% for gasoline cars.[1227] In order to reduce these CO_2 emissions, Brazil states that it put in place a series of measures over the past decades. One of the most relevant measures is the PROCONVE programme.[1228]

7.879. The Panel notes that Brazil's view finds support in *US – Gasoline*, where the panel agreed with the parties that a policy to reduce air pollution resulting from the consumption of gasoline fell within the scope of subparagraph (b) of Article XX.[1229]

7.880. In light of the above, the Panel considers that Brazil has demonstrated that the reduction of CO_2 emissions is one of the policies covered by subparagraph (b) of Article XX, given that it can fall within the range of policies that protect human life or health.

7.881. The Panel therefore finds that both increasing vehicle safety and the reduction of CO_2 emissions are policy objectives that are covered by subparagraph (b) of Article XX of the GATT 1994.

Whether the discriminatory aspects of the INOVAR-AUTO programme are designed to protect human life or health

7.882. Having found that both increasing vehicle safety and the reduction of CO_2 emissions are policy objectives covered under subparagraph (b) of Article XX, the Panel turns to examine whether the aspects of the INOVAR-AUTO programme found to be inconsistent with Article III of the GATT 1994 are designed to achieve such policy objectives.

7.883. The Panel recalls from the legal standard described in paragraphs 7.518 and 7.522 to 7.523 above that in determining whether a measure is "designed to" achieve a particular objective:

> [I]f the measure is *not incapable* of protecting [the objective], this indicates the existence of a relationship between the measure and the protection of [the objective]. In this situation, further examination of whether the measure is "necessary" is required under Article XX(a).[1230]

7.884. The Panel notes that the parties disagree as to the policy objectives of those aspects of the INOVAR-AUTO programme found to be GATT-inconsistent. In this respect, the Panel will take into consideration the characterization of the policy objectives made by the respondent, although it is not bound by such characterization. In order to undertake an objective assessment that allows the Panel to identify the objectives pursued by the challenged measure, there are other elements that the Panel must take into account in addition to the characterization by Brazil. These elements

[1224] Brazil's first written submissions, para. 626 (DS472) and para. 559 (DS497), referring to Transport and Urban Mobility Sectorial Plan for Climate Change Mitigation and Adaptation, (Exhibit BRA-71), p 63.
[1225] Brazil's first written submissions, para. 510 (DS472) and para. 443 (DS497).
[1226] See CONAMA Resolution Nos. 18/1986, (Exhibit BRA-54); 3/1989, (Exhibit BRA-56); 4/1989, (Exhibit BRA-57); 1/1993, (Exhibit BRA-58); 6/1993, (Exhibit BRA-59); 7/1993, (Exhibit BRA-60); 8/1993, (Exhibit BRA-61); 16/1993, (Exhibit BRA-62); 27/1994, (Exhibit BRA-63); 14/1995, (Exhibit BRA-64); 15/1995, (Exhibit BRA-65); 16/1995, (Exhibit BRA-66); 17/1995, (Exhibit BRA-67); 315/2002, (Exhibit BRA-68); 403/2008, (Exhibit BRA-69); and 415/2009, (Exhibit BRA-70).
[1227] Brazil's first written submissions, para. 627 (DS472) and 560 (DS497).
[1228] Brazil's first written submissions, para. 505 (DS472) and para. 440 (DS497).
[1229] Panel Report, *US – Gasoline*, para. 6.21.
[1230] Appellate Body Report, *Colombia – Textiles*, para. 5.68. (footnotes omitted) (emphasis added)

include the text of the relevant legal instruments, the legislative history and the evidence available on the record with respect to the design, structure and application of the challenged measure.[1231]

7.885. The Panel starts by looking at the text of the relevant legal instruments. In this respect, the Panel finds that Law 12,715/2012, establishing the INOVAR-AUTO programme, provides that the aim of the programme is to "[support] technological development, innovation, safety, environmental protection, energy efficiency and the quality of automobiles, lorries, buses and autoparts".[1232] This idea is reinforced in Decree 7,819/2012 that implements and develops Articles 40 to 44 of Law 12,715/2012.[1233] These objectives are also present in the legislative history of the INOVAR-AUTO programme. In particular, Interministerial Explanatory Memorandum No. 00025/2012, that accompanied the Provisional Measure that established INOVAR-AUTO, indicates that the INOVAR-AUTO programme "aims to strengthen the national automotive industry and create impulses [incentives] for an improvement of the technological content of the vehicles produced in the country".[1234] According to this Memorandum, the strengthening of the national automotive industry is expected to bring improvements in several fields, such as environmental protection, safety and energy efficiency.[1235]

7.886. Moving on to the design, architecture and structure of the challenged measure in order to make an objective assessment of its underlying policy objective[1236], the Panel recalls that "the aspects of a measure to be justified under the subparagraphs of Article XX are those that give rise to the finding of inconsistency under the GATT 1994"[1237] and moreover, that "a respondent may not justify the inconsistency of a measure by basing its defence on aspects of [a] measure different from those that were found by the panel to be inconsistent".[1238]

7.887. The Panel therefore conducts its assessment by looking at those aspects of the INOVAR-AUTO programme found to be inconsistent with Article III:2 and III:4, namely: (i) reduced tax rates for specific motor vehicles; (ii) certain aspects of the specific accreditation requirements; (iii) certain aspects of the rules on calculation of tax credits; and (iv) certain aspects of the rules on the use of presumed IPI tax credits.

7.888. The Panel further recalls its findings above that the specific accreditation requirements are inconsistent with Article III:2 and III:4 because: (1) foreign manufacturers are required to comply with three specific requirements whereas domestic manufacturers are required to meet only two specific requirements; and (2) unlike for domestic manufacturers, for foreign manufacturers compliance with the accreditation criteria necessarily entails an additional burden of establishing a commercial presence in Brazil.[1239] The Panel also found that the rules on accrual and use of

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[1231] See Appellate Body Reports, *EC – Seal Products*, para. 5.144; *US – COOL*, para. 371; and *US - Tuna II (Mexico)*, para. 314. See also Panel Reports, *China – Raw Materials*, para. 7.479; and *China – Rare Earths*, para. 7.145.

[1232] Law 12,715/2012, (Exhibit JE-95), Article 40.

[1233] Decree 7,819/2012, (Exhibit JE-132), Article 1.

[1234] Interministerial Explanatory Memorandum No. 00025/2012, (Exhibits JE-183 and BRA-51), para. 44.

[1235] Interministerial Explanatory Memorandum No. 00025/2012, (Exhibits JE-183 and BRA-51), para. 44.

[1236] Panel Report, *EC – Tariff Preferences*, para. 7.200 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, 97, at p. 120, where the Appellate Body stated that "the aim of a measure may not be easily ascertained, nevertheless, its protective application can most often be discerned from the design, the architecture and the revealing structure of a measure").

[1237] Appellate Body Report, *EC – Seal Products*, para. 5.185. Additionally, in *Thailand – Cigarettes (Philippines)*, the Appellate Body observed that:

> [W]hen Article XX(d) is invoked to justify an inconsistency with Article III:4, what must be shown to be "necessary" is the treatment giving rise to the finding of less favourable treatment. Thus, when less favourable treatment is found based on differences in the regulation of imports and of like domestic products, the analysis of an Article XX(d) defence should focus on whether those regulatory differences are "necessary". Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 177.

[1238] Appellate Body Report, *Argentina – Financial Services*, para. 6.169. The Appellate Body made this statement in the context of Article XIV of the GATS. The Panel can see no reason not to also apply this standard in the context of Article XX of the GATT.

[1239] See paragraphs 7.656 to 7.661 and 7.27 to 7.29 above. The Panel recalls that the INOVAR-AUTO programme provides for three different types of accreditations: (i) for companies that manufacture in Brazil; (ii) for importers/distributors (i.e. companies that market products in Brazil and do not engage in manufacturing activities in Brazil); and (iii) for investors (i.e. companies establishing factories in Brazil, or in the case of companies already established in Brazil, companies setting up new factories or industrial projects, to produce new models in Brazil). In order to obtain accreditation, all companies must comply with the same

presumed IPI tax credits are inconsistent with Article III:2 and III:4 because, respectively: the rules on accrual favour domestic manufacturers over foreign manufacturers since domestic manufacturers are more likely to purchase strategic inputs and tools within Brazil; and the rules on use of presumed tax credits from expenditure in Brazil in strategic inputs and tools require that such tax credits can only be used in respect of imported motor vehicles if any credits remain after offsetting the taxes on the sales of domestically manufactured motor vehicles, and also since such tax credits may only be used in respect of a maximum of 4,800 imported motor vehicles per year.[1240] Additionally, the Panel found that one specific accreditation requirement constituted a local content requirement, inconsistently with Article III:4 of the GATT 1994, namely the requirement to perform a minimum number of production steps within Brazil.[1241] The Panel also found that one particular aspect of the accreditation requirements in respect of expenditure and investment in R&D in Brazil, concerning the requirement to purchase laboratory equipment in Brazil, constituted a local content requirement, inconsistently with Article III:4 of the GATT 1994.[1242] Finally, the Panel found that one particular aspect of the rules on accrual and calculation of presumed tax credits, specifically concerning the calculation of the deductible part, constituted a local content requirement, inconsistently with Article III:4 of the GATT 1994.[1243]

7.889. In assessing whether these aspects found to be inconsistent are designed to achieve the objective of protecting human life and health, the Panel recalls Brazil's argument that

> [T]he R&D and production requirements as well as the method of calculating and using the presumed IPI credit were established in order to enhance the contribution of the [INOVAR-AUTO] programme to Brazil's safety and environmental objectives. In Brazil's experience, it is not feasible to achieve the desired level of technological advance in the auto industry without the proper incentives to R&D, productive capacity and a highly developed auto parts industry.[1244]

7.890. Brazil argues that the INOVAR-AUTO programme contributes to vehicle safety through the accreditation requirement that in order to be accredited, companies must comply with at least two out of three possible specific requirements, one of which is the option to "spend, in Brazil, at least the percentages shown in the table below of the total gross proceeds from sales of goods and services, excluding taxes and contributions on sales, on research and development".[1245] Furthermore, "expenditure of the companies accredited under the INOVAR-AUTO scheme may be considered as development of new devices for active and passive vehicle safety pursuant to the provisions, limits and conditions laid down in the joint act of the Minister for Development, Industry and Foreign Trade and the Minister for Science, Technology and Innovation", subject to certain conditions.[1246]

7.891. Brazil's argument attempts to justify specific accreditation requirements, the content of which were never challenged by the complaining parties, and therefore need not be justified under Article XX. Brazil argues that the requirement to make expenditure in R&D in Brazil contributes to vehicle safety, and therefore the protection of human health. In the Panel's view, this justification is irrelevant, because the complaining parties have not challenged the requirement to make

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two general accreditation requirements, as well as a combination of specific accreditation requirements that varies depending on the type of accreditation companies apply for. The general requirements applicable to all accredited companies are as follows: (i) compliance with all tax obligations at the federal level; and (ii) a commitment to achieve certain minimum levels of energy efficiency for products marketed in Brazil. These general requirements have not been challenged by the complaining parties and the Panel has not made any finding in their regard. As for the specific accreditation requirements, each company also must meet some combination of the following: (i) performance of a minimum number of defined manufacturing and engineering infrastructure activities in Brazil; (ii) investment in research and technological development (R&D) in Brazil; (iii) expenditure on engineering, basic industrial technology and capacity-building of suppliers in Brazil; and (iv) participation in the Brazilian Vehicle Labelling Programme established by INMETRO.

[1240] See paragraphs 7.682 to 7.687 and 7.730 to 7.732 above.

[1241] See section 7.4.2.4.2 above.

[1242] See section 7.4.2.4.3 above.

[1243] See section 7.4.2.4.4 above.

[1244] Brazil's second written submission, para. 148.

[1245] Brazil's first written submissions, para. 631 (DS472) and para. 564 (DS497) (referring to Decree 7,819/2012, (Exhibit JE-132), Article 7).

[1246] Brazil's first written submissions, para. 631 (DS472) and para. 564 (DS497) (referring to Decree 7,819/2012, (Exhibit JE-132), Article 7).

expenditure in R&D in Brazil *per se*, nor has the Panel made a finding that such a requirement is *per se* WTO-inconsistent.

7.892. The Panel reiterates that its finding of inconsistency in respect of the accreditation requirements generally is firstly based on the fact that foreign manufacturers are required to comply with *more* requirements than domestic manufacturers. It is this difference in the number of requirements (not the validity of the requirement as such) that Brazil is expected to justify under Article XX. Secondly, the Panel reached a conclusion that foreign manufacturers are subject to a higher burden than domestic manufacturers, because foreign manufacturers must become established in Brazil in order to gain the tax treatment for their products. It is therefore for Brazil to explain why *these* WTO-inconsistent aspects of the accreditation requirements contribute to vehicle safety and protection of human health.

7.893. The Panel notes that it has found that one particular aspect of the accreditation requirement pertaining to expenditure in R&D in Brazil (specifically in respect of purchasing Brazilian laboratory equipment) constitutes a local content requirement, inconsistently with Article III:4. Although Brazil has argued about that particular aspect of the expenditure requirement by which expenditure in vehicle safety counts towards fulfilment of the requirement, Brazil has *not* demonstrated how the discriminatory aspect of the requirement, pertaining to the purchase of Brazilian laboratory equipment specifically, is designed to achieve the objective of vehicle safety.

7.894. In short, Brazil attempts to justify aspects of the accreditation requirements that were not found to be inconsistent and do not need to be justified under Article XX.

7.895. Turning to Brazil's argument in respect of the objective of reducing CO_2 emissions, Brazil argues that:

> [T]he energy efficiency targets are a fundamental element of the program, as the energy efficiency targets are the main condition for the accredited companies to participate in the overall programme and is equally applicable to all accredited companies. INOVAR-AUTO encourages energy efficiency gains by both requiring minimum energy efficiency standards in light vehicles and providing additional incentives for companies surpassing those goals, and by providing the financial means to meet these goals. INOVAR-AUTO also fosters energy efficiency by encouraging minimum investments in R&D and engineering, energy efficiency labelling programmes and promoting the production of energy efficient auto-parts.[1247]

7.896. Brazil elaborates in some detail on the specific energy efficiency targets that are mandatory for all companies seeking to be accredited under the INOVAR-AUTO programme.[1248] Brazil also points to the Brazilian vehicle labelling programme, which is "primarily focused on providing consumers information about energy efficiency and CO_2 emissions" and is an "elective condition to the accreditation to the programme".[1249]

7.897. In this respect the Panel notes that similarly to its discussion above in respect of the specific accreditation requirement relating to expenditure in the energy efficiency requirements, the complaining parties have not challenged the WTO-consistency of such energy efficiency requirements, and therefore Brazil need not justify such a requirement under Article XX.

7.898. Finally, Brazil also argues that the specific accreditation requirement related to vehicle labelling contributes to the protection of human health.[1250] Again, the Panel repeats that the content of this specific accreditation requirement was not challenged *per* se and was not found by the Panel to be WTO-inconsistent. Therefore, Brazil does not need to justify the WTO-consistency of the vehicle labelling requirement.

[1247] Brazil's first written submission, para. 569 (DS497).

[1248] Brazil's first written submissions, paras. 498-527 and 637-639 (DS472) and paras. 435-461 and 570-572 (DS497).

[1249] Brazil's first written submissions, paras. 640 (DS472) and 573 (DS497).

[1250] Brazil's first written submissions, paras. 636 and 640-641 (DS472) and 569 and 573-574 (DS497).

7.899. In short, the Panel considers that Brazil is indeed attempting to "justify the inconsistency of a measure by basing its defence on aspects of [the] measure different from those that were found by the panel to be inconsistent".[1251]

7.900. Thus, Brazil has not explained with any of these arguments, how (i) the reduced tax rates for specific motor vehicles, (ii) the WTO-inconsistent aspects of the rules on accreditation in order to accrue tax credits, (iii) the WTO-inconsistent aspects of the rules on calculation of tax credits, or (iv) the WTO-inconsistent aspects of the rules on the use of presumed IPI tax credits, are in any manner linked to the objectives of increasing vehicle safety or energy efficiency.[1252]

7.901. As the Appellate Body has explained, "the aspects of a measure to be justified under the subparagraphs of Article XX are those that give rise to the finding of inconsistency under the GATT 1994".[1253] In short, the Panel does not consider that any of these arguments by Brazil demonstrate how those aspects of the INOVAR-AUTO programme found to be inconsistent with Article III:2 and III:4 are designed to achieve the stated objectives of vehicle safety or energy efficiency.

7.902. Notwithstanding its findings above, the Panel further notes Brazil's argument that "Brazil wishes to foster its industry to acquire the technology and know-how to manufacture these automobiles in a sustained basis".[1254] Brazil argues that previous efforts to ensure that its domestic industry could meet certain energy efficiency targets failed because companies lacked the appropriate incentives to meet those targets.[1255] As Brazil states, it "could not simply require automobiles to be more efficient without any corresponding incentive. In this context the means by which the Programme's goals are reached are just as relevant in this analysis."[1256]

7.903. On the basis of this argument, the Panel considers that the discriminatory aspects of the INOVAR-AUTO programme are not *incapable* of contributing to vehicle safety and the reduction of CO_2 emissions. Indeed, it is not inconceivable to the Panel that under certain circumstances, the discriminatory aspects of the INOVAR-AUTO programme could indeed contribute to the claimed objectives in a manner similar to that explained by Brazil.

7.904. In the view of the Panel, it is conceivable that the protection afforded to domestic producers by the discriminatory aspects of the measure could enable such domestic producers to develop their industry. The development of the industry could enable an otherwise uncompetitive domestic industry to become competitive, resulting in technological development within the industry, and ultimately enabling the domestic industry to produce more energy-efficient and safer motor vehicles. Ultimately, by elevating the domestic industry from a position of technological and competitive inferiority to a position in which the domestic industry could compete with foreign motor vehicles, the INOVAR-AUTO programme could conceivably contribute in the long-run to overall vehicle safety as well as overall reductions in CO_2 emissions.

7.905. The Panel therefore finds that Brazil has demonstrated that the measure is not incapable of contributing to the objective of increasing vehicle safety and reducing CO_2 emissions, and therefore could potentially contribute to these objectives. In light of its finding above that these objectives have been shown to be objectives within the meaning of Article XX(b) of the GATT

[1251] Appellate Body Report, *Argentina – Financial Services*, para. 6.169.

[1252] This includes those aspects of these rules found to impose local content requirements, inconsistently with Article III:4 of the GATT 1994. In particular, although Brazil has made an argument in respect of the specific accreditation requirement in respect of expenditure in R&D in Brazil, the Panel notes that its finding of inconsistency with this particular specific accreditation requirement relates to the requirement to purchase Brazilian laboratory equipment. Brazil has not shown how the requirement to purchase Brazilian laboratory equipment is designed to achieve the objectives of vehicle safety or energy efficiency.

[1253] Appellate Body Report, *EC – Seal Products*, para. 5.185. Additionally, in *Thailand – Cigarettes (Philippines)*, the Appellate Body observed that:

> [W]hen Article XX(d) is invoked to justify an inconsistency with Article III:4, what must be shown to be "necessary" is the treatment giving rise to the finding of less favourable treatment. Thus, when less favourable treatment is found based on differences in the regulation of imports and of like domestic products, the analysis of an Article XX(d) defence should focus on whether those regulatory differences are "necessary". Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 177.

[1254] Brazil's second written submission, para. 158.

[1255] Brazil's second written submission, para. 149.

[1256] Brazil's second written submission, para. 149.

1994, the Panel consequently finds that Brazil has demonstrated that the measure is designed to protect human life and health within the meaning of Article XX(b).

7.4.6.2.2.2 Whether the discriminatory aspects of the INOVAR-AUTO programme are "necessary" to achieve the claimed objectives

7.906. The Panel found above that Brazil has demonstrated that the discriminatory aspects of the INOVAR-AUTO programme are "designed to" protect human life or health. The Panel therefore proceeds with its analysis by assessing whether Brazil has demonstrated that the discriminatory aspects of the INOVAR-AUTO programme are necessary to protect human life or health.

7.907. As noted above, this necessity analysis involves "a process of 'weighing and balancing' a series of factors, including the importance of the objective, the contribution of the measure to that objective, and the trade-restrictiveness of the measure." [1257] Additionally, in most cases, a comparison between the challenged measure and possible alternatives must be undertaken.[1258]

The importance of the objectives

7.908. Brazil argues that the interests protected by the INOVAR-AUTO programme are vital and important to the highest degree. Brazil states that the INOVAR-AUTO programme's main goal is to obtain safer and more fuel-efficient vehicles[1259] and recalls that the Appellate Body has confirmed that the objectives of protection of human health and the protection of the environment are both vital and important.[1260]

7.909. With respect to the INOVAR-AUTO programme's claimed objective of increasing vehicle safety, Brazil argues that vehicle safety standards are directly linked to the protection of human life and health.[1261] Brazil states that road deaths and injuries are a major public health concern and that it expects that increased vehicle safety is likely to reduce the number of victims and, as a result, protect human life and health.[1262]

7.910. With respect to INOVAR-AUTO's claimed objective of reducing CO_2 emissions, Brazil argues that the Brazilian vehicle fleet is not yet at the energy efficiency level reached in other countries, thereby generating higher CO_2 emissions.[1263]

7.911. The European Union acknowledges that, *in abstracto*, energy efficiency and vehicle safety are objectives that may fall under Article XX(b) of the GATT 1994.[1264] Japan does not address this particular issue.

7.912. The Panel observes that both increasing vehicle safety and the reduction of CO_2 emissions seem to be interests of particular importance for Brazil. With respect to vehicle safety, the Panel notes that Brazil is ranked fifth in the world in terms of deadly vehicle accidents.[1265] The Brazilian Ministry of Health has reported that car accidents were responsible for approximately 20.7% of all deaths from external causes in Brazil during 2013.[1266] The fact that the WHO launched a Global Plan for the Decade of Action for Road Safety 2011-2020 is also indicative of the importance of this objective. In the WHO report, it is stated that 90% of road traffic deaths occur in low- and middle-income countries and that, unless immediate and effective action is taken, road traffic injuries are predicted to become the fifth leading cause of death in the world, resulting in an estimated 2.4

[1257] Appellate Body Report, *EC – Seal Products*, para. 5.214 (referring to Appellate Body Reports, *EC – Seal Products*, para. 5.169; *Brazil – Retreaded Tyres*, para. 182; and *US – Gambling*, para. 307 (referring to Appellate Body Report, *Korea – Various Measures on Beef*, para. 166)). See also Appellate Body Report, *Colombia – Textiles*, para. 5.70.

[1258] See paragraph 7.524 above.

[1259] Brazil's first written submissions, para. 622 (DS472) and para. 555 (DS497).

[1260] Brazil's first written submissions, para. 622 (DS472) and para. 555 (DS497), (referring to Appellate Body Report, *Brazil – Retreaded Tyres*, paras. 144 and 179).

[1261] Brazil's first written submissions, para. 623 (DS472) and para. 556 (DS497).

[1262] Brazil's first written submissions, para. 624-625 (DS472) and paras. 557-558 (DS497).

[1263] Brazil's first written submissions, para. 626 (DS472) and para. 559 (DS497).

[1264] European Union's second written submission, para. 157.

[1265] Article about WHO study on deaths caused by traffic accidents, (Exhibit BRA-75).

[1266] Brazil's first written submissions, para. 624 (DS472) and para. 557 (DS497).

million deaths each year.[1267] Further, one of the recommendations of this report at the national level is to implement five pillars, one of which relates to encouraging deployment of improved vehicle safety technologies for both passive and active safety.

7.913. The Panel, therefore, finds that increasing vehicle safety is an interest of high importance.

7.914. With respect to the reduction of CO_2 emissions, the Panel notes that Brazil has launched numerous initiatives in recent decades to reduce pollutant emissions by motor vehicles, such as the Air Pollution Control Program by Motor Vehicles (PROCONVE).[1268] Further, the Brazilian Transport and Urban Mobility Plan indicates that 78% of total national CO_2 emissions associated with transportation derive from the use of individual vehicles.[1269] A study prepared by the Brazilian Ministry of the Environment shows that vehicle emissions of CO_2 in Brazil have increased significantly. For example, in the five years that preceded the establishment of the INOVAR-AUTO programme this figure increased by 61.5% for gasoline cars.[1270] In the Panel's view, this shows the importance of this objective for Brazil.

7.915. The Panel recalls that the Appellate Body has explained that "few interests are more 'vital' and 'important' than protecting human beings from health risks, and that protecting the environment is no less important".[1271]

7.916. In light of the above, the Panel finds that the level of importance of the interests pursued by Brazil (i.e. increase of vehicle safety and reduction of CO_2 emissions) is high.

The contribution to the objectives

7.917. Brazil argues that the INOVAR-AUTO programme contributes to the protection of human life and health by increasing vehicle safety standards and reducing CO_2 emissions. Brazil argues that certain specific accreditation requirements contribute to these objectives.[1272]

7.918. The Panel recalls its findings above that the specific accreditation requirements identified by Brazil as contributing to an increase in vehicle safety and the reduction of CO_2 emissions are not aspects of the INOVAR-AUTO programme that the Panel has found to be inconsistent *per se*. As noted above, the Panel does not consider these particular aspects of the programme to be individually relevant for a justification of those aspects found to be inconsistent. In the Panel's view, the evidence presented by Brazil in order to demonstrate the contribution made by the discriminatory aspects of the INOVAR-AUTO programme is unrelated to those aspects of the programme that need to be justified.

7.919. In respect of Brazil's argument that the discriminatory aspects of the programme contribute to the stated objectives because the discrimination strengthened the domestic industry, thereby facilitating the technological development of the industry, the Panel notes that Brazil has not submitted any evidence, quantitative or qualitative, to support this assertion.[1273]

7.920. Furthermore, the Panel notes that in the absence of evidence to support the notion that this hypothetical scenario could materialize, the Panel can only assess the likely contribution of the programme on the basis of the design, structure and operation of those aspects of the programme found to be inconsistent. In this respect the Panel notes that insofar as Brazil claims that its

[1267] WHO Article on road traffic injuries, (Exhibit BRA-52), p. 4.

[1268] See CONAMA Resolution Nos. 18/1986, (Exhibit BRA-54); 3/1989, (Exhibit BRA-56); 4/1989, (Exhibit BRA-57); 1/1993, (Exhibit BRA-58); 6/1993, (Exhibit BRA-59); 7/1993, (Exhibit BRA-60); 8/1993, (Exhibit BRA-61); 16/1993, (Exhibit BRA-62); 27/1994, (Exhibit BRA-63); 14/1995, (Exhibit BRA-64); 15/1995, (Exhibit BRA-65); 16/1995, (Exhibit BRA-66); 17/1995, (Exhibit BRA-67); 315/2002, (Exhibit BRA-68); 403/2008, (Exhibit BRA-69); and 415/2009, (Exhibit BRA-70).

[1269] Transport and Urban Mobility Sectorial Plan for Climate Change Mitigation and Adaptation, (Exhibit BRA-71), p. 63.

[1270] Brazil's first written submissions, para. 672 (DS472) and para. 560 (DS497).

[1271] Appellate Body Report, *Brazil – Retreaded Tyres*, paras. 144 and 179.

[1272] See paragraphs 7.889 to 7.890, 7.895, and 7.898 above.

[1273] The Panel notes that Brazil has submitted evidence regarding the impact of the INOVAR-AUTO programme's energy efficiency requirements on CO_2 emissions. As discussed above, this evidence is not relevant to those aspects of the INOVAR-AUTO programme challenged by the complaining parties. See paragraphs 7.895 to 7.897 above.

intended objective is *vehicle safety* and the *reduction of* CO_2 emissions, measures that discriminate against imported products do not appear to make *any* contribution. To the contrary, if imported vehicles subject to the same requirements as domestic vehicles were not discriminated against in the ways the Panel has indicated in this report, it is possible that the number of safe and energy-efficient vehicles within Brazil would actually increase, particularly in the short term, meaning that far from contributing to the stated objectives, the discriminatory aspects actually detract from the attainment of that objective.

7.921. In the Panel's view, Brazil has not demonstrated that the discriminatory aspects of the INOVAR-AUTO programme have led, will lead, or are apt to lead, to an increase in vehicle safety or energy efficiency. Thus, in the Panel's view, although it is possible that the INOVAR-AUTO programme *could*, in theory, contribute to these objectives, Brazil has not demonstrated that the discriminatory aspects of the programme are likely or apt to contribute to the realisation of those goals. In the Panel's view, for the reason indicated in paragraph 7.920 above, it is likely that the INOVAR-AUTO programme will not make much, if any, contribution to these objectives. Nonetheless, the Panel continues its analysis.

The level of trade-restrictiveness

7.922. Brazil argues that the level of trade-restrictiveness of INOVAR-AUTO is low because incentives are granted in a non-discriminatory manner to companies that fulfil the minimum requirements.[1274]

7.923. Neither Brazil nor the complaining parties have presented any evidence to demonstrate the trade-restrictiveness of the discriminatory aspects of the INOVAR-AUTO programme. Nevertheless, the Panel notes the following.

7.924. With respect to the reduced tax rates for certain motor vehicles, this discriminatory aspect of the INOVAR-AUTO programme results in a disincentive to purchase imported motor vehicles, which in the view of the Panel will have a material impact on imports of those products. The Panel therefore considers that the overall trade-restrictiveness of the INOVAR-AUTO programme is material.[1275]

7.925. With respect to the discriminatory rules on accreditation of presumed IPI tax credits, the Panel has observed that the specific accreditation requirements apply to all accredited companies, except for the requirement that certain manufacturing and engineering activities be conducted in Brazil, which only applies to companies accredited as domestic manufacturers. However, the Panel has also noted that, in order to get accredited and be entitled to accrue presumed IPI tax credits, companies must be established in Brazil (in the case of domestic manufacturers and importers/distributors) or must commit to establish manufacturing facilities in Brazil (in the case of investors that do not have a commercial presence in Brazil yet). In the Panel's view, this is highly trade-restrictive because it prevents foreign companies operating outside Brazil from obtaining accreditation, regardless of their level of investment or expenditure in Brazil.

7.926. Additionally, the Panel found that those aspects of the accreditation requirements requiring the performance of a minimum number of production-steps within Brazil (in respect of accreditation as a "domestic manufacturer"), and the purchase of Brazilian laboratory equipment, constitute local content requirements, which discriminate against imported automotive components and laboratory equipment. The Panel considers these local content requirements to be highly trade-restrictive for these imported products.

7.927. With respect to the discriminatory rules on calculation of presumed IPI tax credits, the Panel has noted that in order to accrue credits, expenditure must be made in Brazil by accredited

[1274] Brazil's first written submissions, para. 645 (DS472) and para. 578 (DS497).

[1275] The Panel notes that in *Colombia – Textiles* the Appellate Body considered that there was insufficient clarity with respect to the degree of trade-restrictiveness, such that the Appellate Body saw "no basis to proceed with a comparison of the measure at issue with any possible alternative measures". See Appellate Body Report, *Colombia – Textiles*, para. 5.115. In the present dispute, the Panel considers that the Panel's determination of the level of trade-restrictiveness is sufficiently clear to engage in a comparison of the trade-restrictiveness of alternative measures reasonably available to Brazil, as discussed in section 7.3.6.3.2.4 below.

companies. In the specific case of expenditure in strategic inputs and tools, the Panel has found that these rules are designed in a manner so that domestic manufacturers can accrue higher presumed IPI tax credits than companies accredited as investors or distributors/importers, because domestic manufacturers are more likely to purchase strategic inputs and tools in Brazil given that such inputs and tools are required for those manufacturers to carry out their regular manufacturing activities. This is not the case for foreign manufacturers accredited as importers/distributors in Brazil, because their activity is limited to marketing motor vehicles, and their type of accreditation does not foresee the development of any production activity in Brazil. In addition, the Panel has also found that the rules on calculation of presumed IPI tax credits resulting from expenditure in strategic inputs and tools (referring in particular to the deductible part) favour those strategic inputs and tools with a higher level of local content by according higher presumed IPI tax credits. The Panel considers these particular aspects of the challenged measure to be particularly trade-restrictive given that they penalize foreign companies and imported strategic inputs and tools (whose level of Brazilian content is likely to be non-existent or very low).

7.928. With respect to the discriminatory rules on the use of presumed IPI tax credits, the Panel has noted that these rules prioritize domestic vehicles over imported vehicles. In the view of the Panel, this particular aspect of the INOVAR-AUTO programme is particularly trade-restrictive, because it incentivises the purchase of domestically manufactured vehicles, which has a material impact on imports of like motor vehicles.

7.929. The Panel recognises that a determination of the trade-restrictiveness of a particular measure should be as precise as possible. However, the Panel is not in a position to make a quantitative estimation of the level of trade-restrictiveness. In the present dispute, in light of its observations above, the Panel finds that the level of trade-restrictiveness of these aspects of the rules on accreditation in order to receive the presumed IPI tax credits, calculation of the amount of presumed IPI tax credits to be accrued, and the use of presumed IPI tax credits resulting from expenditure in strategic inputs and tools, is material.[1276]

Comparison with reasonably available alternative measures

7.930. The complaining parties have put forward five alternative measures that they consider to be reasonably available, less trade-restrictive than the challenged measures, and able to contribute to the achievement of the objectives alleged by Brazil.

7.931. The first alternative is to provide tax exemptions to users for sales of all the products at issue that comply with its energy efficiency and vehicle safety standards, regardless of its origin.[1277] The European Union states that this alternative measure (i) is WTO-consistent as it is origin neutral; (ii) provides a higher contribution to the realization of the end pursued than the challenged measure because consumers will have enhanced access to a wider range of products; (iii) is less trade-restrictive than the challenged measure because it provides for the same preferential treatment for both domestic and imported products; and (iv) does not present any difficulty in terms of implementation.[1278] The European Union also points out that it is for Brazil to show that the alternative measure is not reasonably available.[1279]

7.932. The second alternative is the elimination or substantial reduction of customs duties on the products at issue that comply with Brazil's energy efficiency and vehicle safety standards.[1280] The European Union states that this alternative measure (i) is WTO-consistent as WTO Members are free to lower their customs duties below bound tariffs; (ii) provides a higher contribution to the realization of the end pursued than the challenged measure because consumers will have enhanced access to a wider range of products; (iii) is less trade-restrictive than the challenged measure; and (iv) does not present any difficulty in terms of implementation.[1281] The European

[1276] See footnote 884 above.
[1277] European Union's second written submission, paras. 159 and 165.
[1278] European Union's second written submission, paras. 166-169; and European Union's response to Panel's question No. 5.
[1279] European Union's second written submission, para. 169; and European Union's response to Panel's question No. 5.
[1280] European Union's second written submission, paras. 159 and 170.
[1281] European Union's second written submission, paras. 172-175; and European Union's response to Panel's question No. 5.

Union points out that this alternative measure is possible given that Brazil maintains applied *ad valorem* duties of 35% for most of the products at issue.[1282]

7.933. The third alternative is the granting of IPI tax credits, or other types of tax credits, to all cars and components that satisfy specific efficiency targets, regardless of the manufacturing steps performed in Brazil or the level of domestic content.[1283] Since the tax benefit is directly linked to the level of energy efficiency achieved, and not to the fulfilment of other requirements, it would contribute to Brazil's policy objective more directly and effectively than the INOVAR-AUTO programme. In addition, this alternative is reasonably available because Brazil already rewards compliance with energy efficiency targets, subject to additional conditions unrelated to energy efficiency.[1284]

7.934. The fourth alternative is to provide subsidies for all products that comply with Brazil's energy efficiency and vehicle safety standards, regardless of the origin of the product.[1285]

7.935. The fifth alternative is the imposition of direct requirements relating to energy efficiency and vehicle safety that apply to all products regardless of their origin.[1286]

7.936. Brazil considers that the alternative measures submitted by the complaining parties either fail to reach the appropriate level of protection or are unavailable for technical or financial reasons. As regards the alternative measures consisting of tax exemptions or the provision of subsidies to all vehicles that reach certain fuel efficiency levels, Brazil argues that they would undermine the INOVAR-AUTO programme's objectives because they would not contribute to the technological development of the Brazilian automotive sector. With respect to the alternative measure consisting of the reduction or elimination of tariffs for products that meet certain environmental and safety standards, Brazil also contends that this approach does not address a major concern under the INOVAR-AUTO programme, namely the transformation of the Brazilian automotive sector. As regards the alternative measure consisting of the imposition of direct requirements relating to energy efficiency and vehicle safety, Brazil argues that it already tried to impose such requirements in the past without success.[1287]

7.937. The Panel shall compare in turn each of the alternative measures presented by the complaining parties with the challenged measure so as to confirm whether the challenged measures are "necessary" to protect human life and health as alleged by Brazil.

Tax exemptions for all products that comply with certain standards

7.938. The first proposed alternative measure is to provide tax exemptions to users for sales of all products at issue that comply with Brazil's energy efficiency and vehicle safety standards, regardless of their origin.[1288]

7.939. Brazil argues that this alternative would undermine the INOVAR-AUTO programme's objectives because it would not contribute to the technological development of the Brazilian automotive sector.

7.940. The Panel considers that this alternative measure would be WTO-consistent since it would apply to any product, either domestic or imported, that meets certain standards relating to its levels of energy efficiency and vehicle safety. The fact that the products should comply with certain energy efficiency and vehicle safety standards would guarantee the contribution to the claimed policy objectives. In the Panel's view, this alternative would also be less trade-restrictive than the challenged measure since the measure would not be applied in a discriminatory manner and Brazil would be in a position to implement this measure because it does not present a special complexity or financial burden in terms of its application.

[1282] European Union's second written submission, para. 171; and European Union's response to Panel's question No. 5.
[1283] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.
[1284] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.
[1285] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.
[1286] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.
[1287] Brazil's second written submission, paras. 157-160.
[1288] European Union's second written submission, paras. 159 and 165.

7.941. Brazil has argued that the alternative measure is not valid because it would not contribute to one of the objectives of the challenged measures, i.e. the technological development of the Brazilian automotive sector. However, the Panel recalls its finding in the context of Article XX(a) above that a panel cannot reject a reasonably available alternative that achieves the desired level of protection of an interest protected under Article XX, purely because that alternative does not achieve a certain level of protection of an interest *not* protected under Article XX.[1289]

7.942. Brazil has not argued that the technological development of the Brazilian automotive sector is *per se* an objective protected under Article XX. Brazil has only identified the objective of the measure that is justified under Article XX as the protection of human life and health, specifically through increasing vehicle safety and reducing CO_2 emissions. As indicated above, the Panel cannot reject the proposed alternative measure simply because it does not contribute to a *different* objective that is not protected under Article XX.

7.943. In this case, the policy objectives submitted by Brazil were the increase of vehicle safety and the reduction of CO_2 emissions. The Panel considers that requiring certain energy efficiency and vehicle safety standards to products, regardless of their origin, to benefit from tax exemptions would definitely contribute to the achievement of the claimed policy objectives.

Elimination or reduction of customs duties on products that comply with certain standards

7.944. The second alternative measure suggested is the elimination or substantial reduction of customs duties on the products at issue that comply with Brazil's energy efficiency and vehicle safety standards, regardless of their origin.[1290]

7.945. Brazil argues that this alternative would undermine the INOVAR-AUTO programme's objectives because it would not contribute to the technological development of the Brazilian automotive sector.

7.946. The Panel considers that this alternative measure would be WTO-consistent since it would apply to any product, either domestic or imported, that meet certain standards relating to its levels of energy efficiency and vehicle safety. As for the previous alternative measure, the fact that the measure would only affect products that comply with certain energy efficiency and vehicle safety standards would guarantee the contribution to the claimed policy objectives. In the Panel's view, this alternative would be less trade-restrictive than the challenged measure since the measure would not be applied in a discriminatory manner. Finally, the Panel considers that Brazil would be in a position to implement this measure because it does not present a special complexity in terms of its application.

7.947. For the reasons indicated in paragraphs 7.941 and 7.942 above, the Panel also rejects Brazil's argument that this alternative is not reasonably available because it would not contribute to the technological development of the Brazilian automotive sector.

7.948. The Panel notes that the European Union has formulated two variants of the same alternative measure: the first one refers to the "elimination" of the customs duties and the second one consists of a "substantial reduction" of the customs duties. The European Union has explained in this respect, that given that Brazil maintains applied duties of 35% ad valorem for most of the products at issue, Brazil would be in a position to apply the measure. The Panel finds that this double formulation of the alternative measure increases the flexibility that Brazil would enjoy in terms of implementation. This flexibility might be needed given the impact on the revenues of Brazil that the elimination or substantial reduction of customs duties may have.

Tax credits for all products that comply with certain standards

7.949. The third alternative measure suggested consists of granting IPI tax credits, or other types of tax credits, to all cars and components that satisfy specific efficiency targets, regardless of the manufacturing steps performed in Brazil or the level of domestic content.[1291]

[1289] See paragraph 7.617 above.
[1290] European Union's second written submission, paras. 159 and 170.

7.950. Brazil argues that this alternative would undermine the INOVAR-AUTO programme's objectives because it would not contribute to the technological development of the Brazilian automotive sector.

7.951. The Panel first notes that this alternative measure only refers to one of the two claimed policy objectives, i.e. the improvement of the levels of energy efficiency resulting in a reduction of CO_2 emissions. The Panel considers that this alternative measure bears a number of similarities with the first alternative relating to tax exemptions given that tax credits operate in practice as partial tax exemptions. In this regard, the Panel considers that this alternative measure would be WTO-consistent since it would apply to any product, either domestic or imported, that satisfies specific efficiency targets. The measure would only affect products that satisfy specific efficiency targets, what would guarantee the alternative measure's contribution to the relevant policy objectives. The Panel is of the view that this alternative would be less trade-restrictive than the challenged measure since the measure would not be applied in a discriminatory manner. Finally, the Panel considers that Brazil would be in a position to implement this measure because, under INOVAR-AUTO, Brazil is already providing tax credits to products that satisfy certain conditions, the difference being that these conditions are related not just to energy efficiency but also to other aspects.

7.952. For the reasons indicated in paragraphs 7.941 and 7.942 above, the Panel also rejects Brazil's argument that this alternative is not reasonably available because it would not contribute to the technological development of the Brazilian automotive sector.

Subsidies for all products that comply with certain standards

7.953. The fourth alternative measure suggested consists of providing subsidies for all the products that comply with Brazil's energy efficiency and vehicle safety standards, regardless of the origin of the product.[1292]

7.954. Brazil argues that this alternative would undermine the INOVAR-AUTO programme's objectives because it would not contribute to the technological development of the Brazilian automotive sector.

7.955. The Panel considers that this alternative measure would be WTO-consistent since it would apply to any product, either domestic or imported, that meets certain energy efficiency and vehicle safety standards. The contribution to the claimed policy objectives would be assured given that only those products meeting the standards would benefit from the subsidies. Further, this alternative would be less trade-restrictive than the challenged measure since the measure would not be applied in a discriminatory manner. Finally, the Panel notes that, unlike other alternative measures such as tax exemptions or credits, this measure would involve the actual disbursement of funds by the Brazilian government. The limitation on the availability of funds, especially in developing countries, can hinder the implementation of this kind of measures. However, the Panel does not believe that this mere reason would turn this alternative measure into a measure which is not reasonably available, especially when the responding party has not submitted any argument in that respect.

7.956. For the reasons indicated in paragraphs 7.941 and 7.942 above, the Panel also rejects Brazil's argument that this alternative is not reasonably available because it would not contribute to the technological development of the Brazilian automotive sector.

Direct requirements relating to energy efficiency and vehicle safety

7.957. The fifth alternative measure suggested consists of the imposition of direct requirements on energy efficiency and vehicle safety standards to be met by all products, regardless of their origin.[1293]

[1291] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.
[1292] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.
[1293] Japan's second written submission, para. 97; and Japan's response to Panel's question No. 5.

7.958. Brazil argues that it did try to impose such requirements in the past without success. In particular, Brazil states that in light of the difficulties experienced in implementing the Motor Vehicle Air Pollution Control Program (PROCONVE), it decided to establish a system of requirements and incentives (i.e. INOVAR-AUTO) to contribute to the achievement of the energy efficiency goals that Brazil sought to enforce. In Brazil's view, this "carrot and stick" approach was necessary for that purpose.[1294]

7.959. With respect to Brazil's argument that it has tried this approach in the past, the Panel considers that Brazil did not substantiate its assertion.[1295] In the absence of evidence to demonstrate that the alternative failed to achieve the required level of contribution, and evidence that the challenged measure does indeed contribute to a greater degree, the Panel cannot reject the proposed alternative. The Panel recalls its finding above that it has not been demonstrated that the INOVAR-AUTO programme makes any contribution to the objective. Furthermore, in the view of the Panel, the proposed alternative would indeed make a clear contribution to the objective. The Panel therefore considers that this alternative is WTO-consistent, capable of contributing to the stated objective to an equivalent or greater degree than the challenged measure, is less trade-restrictive than the challenged measure, and is reasonably available.

Conclusion on reasonably available alternatives

7.960. In the Panel's view, the complaining parties have identified alternatives which are WTO-consistent and less-trade-restrictive than the discriminatory aspects of the INOVAR-AUTO programme, and which would achieve an equivalent or higher degree of contribution to the claimed objective as the challenged measures. The Panel considers that Brazil has not demonstrated that the alternative measures identified by the complaining parties were not reasonably available, were not less trade-restrictive, or failed to make an equivalent contribution to the claimed policy objectives.

7.4.6.2.2.3 Conclusion on necessity under Article XX(b)

7.961. The Panel has conducted a holistic analysis, weighing and balancing the importance of the objective, the contribution made by the measure to that objective, and the trade-restrictiveness of the measure, in light of reasonably available alternative measures. In the Panel's view, and particularly in light of reasonably available alternatives that in the Panel's view are not only WTO-consistent and less trade-restrictive but are likely to contribute to a greater extent than the discriminatory aspects of the INOVAR-AUTO programme to the objective, Brazil has not demonstrated that the aspects of the measure found to be inconsistent with the provisions of Article III of the GATT 1994 are "necessary" to protect public health and life.

7.4.6.2.3 Whether the discriminatory aspects of the INOVAR-AUTO programme satisfy the requirements of the chapeau of Article XX of the GATT 1994

7.962. Brazil argues that the differences between companies that manufacture vehicles in Brazil and those that only market vehicles in Brazil do not constitute an arbitrary or unjustifiable discrimination. According to Brazil, these differences relate to the level of contribution to the objectives pursued by the programme by both types of companies.[1296] These differences relate to three issues: (i) the conditions for accreditation, (ii) the investment requirements, and (iii) the IPI tax reductions and credits. First, as regards the conditions for accreditation, Brazil contends that they are reasonable.[1297] Second, as regards the requirement that investments be made in Brazil, Brazil argues that it is consistent with the objectives of the INOVAR-AUTO programme because it is the only way to assure that those investments translate into reductions of CO_2 emissions in Brazil,

[1294] Brazil's first written submissions, paras. 512-513 (DS472) and 445-446 (DS497).

[1295] The Panel notes that Brazil refers to two "costly public civil actions" to support its argument that the PROCONVE programme experienced "difficulties" in implementation. See Brazil's first written submissions, para. 512 and fns 337 and 338 (DS472) and para. 445 and footnote 296 (DS497). Notwithstanding that Brazil has not submitted evidence of these civil actions, Brazil has not explained to the Panel how these civil actions are demonstrative of the "technical and logistical difficulties … [that] prevented the implementation of the two phases within the required deadline." See Brazil's first written submissions, para. 338 (DS472) and para. 445 (DS497).

[1296] Brazil's first written submission, para. 682 (DS472) and para. 615 (DS497).

[1297] Brazil's first written submission, paras. 683-684 (DS472) and paras. 616-617 (DS497).

vehicular safety in Brazil, and conservation of petroleum and its derivatives.[1298] Third, as regards IPI tax reductions and credits, Brazil notes that the IPI tax reductions and credits under the INOVAR-AUTO programme are based on reasonable criteria. The higher the energy efficiency, the higher the tax reduction; the more a company contributes to the programme's goals, the higher the credit it gets.[1299] Brazil further argues that the INOVAR-AUTO programme is not a disguised restriction on international trade because "[t]here is nothing deceptive, or concealed about the application of the program".[1300]

7.963. The European Union argues that the INOVAR-AUTO programme unjustifiably discriminates between countries where the same conditions prevail. In the European Union's view, the incentives accorded to domestic producers result in a disguised restriction on international trade. The European Union further contends that the discriminatory treatment under INOVAR-AUTO is not linked to the claimed objectives of increased vehicle safety and reduced CO_2 emissions.[1301] Japan argues that Brazil has failed to establish a *prima facie* case that the challenged measure is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail because it refers to the same standards by which a violation of a WTO provision is determined to exist.[1302] Japan further argues that the fact that the discriminatory aspects of the INOVAR-AUTO programme bear no connection to the claimed policy objectives demonstrates that the requirements of the chapeau have not been met.[1303] Japan is of the view that the fact that the relevant aspects of the challenged measure have been applied in a manner that which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail shows that they are also applied in a manner that constitutes a disguised restriction on international trade.[1304]

7.964. In light of its findings above that the measure is not provisionally justified under Article XX(b) of the GATT 1994, the Panel does not consider it necessary to make findings on whether Brazil has demonstrated that its defence under Article XX(b) meets the requirements of the chapeau to Article XX.

7.4.6.2.4 Conclusion

7.965. In light of the above, the Panel concludes that those aspects of the INOVAR-AUTO programme found to be inconsistent with Article III of the GATT 1994 and Article 2.1 of the TRIMs Agreement are not justified under Article XX(b) of the GATT 1994.[1305]

7.4.6.3 Whether the discriminatory aspects of the INOVAR-AUTO programme are justified under Article XX(g)

7.4.6.3.1 Description of the legal test

7.966. Article XX(g) of the GATT 1994 provides as follows:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> …

[1298] Brazil's first written submission, para. 687 (DS472) and para. 620 (DS497).
[1299] Brazil's first written submission, para. 689 (DS472) and para. 621 (DS497).
[1300] Brazil's first written submission, para. 693 (DS472) and para. 625(DS497).
[1301] European Union's second written submission, paras. 176 and 178.
[1302] Japan's second written submission, paras. 113-114.
[1303] Japan's second written submission, paras. 115-116.
[1304] Japan's second written submission, para. 117.
[1305] The Panel notes that pursuant to Article 3 of the TRIMs Agreement, "[a]ll exceptions under GATT 1994 shall apply, as appropriate to the provisions of this Agreement".

> (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

7.967. As noted above with respect to Article XX(a) and (b), the Appellate Body has explained that:

> [T]he assessment of a claim of justification under Article XX involves a two-tiered analysis in which a measure must first be provisionally justified under one of the subparagraphs of Article XX, before it is subsequently appraised under the chapeau of Article XX.[1306]

7.968. Additionally, as noted, the burden of proving that a measure is provisionally justified under one of the subparagraphs of Article XX rests on the party invoking that defence.[1307] The party invoking the defence also bears the burden of proving that a measure provisionally justified under a subparagraph of Article XX is consistent with the requirements of the chapeau of Article XX.[1308] The Appellate Body has indicated, however, that

> [T]he nature and scope of arguments and evidence required to establish a *prima facie* case will necessarily vary according to the facts of the case, and from measure to measure, provision to provision, and case-to-case. Moreover, these rules and principles of WTO jurisprudence must not be applied in an unduly formalistic or mechanistic fashion, nor inhibit the substantive analysis that must be undertaken by a panel.[1309]

7.969. Article XX of the GATT 1994 therefore involves a two-tiered analysis. First, a panel must assess whether the measure at issue is provisionally justified under the subparagraph of Article XX invoked. Second, if the panel finds that the measure is provisionally justified, it must examine whether the application of the measure satisfies the requirements of the chapeau of Article XX.

7.4.6.3.1.1 Provisional justification under Article XX(g)

7.970. The Panel notes that the general exception of subparagraph (g) of Article XX of the GATT 1994 presents two differences to the two general exceptions examined above (those of subparagraphs (a) and (b) of Article XX of the GATT 1994). First, the nexus between the measure and the interest protected, in Article XX(g), is expressed by the term "relating to" and not "necessary to". Second, the text of the provision incorporates a conditional clause that is not part of any other general exception under Article XX of the GATT 1994, namely: "if such measures are made effective in conjunction with restrictions on domestic production or consumption".[1310]

7.971. The analysis under this provision is "a holistic assessment [that] … must be applied on a case-by-case basis, through careful scrutiny of the factual and legal context in a given dispute".[1311] This context includes the exhaustible natural resource concerned and the specific conservation objective of the Member relying upon Article XX(g). The Appellate Body has explained that the intent and purpose expressed by the Members is relevant, although there is no need for a panel to limit its analysis to the text of the measure at issue or to accept without further questioning the Member's characterization of the measure.[1312]

7.972. As indicated above, the Appellate Body has also emphasized the importance of the design and structure of the challenged measure in analysing whether the measure satisfies the requirements set out in Article XX(g) of the GATT 1994. By focusing on the design and structure,

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[1306] Appellate Body Report, *EC – Seal Products*, para. 5.169. (footnotes omitted) See also footnote 871 above.

[1307] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:I, 323, at p. 335.

[1308] Appellate Body Report, *US – Gasoline*, pp. 22-23, DSR 1996:I, 3, at pp. 21-23.

[1309] Appellate Body Report, *US – Tuna II (Article 21.5 - Mexico)*, para. 7.33.

[1310] The Appellate Body noted that the text of Article XX(g), in particular its use of "if", calls for an holistic assessment of all of its component elements. See Appellate Body Report, *China – Rare Earths*, paras. 5.94 and 5.101.

[1311] Appellate Body Report, *China – Rare Earths*, para. 5.95.

[1312] Appellate Body Report, *China – Rare Earths*, para. 5.95.

the Appellate Body considers that panels benefit from an objective methodology for carrying out the above-mentioned analysis.[1313]

7.973. Additionally, there is no requirement to apply an "empirical effects test" under Article XX(g) of the GATT 1994. However, the Appellate Body has acknowledged that predictable effects of a measure, being those effects inherent in, and discernible from, the design and structure of a measure, may be relevant for a panel's analysis.[1314]

7.974. The Panel notes that the first step of a panel's analysis encompasses two elements: (i) whether the measures at issue relate to the conservation of exhaustible natural resources; and (ii) whether the measures at issue are made effective in conjunction with restrictions on domestic production or consumption.

7.975. The Appellate Body has explained that the term "natural resources" in subparagraph (g) of Article XX of the GATT 1994 is "by definition, evolutionary".[1315] In that sense, the Appellate Body in *US – Shrimp* stated that the terms "exhaustible natural resources" must be read "in the light of contemporary concerns of the community of nations about the protection and conservation of the environment".[1316] The Appellate Body concluded that Article XX(g) referred to conservation of both living and non-living exhaustible natural resources.[1317]

7.976. With respect to the word "conservation", the Appellate Body in *China – Raw Materials* concluded that "conservation" means "the preservation of the environment, especially of natural resources".[1318] The Appellate Body later clarified that "for the purposes of Article XX(g), the precise contours of the word 'conservation' can only be fully understood in the context of the exhaustible natural resource at issue in a given dispute."[1319] In this connection, the Appellate Body explained that the word conservation could encompass different actions depending on whether the exhaustible natural resource was a living or a non-living one.[1320]

7.977. The Panel further notes that the Appellate Body reports in *US – Shrimp* and *China – Raw Materials* addressed the issue of the required nexus between the measure and the interest protected, specifically in respect of the term "relating to" in subparagraph (g) of Article XX of the GATT 1994. The Appellate Body found that "relate to" requires a "close and genuine relationship of ends and means" between the measure and the conservation objective of the measure.[1321] This excludes from the scope of subparagraph (g) measures which are "merely incidentally or inadvertently aimed at a conservation objective".[1322] In addition, the Appellate Body noted that "the absence of a domestic restriction, or the way in which a challenged measure applies to domestic production or consumption, may be relevant to an assessment of whether the challenged measure 'relates to' conservation."[1323] The Appellate Body also emphasized the importance of

[1313] Appellate Body Report, *China – Rare Earths*, para. 5.96.

[1314] The reason is that, as stated by the Appellate Body in *US – Gasoline*, "in the field of conservation of exhaustible natural resources, a substantial period of time, perhaps years, may have to elapse before the effects attributable to implementation of a given measure may be observable". Appellate Body Report, *US - Gasoline*, p. 20, DSR 1996:I, 3, at p. 20. See Appellate Body Report, *China – Rare Earths*, paras. 5.98, 5.100 and 5.113. In this respect, the Panel notes that the Appellate Body in *Brazil – Retreaded Tyres* referred to measures adopted in order to attenuate global warming and climate change as an example of policies the effects of which can only be evaluated with the benefit of time. See Appellate Body Report, *Brazil – Retreaded Tyres*, para. 151.

[1315] Appellate Body Report, *US – Shrimp*, para. 130 (referring to *Namibia (Legal Consequences) Advisory Opinion* (1971) I.C.J. Rep., p. 31, where the International Court of Justice stated that where concepts embodied in a treaty are "by definition, evolutionary", their "interpretation cannot remain unaffected by the subsequent development of law … Moreover, an international instrument has to be interpreted and applied within the framework of the entire legal system prevailing at the time of the interpretation.")

[1316] Appellate Body Report, *US – Shrimp*, para. 129.

[1317] Appellate Body Report, *US – Shrimp*, para. 131.

[1318] Appellate Body Reports, *China – Raw Materials*, para. 355.

[1319] Appellate Body Report, *China – Rare Earths*, para. 5.89.

[1320] For example, in the case of an exhaustible mineral resource, conservation could involve reducing or even stopping its extraction, whereas for a species facing the threat of extinction, it could encompass halting the activities creating the danger of extinction or facilitating the replenishment of that endangered species. See Appellate Body Report, *China – Rare Earths*, para. 5.89.

[1321] Appellate Body Reports, *US – Shrimp*, para. 136; and *China – Raw Materials*, para. 355.

[1322] Appellate Body Report, *China – Rare Earths*, para. 5.90.

[1323] Appellate Body Report, *China – Rare Earths*, para. 5.90.

examining the design and structure of the measure at issue in order to determine whether a measure is related to the conservation of exhaustible natural resources.[1324]

7.978. As for the second element under this first step of the Panel's analysis, namely whether the challenged measures are made effective in conjunction with restrictions on domestic production or consumption, the Panel notes that the Appellate Body has explained that the measure at issue must be promulgated or brought into effect and must operate together with restrictions on domestic production or consumption of exhaustible natural resources. Both restrictions (on international trade and on domestic production and consumption) must operate jointly towards the conservationist objective, i.e. they must "work together".[1325] In addition, the Appellate Body clarified that, in order to comply with the "made effective" element of Article XX(g), it does not suffice that domestic production or consumption is subject to possible limitations at some undefined point in the future. The restriction on domestic production or consumption must be "real" and must reinforce and complement the restriction on international trade.[1326]

7.979. The Appellate Body has considered this to be a "requirement of *even-handedness* in the imposition of restrictions, in the pursuit of conservation, upon the production or consumption of exhaustible natural resources".[1327] This requirement, however, is not a separate requirement in addition to the requirement that the measure be "made effective in conjunction with restrictions on domestic production or consumption"; it is embodied in the terms of Article XX(g) as regards the imposition of restrictions, because the test and the assessment under XX(g) is holistic.[1328] Furthermore, according to the Appellate Body, Article XX(g) does not contain "a requirement that the burden of conservation be evenly distributed".[1329] However, the Appellate Body also stated that "it would be difficult to conceive of a measure that would impose a *significantly more onerous* burden on foreign consumers or producers and that could still be shown to satisfy all of the requirements of Article XX(g)."[1330] Additionally, in *US – Gasoline* the Appellate Body stated that:

> There is, of course, no textual basis for requiring identical treatment of domestic and imported products. Indeed, where there is identity of treatment - constituting real, not merely formal, equality of treatment - it is difficult to see how inconsistency with … would have arisen in the first place. On the other hand, if no restrictions on domestically-produced like products are imposed at all, and all limitations are placed upon imported products alone, the measure cannot be accepted as primarily or even substantially designed for implementing conservationist goals. The measure would simply be naked discrimination for protecting locally-produced goods.

7.4.6.3.1.2 The chapeau of Article XX of the GATT 1994

7.980. With respect to the second step of the analysis under Article XX of the GATT 1994, the Panel recalls the legal standard described in section 7.3.6.2.2 above.

7.981. As indicated above, Article XX of the GATT 1994 involves a two-tiered analysis. First, the Panel must assess whether the measure at issue is provisionally justified under a subparagraph of Article XX. Second, if the Panel finds that the measure is provisionally justified, it must examine whether the application of the measure satisfies the requirements of the chapeau of Article XX. The Panel proceeds with its analysis in this order.

7.4.6.3.2 Whether the discriminatory aspects of the INOVAR-AUTO programme are provisionally justified under Article XX(g)

7.982. As mentioned above, in order to determine whether the discriminatory aspects of the INOVAR-AUTO programme are provisionally justified under subparagraph (g) of Article XX, the

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[1324] Appellate Body Report, *China – Rare Earths*, para. 5.111 (referring to Appellate Body Reports, *US – Shrimp*, paras. 135-137; and *China – Raw Materials*, para. 355).

[1325] Appellate Body Report, *China – Raw Materials*, paras. 356 and 360

[1326] Appellate Body Report, *China – Rare Earths*, paras. 5.92 and 5.132.

[1327] Appellate Body Report, *China – Rare Earths*, para. 5.93 (referring to Appellate Body Report, *US – Gasoline*, p. 21, DSR 1996:I, 3, at p. 19). (emphasis original)

[1328] Appellate Body Report, *China – Rare Earths*, para. 5.124.

[1329] Appellate Body Report, *China – Rare Earths*, para. 5.134.

[1330] Appellate Body Report, *China – Rare Earths*, para. 5.134. (emphasis added)

Panel must perform a holistic analysis of the various elements of Article XX(g). For analytical purposes, the Panel addresses in turn, first whether the discriminatory aspects of the INOVAR-AUTO programme relate to the conservation of natural resources, and secondly, whether the discriminatory aspects of the programme are made effective in conjunction with restrictions on domestic production or consumption.

7.4.6.3.2.1 Whether the discriminatory aspects of the INOVAR-AUTO programme relate to the conservation of exhaustible natural resources

7.983. Brazil contends that the INOVAR-AUTO programme relates to the conservation of petroleum and its by-products, including gasoline, because the different tax treatment it provides directly aims to reduce gasoline consumption by increasing vehicle energy efficiency.[1331] Brazil argues that the Appellate Body has found that petroleum and its by-products are "finite" and, consequently, an "exhaustible natural resource".[1332] Brazil also argues that the INOVAR-AUTO programme is part of a broader policy and regulatory context for the conservation of petroleum and its derivatives.[1333] In its view, the design and structure of the INOVAR-AUTO programme shows a clear link between the programme and the conservation of petroleum and its derivatives, including gasoline. First, the INOVAR-AUTO programme promotes significant energy efficiency gains through energy efficiency requirements. Second, it promotes investments in R&D and engineering and an energy conservation labelling scheme. Third, it promotes the use of alternative fuels by providing special IPI tax rates to flex fuel vehicles.[1334]

7.984. The European Union does not dispute that petroleum and its derivatives, including gasoline, are "exhaustible natural resources" within the meaning of Article XX(g) of the GATT 1994. However, it contends that Brazil has not demonstrated that the discriminatory aspects of the INOVAR-AUTO programme have been adopted, enforced or designed for the conservation of this exhaustible natural resource.[1335] The European Union further argues that Brazil has not demonstrated the existence of a "close and genuine relationship of ends and means" between the discriminatory aspects of the INOVAR-AUTO programme and the conservation of petroleum and its by-products, including gasoline.[1336]

7.985. Japan does not rebut Brazil's arguments on the conservation of an exhaustible natural resource such as petroleum and its derivatives. However, Japan argues that Brazil's defence is misplaced because it focuses on aspects which have not been challenged by the complaining parties, such as requirements in the INOVAR-AUTO programme pertaining to energy efficiency levels and expenditure in R&D. Japan states that Brazil has not addressed the discriminatory aspects of INOVAR-AUTO, i.e. the discriminatory aspects of the accreditation requirements, rules on calculation of presumed IPI tax credits arising from expenditure in strategic inputs and tools and the rules on the use of presumed IPI tax credits.[1337]

7.986. The Panel starts by noting that the complaining parties have not disputed that petroleum and its by-products, constitute an exhaustible natural resource. The Panel notes that the Appellate Body has already found that petroleum is a finite exhaustible natural resource.[1338]

7.987. Turning to the task of determining the nexus between the discriminatory aspects of the INOVAR-AUTO programme and the conservation of petroleum and its by-products, including gasoline, the Panel recalls that the legal standard for determining whether the discriminatory aspects of a measure are "related to" conservation of exhaustible natural resources, is whether

[1331] Brazil's first written submissions, paras. 650-654 (DS472) and paras. 583-587 (DS497).
[1332] Brazil's first written submissions, para. 654 (DS472) and para. 587 (DS497), referring to Appellate Body Report, *US – Shrimp*, para. 128.
[1333] Brazil's first written submissions, paras. 658 and 663-667 (DS472) and paras. 591 and 596-600 (DS497).
[1334] Brazil's first written submissions, paras. 655-668 (DS472) and paras. 588-601 (DS497).
[1335] European Union's second written submission, para. 180.
[1336] European Union's second written submission, para. 181.
[1337] Japan's second written submission, para. 103.
[1338] Appellate Body Report, *US – Shrimp*, para. 128.

there is a "close and genuine relationship of ends and means" between the measure and the conservation objective of the measure.[1339]

7.988. The Panel notes that Brazil has based its defence on (1) the general requirement that applies to firms, that in order to get accredited vehicles must meet certain energy efficiency targets; (2) certain accreditation requirements relating to expenditure in R&D in Brazil; and (3) the accreditation requirement pertaining to compliance with the Brazilian vehicle labelling programme.[1340]

7.989. In this respect, the Panel recalls once again that "the aspects of a measure to be justified under the subparagraphs of Article XX are those that give rise to the finding of inconsistency under the GATT 1994"[1341] and moreover, that "a respondent may not justify the inconsistency of a measure by basing its defence on aspects of [a] measure different from those that were found by the panel to be inconsistent".[1342]

7.990. As explained in the context of Article XX(b), those aspects of the INOVAR-AUTO programme found to be inconsistent with Article III:2 and III:4, are (i) reduced tax rates for specific motor vehicles; (ii) certain aspects of the specific accreditation requirements; (iii) certain aspects of the rules on calculation of tax credits; and (iv) certain aspects of the rules on the use of presumed IPI tax credits. The Panel also found that one specific accreditation requirement constituted a local content requirement, inconsistently with Article III:4 of the GATT 1994, namely the requirement to perform a minimum number of production steps within Brazil. Additionally, the Panel found that one particular aspect of the rules on accreditation, concerning the requirement to purchase laboratory equipment in Brazil, in order to satisfy the requirements to make expenditure and investment in R&D in Brazil, constituted a local content requirement, inconsistently with Article III:4 of the GATT 1994. Finally, the Panel found that one particular aspect of the rules on accrual and calculation of presumed tax credits, specifically concerning the calculation of the deductible part, constituted a local content requirement, inconsistently with Article III:4 of the GATT 1994.

7.991. In the view of the Panel, and in respect of Brazil's argument regarding the nexus between the discriminatory aspects of the INOVAR-AUTO programme and the conservation of petroleum and its by-products, the Panel notes that Brazil has primarily developed its defence on the basis of aspects of the INOVAR-AUTO programme that have not been challenged by the complaining parties. In particular, the Panel recalls from paragraphs 7.895 to 7.897 above that the Panel has not made findings of inconsistency related to the energy efficiency requirement, which is a general accreditation requirement, nor has the Panel made findings on the consistency of the special IPI tax rates for vehicles that work with a flex fuel option. Furthermore, in respect of the specific accreditation requirements related to expenditure in R&D in Brazil and vehicle labelling, the Panel recalls its explanation in paragraphs 7.889 to 7.894 and 7.898 above that the Panel did not make findings of inconsistency on these particular requirements *per se*.[1343] The Panel therefore does not expect Brazil to justify aspects of a measure that have not been challenged, and on which the Panel has made no findings of inconsistency.

[1339] Appellate Body Reports, *US – Shrimp*, para. 136; and *China – Raw Materials*, para. 355. As explained above, this excludes measures which are "merely incidentally or inadvertently aimed at a conservation objective". Appellate Body Report, *China – Rare Earths*, para. 5.90.

[1340] See paragraph 7.983 above.

[1341] Appellate Body Report, *EC – Seal Products*, para. 5.185. Additionally, in *Thailand – Cigarettes (Philippines)*, the Appellate Body observed that:

> [W]hen Article XX(d) is invoked to justify an inconsistency with Article III:4, what must be shown to be "necessary" is the treatment giving rise to the finding of less favourable treatment. Thus, when less favourable treatment is found based on differences in the regulation of imports and of like domestic products, the analysis of an Article XX(d) defence should focus on whether those regulatory differences are "necessary". Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 177.

[1342] Appellate Body Report, *Argentina – Financial Services*, para. 6.169. The Appellate Body made this statement in the context of Article XIV of the GATS. The Panel can see no reason not to also apply this standard in the context of Article XX of the GATT.

[1343] The Panel notes that the only specific accreditation requirement found to be *per se* inconsistent with a provision of the GATT 1994 is the requirement in respect of domestic manufacturers, pertaining to a minimum number of manufacturing and production processes to be performed in Brazil, which the Panel found to be inconsistent with Article III:4 of the GATT 1994. See paragraph 7.888 above. Brazil has not made any arguments in respect of this particular specific accreditation requirement.

7.992. The Panel takes no position on whether the aspects of the INOVAR-AUTO programme identified by Brazil (and not challenged by the complaining parties) may have a close and genuine relationship with the objective of conserving petroleum and its by-products, since such a finding is meaningless in terms of justifying those aspects of the measure found to be inconsistent. As stated above, it is not for this Panel to look at other aspects of the INOVAR-AUTO programme that have not been challenged and on which no findings have been made.[1344]

7.993. Notwithstanding that the specific aspects of the programme identified by Brazil are not challenged, the Panel notes the statements of Brazil that "[a]s demonstrated earlier in [Brazil's first written] submission, the programme promotes significant energy efficiency gains both by requiring minimum energy efficiency and by encouraging companies to surpass those targets."[1345] Brazil has further elaborated that "[t]he fuel efficiency standards, together with the investment and production step requirements, on the one hand, and the benefit structure, on the other, promote a long-lasting, structured and sustained development of cleaner, more efficient vehicles circulating in Brazil."[1346] Furthermore, "INOVAR-AUTO's particular contribution is its 'carrot-and-stick' structure, which allows for the overall energy efficiency improvement of the automotive sector in Brazil."[1347]

7.994. From these comments the Panel understands Brazil to be arguing that by protecting its domestic industry from foreign competition, Brazil seeks to ensure that the domestic industry develops its competitiveness and technological capabilities. In this way, in Brazil's view, the discriminatory aspects of the INOVAR-AUTO programme would ultimately in the long-run produce more energy-efficient motor vehicles, thereby contributing to the objective of conserving petroleum.

7.995. The Panel notes the similarities between this argument and one of Brazil's arguments in the context of Article XX(b).[1348] As noted there, the Panel considers that it is not inconceivable that the protection afforded by the discriminatory aspects of the INOVAR-AUTO programme could ultimately contribute to increased energy-efficiency levels of motor vehicles produced in Brazil.[1349] However, for the same reasons explained by the Panel in that context, the Panel does not consider that Brazil has provided any evidence to demonstrate that this theoretical possibility is in fact likely to occur as a result of the discriminatory aspects of the INOVAR-AUTO programme.[1350] On the contrary, such discriminatory treatment may exclude imported products from the market, thus reducing competition domestically and weakening the domestic industry's competitiveness and technological capabilities. On the basis of the evidence before the Panel, the Panel concludes that Brazil has not demonstrated that the discriminatory aspects of the measure will in fact make any contribution to the objective of increasing energy efficiency, thereby conserving petroleum.

7.996. The Panel considers that Brazil has not demonstrated that there is a close and genuine relationship of ends and means between the discriminatory aspects of the INOVAR-AUTO programme and the objective of increasing energy efficiency. The Panel therefore considers that Brazil has not demonstrated that the discriminatory aspects of the INOVAR-AUTO programme are related to conservation of exhaustible natural resources. As the test under Article XX(g) is holistic, the Panel continues its discussion on the application of the second element of Article XX(g) to the facts of this dispute.

7.4.6.3.2.2 Whether the discriminatory aspects of the INOVAR-AUTO programme are made effective in conjunction with restrictions on domestic production or consumption

7.997. Recalling that the analysis under Article XX(g) is a holistic analysis, the Panel proceeds with its analysis by assessing whether the discriminatory aspects of the INOVAR-AUTO programme are made effective in conjunction with restrictions on domestic production or consumption.

[1344] The Panel refers to its statements on this issue in paragraph 7.891 above.
[1345] Brazil's first written submissions, para. 659 (DS472) and para. 592 (DS497).
[1346] Brazil's second written submission, para. 163.
[1347] Brazil's second written submission, para. 164.
[1348] See paragraph 7.902 above.
[1349] See paragraph 7.904 above.
[1350] See paragraphs 7.919 to 7.921 above.

7.998. Brazil argues that the requirement that the measure be made effective in conjunction with restrictions on domestic production or consumption is met because energy efficiency requirements translate into restrictions on the consumption of gasoline.[1351] Brazil argues that the INOVAR-AUTO programme imposes these requirements on both domestic manufacturers and importers seeking accreditation. Therefore, it is Brazil's view that no difference in treatment exists regarding the level of restriction on the consumption of gasoline.[1352]

7.999. The European Union argues that the measure at issue is not made effective in conjunction with restrictions on domestic production or consumption. In addition to its argument that the energy efficiency requirements fall outside the scope of the Article XX analysis because they have not been challenged, the European Union states that the requirements imposed by the programme are not applied even-handedly because they do not apply to 30 out of 52 product codes covered under the INOVAR-AUTO programme.[1353]

7.1000. Japan argues that Brazil's arguments with respect to whether the measure is "made effective in conjunction with restrictions on domestic production or consumption" are without merit because they focus on aspects of the INOVAR-AUTO programme which have not been challenged and, therefore, need not be justified under the Article XX defence.[1354] Japan argues that, assuming arguendo that the energy efficiency requirements were relevant under the Article XX analysis, the INOVAR-AUTO programme imposes a significantly more onerous burden on foreign producers than on accredited domestic producers with respect to energy efficiency requirements. The reason is that accredited domestic manufacturers can offset the costs incurred by fulfilling the energy efficiency requirements with presumed IPI tax credits whereas foreign producers cannot, except for foreign producers accredited as importers/distributors and investors.[1355] Japan further argues that Brazil has not attempted to demonstrate that the discriminatory aspects of INOVAR-AUTO work together with restrictions on domestic consumption such that they reinforce and complement each other towards the conservation objective.[1356]

7.1001. The Panel notes Brazil's argument that because "both domestic manufacturers and importers have to comply with the same energy conservation/efficiency requirements established in the programme, there is 'even-handedness' in the efficiency requirements applicable to domestic manufacturers and importers alike."[1357] In this sense, the Panel agrees with Brazil that the requirements identified by Brazil do indeed apply to both domestic and foreign manufacturers.

7.1002. The Panel repeats that those aspects of the INOVAR-AUTO programme referred to by Brazil, regarding energy efficiency requirements, vehicle labelling, investment in R&D, and special IPI tax rates to flex fuel vehicles[1358], were not challenged by the complaining parties nor were they found to be WTO-inconsistent.[1359] Nevertheless, the Panel recalls the finding of the Appellate Body in *US – Gasoline* that in the context of this analysis, "[t]here is, of course, no textual basis for requiring identical treatment of domestic and imported products." [1360] Furthermore, notwithstanding that Brazil has not presented any domestic restrictions that correspond to the specific discriminatory aspects of the measure, Brazil has indicated that all domestic manufacturers are subject to certain requirements such as energy efficiency targets. Additionally, domestic manufacturers may be subject to either vehicle labelling requirements, or requirements related to expenditure in R&D in Brazil. Brazil contends that all such requirements are likely to contribute to the objective of conserving petroleum.

[1351] Brazil's first written submissions, para. 672 (DS472) and 605 (DS497).
[1352] Brazil's first written submissions, para. 673 (DS472) and 606 (DS497).
[1353] European Union's second written submission, para. 182.
[1354] Japan's second written submission, para. 107a.
[1355] Japan's second written submission, para. 108.
[1356] Japan's second written submission, para. 109.
[1357] Brazil's second written submission, para. 164.
[1358] Brazil's first written submissions, paras. 656 and 659-661 (DS472) and paras. 589 and 592-594 (DS497).
[1359] The Panel recalls that those aspects found to be inconsistent and required to be justified under Article XX are (i) reduced tax rates for specific motor vehicles; (ii) certain aspects of the specific accreditation requirements; (iii) certain aspects of the rules on calculation of tax credits; and (iv) certain aspects of the rules on the use of presumed IPI tax credits. Furthermore, those aspects of the specific accreditation requirements found to be inconsistent do not include the energy efficiency requirement or the vehicle labelling requirement *per se*.
[1360] Appellate Body Report, *US – Gasoline*, p. 19, DSR 1996:I, 3, at p. 19.

7.1003. In the view of the Panel, compliance with these requirements are indeed likely to contribute to the claimed objective. Furthermore, although these requirements have not been challenged by the complaining parties, they nevertheless serve as evidence of "restrictions on domestic manufacturers".

7.1004. The Panel further notes that the Appellate Body has indicated that Article XX(g) does not contain "a requirement that the burden of conservation be evenly distributed".[1361] Therefore, the Panel does not accept the argument that simply because 30 out of 52 product codes are not covered by the relevant requirements, the measure is not applied even-handedly. In the Panel's view, a requirement that applies both to domestic and foreign manufacturers, concerning production of motor vehicles in accordance with certain energy efficiency targets, constitutes a "restriction on domestic production" within the meaning of Article XX.

7.1005. However, Article XX(g) requires not only that such domestic restrictions exist, but that the discriminatory aspects of the measure (considered to be WTO-inconsistent, and for which justification is sought) are "made effective in conjunction with [such] restrictions". The Appellate Body has indicated that in order to satisfy this element, "the trade restriction must operate jointly with the restrictions on domestic production or consumption", in other words that they must "work together with" the domestic restrictions.[1362] Brazil has not made any such demonstration.

7.1006. In the present dispute, the Panel has found above that the discriminatory aspects of the measure are not "related to" that objective. Thus, even though the domestic restrictions pursue the conservation objective, the discriminatory aspects of the measure do not work "together with" those domestic restrictions to achieve the objective, and therefore cannot be considered "even-handed". Therefore, Brazil has not demonstrated that the discriminatory aspects of the measure are "made effective" in conjunction with the domestic restrictions.

7.4.6.3.2.3 Conclusion on whether the discriminatory aspects of the INOVAR-AUTO programme are provisionally justified under Article XX(g)

7.1007. The Panel has conducted a holistic assessment of the legal standard under Article XX(g) of the GATT 1994, and concluded that Brazil has neither demonstrated that the discriminatory aspects of the measure are related to the conservation of natural resources, nor has Brazil demonstrated that the discriminatory aspects of the measure are made effective in conjunction with restrictions on domestic production or consumption. The Panel therefore concludes that Brazil has not demonstrated that the discriminatory aspects of the INOVAR-AUTO programme are provisionally justified under Article XX(g).

7.4.6.3.3 Whether the discriminatory aspects of the INOVAR-AUTO programme satisfy the requirements in the chapeau

7.1008. Brazil argues that the differences between companies that manufacture vehicles in Brazil and those that only market vehicles in Brazil do not constitute an arbitrary or unjustifiable discrimination. According to Brazil, these differences relate to the level of contribution to the objectives pursued by the programme by both types of companies.[1363] These differences relate to three issues: (i) the conditions for accreditation, (ii) the investment requirements, and (iii) the IPI tax reductions and credits. First, as regards the conditions for accreditation, Brazil contends that they are reasonable.[1364] Second, as regards the requirement that investments be made in Brazil, Brazil argues that it is consistent with the objectives of the INOVAR-AUTO programme because it is the only way to assure that those investments translate into reductions of CO_2 emissions in Brazil, vehicular safety in Brazil, and conservation of petroleum and its derivatives.[1365] Third, as regards IPI tax reductions and credits, Brazil notes that the IPI tax reductions and credits under the INOVAR-AUTO programme are based on reasonable criteria. The higher the energy efficiency, the higher the tax reduction; the more a company contributes to the programme's goals, the higher the credit it obtains.[1366] Brazil further argues that the INOVAR-AUTO programme is not a disguised

[1361] Appellate Body Report, *China – Rare Earths*, para. 5.134.
[1362] Appellate Body Report, *China – Raw Materials*, para. 356.
[1363] Brazil's first written submissions, para. 682 (DS472) and para. 615 (DS497).
[1364] Brazil's first written submissions, paras. 683-684 (DS472) and paras. 616-617 (DS497).
[1365] Brazil's first written submissions, para. 687 (DS472) and para. 620 (DS497).
[1366] Brazil's first written submissions, para. 689 (DS472) and para. 621 (DS497).

restriction on international trade because "[t]here is nothing deceptive, or concealed about the application of the program".[1367]

7.1009. The European Union argues that the INOVAR-AUTO programme discriminates between countries where the same conditions prevail in an unjustifiable manner. It further contends that the incentives granted under this programme result in a disguised restriction on international trade.[1368] Japan argues that Brazil has failed to establish a *prima facie* case that the challenged measure is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail because it refers to the same standards by which a violation of a WTO provision is determined to exist.[1369] Japan further argues that the fact that the discriminatory aspects of the INOVAR-AUTO programme bear no connection to the claimed policy objectives demonstrates that the requirements of the chapeau have not been met.[1370] Japan is of the view that the fact that the relevant aspects of the challenged measure have been applied in a manner that which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail shows that they are also applied in a manner that constitutes a disguised restriction on international trade.[1371]

7.1010. In light of its findings above that the measure is not provisionally justified under Article XX(g) of the GATT 1994, the Panel does not consider it necessary to make findings on whether Brazil has demonstrated that its defence under Article XX(g) meets the requirements of the chapeau to Article XX.

7.4.6.3.4 Conclusion

7.1011. In light of the above, the Panel concludes that those aspects of the INOVAR-AUTO programme found to be inconsistent with Article III of the GATT 1994 and Article 2.1 of the TRIMs Agreement are not justified under Article XX(g) of the GATT 1994.[1372]

7.4.7 Claims under Article I:1 of the GATT 1994

7.4.7.1 Introduction

7.1012. The European Union and Japan raise claims under Article I:1 of the GATT 1994 with respect to certain aspects of the INOVAR-AUTO programme. Specifically, the complaining parties allege that Brazil accords an advantage in the form of tax reductions implemented through Articles 21 and 22(I) of Decree 7,819/2012, to motor vehicles imported into Brazil from a member-country of *Mercado Comun del Sur* (MERCOSUR) or Mexico, that is not accorded to like motor vehicles imported into Brazil from other WTO Members, including the European Union and Japan.[1373]

7.1013. Brazil argues that the tax reductions are not within the scope of Article I:1 of the GATT 1994, and are only accorded to Argentina, Mexico and Uruguay, and not to all members of MERCOSUR.[1374]

7.1014. The Panel recalls from paragraph 2.102 above that Articles 21 and 22(I) of Decree 7,819/2012 respectively provide for a 30 percentage point reduction of the IPI tax rates on certain categories of motor vehicles[1375] if:

[1367] Brazil's first written submissions, para. 693 (DS472) and para. 625 (DS497).

[1368] European Union's second written submission, para. 183.

[1369] Japan's second written submission, paras. 113-114.

[1370] Japan's second written submission, paras. 115-116.

[1371] Japan's second written submission, para. 117.

[1372] The Panel notes that pursuant to Article 3 of the TRIMs Agreement, "[a]ll exceptions under GATT 1994 shall apply, as appropriate to the provisions of [the TRIMs] Agreement".

[1373] European Union's first written submission, paras. 346-365; Japan's first written submission, paras. 274-281.

[1374] Brazil's first written submissions, paras. 701 (DS472) and 633 (DS497); Brazil's response to Panel question No. 52.

[1375] The particular motor vehicles subject to a tax reduction are specified in Annex I and Annex VIII of Decree 7,819/2012, as indicated in paragraph 2.106 of this Report. The Panel notes that although Article 21 refers to "vehicles" and Article 22(I) refers to "products", this distinction does not denote a difference in

a. Under Article 21, those motor vehicles are imported into Brazil by companies accredited as "domestic manufacturers" or "investors" under the INOVAR-AUTO programme, and the motor vehicles are imported from "countries that are signatories to the agreements established by Legislative Decree 350 of 21 November 1991, Decree 4,458 of 5 November 2002 and Decree 6 500 of 2 July 2008"[1376]; or

b. Under Article 22(I), those motor vehicles are imported into Brazil by any company (whether accredited or unaccredited) under the INOVAR-AUTO programme, and the motor vehicles are imported "under the agreement established by Decree 6,518 of 30 July 2008 and Decree 7,658 of 23 December 2011".[1377]

7.1015. Article I:1 of the GATT 1994 embodies the most-favoured-nation (MFN) principle. This provision reads as follows:

> With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

7.1016. The Appellate Body has described the MFN obligation in Article I:1 as "pervasive", a "cornerstone of the GATT", and "one of the pillars of the WTO trading system".[1378] In *EC – Tariff Preferences*, the Appellate Body confirmed its findings in *EC – Bananas III* that the non-discrimination obligation of Article I:1 of the GATT 1994 "plainly imposes … the obligation to treat 'like products … equally, irrespective of their origin'".[1379] In *Canada – Autos*, the Appellate Body established that Article I:1 prohibits discrimination between like imported products originating in or destined for the territories of all other WTO Members, and indicated that Article I:1 covers both *de facto* and *de jure* discrimination.[1380] The Appellate Body in *EC – Seal Products* further summarized the legal standard under Article I:1 of the GATT 1994 as follows:

> Based on the text of Article I:1, the following elements must be demonstrated to establish an inconsistency with that provision: (i) that the measure at issue falls within the scope of application of Article I:1; (ii) that the imported products at issue are "like" products within the meaning of Article I:1; (iii) that the measure at issue confers an "advantage, favour, privilege, or immunity" on a product originating in the territory of any country; and (iv) that the advantage so accorded is not extended

product scope between the two provisions. Both provisions refer to all products covered in Annexes I and VIII to Decree 7,819/2012. See all parties' responses to Panel question No. 51.

[1376] Decree 7,819/2012, (Exhibit JE-132), Article 21. Decree 350/1991 refers to the MERCOSUR Treaty, and indicates therein that the signatory countries include Brazil, Argentina, Paraguay and Uruguay. Decree 350/1991, (Exhibit JE-163). Additionally, the Panel notes that Venezuela became a signatory to the MERCOSUR agreement in July 2006, deposited its instrument of ratification in July 2012, and officially became a MERCOSUR member on 12 August 2012. CMC Decision No. 27/12, *Adesão da República Bolivariana da Venezuela ao Mercosul*, 30 July 2012, (Exhibit JE-245). Decree 4,458/2002 refers to Economic Complementation Agreement (ECA) No. 55, and indicates therein that the signatory countries include Brazil, Argentina, Paraguay, Uruguay, other Member States of MERCOSUR, and Mexico. Decree 4,458/2002, (Exhibit JE-164). Decree 6,500/2008 refers to the 38th Additional Protocol to ECA No. 14, and indicates therein that the signatory countries are Argentina and Brazil. Decree 6,500/2008 (Exhibit JE-165).

[1377] Decree 7,819/2012, (Exhibit JE-132), Article 22(I). Decree 6,518/2008 refers to the 68th Additional Protocol to Economic Complementation Agreement No. 2, and indicates therein that the signatory countries to ECA No. 2 are Brazil and Uruguay. Decree 6,518/2008, (Exhibit JE-203). Decree 7,658/2011 refers to the 69th Additional Protocol to Economic Complementation Agreement No. 2, and reiterates that the signatory countries to ECA No. 2 are Brazil and Uruguay. Decree 7,658/2011, (Exhibit JE-204).

[1378] Appellate Body Report, *EC – Seal Products*, para. 5.86.

[1379] Appellate Body Report, *EC –Tariff Preferences,* para. 89 (referring to Appellate Body Report, *EC - Bananas III*, para. 190).

[1380] Appellate Body Report, *Canada – Autos*, para. 78.

"immediately" and "unconditionally" to "like" products originating in the territory of all Members.[1381]

7.1017. We proceed by applying this four-step analysis to the facts of the present dispute.

7.4.7.2 Whether the tax reductions under Articles 21 and 22(I) of Decree 7,819/2012 fall within the scope of Article I:1 of the GATT 1994

7.1018. Under the first element of the legal standard under Article I:1, the Panel shall assess whether the tax reductions of 30 percentage points in the IPI tax rates accorded to certain imported motor vehicles under Articles 21 and 22(I) of Decree 7,819/2012 are covered by Article I:1 of the GATT 1994.

7.1019. The European Union and Japan submit that the tax reductions accorded under Articles 21 and 22(I) of Decree 7,819/2012 are within the scope of Article I:1 because they concern matters referred to in Articles III:2 and III:4 of the GATT 1994.[1382]

7.1020. Brazil argues that "the INOVAR-AUTO programme falls outside the scope of Article III of the GATT 1994 and, consequently, it also falls outside the scope of Article I:1."[1383]

7.1021. The scope of application of Article I:1 of the GATT 1994 is explicitly provided in the text thereof, and includes "all matters referred to in paragraphs 2 and 4 of Article III". Article III:2 and III:4 cover, respectively, "internal taxes or other internal charges of any kind … applied, directly or indirectly, to … products" and "laws, regulations and requirements affecting the[] internal sale, offering for sale, purchase, transportation, distribution or use" of imported products".

7.1022. The Panel notes the European Union's argument that Brazil fails to explain why a measure not falling under Article III would also escape the application of Article I.[1384] Despite Brazil's limited explanation of its argument, the Panel understands Brazil to be arguing that if a measure does not concern a "matter referred to in Article III:2 or III:4" then it is outside the scope of Article I:1. Such an understanding would accord with the plain text of Article I:1. The Panel therefore proceeds in its analysis by examining whether the tax reductions at issue under Article I:1 constitute "matters referred to in paragraphs 2 and 4 of Article III". In other words, whether the measures at issue constitute either internal taxes or other internal charges of any kind applied directly or indirectly to products; or laws, regulations, or requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of imported products.

7.1023. The Panel recalls from its discussion in section 7.2.1 above that the fact that a measure may be imposed on firms, or may relate to production and process methods, does not imply that its effects on trade in products are not covered by the disciplines of GATT Article III prohibiting discrimination between imported and domestic like products. The Panel believes that this is also true with respect to the disciplines of GATT Article I prohibiting discrimination between like imported products.[1385]

7.1024. More specifically, the tax reductions challenged under Article I:1 and discussed here are explicitly imposed on *products*. Article 21 of Decree 7,819/2012 states that "*vehicles* … may benefit from a reduction in IPI tax rates", and Article 22(I) of the same decree states that "[t]he reduction in IPI tax rates referred to in Article 21 … shall also apply to the *products*".[1386]

7.1025. Since the tax reductions are on their face applied directly to products, the Panel considers that such tax reductions relate to "internal taxes … applied, directly or indirectly, to … products",

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[1381] Appellate Body Report, *EC – Seal Products*, para. 5.86.

[1382] European Union's first written submission, para. 348; Japan's first written submission, para. 276.

[1383] Brazil's first written submissions, paras. 701 (DS472) and 633 (DS497).

[1384] European Union's opening statement at the first meeting, para. 84 (referring to Brazil's first written submission, para. 701 (DS472)). See also European Union's second written submission, para. 192.

[1385] Nor has Brazil indicated how or why the particular tax reductions challenged under Article I:1 could be exempted from the scope of Article III for any other reason.

[1386] Decree 7,819/2012, (Exhibit JE-132). (emphasis added) The Panel recalls from footnote 1375 above that this difference in wording does not alter the product scope of Articles 21 and 22(I).

and also comprise "laws, regulations and requirements affecting the[] internal sale, offering for sale, purchase, transportation, distribution or use" of imported products.

7.1026. The Panel therefore concludes that such tax reductions are indeed "matters referred to in paragraphs 2 and 4 of Article III" and therefore are within the scope of Article I:1 of the GATT 1994.[1387]

7.4.7.3 Whether the relevant products at issue are "like" products

7.1027. Turning to the second element, the Panel shall assess whether the products at issue (i.e. imported motor vehicles listed in Annexes I and VIII of Decree 7,819/2012) originating from certain countries, and those same products imported from other WTO Members are "like products".

7.1028. The European Union and Japan contend that under Articles 21 and 22(I) of Decree 7,819/2012, Brazil accords tax reductions to certain types of motor vehicles imported from MERCOSUR members (namely Argentina, Paraguay, Uruguay and Venezuela) and Mexico, and not to the same types of motor vehicles from other WTO Members, including the European Union and Japan. The complaining parties argue that the only distinction between whether a motor vehicle is or is not accorded the tax reduction is the origin of the motor vehicle, and that it is therefore not necessary for the Panel to examine the four criteria of likeness relied upon by panels and the Appellate Body in previous disputes.[1388]

7.1029. Brazil does not submit any arguments with respect to likeness under Article I:1, nor does Brazil object to reliance upon a "hypothetical likeness" analysis. Indeed, no parties have argued that the relevant products at issue under Article I:1 of the GATT 1994 are not "like" within the meaning of Article I:1.

7.1030. For the Panel's analysis, it is necessary to determine the precise country-scope of the relevant tax reductions in order to determine which precise products are being compared for the purposes of ascertaining "likeness" of the products. Brazil argues that:

> The tax treatment afforded to Argentina, Mexico and Uruguay within the framework of INOVAR-AUTO is inscribed in the implementation process of the Economic Complementation Agreements negotiated by Brazil with these three countries under the umbrella of the Treaty of Montevideo-1980 … establishing the LAIA [Latin American Integration Association] to further economic integration in Latin America. It follows that the scope of Article 21 and 22 of Decree No. 7819 of 2012 is necessarily informed by the conditions established in the agreements to which the tax treatment applies. Therefore, Decree No 7819 does not apply to vehicles imported from countries that have not negotiated an ECA [Economic Complementation Agreement] in the automotive sector with Brazil, such as Venezuela and Paraguay.[1389]

7.1031. Additionally, Brazil maintains that the tax reductions under Article 21 of Decree 7,819/2012 "are not accorded because of the MERCOSUR Treaty. While there is a reference to the MERCOSUR Treaty in the Decree, the tax treatment under INOVAR-AUTO *afforded to Argentina, Mexico and Uruguay within the framework of INOVAR-AUTO is inscribed in the implementation process of the Economic Complementation Agreements negotiated by Brazil with these three countries under the umbrella of the Treaty of Montevideo-1980*".[1390]

7.1032. In the Panel's view, the plain language of the header paragraph of Article 21 of Decree 7,819/2012 indicates that the tax reductions under Article 21 apply to products imported by accredited companies from "countries that are signatories to the agreements established by" the various decrees referred to therein. As discussed in footnote 1376 above, the countries that are signatories to the agreements established by the relevant decrees are as follows:

[1387] The Panel recalls that the tax reductions challenged under Article III of the GATT 1994 were found to be within the scope of Article III. See paragraph 7.636 and section 7.4.2.2 above.

[1388] European Union's first written submission, paras. 295-296 and 350-354; Japan's first written submission, paras. 179-186 and 277. See also European Union's response to Panel question No. 52; Japan's response to Panel question No. 52.

[1389] Brazil's response to Panel question No. 52.

[1390] Brazil's comments on other parties' responses to Panel question No. 52. (emphasis original)

a. Decree 350/1991 refers to the MERCOSUR Treaty, and indicates therein that the signatory countries include Brazil, Argentina, Paraguay and Uruguay. Additionally, at the time of the Panel's establishment, Venezuela had become an additional signatory to (and member of) the MERCOSUR Treaty;

b. Decree 4,458/2002 refers to Economic Complementation Agreement (ECA) No. 55, and indicates therein that the signatory countries include Brazil, Argentina, Paraguay, Uruguay, other Member States of MERCOSUR (which would include Venezuela), and Mexico; and

c. Decree 6,500/2008 refers to the 38th Additional Protocol to ECA No. 14, and indicates therein that the signatory countries are Argentina and Brazil.[1391]

7.1033. On the basis of the plain language of Article 21, the relevant tax reductions apply to motor vehicles imported from all MERCOSUR members (i.e. Argentina, Paraguay, Uruguay and Venezuela) and Mexico.[1392] The Panel therefore finds that the products to be compared are motor vehicles identified in Annexes I and VIII to Decree 7,819/2012, imported from MERCOSUR members (i.e. Argentina, Paraguay, Uruguay and Venezuela) and Mexico, on the one hand, and those same motor vehicles imported from other WTO Members (including the European Union and Japan) on the other hand.

7.1034. As explained in paragraphs 7.124 to 7.126 above, panels and the Appellate Body have followed a hypothetical analysis of likeness in situations where the measures at issue distinguish between products exclusively on the basis of origin.[1393] Previous panels have followed such an approach not only with respect to likeness under Article III, but also likeness under Article I:1.[1394]

7.1035. With respect to the measure at issue under Article I:1 of the GATT 1994, the Panel considers that the only relevant distinguishing factor between products receiving the tax reductions under Articles 21 and 22(I) of Decree 7,819/2012 and products that do not receive that tax reduction, is indeed their country of origin. The Panel also notes that the fact that Brazil might provide the challenged tax reductions under Articles 21 and 22(I) of Decree 7,819/2012 only to Argentina, Mexico and Uruguay, and not to Paraguay or Venezuela, would not affect the Panel's reliance upon a hypothetical likeness analysis, or the Panel's conclusion that the relevant imported products being compared are like.

7.1036. Since Articles 21 and 22(I) of Decree 7,819/2012 explicitly and clearly grant tax reductions to certain products based *exclusively* on their origin, and taking into account that Brazil has not objected to such an analysis in respect of the complaining parties' claims under Article I:1, the Panel therefore concludes that the relevant products at issue are "like" within the meaning of Article I:1.

[1391] See footnote 1375 above.

[1392] The Panel also notes certain inconsistencies in Brazil's argument. First, Brazil's interpretation of Articles 21 and 22(I) of Decree 7,819/2012 suggests that the relevant tax reductions accorded under those provisions are conditioned on the existence of an ECA. In this respect, ECA No. 2 (the relevant ECA between Brazil and Uruguay) is *only* referred to in Article 22(I) and not in Article 21. Therefore, pursuant to Brazil's interpretation, Uruguay should not benefit from the tax advantage accorded under Article 21. However, Brazil has made no such distinction between Articles 21 and 22(I). Second, and more pertinently, as noted above, Brazil argues that the relevant tax reductions accorded under Articles 21 and 22 are conditioned on the existence of an ECA. However, in its first written submissions, Brazil explicitly identifies the MERCOSUR Treaty as a relevant ECA. See Brazil's first written submissions, para. 707 and fn 473 (DS472) and para. 639 and fn 423 (DS497). It is therefore contradictory to assert that on the one hand the MERCOSUR Treaty is an ECA "negotiated under the auspices of [the Treaty of Montevideo]", but that the preferential treatment under Articles 21 and 22, resulting from "the implementation process of the Economic Complementation Agreements negotiated by Brazil", exclude signatories to the MERCOSUR Treaty. Compare Brazil's first written submissions, para. 707 and fn 473 (DS472) and para. 639 and fn 423 (DS497), with Brazil's comments on other parties' responses to Panel question No. 52.

[1393] Appellate Body Report, *Canada – Periodicals*, pp. 20-21, DSR 1997:1, 449, at pp. 466-467. See also Panel Report, *Indonesia – Autos*, para. 14.113.

[1394] See e.g. Panel Reports, *Colombia – Ports of Entry*, paras. 7.355-7.357; *US – Poultry (China)*, paras. 7.431-7.432.

7.4.7.4 Whether the tax reductions at issue confer an "advantage"

7.1037. The Panel now turns to the third element of the legal standard, whether the tax reductions at issue confer an "advantage, favour, privilege, or immunity" on the vehicles originating from MERCOSUR members and Mexico.

7.1038. The complaining parties argue that the relevant advantages are the tax reductions accorded to (i) motor vehicles imported from MERCOSUR members or from Mexico, by accredited companies; and (ii) motor vehicles imported from Uruguay by unaccredited companies.[1395]

7.1039. Brazil has not made any arguments on this issue.

7.1040. The Appellate Body and past panels have interpreted the term "advantage" broadly. In *EC – Bananas III*, the Appellate Body stated that "a broad definition has been given to the term 'advantage' in Article I:1".[1396] The Panel in *EC – Bananas III* indicated that an advantage within the meaning of Article I:1 of GATT 1994 "create[s] more favourable competitive opportunities" between products of different origins.[1397] The Appellate Body has also indicated that a finding of inconsistency with Article I:1 "is not contingent upon the actual trade effects of a measure".[1398]

7.1041. The Panel understands that an "advantage" within the meaning of Article I:1 of the GATT 1994 exists when a measure alters the conditions of competition for certain imported products relative to other like imported products.

7.1042. Applying this to the present dispute, the Panel considers that the tax reductions challenged under Article I:1 do indeed act as advantages relative to like imported products that do *not* receive that tax reduction. Insofar as one product receives a lower tax burden than another like product, there is a change in the conditions of competition for the like product relative to the less-taxed product.[1399] Brazil has not presented any argument to the contrary.[1400]

7.1043. The Panel therefore concludes that the tax reductions accorded under Articles 21 and 22(I) of Decree 7,819/2012 to motor vehicles imported from MERCOSUR members and Mexico, and not accorded to other WTO Members, constitute advantages within the meaning of Article I:1 of the GATT 1994.[1401]

[1395] European Union's first written submission, paras. 356-357; Japan's first written submission, paras. 278-279.

[1396] Appellate Body Report, *EC – Bananas III*, para. 206.

[1397] Panel Report, *EC – Bananas III*, para. 7.239.

[1398] Appellate Body Report, *EC – Seal Products*, para. 5.87.

[1399] As the panel in *Indonesia – Autos* stated, "duty free treatment obviously is an advantage" within the meaning of Article I:1. Panel Report, *Indonesia – Autos*, para. 7.11.

[1400] The Panel notes that Brazil does raise arguments that any differential and more favourable treatment is nevertheless justified under the Enabling Clause. See section 7.4.8 below. Nevertheless, Brazil does not present any arguments in respect of the particular issue addressed here, namely whether the measure at issue confers an advantage to products from certain countries.

[1401] The Panel notes the following with respect to the scope of the relevant "advantages". First, Article 21 §1(III) of Decree 7,819/2012 states that the tax reductions accorded under Article 21 shall apply "to the products that meet the respective requirements, limits or quantitative restrictions under the agreements referred to in the header paragraph" (namely the MERCOSUR Treaty, ECA No. 55, and ECA No. 14). Article 22 §1(II) states that the tax reductions accorded under Article 22(I) shall apply "to the products that meet the respective requirements, limits or quantitative restrictions of the relevant agreement" (namely ECA No. 2). Thus, to the extent any quantitative limitations do apply, such limitations constrain the scope of the advantage. Second, under Article 22(II)(b) of Decree 7,819/2012, a tax reduction of 30 percentage points is available to a limited number of motor vehicles from any country that are imported by or on behalf of companies accredited under the INOVAR-AUTO programme. Decree 7,819/2012, (Exhibit JE-132). The Panel considers that on the face of the relevant provisions, Articles 21, 22(I) and 22(II) appear to operate cumulatively, and do not displace or modify one another. The use of the word "also" ("*ainda*" in the original Portuguese) in Article 22 of Decree 7,819/2012 confirms that the provisions apply cumulatively. The Panel therefore considers that the generic treatment accorded to vehicles from all countries under Article 22(II)(b), does not modify the special dispensation (i.e. the advantages) granted to motor vehicles imported from MERCOSUR members and Mexico under Articles 21 and 22(I). Third, motor vehicles imported from Uruguay are subject to two distinct advantages: first, the tax reduction accorded under Article 21 to motor vehicles imported from Uruguay by accredited companies; and second, the tax reduction accorded under Article 22(I) to motor vehicles imported from Uruguay by any company (accredited or unaccredited).

7.4.7.5 Whether that advantage is not accorded "immediately" and "unconditionally" to other WTO Members

7.1044. Finally, the Panel must examine whether the advantages accorded by Brazil to motor vehicles originating in the territories of MERCOSUR members and Mexico are not extended "immediately" and "unconditionally" to like imported motor vehicles from other WTO Members.

7.1045. The European Union and Japan argue that the tax advantage accorded under Articles 21 and 22(I) of Decree 7,819/2012 results in a detrimental impact on the competitive opportunities for like imported products and therefore the relevant advantages are not accorded immediately and unconditionally to like imported motor vehicles from other WTO Members.[1402]

7.1046. Brazil has not made any arguments on this issue.

7.1047. The tax advantages under Articles 21 and 22(I) of Decree 7,819/2012 are accorded solely to MERCOSUR Members and Mexico. On the basis of the evidence before it, the Panel concludes that the advantages accorded to motor vehicles imported into Brazil from MERCOSUR members and Mexico are not extended immediately and unconditionally to like products from other WTO Members.

7.4.7.6 Conclusion

7.1048. In light of the foregoing, the Panel concludes that the tax reductions accorded to imported products from MERCOSUR members and Mexico under the INOVAR-AUTO programme are advantages granted by Brazil to products originating in those countries, which are not accorded immediately and unconditionally to like products originating in other WTO Members, inconsistently with Article I:1 of the GATT 1994.

7.4.8 Brazil's justifications under the Enabling Clause

7.4.8.1 Introduction

7.1049. The Panel now turns to Brazil's defence under the 1979 Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (the Enabling Clause).

7.1050. At the outset, the Panel notes that a number of the issues raised by the parties in respect of the Enabling Clause pertain to notification of measures adopted pursuant to the Enabling Clause. The Panel is aware that there are ongoing and important debates between WTO Members in the Committee on Trade and Development, and the Committee on Regional Trade Agreements, regarding the legal requirements relating to notification under the Enabling Clause. [1403] Furthermore, the Panel notes that only one Appellate Body report has previously addressed the interpretation of the Enabling Clause, namely the report in *EC – Tariff Preferences*, which concerned a tariff preference scheme adopted by a developed country in favour of imports from developing countries, and notified to the WTO as adopted pursuant to paragraph 2(a) of the Enabling Clause.[1404] As further explained below, in that dispute the parties did not disagree on the WTO-consistency of said notification, and all parties were well aware of the conditions of the preference scheme notified by the European Union (formerly the European Communities) – aspects of which were considered to be inconsistent with the non-discrimination obligation of footnote 3 of the Enabling Clause. The present dispute raises different, additional and complex issues relating to the type and content of notifications required under paragraph 4 of the Enabling

[1402] European Union's first written submission, paras. 115-117 and 361-364; Japan's first written submission, paras. 114-115 and 280-281.

[1403] Notes on the Meeting of 5-6 April 2016 and 27 June 2016, Committee on Regional Trade Agreements, WT/REG/M/80 and WT/REG/M/81, distributed 10 May 2016 and 12 July 2016, respectively. See also Note on the Meeting of 16 March 2016, WT/COMTD/M/98, distributed 25 May 2016; Communication from Uruguay on behalf of Latin American Integration Association (LAIA), Committee on Trade and Development/Committee on Regional Trade Agreements, WT/COMTD/W/217, WT/REG/W/105, distributed 14 June 2016.

[1404] See generally Panel and Appellate Body Reports, *EC – Tariff Preferences*.

Clause and how to interpret and apply the justifications under paragraph 2(b) and 2(c) of the Enabling Clause.

7.1051. The Enabling Clause states in relevant parts that:

> 1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries[1], without according such treatment to other contracting parties.
>
> 2. The provisions of paragraph 1 apply to the following[2]:
>
> …
>
> b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT;
>
> c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another;
>
> …
>
> 3. Any differential and more favourable treatment provided under this clause:
>
> a) shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties;
>
> b) shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a most-favoured-nation basis;
>
> …
>
> 4. Any contracting party taking action to introduce an arrangement pursuant to paragraphs 1, 2 and 3 above or subsequently taking action to introduce modification or withdrawal of the differential and more favourable treatment so provided shall:[4]
>
> a) notify the CONTRACTING PARTIES and furnish them with all the information they may deem appropriate relating to such action;

[1] The words "developing countries" as used in this text are to be understood to refer also to developing territories.
[2] It would remain open for the CONTRACTING PARTIES to consider on an ad hoc basis under the GATT provisions for joint action any proposals for differential and more favourable treatment not falling within the scope of this paragraph.
[3] As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of "generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries" (BISD 18S/24).
[4] Nothing in these provisions shall affect the rights of contracting parties under the General Agreement.

7.1052. In *EC – Tariff Preferences*, the Appellate Body found that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994 and that, "to the extent that there is a conflict between measures under the Enabling Clause and the MFN obligation in Article I:1 [of the GATT 1994], the Enabling Clause, as the more specific rule, prevails over Article I:1".[1405] The Appellate Body established that a panel should first look at the consistency of the challenged measure with Article I:1 of the GATT 1994 and, in the event of inconsistency, the panel should, as a second step, examine whether the measure is nevertheless justified under the Enabling Clause.[1406]

[1405] Appellate Body Report, *EC – Tariff Preferences*, paras. 99 and 101.
[1406] Appellate Body Report, *EC – Tariff Preferences*, para. 101.

7.1053. As agreed by all parties, the exception in paragraph 1 is subject to the conditions set out in paragraphs 2, 3 and 4.[1407] Paragraph 2 sets out the scope of application of the Enabling Clause, enumerating four specific types of "differential and more favourable treatment" that may be justified pursuant to the Enabling Clause. Paragraph 3 sets out a number of conditions or requirements that must be satisfied in order for any differential and more favourable treatment to be covered by the Enabling Clause. Paragraph 4 imposes certain procedural obligations on any WTO Member seeking to introduce or modify an "arrangement" pursuant to paragraphs 1, 2 and 3 of the Enabling Clause.

7.1054. Brazil contends that, in the event the Panel finds any inconsistency with Article I:1 of the GATT 1994 in respect of Argentina, Mexico and Uruguay, such differential and more favourable treatment is nonetheless justified under both paragraph 2(b) and 2(c) of the Enabling Clause. The Panel therefore understands from Brazil's multiple written submissions and responses to questions that Brazil does not invoke the Enabling Clause with respect to the differential and more favourable treatment for motor vehicles imported from Paraguay and Venezuela.[1408] Brazil asserts that this differential and more favourable treatment was notified to the WTO, as required under paragraph 4(a) of the Enabling Clause, and satisfies the substantive requirements in paragraph 3 of the Enabling Clause. Brazil also argues that the European Union and Japan had the burden of invoking the Enabling Clause in their panel requests and since they did not do so, they cannot challenge the right of Brazil to invoke paragraph 2(b) and 2(c) of the Enabling Clause to justify the inconsistency of the INOVAR-AUTO programme with Article I:1 of the GATT 1994.[1409]

7.1055. The European Union and Japan object to Brazil's reliance on the Enabling Clause. They argue that Brazil did not comply with the notification requirement contained in paragraph 4(a) of the Enabling Clause, and that Brazil did not demonstrate that its measure is covered by either paragraph 2(b) or paragraph 2(c) of the Enabling Clause. The complaining parties also argue that the challenged measures and the justifications invoked by Brazil do not satisfy certain requirements in paragraph 3 of the Enabling Clause.[1410] The complaining parties also argue that

[1407] Brazil's first written submissions, paras. 702 and 704 (DS472) and paras. 634 and 636 (DS497); European Union's responses to Panel questions No. 53, 54 and 55; Japan's responses to Panel questions No. 53, 54 and 55.

[1408] In response to questions from the Panel regarding any differential and more favourable treatment accorded to Paraguay or Venezuela, Brazil indicated that, in its view, no differential and more favourable treatment is accorded under Articles 21 and 22(I) of Decree 7,819/2012 to vehicles imported from Paraguay or Venezuela. Brazil's response to Panel question No. 52; Brazil's comments on other parties' responses to Panel question No. 52. The Panel has addressed this argument of Brazil in further detail above, in the context of the complaining parties' claims under Article I:1 of the GATT 1994, and has concluded that Article 21 of Decree 7,819/2012 does accord differential and more favourable tax treatment to companies accredited under the INOVAR-AUTO programme that import motor vehicles from all MERCOSUR members, including Venezuela and Paraguay. See paragraphs 7.1030 to 7.1033 above. Brazil has not made any arguments under the Enabling Clause in respect of Venezuela and Paraguay, even on an *arguendo* basis in the event that the Panel were to find that indeed Decree 7,819/2012 *did* grant differential and more favourable treatment to goods imported from Paraguay and Venezuela. Additionally, the Panel notes that Articles 21 and 22(I) of Decree 7,819/2012 accord two distinct types of advantages to motor vehicles imported from Uruguay. See paragraph 7.1014 above. The treatment provided to Uruguay under Article 21 of Decree 7,819/2012 is identical to the treatment provided to Paraguay and Venezuela under that provision (resulting from being a signatory to the MERCOSUR Treaty) while the treatment accorded to Uruguay under Article 22(I) of Decree 7,819/2012 is distinct (and results from being a signatory to ECA No. 2). The Panel notes at this stage that Brazil argues generally that the "preferential treatment given to … Uruguay in INOVAR-AUTO … is justified under the Enabling Clause", even though Brazil does not argue that the differential and more favourable treatment accorded to Paraguay and Venezuela under Article 21 (which is identical to the differential and more favourable treatment accorded to Uruguay under Article 21) is covered by the Enabling Clause. Brazil's response to Panel question No. 52.

[1409] Brazil's first written submissions, paras. 694-742 (DS472) and 627-674 (DS497); Brazil's response to Panel question No. 4; Brazil's second written submission, paras. 166-181; Brazil's response to Panel questions No. 4, 53, 54 and 55; Brazil's comments on other parties' responses to Panel questions No. 53, 54 and 55.

[1410] European Union's opening statement at the first meeting, paras. 84-97; European Union's responses to Panel question No. 4; European Union's second written submission, paras. 196-200; European Union's responses to Panel questions No. 53, 54 and 55; Japan's opening statement, paras. 36-42; Japan's responses to Panel question No. 4; Japan's second written submission, para. 129; Japan's responses to Panel questions No. 53, 54 and 55.

they were under no obligation to raise the Enabling Clause in their panel requests since the measure was not plainly introduced pursuant to the Enabling Clause.[1411]

7.1056. The Panel will first address the issue raised by Brazil regarding the burden of invoking the Enabling Clause, i.e. whether the European Union and Japan were obliged to raise matters relating to the Enabling Clause in their panel request if they wished to challenge the consistency of Brazil's justification under the Enabling Clause. The Panel will then address separately each of the two affirmative defences raised by Brazil – namely that the challenged measures are justified pursuant to paragraph 2(b) and 2(c) of the Enabling Clause. In conducting those analyses the Panel will consider first whether Brazil notified the challenged measure to the WTO as required by paragraph 4(a) of the Enabling Clause, and second, whether Brazil demonstrated that the challenged measures comply with the requirements of paragraph 2(b) and 2(c). Finally, and only if necessary, the Panel will address whether the measure is consistent with the requirements of paragraph 3 of the Enabling Clause.

7.4.8.2 The burden of invoking the Enabling Clause

7.1057. Brazil argues that based on the Appellate Body's decision in *EC – Tariff Preferences*, a complaining party has the burden of indicating in its panel request that a particular challenged measure is not consistent with the relevant provisions of the Enabling Clause.[1412] Argentina as a third party supports this view and also asserts that because the European Union and Japan did not identify the relevant provisions of the Enabling Clause with which they take issue, their "argument does not appear to fulfil[] the standard set forth by the Appellate Body in *EC – Tariff Preferences* for raising this type of claim[]."[1413]

7.1058. The European Union and Japan maintain that because the INOVAR-AUTO programme does not "manifestly" (in the European Union's words) or "on its face" (in Japan's words) indicate that the discriminatory treatment was introduced pursuant to the Enabling Clause, there was no burden on the complaining parties to invoke the Enabling Clause in their panel requests.[1414]

7.1059. In *EC – Tariff Preferences* the Appellate Body highlighted the special status of the Enabling Clause, noting that it was not a "typical 'exception', or 'defence', in the style of Article XX of the GATT 1994, or of other exception provisions".[1415] The Appellate Body indicated that it was clear that the challenged measure in that dispute was "part of a preferential tariff scheme implemented … pursuant to the authorization in paragraph 2(a) of the Enabling Clause".[1416] On that basis, the Appellate Body stated that:

> [W]hen a complaining party considers that a preference scheme of another Member does not meet one or more of [the requirements of the Enabling Clause], the specific provisions of the Enabling Clause with which the scheme allegedly falls afoul, form critical components of the 'legal basis of the complaint' and, therefore, of the 'matter' in dispute. Accordingly, a complaining party cannot, in good faith, ignore those provisions and must, in its [panel request] identify them and thereby 'notif[y] the parties and third parties of the nature of [its] case'. For the failure of such a complaining party to raise the relevant provisions of the Enabling Clause would place an unwarranted burden on the responding party.
>
> … [A]lthough a responding party must defend the consistency of its preference scheme with the conditions of the Enabling Clause and must prove such consistency, a

[1411] European Union's response to Panel questions No. 4 and 53; European Union's second written submission, paras. 195-198 and 205; Japan's response to Panel questions No. 4 and 53; Japan's second written submission, para. 129.

[1412] Brazil's response to Panel question No. 4 (referring to Appellate Body Report, *EC – Tariff Preferences*, para. 110).

[1413] Argentina's third party written submissions, paras. 13 (DS472) and 14 (DS497) (referring to Appellate Body Report, *EC – Tariff Preferences*, para. 113).

[1414] European Union's response to Panel questions No. 4 and 53; European Union's second written submission, paras. 195-198 and 205; Japan's response to Panel questions No. 4 and 53; Japan's second written submission, para. 129.

[1415] Appellate Body Report, *EC – Tariff Preferences*, paras. 106 and 110.

[1416] Appellate Body Report, *EC – Tariff Preferences*, para. 117.

> complaining party has to define the parameters within which the responding party must make that defence.[1417]

7.1060. From these paragraphs the Panel understands that the Appellate Body distinguished between the burden on the complainant of "raising" or "invoking" the Enabling Clause, that involves the identification of the relevant provisions of the Enabling Clause with which the complaining parties consider the measure to be inconsistent, and the burden on the respondent of "proving" that the relevant differential and more favourable treatment satisfies the requirements of the Enabling Clause.[1418]

7.1061. The Panel also notes that the Appellate Body's statements in *EC – Tariff Preferences* were made in the context of a "tariff preference scheme" adopted by a developed country in favour of a developing country. In particular the Panel notes that the *EC – Tariff Preferences* dispute did not involve any issues in respect of notification of regional trade agreements, unlike the present dispute.

7.1062. From the foregoing, and in light of other comments made by the Appellate Body in *EC – Tariff Preferences*[1419], the Panel understands that the issue of whether the Enabling Clause has been properly invoked by the complaining parties pertains to the jurisdiction of the Panel, and specifically whether the complaining parties' claim under Article I:1 of the GATT 1994 is within the Panel's terms of reference. Brazil has not clearly expressed its concerns with respect to the burden of invocation as a jurisdictional issue.[1420] Regardless, the Panel notes that a panel has a duty to address "issues which go to the root of their jurisdiction … if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed."[1421]

7.1063. The Panel further notes that the Appellate Body's statements in *EC – Tariff Preferences* were made in the specific context of a "a preference scheme of another Member", and that the Appellate Body's rationale for placing the burden of invocation on the complainant was that "[e]xposing preference schemes to open-ended challenges would be inconsistent … with the intention of Members, as reflected in the Enabling Clause, to 'encourage' the adoption of preferential treatment for developing countries and to provide a practical means of doing so within

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[1417] Appellate Body Report, *EC – Tariff Preferences*, paras. 113-114. (footnotes omitted) (emphasis original)

[1418] To this end, the Panel notes as a general matter that regardless of the burden of "raising" or "invoking" the Enabling Clause, the Appellate Body has indicated that the burden of "proof" is always on the responding party (in this dispute, Brazil) to demonstrate that the differential and more favourable treatment found to be inconsistent with Article I:1 of the GATT 1994 is nonetheless justified under the Enabling Clause. See Appellate Body Report, *EC – Tariff Preferences*, paras. 114-115.

[1419] The Appellate Body stated that "India, as the complaining party, should reasonably have articulated its claims of inconsistency with specific provisions of the Enabling Clause at the outset of this dispute as part of its responsibility to 'engage in [dispute settlement] procedures in good faith in an effort to resolve the dispute." Appellate Body Report, *EC – Tariff Preferences*, para. 117 (referring to DSU Art. 3.10 and Appellate Body Report, *US – FSC*, para. 166). Furthermore, because India's panel request identified those specific requirements of the Enabling Clause with which India considered the preference scheme to be inconsistent, "[t]he Panel's terms of reference … included India's allegations that certain aspects of the [challenged measure] were not 'consistent' with, or did not 'meet the requirements set out in', [specific provisions] of the Enabling Clause." Appellate Body Report, *EC – Tariff Preferences*, para. 119. Additionally, "India was required to raise the Enabling Clause in making its claim of inconsistency with Article I:1" and "it was incumbent upon India to *raise* the Enabling Clause in making its claim of inconsistency with Article I:1 of the GATT 1994". Appellate Body Report, *EC – Tariff Preferences*, paras. 123 and 125.

[1420] See Brazil's response to Panel question No. 4.

[1421] The Appellate Body stated that:

> [P]anels are required to address issues that are put before them by the parties to a dispute [and] panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues. In this regard, … '[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for lawful panel proceedings.' For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction – that is, to their authority to deal with and dispose of matters. Rather, panels must deal with such issues – if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed. Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 36 (quoting Appellate Body Report, *United States – 1916 Act*, para. 54).

See also Award of the Arbitrators, *US – Section 110(5) Copyright Act (Article 25)*, para. 2.1; and Decisions by the Arbitrator, *US – COOL (Article 22.6 – United States)*, paras. 2.6-2.7.

the legal framework of the covered agreements."[1422] Furthermore, the Appellate Body emphasized that, in that dispute:

> [It was] clear, on the face of the Regulation and from official, publicly-available explanatory documentation, that the [challenged measure was] part of a preferential tariff scheme implemented by the European Communities pursuant to the authorization in paragraph 2(a) of the Enabling Clause. As such, India would have been well aware that the Drug Arrangements must comply with the requirements of the Enabling Clause, and that the European Communities was likely to invoke the Enabling Clause in response to a challenge of inconsistency with Article I:1.[1423]

7.1064. On the basis of the foregoing, the Panel considers that the burden of invoking the Enabling Clause is placed on the complaining party in situations where the complaining party is on notice that the challenged measure was adopted (and in the view of the adopting member, justified) under the Enabling Clause. In other words, a burden to invoke a particular provision of the Enabling Clause in a panel request could only be placed on a complaining party, if that complaining party was appropriately informed prior to the time of the panel request that the responding party considered the relevant measure to be adopted and justified pursuant to the Enabling Clause. Indeed, the Panel considers that an alternative approach could result in absurd outcomes, such as a complaining party invoking *all* the provisions of the Enabling Clause in its panel request in any dispute involving claims under Article I:1 of the GATT 1994, in order to resolve its burden of invocation, and guard against *all* possible defences raised by a responding party pursuant to the Enabling Clause.

7.1065. In the present dispute, the only argument raised by Brazil in support of placing the burden of invocation on the complaining parties is that the relevant measures were notified to the WTO as adopted pursuant to the Enabling Clause.

7.1066. The Panel notes that in situations where a WTO Member has notified a particular arrangement imposing discriminatory treatment as adopted or modified under the Enabling Clause, other WTO Members are presumed to be aware that the specific discriminatory treatment was adopted pursuant to the Enabling Clause. In such circumstances, in light of the Enabling Clause's special nature (as identified by the Appellate Body in *EC – Tariff Preferences*), it is reasonable to impose the burden of pleading specific provisions of the Enabling Clause on the party alleging that the particular differential treatment is inconsistent with Article I:1 of the GATT 1994.

7.1067. The Panel recalls the complaining parties' argument that Brazil failed to notify the relevant arrangements imposing the differential and more favourable treatment, as required under paragraph 4(a) of the Enabling Clause.[1424] In the Panel's view, if this assertion is correct, then that failure to notify would be a relevant factual distinction between *EC – Tariff Preferences* (where the preference scheme was indisputably adopted pursuant to the Enabling Clause) and the present dispute (where even the fact of notification is contested by the parties). Furthermore, the Panel emphasizes that Brazil has not indicated any other reason to impose on the complaining parties the burden of invoking the Enabling Clause.

7.1068. The Panel therefore concludes that a complaining party cannot be under an obligation to invoke the Enabling Clause in its panel request, *unless* that complaining party is appropriately informed that the responding party considers the challenged measure to have been adopted pursuant to (and justified under) the Enabling Clause. In the Panel's view, such an approach is sufficient to address the concerns raised by the complaining parties in paragraph 7.1058 above, without imposing an unnecessarily excessive burden on a party seeking to invoke the Enabling Clause in dispute settlement. In the present dispute, the Panel considers that, on the basis of the arguments and evidence presented by the parties in the present dispute, the European Union and Japan could not have been presumed to be informed of Brazil's intentions *unless* the adoption of those discriminatory taxes pursuant to the Enabling Clause was notified to the WTO, as required by paragraph 4(a) of the Enabling Clause. The Panel addresses below in the context of each

[1422] Appellate Body Report, *EC – Tariff Preferences*, para. 114.
[1423] Appellate Body Report, *EC – Tariff Preferences*, para. 117.
[1424] European Union's opening statement at the first meeting, paras. 85-86; response to Panel question No. 4; responses to Panel question to the third parties Nos. 8 and 9; second written submission, para. 193; Japan's opening statement at the first meeting, paras. 37-38; response to Panel question No. 4.

justification asserted by Brazil (i.e. in respect of paragraph 2(b) and paragraph 2(c) respectively), the issue of whether the challenged measures and their related justifications were notified to the WTO.

7.4.8.3 Brazil's affirmative defence under paragraph 2(b) of the Enabling Clause

7.1069. Brazil asserts that the tax reductions accorded to motor vehicles from Argentina, Mexico and Uruguay, and found to be inconsistent with Article I:1 of the GATT 1994, are justified under paragraph 2(b) of the Enabling Clause. Brazil asserts that this differential and more favourable treatment was notified to the WTO, as required under paragraph 4(a) of the Enabling Clause, and satisfies the substantive requirements in paragraph 3 of the Enabling Clause.[1425]

7.1070. The European Union and Japan argue that Brazil did not comply with the notification requirement contained in paragraph 4(a) of the Enabling Clause, and that Brazil did not demonstrate that its measure is covered by paragraph 2(b) of the Enabling Clause. The complaining parties also argue that the differential and more favourable treatment does not satisfy certain requirements in paragraph 3 of the Enabling Clause.[1426]

7.1071. Paragraph 4(a) of the Enabling Clause states that a Member "taking action to introduce an arrangement pursuant to paragraphs 1, 2 and 3 above … shall: (a) notify the CONTRACTING PARTIES".

7.1072. Brazil acknowledges that paragraph 4(a) imposes a requirement to notify any differential and more favourable treatment adopted pursuant to the Enabling Clause.[1427] Brazil argues that the notification requirement in paragraph 4(a) is satisfied because the 1980 Treaty of Montevideo establishing the Latin American Integration Association (LAIA) was notified to the WTO under Article 2(c) of the Enabling Clause. Brazil argues that the differential and more favourable treatment granted to Argentina, Mexico and Uruguay, is based on ECAs negotiated under the auspices of the 1980 Treaty of Montevideo instituting LAIA.[1428] Brazil argues that the ECAs "are implementation measures of the Treaty of Montevideo and [we]re notified to the WTO by the LAIA Secretariat. INOVAR-AUTO's tax treatment to certain LAIA countries is the corollary of these ECAs and does not require further notification."[1429]

7.1073. The European Union and Japan argue that Brazil did not comply with the notification requirements in paragraph 4(a), because neither the Treaty of Montevideo nor the ECAs cover internal taxation and Brazil did not notify either the INOVAR-AUTO programme or the ECAs.[1430] The European Union also highlights that Brazil's only claimed notifications were under paragraph 2(c) and not under paragraph 2(b). Additionally, the European Union argues, and Ukraine agrees as a third party, that Brazil was required to comply with the notification requirements set forth in the Transparency Mechanism on Preferential Trade Arrangements, and failed to do so.[1431]

7.1074. As an initial matter, the Panel finds as a matter of fact that the 1980 Treaty of Montevideo was notified to the WTO on 1 July 1982, as adopted pursuant to paragraph 2(c) of the

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[1425] Brazil's first written submissions, paras. 695-742 (DS472) AND 627-674 (DS497).

[1426] European Union's opening statement at the first meeting, paras. 84-97; European Union's responses to Panel question No. 4; European Union's second written submission, paras. 196-200; European Union's responses to Panel questions No. 53, 54 and 55; Japan's opening statement, paras. 36-42; Japan's responses to Panel question No. 4; Japan's second written submission, para. 129; Japan's responses to Panel questions No. 53, 54 and 55.

[1427] Brazil's first written submissions, paras. 740-742 (DS472) and paras. 672-674 (DS497).

[1428] Brazil's first written submissions, paras. 706-707 (DS472) and paras. 638-639 (DS497).

[1429] Brazil's second written submission, para. 181. See also Brazil's response to Panel question No. 53; Communication from LAIA to the Chair of the Trade and Development Committee, WTO, 19 May 2016, (Exhibits BRA-114 and BRA-115).

[1430] Japan occasionally refers to the ECAs as Economic Complementarity Agreements. See e.g. Japan's first written submission, para. 179. The Panel notes that Article 11 of the Treaty of Montevideo itself refers to Economic Complementarity Agreements. See Treaty of Montevideo, 1980, (Exhibit BRA-93).

[1431] European Union's opening statement at the first meeting, paras. 86-87; responses to Panel question to the third parties Nos. 8 and 9; second written submission, paras. 196 and 198; Japan's opening statement, paras. 37-38; second written submission, para, 129; Ukraine's third party written submission, para. 5; third party statement at the first meeting, para. 5; response to question No. 7 from the Panel to the third parties.

Enabling Clause.[1432] The Panel further notes that no explicit notification in respect of paragraph 2(b) has been identified by any party, or submitted to the Panel as evidence.

7.1075. In the Panel's view, three issues are raised. First, since Brazil asserts that the notification of the Treaty of Montevideo under paragraph 2(c) is sufficient to satisfy the notification requirement for an arrangement adopted pursuant to paragraph 2(b), the Panel must determine whether a notification of an arrangement adopted pursuant to paragraph 2(c) can also serve as a notification of an arrangement adopted pursuant to paragraph 2(b). Second, in the event that a notification under one provision can serve as a notification under another provision, the Panel must determine whether the notification of the Treaty of Montevideo and the ECAs could substantively serve as a notification of the specific differential and more favourable treatment sought to be justified under paragraph 2(b). Third, if Brazil prevails on both of the above issues, the Panel must decide whether the MERCOSUR Treaty and the ECAs, procedurally speaking, have been notified to the WTO as independent RTAs adopted pursuant to paragraph 2(c) of the Enabling Clause, or whether notification of the "umbrella" Treaty of Montevideo[1433] is sufficient.

7.1076. Addressing the first issue, the Panel notes that the ordinary meaning of paragraph 4(a) alone is unhelpful in determining whether a notification under one provision can function as a notification of that same measure being also adopted under another provision.

7.1077. The Panel notes, however, that the object and purpose of a notification requirement is to enable other Members to be informed of arrangements that are inconsistent with Article I:1, but that are considered by the adopting Member to nonetheless be justified under the Enabling Clause.[1434] Indeed, as Brazil itself indicates, paragraph 4(a) of the Enabling Clause "requires that when giving enhanced market access to products from developing countries [pursuant to the Enabling Clause] the granting Member must notify all WTO Members *as to inform them about the measures to be taken* [and] … *give them the opportunity to question the deviation from the MFN obligation*."[1435] The Panel agrees with Brazil's characterization of the notification requirement, and considers that the object and purpose of notification (namely informing other Members about the measures to be taken, and giving them the opportunity to question the deviation from the MFN obligation) would be circumvented if Members could initially notify an arrangement under one provision, but later justify it in dispute settlement under another provision.[1436]

7.1078. Furthermore, and bearing in mind the allocation of burden of invoking the Enabling Clause described in paragraphs 7.1059 to 7.1060 above, permitting notification under *one* provision of the Enabling Clause to suffice for notification under *all* provisions of the Enabling Clause could result in undesirable outcomes. In order to comply with the Appellate Body's standard in respect of burden of invocation, in cases where the responding Member has notified the challenged arrangement under a particular provision, a complaining party would be at risk of failing to meet its burden of invocation if it only identifies the notified provision in its panel

[1432] Although Brazil neither submitted the actual notification as evidence, nor explicitly indicated a document reference for the Panel to locate a publically available document, Argentina as a third party did indicate the document number of the notification. Additionally, that document reference can also be located within an exhibit submitted by Brazil. See Communication from LAIA, (Exhibit BRA-114). Thus, the Panel can confirm that the 1980 Treaty of Montevideo was indeed notified to the WTO by Uruguay, on behalf of LAIA, on 1 July 1982. See GATT document L/5342, 1 July 1982.

[1433] The Panel has found in paragraph 7.1074 above that the Treaty of Montevideo was notified.

[1434] The Panel notes that the Appellate Body has cautioned against relying upon the object and purpose of a specific provision in order to interpret that particular provision, at least when "interpreting WTO law in the light of the purported 'object and purpose' of specific provisions … in isolation from the object and purpose of the treaty on the whole". Appellate Body Report, *EC – Chicken Cuts*, para. 239. In this respect, the Panel notes that the general object and purpose of the Enabling Clause as identified by the Appellate Body in *EC – Tariff Preferences* provides little interpretative value in respect of the notification requirement itself, which is a procedural requirement unrelated to the substantive obligations that are the primary focus of the Enabling Clause. See Appellate Body Report, *EC – Tariff Preferences*, paras. 168-169. The Panel considers it appropriate to take into account the object and purpose of the notification provision itself, in order to render an interpretation that gives effect to that provision. Such an approach accords with the Appellate Body's guidance that Article 31(1) of the Vienna Convention does not "exclud[e] taking into account the object and purpose of particular treaty terms, if doing so assists the interpreter in determining the treaty's object and purpose on the whole." See Appellate Body Report, *EC – Chicken Cuts*, para. 238.

[1435] Brazil's first written submissions, para. 741 (DS472) and para. 673 (DS497). (emphasis added)

[1436] The Panel notes that the purpose of "questioning" a deviation is irrelevant if the deviation is to be justified under an entirely different provision to that under which it is *claimed* to be justified.

request, and the responding party subsequently seeks to justify the arrangement under a different provision. Thus, complaining parties would have an incentive to invoke the entirety of paragraph 2 of the Enabling Clause in their panel requests, resulting in *less* clarity for responding parties.[1437]

7.1079. The Panel therefore does not consider that paragraph 4(a) of the Enabling Clause permits notification of a measure adopted under one provision of the Enabling Clause to serve equally as a notification of that measure being adopted under another provision of the Enabling Clause, unless indicated in the notification itself.

7.1080. The Panel notes that the same logic exists in the explicit language of two General Council decisions that pertain to the notification requirement in the Enabling Clause. Specifically, the Transparency Mechanism for Preferential Trade Arrangements, adopted on 14 December 2010, contains procedures for notifying so-called "preferential trade arrangements" (PTAs) adopted pursuant to paragraph 2(a), (b) or (d) of the Enabling Clause.[1438] The Transparency Mechanism for PTAs indicates in paragraph 4 that "[n]otifying Members shall specify under which provision or provisions in paragraph 1 their PTAs are notified."[1439] Similarly, the Transparency Mechanism for Regional Trade Agreements, adopted on 14 December 2006, contains procedures for notifying "regional trade agreements" (RTAs) adopted pursuant to paragraph 2(c) of the Enabling Clause.[1440] Paragraph 4 of that Transparency Mechanism indicates that "[i]n notifying their RTA, the parties shall specify under which provision(s) of the WTO agreements it is notified."[1441] Both Transparency Mechanisms indicate that Members notifying an RTA or PTA must specify under which precise provision of the Enabling Clause the RTA or PTA is being notified.[1442] Thus, per the plain language of the Transparency Mechanisms, a notification under one provision of the Enabling Clause is *not* sufficient to serve as a notification under another provision of the Enabling Clause. In the view of the Panel, the Transparency Mechanisms serve to further confirm, at least in respect of those alleged notifications that took place *subsequent* to the adoption of one or both transparency mechanisms, that paragraph 4(a) does not permit a notification of a measure adopted one provision of the Enabling Clause to function as a notification of adoption of that same measure under another provision of the Enabling Clause.[1443]

[1437] This would contradict the whole purpose of allocating to the complaining party the burden of invoking the Enabling Clause, which according to the Appellate Body, is "to define the parameters within which the *responding* party must make [its] defence." Appellate Body Report, *EC – Tariff Preferences*, para. 114. (emphasis original)

[1438] Transparency Mechanism for Preferential Trade Arrangements, General Council Decision of 14 December 2010, WT/L/806.

[1439] Transparency Mechanism for PTAs, para. 4.

[1440] Transparency Mechanism for Regional Trade Agreements, General Council Decision of 14 December 2006, WT/L/671.

[1441] Transparency Mechanism for RTAs, para. 4.

[1442] Transparency Mechanism for RTAs, para. 4; Transparency Mechanism for PTAs, para. 4.

[1443] The Panel notes that per the Appellate Body reports in *US – Clove Cigarettes* and *US – Tuna II (Mexico)*, these two General Council decisions are "subsequent agreements regarding the interpretation of the treaty or the application of its provisions" pursuant to Article 31(3)(a) of the Vienna Convention, to be taken into account when interpreting the Enabling Clause. See Appellate Body Reports, *US – Clove Cigarettes*, para. 262; *US – Tuna II (Mexico)*, paras. 366-372. Indeed, the Panel considers that pursuant to Article II:2 of the WTO Agreement, the Enabling Clause is a component of the GATT 1994, the Transparency Mechanisms were adopted subsequent to the GATT 1994, and the terms and content of the Transparency Mechanisms express agreement between members regarding specific requirements to be met in respect of notifying to the WTO a measure adopted pursuant to the Enabling Clause. However, the Panel is aware that these Transparency Mechanisms were not only adopted subsequently to the Enabling Clause, but also subsequent to the notification of the "umbrella treaty" allegedly notified by Brazil, namely the Treaty of Montevideo (notified on 1 July 1982 in GATT document L/5342), as well as the alleged notification of certain specific ECAs that Brazil claims to have notified as adopted under the Treaty of Montevideo, but not others. Specifically, the MERCOSUR agreement was allegedly notified on 5 March 1992 in document L/6985; ECA No. 55 was allegedly notified on 21 November 2012 in document WT/COMTD/77; the 38th Additional Protocol to ECA No. 14 and the 68th Additional Protocol to ECA No. 2 were allegedly notified on 8 November 2010, in document WT/COMTD/72; and the 69th Additional Protocol to ECA No. 2 was allegedly notified on 25 October 2013 in document WT/COMTD/82. See Communication from LAIA, (Exhibits BRA-114 and BRA-115). The Panel recalls that the Transparency Mechanism for RTAs was adopted on 14 December 2006, and the Transparency Mechanism for PTAs was adopted on 14 December 2010. In light of its considerations in paragraphs 7.1077 to 7.1079 above, the Panel does not consider it necessary to determine in general terms whether a "subsequent agreement" adopted *subsequent* to a particular act, can be used to interpret an agreement that assesses the legality of that act. The Panel has concluded above that, without reference to the Transparency Mechanisms, paragraph 4(a) of the Enabling Clause does not permit notification of a measure adopted pursuant to one provision of the

7.1081. In conclusion, the Panel considers that a notification of an RTA adopted under paragraph 2(c) of the Enabling Clause, even if valid, is *not* sufficient to serve as a notification of a PTA adopted under paragraph 2(b) of the Enabling Clause. As indicated above, there was no notification made under 4(a) to support a justification under paragraph 2(b).

7.1082. The Panel therefore concludes that Brazil has not demonstrated that any arrangement providing for the differential and more favourable treatment at issue was notified to the WTO as adopted pursuant to paragraph 2(b).[1444]

7.1083. Moreover, with respect to the burden of invoking the Enabling Clause, the Panel recalls its finding in paragraph 7.1068 above to the effect that there was no burden on the complaining parties to invoke the Enabling Clause in their panel request unless the relevant measures were notified to the WTO. In light of its finding that no relevant arrangement was notified, the Panel concludes that there was no burden on the complaining parties to invoke paragraph 2(b) of the Enabling Clause in their panel requests.

7.1084. Notwithstanding the absence of notification under paragraph 2(b), the Panel considers it appropriate to continue its analysis of the substantive provisions of the Enabling Clause, in order to determine whether Brazil has demonstrated that the differential and more favourable treatment at issue could fit within the scope of paragraph 2(b), assuming it had been duly notified under paragraph 2(b).

7.1085. Paragraph 2(b) of the Enabling Clause states that the Enabling Clause applies to

> Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT.

7.1086. Brazil contends that the tax reductions challenged by the complaining parties fall within the scope of paragraph 2(b). According to Brazil, the internal tax reductions are non-tariff measures (NTMs) because they constitute internal taxes subject to Article III of the GATT 1994 and, consequently, are subject to the MFN obligation under Article I:1 of the GATT 1994.[1445] Brazil argues that internal taxes are NTMs "governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT" because the GATT 1947 (and subsequently the GATT 1994) are relevant multilaterally-negotiated instruments covering internal taxation, and there is no specific agreement covering internal taxes.[1446]

7.1087. According to the complaining parties, Brazil failed to explain how the differential arrangements could be covered by paragraph 2(b).[1447] In particular, the complaining parties argue that the term "non-tariff measures" does not include *all* measures unrelated to tariffs, but rather specifically non-tariff border measures, which would exclude internal taxes. The complaining parties also dispute that the GATT 1994 can be considered an "instrument[] multilaterally negotiated under the auspices of the GATT".[1448]

7.1088. The alleged "differential and more favourable treatment" in this dispute is in the form of internal tax reductions. The issue before the Panel includes whether internal taxes are "non-tariff

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Enabling Clause, to suffice as notification of that same measure being adopted pursuant to a different provision of the Enabling Clause. Therefore, with respect to those alleged notifications that occurred *prior* to the adoption of the transparency mechanisms, it is sufficient for the Panel's purposes to note that its interpretation of paragraph 4(a) of the Enabling Clause is not contradicted by the Transparency Mechanisms.

[1444] In light of this finding, the Panel does not consider it necessary to examine the second and third issues described in paragraph 7.1075 above.

[1445] Brazil's first written submissions, paras. 708-709 and 729 (DS472) and paras. 640-641 and 661 (DS497); Brazil's second written submission, paras. 167-171. Argentina agrees with Brazil that non-tariff measures include internal taxes. See Argentina's third party written submission, paras. 14-18.

[1446] Brazil's second written submission, paras. 167-175.

[1447] European Union's opening statement at the first meeting, paras. 88-89; European Union's response to Panel question No. 4; European Union's second written submission, paras. 199-200; Japan's opening statement at the first meeting, para. 39; Japan's response to Panel question No. 4; Japan's second written submission, para. 129.

[1448] Japan's opening statement at the first meeting, paras. 39-42; response to Panel question No. 4(b); second written submission, para. 129.

measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT". In this respect, the Panel does not consider it necessary to define the term "non-tariff measures" in isolation from the rest of paragraph 2(b).[1449] The Panel proceeds by first assessing whether paragraph 2(b) applies to non-tariff measures governed exclusively by those provisions of the GATT 1994 that were incorporated from the GATT 1947. The Panel then examines the historical context of the Enabling Clause.

7.1089. In the Panel's view, the term "General Agreement" in paragraph 2(b) refers to the "General Agreement on Tariffs and Trade 1947". Applying the principle of effectiveness in treaty interpretation[1450], by which the Panel must give meaning to all parts of paragraph 2(b), the Panel considers that the terms of paragraph 2(b) (referring to "[d]ifferential and more favourable treatment with respect to the provisions of the General Agreement concerning *non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT*"), at the time the Enabling Clause was adopted, meant non-tariff measures *other than* those non-tariff measures governed exclusively by the provisions of the GATT 1947. If at the time of its adoption paragraph 2(b) covered non-tariff measures governed exclusively by the provisions of the GATT 1947, then the second half of paragraph 2(b) would have been superfluous.[1451] The Panel therefore considers that at the time of the Enabling Clause's initial adoption, the scope of paragraph 2(b) did *not* include non-tariff measures governed solely by the provisions of the GATT 1947.

7.1090. Paragraph 1(a) of the language of Annex 1A incorporating the GATT 1994 into the WTO Agreement indicates that the GATT 1994 consists of, amongst other things, "the provisions in the [GATT 1947]".[1452] Indeed, the provisions of the GATT 1994 that Brazil relies on here, namely Article III:2 and III:4 of the GATT 1994, are substantively no different to Article III:2 and III:4 of the GATT 1947 as they existed at the time of the Enabling Clause's adoption. At the time of the Enabling Clause's adoption, these provisions would have been considered provisions of the "General Agreement". As indicated above, at the time of the Enabling Clause's adoption, non-tariff measures governed only by the provisions of the General Agreement and not by the Tokyo Round Codes would *not* have been covered by paragraph 2(b).

7.1091. The Panel further notes that Brazil's proposed interpretation of paragraph 2(b) – that internal taxes are non-tariff measures "governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT" - would mean that any and all non-tariff measures governed by *any* provisions of *any* WTO covered agreement could be subject to differential and more favourable treatment in favour of developing countries, via the Enabling Clause. This would imply that WTO Members are free under the Enabling Clause to adopt any non-tariff measures that discriminate in favour of developing countries. Such an interpretation would appear to contradict the plain language of paragraph 2(b), which does not refer to differential and more favourable treatment with respect to any and all non-tariff measures, but rather refers to a limited category of differential and more favourable treatment, namely that "concerning non-tariff measures

[1449] Although the European Union and Japan argue that the term "non-tariff measures" in paragraph 2(b) does not include "behind-the-border" non-tariff measures such as internal taxes, the Panel does not consider it necessary to define the otherwise generic term "non-tariff measures" in isolation. Paragraph 2(b) when read as a whole does not refer to "non-tariff measures" generally, but rather refers to a limited category of non-tariff measures, namely "non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT". It would be unnecessary and inappropriate for the Panel to interpret only one part of paragraph 2(b) without reference to the rest of the provision. Whether the alleged non-tariff measures at issue here have been demonstrated to be within the scope of 2(b) or not 2(b), that is the question before the Panel.

[1450] The Appellate Body in *US – Gasoline* stated that "[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility." Appellate Body Report, *US – Gasoline*, p. 21, DSR 1996:I, 3, at p. 21. See e.g. Appellate Body Reports, *Japan – Alcoholic Beverages II*, p. 12, DSR 1996:I, 97, at p. 106; *Canada – Dairy*, para. 133; *US – Offset Act (Byrd Amendment)*, para. 271.

[1451] If paragraph 2(b) had read solely "differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures" then its scope would necessarily have included both non-tariff measures governed exclusively by the provisions of the GATT 1947, and "non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT". By virtue of the principle of effectiveness in treaty interpretation, the latter reference in paragraph 2(b) must be meaningful.

[1452] Paragraph 1(a) of the language of Annex 1A incorporating the GATT 1994 into the WTO Agreement.

governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT".

7.1092. The Panel notes that the Enabling Clause was adopted by the GATT Contracting Parties during the Tokyo Round of negotiations, an important element of which was the conclusion of a number of plurilateral agreements governing certain non-tariff measures, including subsidies and countervailing duties, standards, customs valuation, government procurement, import licensing, and anti-dumping duties. These agreements, the Tokyo Round "Codes", also included a number of provisions on special and differential (S&D) treatment for developing countries.[1453] A Decision of the Contracting Parties adopted during the Tokyo Round states that "existing rights and benefits under the GATT of contracting parties not being parties to [the Tokyo Round Codes], including those derived from Article I, are not affected by [the Tokyo Round Codes]."[1454] This Decision explicitly recognized the continued applicability of the GATT MFN obligation in respect of those Contracting Parties that did not become party to the Tokyo Round Codes. In that context, paragraph 2(b) of the Enabling Clause clarifies that the S&D provisions in the Codes, as well as any measures adopted in accordance with those S&D provisions, were institutionally justified, notwithstanding the MFN principle in Article I:1 of the GATT 1947. The goal of paragraph 2(b) was therefore to institutionally link the S&D provisions in the Tokyo Round Codes with the general MFN obligation of the GATT 1947, such that a Contracting Party granting more favourable treatment to developing countries, in accordance with the S&D provisions contained in the Tokyo Round Codes, would not be subject to claims of inconsistency under Article I:1.[1455]

7.1093. The Panel notes that paragraph 2(b) refers generally to "non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT", and does not refer explicitly to S&D provisions. If paragraph 2(b) were interpreted to grant a general right to adopt any discriminatory non-tariff measures, insofar as those non-tariff measures are the subject matter of the general provisions of the Tokyo Round Codes, such an interpretation would render superfluous those specific S&D provisions that were provided at the time in the Tokyo Round Codes (and today in the multilateral trade agreements), that explicitly permitted (and today permit) limited deviations from the MFN principle in favour of developing countries. Bearing in mind the principle of effectiveness in treaty interpretation, the Panel therefore considers that the intended application of paragraph 2(b) must have been limited to the discrimination explicitly provided for in specific S&D provisions of the Tokyo Round Codes. In other words, paragraph 2(b) must have been intended to cover those situations in which specific "differential and more favourable treatment" in favour of developing countries was "governed by the provisions" of the Codes.

7.1094. Additionally, the Panel notes that paragraph 2(b) does not refer exclusively to the Tokyo Round Codes, but rather refers generally to instruments multilaterally negotiated under the "auspices of the GATT". Indeed, given the manner in which negotiations were conducted during the GATT-era, the drafters must have anticipated that additional "codes" or agreements could be concluded in the future. Paragraph 2(b) ensured that the application of S&D treatment in respect of non-tariff measures governed by any covered agreement other than the GATT 1947 would not be inconsistent with the GATT 1947 itself.

7.1095. The Panel notes that since the adoption of the Enabling Clause in 1979, the relationship between the different multilateral agreements has been clarified. As explained above, the provisions of the GATT 1947 have been incorporated into the WTO Agreement as part of the GATT 1994.[1456] The Enabling Clause has also been incorporated into the WTO Agreement as part of the

[1453] See e.g. Article 13 of the Agreement on Implementation of Article VI of the GATT; Article 14 of the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT; Article I of the Protocol to the agreement on Implementation of Article VII of the GATT; Article 12 of the Agreement on Technical Barriers to Trade; and Article III of the Agreement on Government Procurement.

[1454] Paragraph 3, Action by the Contracting Parties on the Multilateral Trade Negotiations, Decision by the Contracting Parties of 28 November 1979, L/4905.

[1455] For example, Article III:1 and III:2 of the Government Procurement Code indicates that parties to the Code shall take into account the "development, financial and trade needs of developing countries" and "in the preparation and application of laws, regulations and procedures affecting government procurement, facilitate increased imports from developing countries". In implementing this obligation, a GATT Contracting Party might have granted more favourable treatment to developing countries than to developed countries, in a manner that some might have argued to be inconsistent with Article I:1 of the GATT 1947.

[1456] See paragraph 7.1090 above.

GATT 1994.[1457] The Tokyo Round Codes no longer exist, and have been replaced with the multilateral agreements indicated in Annex 1 of the WTO Agreement. The General Interpretative Note to Annex 1A of the WTO Agreement indicates that if a provision of a covered agreement conflicts with the GATT 1994, the *other* agreement "shall prevail to the extent of the conflict". The S&D provisions of the WTO covered agreements therefore prevail over the GATT 1994 (and therefore also the Enabling Clause[1458]). Additionally, it has been clarified that the various agreements constituting the WTO Agreement constitute a single package of rights and obligations that should be interpreted harmoniously and coherently.[1459]

7.1096. The Panel, being mindful of its duty not to "add to or diminish the rights and obligations provided in the covered agreements", is not in a position to modify the scope of the Enabling Clause as it was agreed upon by the GATT Contracting Parties, and subsequently the WTO Members, as adopted into the GATT 1994.[1460] In light of its findings above, the Panel considers that a non-tariff measure within the scope of paragraph 2(b) must be governed by specific provisions on special and differential treatment, that are distinct from the provisions of the GATT 1994 incorporating the GATT 1947.[1461] The provisions of the GATT 1994 that Brazil relies on here, namely Article III:2 and III:4 of the GATT 1994, do not introduce any special and differential treatment for taxes in the form of non-tariff measures, are substantively identical to provisions in the GATT 1947, and are part of the GATT 1994. Brazil concedes that other than the GATT 1994 there is no specific WTO covered agreement dealing with internal taxation.[1462] Brazil has not indicated any provisions governing internal taxes other than Article III:2 and III:4 of the GATT 1994.

7.1097. The Panel therefore concludes that the tax reductions accorded to imported products from Argentina, Mexico and Uruguay and found to be inconsistent under Article I:1 of the GATT 1994 are not justified under paragraph 2(b) of the Enabling Clause.

7.1098. The Panel notes that the complaining parties have also raised concerns regarding whether Brazil's justification under paragraph 2(b) could satisfy the substantive requirements of paragraph 3(a) and 3(b) of the Enabling Clause.[1463] Brazil maintains that the relevant differential and more favourable treatment is consistent with the substantive requirements of paragraph 3(a) and 3(b).[1464] In light of its findings above, the Panel does not consider it necessary to make findings on paragraph 3(a) or 3(b) of the Enabling Clause, in respect of Brazil's asserted justification under paragraph 2(b).[1465]

7.4.8.4 Brazil's affirmative defence under paragraph 2(c) of the Enabling Clause

7.1099. In addition to its argument in respect of paragraph 2(b), in its second written submission Brazil indicated that in its view, any differential and more favourable treatment accorded to Argentina, Mexico and Uruguay, and found to be inconsistent with Article I:1 of the GATT 1994, is

[1457] Paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the WTO Agreement.

[1458] As indicated, the Enabling Clause has also been incorporated into the WTO Agreement as part of the GATT 1994. See footnote 1457.

[1459] Appellate Body Report, *Korea – Dairy,* para. 74; Appellate Body Report, *Argentina – Footwear (EC),* para. 81.

[1460] Articles 3.2 and 19.2 of the DSU.

[1461] Indeed, the Panel notes that in the time-period from the adoption of the WTO Agreement up to the date of the Panel's establishment, while many notifications to the Committee on Trade and Development have been made under paragraph 2(a), 2(c) and 2(d), the Panel could find no indication that any WTO Member notified any measures as adopted pursuant to paragraph 2(b) of the Enabling Clause.

[1462] See Brazil's second written submission, para. 174.

[1463] European Union's opening statement at the first meeting, paras. 95-96; European Union's response to Panel questions No. 4 and 54; Japan's response to Panel question No. 54; Japan's comments on Brazil's response to Panel question No. 52; Japan's opening statement at the first meeting, para. 42; Japan's response to Panel question No. 54; Japan's comments on Brazil's response to Panel question No. 52.

[1464] Brazil's first written submissions, paras. 736-739 (DS472) and paras. 668-671 (DS497).

[1465] The Panel agrees with the European Union that because the measures at issue have not been demonstrated to be capable of being "within the scope of the Enabling Clause … it is not necessary to analyse into any further detail the provisions of paragraphs 3(a) and (b) of the Enabling Clause for the purposes of the present proceedings." European Union's response to Panel question No. 54.

justified under paragraph 2(c) of the Enabling Clause.[1466] The Panel notes that the complainants have not raised any objection to the timeliness of raising this defence.[1467]

7.1100. Brazil asserts that any tax reductions accorded to motor vehicles from Argentina, Mexico and Uruguay, and found to be inconsistent with Article I:1 of the GATT 1994, are justified under paragraph 2(c) of the Enabling Clause. Brazil asserts that this differential and more favourable treatment was notified to the WTO, as required under paragraph 4(a) of the Enabling Clause, and satisfies the substantive requirements in paragraph 3 of the Enabling Clause.

7.1101. The European Union and Japan argue that with respect to this additional justification, Brazil did not comply with the notification requirement contained in paragraph 4(a) of the Enabling Clause, and that, in any case, Brazil did not demonstrate that its measure is covered by paragraph 2(c) of the Enabling Clause. The complaining parties also argue that the differential and more favourable treatment does not satisfy certain requirements in paragraph 3 of the Enabling Clause.[1468]

7.1102. As explained above, paragraph 4(a) of the Enabling Clause states that a Member "taking action to introduce an arrangement pursuant to paragraphs 1, 2 and 3 above … shall: (a) notify the CONTRACTING PARTIES".

7.1103. The Panel recalls that the 1980 Treaty of Montevideo was notified to the WTO on 1 July 1982, as adopted pursuant to paragraph 2(c) of the Enabling Clause.[1469]

7.1104. Since Brazil has submitted the notification of the Treaty of Montevideo as adopted pursuant to paragraph 2(c), two issues are raised for the Panel's consideration.

7.1105. First, the Panel should decide whether the notification of the Treaty of Montevideo and the ECAs could substantively serve as a notification of the adoption under paragraph 2(c) of the Enabling Clause of the arrangement introducing the differential and more favourable treatment (in the form of tax treatment) found to be inconsistent with Article I:1 of the GATT 1994. In other words, whether the content and substance of the Treaty of Montevideo and the ECAs would or could comply with the notification requirements of paragraph 4(a), independently of whether such notification was procedurally correct (i.e. sent by the right actor or body, under the right procedure, at the right time, etc.). Second, in the event that the Panel considers that these agreements include or refer to the appropriate substantive differential and more favourable treatment, the Panel must consider whether the notification was procedurally sufficient (i.e. whether such notification was sent by the right actor or body, under the right procedure, at the right time, etc.).

7.1106. As an initial matter, the Panel notes that paragraph 4(a) does not explicitly indicate what precisely is required to be notified (nor who should make the notification).

[1466] Brazil's second written submission, para. 181.

[1467] The European Union in its responses to question from the panel following the second meeting with the parties, indicated that in its view "the only defence under the Enabling Clause raised by Brazil in this case is under paragraph 2(b) of the Enabling Clause." European Union's response to Panel question No. 53. Brazil's second written submission indicates that Brazil is invoking paragraph 2(c), albeit for the first time. Brazil states therein that "the treatment given to certain LAIA Members fell under Articles 2(b) and 2(c) of the Enabling Clause", and that "[t]he Measure at issue falls under the purview of Article 2(c) of the Enabling Clause". Brazil's second written submission, para. 166. Indeed, the European Union in its opening statement at the second meeting, as well as in its discussion with the Panel during that second meeting, did discuss paragraph 2(c) and presented arguments to rebut Brazil's assertion that the measures could be justified under paragraph 2(c). See European Union's opening statement at the second meeting, paras. 54-58. The Panel therefore does not consider that the European Union's view, as expressed in their responses to questions following the second meeting, has any bearing on Brazil's right to invoke paragraph 2(c) at that stage of the proceedings.

[1468] European Union's opening statement at the first meeting, paras. 84-97; European Union's responses to Panel question No. 4; European Union's second written submission, paras. 196-200; European Union's responses to Panel questions No. 53, 54 and 55; Japan's opening statement, paras. 36-42; Japan's responses to Panel question No. 4; Japan's second written submission, para. 129; Japan's responses to Panel questions No. 53, 54 and 55.

[1469] See paragraph 7.1074 above.

7.1107. The Panel recalls Brazil's explanation that the notification requirement in paragraph 4(a) "requires that when giving enhanced market access to products from developing countries [pursuant to the Enabling Clause] the granting Member must notify all WTO Members *as to inform them about the measures to be taken* [and] … *give them the opportunity to question the deviation from the MFN obligation*."[1470]

7.1108. In the view of the Panel, in order for all WTO Members to be put on notice as to the differential and more favourable treatment being introduced by the adopting Member, there must be a clear connection between the RTA itself and the differential and more favourable treatment being adopted. In the Panel's view, the differential and more favourable treatment sought to be justified under paragraph 2(c) must have a close and genuine link to the arrangement notified to the WTO *such as to put other WTO Members on notice* as to the adoption of the differential and more favourable treatment pursuant to the Enabling Clause. The key question in respect of the notification requirement for paragraph 2(c) is therefore whether the RTA notified to the WTO put the rest of the Membership on notice as to the adoption of the particular differential and more favourable treatment sought to be justified under paragraph 2(c).

7.1109. Applying this standard to the current dispute, the Panel recalls that the differential and more favourable treatment to be justified under the Enabling Clause consists of internal tax reductions applied to motor vehicles imported from Argentina, Mexico and Uruguay. Brazil argues that these tax reductions "are implementation measures of the Treaty of Montevideo and [we]re notified to the WTO by the LAIA Secretariat. INOVAR-AUTO's tax treatment to certain LAIA countries is the corollary of these ECAs and does not require further notification."[1471]

7.1110. In support of its argument, Brazil points to several Articles in the Treaty of Montevideo, specifically Article 3(c) and (e)[1472], Article 9[1473], and Article 11.[1474] Having reviewed these provisions[1475] the Panel notes that Article 3(c) and (e) enshrine certain principles of the LAIA integration framework, including an acknowledgement of the potential for LAIA members to adopt partial agreements (such as ECAs) between themselves. Article 9 sets forth certain substantive

[1470] Brazil's first written submissions, para. 741 (DS472) and para. 673 (DS497). (emphasis added)

[1471] Brazil's second written submission, para. 181. See also Brazil's first written submissions, paras. 638-639.

[1472] Brazil's response to Panel question No. 52. Article 3(c) and (e) states:

In the implementation of this Treaty and in the advance towards its final objective, the member countries shall bear in mind the following principles: … (c) Flexibility, characterized by the capacity to allow the conclusion of partial agreements, regulated in a manner compatible with the gradual achievement of convergence and the strengthening of ties of integration; … (e) Multiplicity, to make possible various types of agreement between member countries, in harmony with the objectives and functions of the integration process, using all instruments capable of activating and expanding regional markets. Treaty of Montevideo, 1980, (Exhibit BRA-93), Article 3.

[1473] Brazil's second written submission, para. 179. Article 9 states:

Partial agreements shall be subject to the following general rules: (a) They shall be open for accession, after prior negotiations, to the other member countries; (b) They shall contain clauses advocating convergence so that their benefits extend to all member countries; (c) They may contain clauses advocating convergence with other Latin American countries, in conformity with the mechanisms established in this Treaty; (d) They shall recommend different treatment for the three categories of countries recognized by this Treaty; each agreement shall specify the kind of treatment to be applied and negotiation procedures for its periodic revision at the request of any member country which considers itself at a disadvantage; (e) Tariff reductions may be applied to the same products or tariff sub-items and on the basis of a percentage reduction in the tariffs on imports originating from non-participating countries; (f) They shall be applied for a minimum period of one year; and (g) They may include, among others, specific rules regarding origin, safeguard clauses, non-tariff restrictions, withdrawal of concessions, renegotiation of concessions, denunciation, co-ordination and harmonization of policies. In the event that such specific rules have not been adopted, account will be taken of the provisions adopted by member countries on the matters in question. Treaty of Montevideo, Article 9, (Exhibit BRA-93).

[1474] Brazil's first written submissions, para. 706 (DS472) and para. 638 (DS497). Article 11 states that:

The economic complementarity agreements shall be designed inter alia to promote the maximum utilization of the factors of production, to stimulate economic complementarity, to ensure equitable conditions of competition, to facilitate the competitiveness of products on the international market and to encourage the balanced and harmonious development of member countries. Treaty of Montevideo, Article 11, (Exhibit BRA-93).

These agreements shall be subject to the specific rules to be established for this purpose.

[1475] See footnotes 1472, 1473, and 1474 above.

rules governing these partial agreements. Article 11 describes the principles underpinning the adoption of the partial agreements.

7.1111. Brazil asserts that in pursuit of the objectives of LAIA, as enshrined in the Treaty of Montevideo, four specific ECAs were "negotiated under the auspices of [the Treaty of Montevideo] in order to progressively achieve the reduction and elimination of tariff and non-tariff barriers in the automotive sector … in line with LAIA's objectives."[1476] These ECAs are the MERCOSUR Treaty, ECA No. 55 (between Mexico and MERCOSUR), ECA No. 14 (between Brazil and Argentina), and ECA No. 2 (between Brazil and Uruguay).[1477] As indicated above, Brazil claims that the differential and more favourable treatment accorded to Argentina, Mexico, and Uruguay, is the "corollary of these ECAs and does not require further notification."[1478]

7.1112. In the view of the Panel, none of the provisions cited to in the Treaty of Montevideo bear the slightest relation in and of themselves, to the internal tax reductions found to be inconsistent with Article I:1 of the GATT 1994. Furthermore, Brazil has not pointed to a single provision of any ECA that would attest to the fundamental premise of Brazil's argument, namely that the INOVAR-AUTO programme is implementing the objectives of the ECAs. Indeed, in its own review of the evidence before it[1479], the Panel could not discern any such relationship: the MERCOSUR Treaty is completely silent with respect to the automotive industry[1480]; and while ECAs No. 55, No. 14 and No. 2 refer to trade in the automotive sector, they do not refer to internal taxation.[1481]

7.1113. Indeed, in its own review, the Panel notes that ECA No. 55, between MERCOSUR and Mexico, indicates that its objective is to "lay the foundations for the establishment of free trade in the motor vehicle sector and to promote the productive integration and complementation of their respective motor vehicle sectors".[1482] However, the definition of "free trade" in ECA No. 55 is limited to tariff reductions, and the term "tariff" is defined in ECA No. 55 as concerning taxes or charges "in connection with importation of goods".[1483] Additionally, the 38th Additional Protocol to ECA No. 14, in respect of Argentina and Brazil, indicates that "automotive goods shall be placed on the market between the parties with a 100% preferential tariff (0% of ad valorem tariff within the area) provided that the origin requirements and the conditions laid down in the Agreements have been met".[1484] Finally, the 68th Additional Protocol to ECA No. 2, between Uruguay and Brazil, indicates that "motor vehicle products shall be sold between the Parties with 100% (one hundred) preference (0% (zero) 'ad valorem' intra-zone tariff), whenever they meet the requirements of origin and the conditions set out in this Agreement."[1485]

7.1114. The Panel considers that all of these provisions are indicative of tariff preferences granted by Brazil to Mexico, Argentina and Uruguay. However, these provisions do not refer to internal taxation. Moreover, the Panel could not find any provision authorizing Brazil to adopt any preferential treatment it wishes towards products imported from those countries. In this respect, the Panel notes that the Enabling Clause contains four distinct sub-paragraphs defining its scope of application, and that these paragraphs distinguish between "tariff" measures (as referred to in paragraph 2(a), and the first clause of paragraph 2(c), of the Enabling Clause) and "non-tariff" measures (as referred to in paragraph 2(b) and the second clause of paragraph 2(c)). Without prejudice to the issue of whether an internal tax measure could be considered a "non-tariff measure", the Panel does not consider that internal tax preferences are the same as tariff preferences.

[1476] Brazil's first written submissions, para. 707 (DS472) and para. 639 (DS497). See also Brazil's response to Panel question No. 53; Brazil's comments on other parties' responses to Panel question No. 53.

[1477] Brazil's first written submissions, para. 707 (DS472) and para. 639 (DS497).

[1478] Brazil's second written submission, para. 181.

[1479] The Panel notes the Appellate Body's statement that " it is incumbent upon a party to identify in its submissions the relevance of the provisions of legislation — the evidence — on which it relies to support its arguments. It is not sufficient merely to file an entire piece of legislation and expect a panel to discover, on its own, what relevance the various provisions may or may not have for a party's legal position." Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 191.

[1480] Decree 350/1991, (Exhibit JE-163).

[1481] Decree 4,458/2002, (Exhibit JE-164); Decree 6,500/2008 (Exhibit JE-165); Decree 6,518/2008, (Exhibit JE-203); Decree 7,658/2011, (Exhibit JE-204).

[1482] Decree 4,458/2002, (Exhibit JE-164), ECA No. 55, Article 1.

[1483] Decree 4,458/2002, (Exhibit JE-164), ECA No. 55, Article 2.

[1484] Decree 6,500/2008, (Exhibit JE-165), 38th Additional Protocol to ECA No. 14, Article 9.

[1485] Decree 6,518/2008, (Exhibit JE-203), 68th Additional Protocol to ECA No. 2, Article 3.

7.1115. In the view of the Panel, on the basis of the evidence and arguments before it, other WTO Members could not have been expected to be informed that Brazil intended to accord internal tax reductions to motor vehicles from Argentina, Mexico and Uruguay, and not to motor vehicles from other WTO Members. Brazil has not demonstrated how the relevant tax reductions found to be inconsistent under Article I:1 of the GATT 1994 are related to the RTA that Brazil has notified to the WTO (the Treaty of Montevideo) or the ECAs allegedly implementing that RTA.

7.1116. As stated in paragraph 7.1105 above, the Panel considers that it would only be necessary to rule on whether the notification of the various agreements was procedurally sufficient, in the event that the Panel considered that the content of such agreements, as notified, would be substantively sufficient to satisfy the requirements of paragraph 4(a) of the Enabling Clause. In light of its findings above, the Panel does not consider it necessary to rule on the procedural aspects of the agreements (in other words, whether the relevant agreements were notified correctly under either the Enabling Clause or the Transparency Mechanism on RTAs).

7.1117. Furthermore, the Panel notes that this finding in paragraph 7.1115 above has consequences for the substantive justification under paragraph 2(c) itself. As explained above, to satisfy the notification requirement in paragraph 4(a), any differential and more favourable treatment adopted under paragraph 2(c) must have a close and genuine link to an RTA sufficient to alert other WTO Members to the adoption of such differential and more favourable treatment pursuant to the Enabling Clause.[1486] In the Panel's view, a similar standard applies in respect of the substantive justification under paragraph 2(c) itself. In order for any differential and more favourable treatment to be justified under paragraph 2(c) of the Enabling Clause, there must exist a close and genuine link to a "regional arrangement entered into amongst less-developed contracting parties" (i.e. an RTA).

7.1118. In the present dispute, Brazil has not identified an RTA with a close and genuine link to the tax reductions at issue. Brazil has made assertions regarding the Treaty of Montevideo and the ECAs, but has not pointed to a provision providing for tax preferences in those RTAs nor demonstrated how the tax reductions at issue are related to those RTAs[1487], and therefore how the relevant differential and more favourable treatment could be justified under paragraph 2(c).[1488] Since no RTA with a close and genuine link to the relevant differential and more favourable treatment has been indicated, it is the Panel's view that Brazil has not met its burden of proof in respect of the substantive requirements of paragraph 2(c).

7.1119. The Panel also finds that Brazil has not demonstrated that the arrangements allegedly notified to the WTO included the relevant differential and more favourable treatment required to be notified to the WTO under paragraph 2(c), pursuant to paragraph 4(a) of the Enabling Clause. Therefore, the Panel concludes that the relevant differential and favourable treatment was not notified as adopted under paragraph 2(c), as required pursuant to paragraph 4(a).

7.1120. Moreover, with respect to the burden of invoking the Enabling Clause, the Panel recalls its finding in paragraph 7.1068 above to the effect that there was no burden on the complaining parties to invoke the Enabling Clause in their panel requests unless the relevant measures were notified to the WTO. In light of its finding that no arrangement with a close and genuine link to the tax reductions was notified, the Panel concludes that there was no burden on the complaining parties to invoke paragraph 2(c) of the Enabling Clause in their panel requests.

7.1121. The Panel therefore concludes that the tax reductions accorded to imported products from Argentina, Mexico and Uruguay and found to be inconsistent under Article I:1 of the GATT 1994 are not justified under paragraph 2(c) of the Enabling Clause.

7.1122. The Panel notes that the complaining parties have also raised concerns regarding whether Brazil's justification under paragraph 2(c) could satisfy the substantive requirements of paragraph

[1486] See paragraph 7.1108 above.

[1487] See paragraphs 7.1109 to 7.1115 above.

[1488] The Panel recalls the position of the Appellate Body that "it is incumbent upon a party to identify in its submissions the relevance of the provisions of legislation — the evidence — on which it relies to support its arguments. It is not sufficient merely to file an entire piece of legislation and expect a panel to discover, on its own, what relevance the various provisions may or may not have for a party's legal position." Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 191.

3(a) and 3(b) of the Enabling Clause.[1489] Brazil maintains that the relevant differential and more favourable treatment is consistent with the substantive requirements of paragraph 3(a) and 3(b).[1490] In light of its findings above, the Panel does not consider it necessary to make findings on paragraph 3(a) or (b) of the Enabling Clause, in respect of Brazil's asserted justification under paragraph 2(c).[1491]

7.4.8.5 Separate opinion on Brazil's affirmative defence under paragraph 2(c) of the Enabling Clause

7.1123. One Panelist disagrees with the Panel's findings in paragraphs 7.1112 to 7.1115 above. This Panelist notes the following:

7.1124. ECA No. 55, between MERCOSUR and Mexico, indicates that its objective is to "lay the foundations for the establishment of free trade in the motor vehicle sector and to promote the productive integration and complementation of their respective motor vehicle sectors".[1492] This Panelist is aware that the definition of "free trade" in ECA No. 55 is limited to tariff reductions, and that the term "tariff" is defined in ECA No. 55 as concerning taxes or charges "in connection with importation of goods".[1493] Nevertheless, ECA No. 55 clearly indicates that certain preferences will be granted to motor vehicles imported into Brazil from Mexico.

7.1125. Similar reasoning applies to the 38th Additional Protocol to ECA No. 14, in respect of Argentina and Brazil, which indicates that "automotive goods shall be placed on the market between the parties with a 100% preferential tariff (0% of ad valorem tariff within the area) provided that the origin requirements and the conditions laid down in the Agreements have been met", indicating the existence of tariff preferences on motor vehicles imported into Brazil from Argentina.[1494]

7.1126. Likewise, the 68th Additional Protocol to ECA No. 2, between Uruguay and Brazil, indicates that "motor vehicle products shall be sold between the Parties with 100% (one hundred) preference (0% (zero) 'ad valorem' intra-zone tariff), whenever they meet the requirements of origin and the conditions set out in this Agreement."[1495] This indicates the existence of tariff preferences on motor vehicles imported into Brazil from Uruguay.

7.1127. In the view of this Panelist, such references in these agreements to tariff preferences are sufficient to put Members on notice that, at a minimum, motor vehicles imported into Brazil from Mexico, Argentina and Uruguay will be treated differently to motor vehicles imported into Brazil from other Members. Furthermore, the Treaty of Montevideo explicitly refers to "regional economic integration", and provides for "partial agreements" for this purpose.[1496] Therefore, it is reasonable for Members to assume that such preferences would not be limited to fiscal measures applied at the border, but could potentially include internal fiscal measures. Thus, on the basis of the tariff preferences clearly and explicitly indicated in these agreements, and in light of the provisions of the Treaty of Montevideo, Members could be presumed to be informed that motor vehicles imported into Brazil from Mexico, Argentina and Uruguay may be subject to a differential tax burden.

7.1128. This Panelist therefore disagrees with the Panel's conclusion on this issue in paragraph 7.1119 above, and considers that the ECAs are indeed substantively sufficient to satisfy the notification obligation in paragraph 4(a) of the Enabling Clause.

[1489] European Union's opening statement at the first meeting, paras. 95-96; European Union's response to Panel questions No. 4 and 54; Japan's response to Panel question No. 54; Japan's comments on Brazil's response to Panel question No. 52; Japan's opening statement at the first meeting, para. 42; Japan's response to Panel question No. 54; Japan's comments on Brazil's response to Panel question No. 52.

[1490] Brazil's first written submissions, paras. 736-739 (DS472) and paras. 668-671 (DS497).

[1491] As indicated above, the Panel agrees with the European Union that because the measures at issue have not been demonstrated to be capable of being "within the scope of the Enabling Clause … it is not necessary to analyse into any further detail the provisions of paragraphs 3(a) and (b) of the Enabling Clause for the purposes of the present proceedings." European Union's response to Panel question No. 54.

[1492] Decree 4,458/2002, (Exhibit JE-164), ECA No. 55, Article 1.

[1493] Decree 4,458/2002, (Exhibit JE-164), ECA No. 55, Article 2.

[1494] Decree 6,500/2008, (Exhibit JE-165), 38th Additional Protocol to ECA No. 14, Article 9.

[1495] Decree 6,518/2008, (Exhibit JE-203), 68th Additional Protocol to ECA No. 2, Article 3.

[1496] See Treaty of Montevideo, 1980, (Exhibit BRA-93), Article 3(c) and (e), Article 9, and Article 11.

7.1129. Furthermore, in the view of this Panelist, regardless of whether and how these agreements were notified to the WTO, Brazil has at a minimum demonstrated that the European Union and Japan were informed that the Treaty of Montevideo, the MERCOSUR Agreement, and the relevant ECAs were adopted pursuant to paragraph 2(c) of the Enabling Clause. Specifically, the documentation provided by Brazil demonstrates that, although the European Union and Japan may dispute the form of the notification, the WTO Membership was informed of the adoption of the relevant ECAs pursuant to paragraph 2(c) of the Enabling Clause.[1497] This Panelist therefore considers that the European Union and Japan were sufficiently on notice that the Enabling Clause might be invoked by Brazil, a signatory to those ECAs, as a defence to a claim under Article I:1 of the GATT 1994, in respect of preferences granted to the signatories to those ECAs.

7.1130. This Panelist further recalls the Panel's finding in paragraph 7.1068 above that, based on the Appellate Body's findings in *EC – Tariff Preferences*, "the burden of invoking the Enabling Clause is placed on the complaining party in situations where the complaining party is on notice that the challenged measure was adopted (and in the view of the adopting member, justified) under the Enabling Clause".

7.1131. In light of the considerations above, this Panelist concludes that the European Union and Japan were under an obligation to include the relevant provisions of the Enabling Clause within their respective panel requests. In the view of this Panelist, the failure of the complaining parties to include the Enabling Clause in their panel requests means that their claims under Article I:1 of the GATT 1994 are outside the Panel's terms of reference.

7.5 The PEC and RECAP programmes

7.5.1 Claims under Article 3.1(a) of the SCM Agreement

7.5.1.1 Overview

7.1132. The complaining parties have raised claims under Article 3.1(a) of the SCM Agreement with respect to two programmes: the Regime for Predominantly Exporting Companies (PEC programme) and the Special Regime for the Purchase of Capital Goods for Exporting Companies (RECAP programme).

7.1133. As will be explained in detail below, Article 3.1(a) of the SCM Agreement prohibits subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance.

7.1134. The Panel recalls that under the PEC programme, a legal person registered as a "predominantly exporting company" is entitled to the suspension of the IPI tax on its purchases of raw materials, intermediate goods and packaging materials. The IPI tax suspension expires, and the IPI tax becomes definitively non-due, with the export or domestic sale of products in which those purchased raw materials, intermediate goods and packaging materials have been "used in the manufacture" or "incorporated".[1498]

7.1135. Also, under the PEC programme, a legal person accredited as a predominantly exporting company is entitled to the suspension of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, on its purchases of raw materials, intermediate goods and packaging materials. The suspension becomes definitive, and the PIS/PASEP, COFINS, PIS/PASEP-importation and COFINS-importation contributions become definitively non-due, upon exportation or sale in the domestic market of the final goods incorporating the raw materials, intermediate goods and packaging materials.[1499]

7.1136. For purposes of the IPI tax suspension under the PEC programme, a predominantly exporting company is a legal person whose gross revenue derived from exports to other countries during the calendar year immediately prior to the year of purchase, exceeded 50 per cent of its

[1497] See Communication from LAIA, (Exhibits BRA-114 and BRA-115) (referring *inter alia* to documents L/5342; L/6985; WT/COMTD/77; WT/COMTD/72; and WT/COMTD/82).
[1498] See paragraphs 2.150 to 2.152 above.
[1499] See paragraphs 2.150 to 2.152 above.

total gross revenue from the sales of goods and services over the same period, after taxes and other contributions on the sales.[1500]

7.1137. Also, for purposes of the suspensions of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, under the PEC programme, a predominantly exporting company is a legal person whose gross revenue from exports, in the calendar year immediately before that of the purchase, was equal to or greater than 50 per cent of its total gross revenue from the sale of goods and services in the same period, after taxes and contributions levied on sales. Companies which have not yet attained the 50 per cent export threshold can be entitled to the suspension if they commit to reach and maintain the required export level for a period of three calendar years.[1501]

7.1138. Under the RECAP programme, a legal person accredited as a "predominantly exporting company" is entitled to the suspension of the PIS/PASEP and COFINS contributions, or PIS/PASEP-Importation and COFINS-Importation contributions, on its purchases of new machinery, apparatuses, instruments and equipment. The suspension becomes a zero rate once the export commitments have been achieved.[1502]

7.1139. For purposes of the RECAP programme, a predominantly exporting company is a legal person whose gross revenue from exports was 50 per cent of, or greater than, its total gross revenue derived from sales of goods and services in the calendar year immediately preceding the year in which it became a member in the scheme. A legal person just starting operations, or who does not meet the export target, may qualify for the suspension by committing to achieve export sales equal to or greater than fifty per cent of its total gross revenue derived from the sale of goods and services over a period of three calendar years.[1503]

7.1140. The European Union and Japan argue that the tax suspensions granted to registered or accredited companies under the PEC and RECAP programmes are subsidies within the meaning of the SCM Agreement, as they constitute financial contributions in the form of government revenue otherwise due that is foregone or not collected, through which a benefit is conferred.[1504]

7.1141. The European Union and Japan also argue that the alleged subsidies granted under the PEC and RECAP programmes are contingent upon export performance. The European Union and Japan submit that, to be entitled to the tax suspensions under both programmes, companies must be accredited as predominantly exporters and this requirement constitutes a contingency upon export performance.[1505] The European Union submits that its challenge is not concerned with the question of whether or not WTO Members may, under the SCM Agreement, implement measures to exempt from indirect taxes upstream stages in the supply chain of goods for export.[1506]

7.1142. Brazil rejects that the tax suspensions granted to registered or accredited companies under the PEC and RECAP programmes constitute financial contributions in the form of revenue foregone by the government, through which a benefit is conferred.[1507]

7.1143. Brazil contends that there is neither revenue foregone nor any benefit with the tax suspensions granted to registered or accredited companies under the PEC programme. Brazil argues that, according to the principle of non-accumulation in the Brazilian tax system, the payments of taxes and contributions on the sales of raw materials, intermediate goods and packaging materials are neutral in terms of tax collection. Brazil argues that, according to the mechanism of credits and debits under the principle of non-accumulation, the companies that

[1500] See paragraphs 2.155 to 2.156 above.
[1501] See paragraphs 2.157 to 2.158 above.
[1502] See paragraphs 2.165 to 2.166 above.
[1503] See paragraphs 2.169 to 2.171 above.
[1504] European Union's first written submission, paras. 1184-1206 and 1227-1247; Japan's first written submission, paras. 567-569 and 586-593; European Union's second written submission, paras. 507-522 and 531-548; Japan's second written submission, paras. 178-188.
[1505] European Union's first written submission, paras. 1207-1215 and 1248-1252; Japan's first written submission, paras. 570-572 and 594-595; European Union's second written submission, paras. 523-525 and 549-550; Japan's second written submission, para. 189.
[1506] European Union's first written submission, paras. 1166 and 1219.
[1507] Brazil's first written submissions, paras. 803-805 and 859 (DS472) and 714-715 and 763 (DS497); Brazil's second written submission paras. 206-207 and 250-251.

purchase raw materials, intermediate goods and packaging materials generate tax credits when they pay the IPI tax and the PIS/PASEP and COFINS contributions to the seller. These companies can later offset the credits generated by the taxes and contributions paid, against debits from the same taxes and contributions. If the companies do not generate enough tax debits to fully offset the credits, they can ask for compensation or reimbursement. Brazil submits, however, that asking for compensation or reimbursement is burdensome for both the government and the taxpayers. Brazil explains that the tax suspensions are, thus, a tax administration measure to prevent the accumulation of tax credits by companies whose final products are exempted or subject to low taxation, and that are unable to generate enough tax debits to offset the tax credits generated.[1508]

7.1144. Brazil similarly contends that there is neither revenue foregone nor any benefit with the tax suspensions granted to accredited companies under the RECAP programme. Brazil argues that, according to the principle of non-accumulation in the Brazilian tax system, the payments of taxes on the sales of new machinery, apparatuses, instruments and equipment are neutral in terms of tax collection. Brazil argues that, according to the mechanism of credits and debits under the principle of non-accumulation, the companies that purchase new machinery, apparatuses, instruments and equipment generate tax credits when they pay the PIS/PASEP and COFINS contributions to the seller. These companies can later offset the credits generated by the taxes and contributions paid, against debits from the same taxes and contributions. If the companies do not generate enough tax debits to fully offset the credits, they can ask for compensation or reimbursement. Brazil submits, however, that asking for compensation or reimbursement is burdensome for both the government and the taxpayers. Brazil explains that the tax suspensions are, thus, a tax administration measure to prevent the accumulation of tax credits by companies whose final products are exempted or subject to low taxation, and that are unable to generate enough tax debits to offset the tax credits generated.[1509]

7.1145. Brazil also submits that the requirement for accreditation does not reflect contingency upon export performance, but an objective value for the threshold dividing structurally credit-accumulating companies from those that do not accumulate tax credits. Brazil submits that the companies whose percentage of total gross revenue derived from export is around 45% to 50% accumulate tax credits with their purchases of inputs and capital goods, and do not generate enough tax debits thereafter to offset those tax credits. Brazil submits that this 50% requirement is the threshold dividing structurally credit-accumulating companies from those that are able to offset their tax credits with tax debits.[1510]

7.1146. In order to determine whether the tax suspensions granted to registered or accredited companies under the PEC and RECAP programmes are inconsistent with Article 3.1(a) of the SCM Agreement, the Panel will assess:

a. First, whether the tax suspensions granted under the PEC and RECAP programmes constitute subsidies, i.e., whether the tax suspensions granted under the PEC and RECAP programmes constitute financial contributions by the Brazilian Government, in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred; and

b. Second, if the Panel concludes that the tax suspensions granted under the PEC and RECAP programmes constitute subsidies within the meaning of the SCM Agreement, whether those subsidies are contingent upon export performance and thus prohibited.[1511]

[1508] Brazil's first written submission, paras. 803-845 (DS472) and 716-751 (DS497); Brazil's second written submission paras. 208-242.

[1509] Brazil's first written submission, paras. 859-865 (DS472) and 764-765 (DS497); Brazil's second written submission, paras. 250-251.

[1510] Brazil's first written submission, paras. 846-852 and 866-867 (DS472) and 752-758 and 768-769 (DS497); Brazil's second written submission paras. 243-249 and 250-251.

[1511] As will be explained in paragraphs 7.497 to 7.498 above, pursuant to Article 2.3 of the SCM Agreement, consideration of the question of contingency also will address whether the subsidies are specific in the sense argued by the complaining parties (the complaining parties make no claims or arguments in respect of any other mode of specificity.)

7.5.1.2 Whether the tax suspensions granted under the PEC and RECAP programmes constitute subsidies within the meaning of the SCM Agreement

7.1147. The Panel recalls from section 7.3.5.3 above that, pursuant to the relevant part of Article 1 of the SCM Agreement, a subsidy will exist in the case at issue, if:

a. there is a financial contribution by a government, in the form of government revenue otherwise due that is foregone or not collected; and

b. a benefit is thereby conferred.

7.1148. With respect to the term financial contribution, the Panel recalls from section 7.3.5.3.1 above that, in order to assess whether "government revenue that is otherwise due is foregone or not collected", the panel must:

a. First, identify the tax treatment that applies to the income of the alleged recipients, considering the objective reasons behind that treatment.

b. Second, identify a benchmark for comparison, i.e. the tax treatment of comparable income of comparably situated taxpayers. This will involve an examination of the structure of the Member's domestic tax regime and its organizing principles.

c. Third, compare the challenged tax treatment, and its reasons, with the identified benchmark tax treatment. Such a comparison will enable a panel to determine whether the government is foregoing revenue that is otherwise due in relation to the income of the alleged recipients.[1512]

7.1149. With respect to the concept of benefit, the Panel also recalls that in those cases where a financial contribution has been found to exist in the form of the foregoing of revenue otherwise due, the conclusion that a benefit exists has been made with little difficulty because a tax break is essentially a gift from the government, or a waiver of obligations due, and it is clear that the market does not give such gifts.[1513]

7.1150. Because this dispute involves products for export, it is important to note that footnote 1 of the SCM Agreement states as follows:

> In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, 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.

7.1151. In this respect, the Appellate Body in *US – FSC* explained that the tax measures identified in footnote 1 as not constituting a subsidy involve the exemption of exported products from product-based consumption taxes.[1514]

7.1152. Thus, in the Panel's analysis of whether the tax suspensions constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred, the Panel will also assess to what extent the tax suspensions affecting exported products may fall within the provisions of footnote 1 of the SCM Agreement, and thus fall outside the scope of the SCM Agreement.

[1512] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 812-815.

[1513] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 7.169-7.171. See also: Panel Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, fn 509; *US – FSC*, para. 7.103; and *US – FSC (Article 21.5 – EC)*, paras. 8.44-8.48; and Appellate Body Reports, *US – FSC*, para. 140; and *US – FSC (Article 21.5 – EC)*, para. 198.

[1514] Appellate Body Report, *US – FSC*, para. 93.

7.5.1.2.1 Whether the tax suspensions granted under the PEC and RECAP programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected"

7.1153. As explained in paragraph 7.1148 above, in order to assess whether the tax suspensions granted under the PEC and RECAP programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", the Panel needs to respond to the following questions: a) What is the challenged tax treatment that applies to the income of the alleged recipients, and what are the objective reasons behind this treatment? b) What is the benchmark treatment or tax treatment of comparable income of comparably situated taxpayers? And, c) What is the difference between the challenged tax treatment, and its reasons, with the identified benchmark tax treatment?[1515]

7.5.1.2.1.1 What is the tax treatment that applies to the income of the alleged recipients, and what are the objective reasons behind this treatment?

7.1154. As described in paragraphs 7.1134 to 7.1139 above, the tax treatment applicable to the PEC recipients is the tax suspension, and ultimate exemption (when the final product is exported or sold in the domestic market), of the IPI tax and the PIS/PASEP, COFINS, PIS/PASEP-importation and COFINS-importation contributions on the purchase of raw materials, intermediate goods and packaging materials.[1516]

7.1155. The tax treatment applicable to the RECAP recipients is the tax suspension, and ultimate exemption (when the final product is exported or sold in the domestic market), of the PIS/PASEP, COFINS, PIS/PASEP-importation and COFINS-importation contributions on the purchase of new machinery, apparatuses, instruments and equipment.[1517]

7.1156. The Panel recalls that, as explained in paragraph 7.406 above in the context of the ICT programmes, the case at issue involves a range of different tax treatments, and each of the examined programmes provides a different package of suspensions from one or more particular types of tax. In the Panel's view, these different tax treatments can be best classified and identified for purposes of determining whether revenue that is otherwise due is foregone or not collected and a benefit thereby is conferred in these specific programmes on the basis of (i) the tax at issue and (ii) whether the tax suspensions are on the purchases of inputs[1518] or capital goods[1519]. Based on these criteria, the Panel has grouped the tax treatments for PEC and RECAP programmes into the following categories:

a. The IPI tax suspensions on purchases of raw materials, intermediate goods and packaging materials (for purposes of PEC).

b. The suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, on purchases of raw materials, intermediate goods and packaging materials (for purposes of PEC); and

c. The suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, on purchases of new machinery, apparatuses, instruments and equipment that will be incorporated into the fixed assets of the accredited company (for purposes of RECAP),

7.1157. The Panel recalls that the Appellate Body in *US – Large Civil Aircraft (2nd complaint)* explained that the identification of the tax treatment that applies to the income of the alleged recipients will entail consideration of the objective reasons behind that treatment and, where it involves a change in a Member's tax rules, an assessment of the reasons underlying that change.[1520]

[1515] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 812-815.
[1516] See paragraphs 2.150 to 2.152 above.
[1517] See paragraphs 2.165 to 2.166 above.
[1518] Raw materials, intermediate goods and packaging materials.
[1519] New machinery, apparatuses, instruments and equipment.
[1520] Appellate Body Report, *US – Large Civil Aircraft (2nd complaint)*, para. 812.

7.1158. The European Union and Japan submit that the objective for the tax treatment at issue under both programmes is to increase the competitiveness of national companies through better cash availability conditions for exporting companies.[1521] Brazil, in turn, argues that the reason for the tax treatment is to avoid the accumulation of credits by companies that will not be able to offset taxes paid with other debits.[1522]

7.1159. With respect to the PEC programme, Explanatory Memorandum No. 00211 of 29 August 2002 by the Ministry of Finance describes the aim of the programme as follows:

> Article 31 establishes a suspension of the Imposto sobre Produtos Industrializados (IPI), with respect to mentioned products, in order to avoid the accumulation of credits, which implies providing for better operating conditions and cash flow for domestic companies, making them more competitive, including by reducing the prices of their products. Such suspension is appropriate for predominantly exporting companies in the terms and conditions to be established by the Secretariat of the Federal Revenue (Secretaria da Receita Federal), with a view to supporting national export activities.[1523]

7.1160. With respect to the RECAP programme, Interministerial Explanatory Memorandum No. 00084/2005 by the Ministry of Finance and the Ministry of Development, Industry and Trade describes the aim of the programme as follows:

> The creation of RECAP aims at encouraging investment on production and improving exports by correcting the distortions that generate a cost on the capital goods of predominantly exporting companies. This scheme suspends the incidence of the contribution to PIS/PASEP and of COFINS on sales and imports of new machines, appliances, instruments and equipment, listed in a regulation, when purchased by predominantly exporting companies. Like the REPES, the RECAP aims at eliminating the accumulation of PIS and COFINS credits for exporters, complementing the scheme already established by Article 40 of Law No. 10,865 of 30 April 2004, which suspends the levying of the contribution with regard to the sales of raw materials, intermediary products and packaging materials when they are destined to predominantly exporting legal persons.[1524]

7.1161. Also, Interministerial Explanatory Memorandum No. 00025/2012 explains that, with respect to the reduction to 50% of the percentage of total revenue required to be derived from exports in order for a company to qualify as a predominantly exporting company:

> By extending the concept of predominantly exporting company to those who export 50% of their gross revenue, including those applying to […]Recap, almost all Brazilian companies that generate credits to be reimbursed in kind in relation to their export activities are covered. Thus, it is expected that, at least at the federal level, the accumulation of export credits loses relevance. […] Finally, the adoption of a measure that contributes to solve the serious problem of accumulation of tax credits arising from exports, which erodes the working capital of exporting companies and reduces their competitiveness, undoubtedly makes this proposal for a provisional measure to meet the requirements of emergency and relevance.[1525]

7.1162. In the Panel's view, both the complaining parties and Brazil are correct regarding the objective reasons behind the tax treatment. The Panel finds that there is evidence demonstrating that the objective reasons for the tax treatment is to tackle the problem of credit-accumulation, and in so doing to increase the competitiveness of Brazilian companies.

[1521] European Union's first written submission, para. 1154; Japan's opening statement at the first meeting of the Panel, para. 24.

[1522] Brazil's first written submission, paras. 757-759 (DS472) and 690-692 (DS497); Brazil's opening statement at the first meeting of the Panel, para. 17.

[1523] See paragraph 2.162 above.

[1524] See paragraph 2.175 above.

[1525] See paragraph 2.176 above.

7.1163. The Panel will address later the evidence before it in respect of these arguments, and whether the alleged reasons affect the comparison between the challenged tax treatment and the benchmark treatment.

7.5.1.2.1.2 What are the relevant benchmark treatments and the difference between each of the challenged treatments and the identified benchmark tax treatments?

7.1164. The Panel will address separately the specific benchmark for each of the three categories of tax treatments previously identified. In so doing, the Panel notes that the challenged tax treatments are "suspensions" of economy-wide taxes that apply, in principle, to all transactions by all businesses. As will be explained in detail below, on the basis of the evidence before the Panel and the analytical framework set forth above, in every instance the Panel finds that the benchmarks to be applied are the economy-wide tax treatments from which the suspensions are taken or, in other words, the tax treatment applicable to non-accredited companies.

a. The IPI tax suspensions on purchases of raw materials, intermediate goods and packaging materials (for purposes of PEC).

The benchmark treatment

7.1165. Brazil argues that the IPI tax suspensions are the benchmark treatment for structurally credit-accumulating companies, including the predominantly exporting companies. For Brazil, the suspension of taxes is the rule for credit-accumulating companies, and not an exception to the rule.[1526]

7.1166. The European Union and Japan argue, in turn, that Brazil has failed to prove the existence of a rule in Brazil's taxation system, according to which "predominantly credit-accumulating companies" are not subject to taxation with regard their acquisition of inputs. The complaining parties argue that the correct benchmark should include all domestic companies that pay the taxes suspended by these programmes.[1527]

7.1167. The Panel agrees with Brazil that there are other companies, in addition to the companies accredited or registered as predominantly exporting companies, which are entitled to the IPI tax suspension on the purchase of raw materials, intermediate goods and packaging materials. Indeed, according to Article 29 of Law 10,637/2002, the tax suspension also applies to establishments dedicated primarily to the manufacture of products classified in Chapters 2, 3, 4, 7, 8, 9, 10, 11, 12, 15, 16, 17, 18, 19, 20, 23, 28, 29, 30, 31 and 64, under code 2209.00.00 and 2501.00.00, and at positions 21.01 to 21.05.00 of the Industrial Goods Tax Classification Table; industrial establishments which primarily manufacture components, chassis, bodies, parts and pieces of automotive products; industrial establishments which primarily manufacture parts and pieces intended for the aerospace industry; and industrial establishments which primarily manufacture the goods benefiting from the informatics programme.[1528] The suspension also applies to companies qualified under the Special Regime for the Brazilian Aerospace Industry RETAERO and the Special Regime to Incentive Computers for Educational Use (REIMCOMP).[1529] However, in the Panel's view, the selection by the Brazilian Government of companies entitled to the IPI tax suspensions does not seem to be directly linked to the problem of credit-accumulation, so as to create a general rule for structurally or predominantly credit accumulating companies. Nothing in the text of Law 10,637/2002 or in the evidence on the record seems to suggest that the other companies to which the tax suspensions apply are structural credit accumulators, or that the tax suspensions in Article 29 of Law 10,637/2002, and in the rules for the REATERO AND REIMCOMP regimes, were created to tackle the problem of structural credit accumulation for these companies.

7.1168. Also, there are producers of low taxed products (more likely to accumulate tax credits) that are not entitled to tax suspensions, and producers of higher taxed products (less likely to accumulate tax credits) that are entitled to such tax suspensions, contrary to Brazil's allegations

[1526] Brazil's first written submission, paras. 812-818 and 860-861 (DS472) and 725-729 and 764-765 (DS497).
[1527] European Union's and Japan's responses to Panel question No. 41.
[1528] Law 10,637/2002, (Exhibit JE-94).
[1529] See Brazil's response to Panel question No. 21.

that the tax suspensions are the rule for structurally credit accumulating companies. As exemplified by the European Union in Exhibit JE-235, an examination of the products for which the IPI tax is suspended or exempted pursuant to Article 29 of Law 10,637/2002 indicates that there is no pattern of suspending the IPI tax only for products with no or low taxation. As can be seen from Exhibit JE-235, many of the products that are subject to special regimes are subject to a tax rate of 5%, 10%, 20% and even 30% and, for instance, Chapters 50 to 54 of the TIPI are subject to 0% rate and are not covered by Article 29 of Law 10,637/2002.[1530]

7.1169. Finally, there are credit-accumulating companies not entitled to the tax suspensions, which puts further into question the existence of a general rule for credit accumulators. For example, as Japan explained[1531], companies that export products but do not reach the 50% threshold of gross revenue derived from exports can be credit accumulators and yet cannot benefit from the tax suspensions.

7.1170. In this respect, Brazil explains that a specific good "can have its rates reduced to a point where the company will accumulate credits, but this tax situation cannot be predicted. Such companies request this suspension and are included. By the same token, a company may become a credit accumulating company if the goods it produces suddenly have lower taxation. In this sense it is not possible to predict as a general rule and for all situations when a company that accumulates credits becomes a structurally credit accumulating company"[1532] However, the Panel is not convinced that the availability of suspensions for the companies mentioned in paragraph 7.1167 above is sufficient to prove the existence of a general rule for structurally or predominantly credit accumulating companies.

7.1171. In light of the above, the Panel finds that Brazil has not demonstrated that the tax suspensions are the benchmark treatment for structurally credit-accumulating companies. As the Panel is not convinced by Brazil's proposed benchmark treatment, it will continue with its task of identifying the benchmark treatment, taking into account the complaining parties' position that the benchmark treatment should include all domestic companies that pay the taxes suspended by this programme.

7.1172. In this respect, the Panel considers that in the case at issue the appropriate benchmark treatment is the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods and packaging materials that will be used by those companies to manufacture their products, i.e. the obligation to pay the full amount of the applicable IPI tax rate on the purchases of raw materials, intermediate goods and packaging materials used to manufacture products, subject to the mechanism of credits and debits under the principle of non-accumulation. In particular, the accredited and non-accredited companies purchasing the raw materials, intermediate goods and packaging materials used to manufacture their products are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential IPI tax treatment of these products. Thus, the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods and packaging materials used in the manufacture of their products can be considered as the benchmark treatment or normal rule of general application.

Comparison

7.1173. The Panel now compares the IPI tax suspensions granted to accredited companies on their purchases of raw materials, intermediate goods and packaging materials, under the PEC programme, with the benchmark treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods and packaging materials.

7.1174. The Panel notes that under the benchmark treatment, the seller of the raw materials, intermediate goods and packaging materials will always charge the IPI tax to the non-accredited company buying the products, at the moment of the sale, and the non-accredited company buying the products will accrue a tax credit in the amount of the IPI tax paid. The seller then will remit to the Federal Revenue Service the amount of IPI tax charged, when it pays its monthly liabilities due

[1530] European Union's response to Panel question No. 41, para. 156.
[1531] Japan's response to Panel question No. 41, para. 59.
[1532] Brazil's response to Panel question No. 21.

on the 25th day of the month following the transaction. In turn, the non-accredited company buying the products will be allowed to use the credit it has accrued to offset its IPI tax debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the seller pays the tax to the Brazilian Government.[1533] However, if the non-accredited company buying the products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods[1534]. If the non-accredited company buying the products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement, within five years of the accrual of the credit.[1535] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the non-accredited company buying the products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[1536] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[1537]

7.1175. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the non-accredited company buying the products, the Government will receive the full amount of IPI tax due from the seller and the non-accredited company buying the products will be able to offset the amount of IPI tax paid during the same taxation period. However, if the non-accredited company buying the products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the seller until the non-accredited company buying the products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the non-accredited company buying the products (within 360 days of the date of the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[1538] This cash availability and associated implicit interest can last from one taxation period[1539] (if the non-accredited company is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the non-accredited company requests it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to the non-accredited company buying the products within 360 days after the request, the Brazilian Government will not have to pay the non-accredited company buying the products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the non-accredited company buying the products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[1540]

[1533] See paragraphs 2.16 to 2.17 above.

[1534] See paragraphs 2.19 to 2.20 above.

[1535] See paragraph 2.20 above.

[1536] See paragraph 2.20 above.

[1537] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, paras. 758 (DS472) and 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). Exporters_2012 study on Brazilian exports – delays in refunds (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

[1538] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[1539] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[1540] See paragraph 2.20 above and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6) (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim

7.1176. With respect to imported raw materials, intermediate goods and packaging materials, the Panel notes that the IPI tax is collected by the customs authorities from the importer during the customs clearance process.[1541] Therefore, the Government will enjoy the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that is collected, from the moment the product is imported until the moment the non-accredited company buying the product is able to offset the credit, or receives compensation or reimbursement (within 360 days of the request).

7.1177. In contrast, pursuant to the challenged treatment under the PEC programme, whereby the IPI tax is suspended, the seller will not have to charge the IPI tax to the accredited company buying the products and will not have to remit any amount of tax to the Brazilian Government. The accredited company buying the products, in turn, will not accrue any credit.[1542]

7.1178. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction, in the case of domestic products, or on the date of importation (in the case of imported products). By the same token, it also will not have to allow the accredited company buying the products to offset the amount of tax paid.[1543]

7.1179. If the Panel compares the challenged treatment with the best case scenario for the non-accredited company buying domestic products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period, there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the non-accredited company buying the products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from the moment of importation (in the case of imported products) or from one taxation period[1544] (in the case of domestic products) to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used.

7.1180. Furthermore, from the buyer's standpoint, as explained in paragraph 2.16 above, when the accredited company buying the raw materials, intermediate goods and packaging materials sells its finished goods incorporating those products, under normal circumstances the Brazilian Government ultimately will collect the full amount of IPI tax corresponding to both the value added by the seller and the value added by the accredited company buying the products, i.e., the same nominal amount of IPI tax that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the accredited company buying the products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the seller of the products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

b. The suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions on purchases of raw materials, intermediate goods and packaging materials (for purposes of PEC).

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for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submission, para. 780 (DS472) and fn 451 (DS497).

[1541] See paragraph 2.8 above.

[1542] See paragraph 2.18 above.

[1543] See paragraph 2.13 above.

[1544] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

The benchmark treatment

7.1181. As in the case of the IPI tax suspensions, Brazil argues that the suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, are the benchmark treatment for structurally credit-accumulating companies, including the predominantly exporting companies. For Brazil, the suspension of taxes is the rule for credit-accumulating companies, and not an exception to the rule.[1545]

7.1182. The European Union and Japan argue, in turn, that Brazil has failed to prove the existence of a rule in Brazil's taxation system, according to which "predominantly credit-accumulating companies" are not subject to taxation with regard their acquisition of inputs. The complaining parties argue that the correct benchmark should include all domestic companies that pay the taxes suspended by these programmes.[1546]

7.1183. As in the case of the IPI tax suspensions, Brazil is correct in its affirmation that there are other companies, in addition to predominantly exporting companies, that are entitled to the suspensions of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, on their purchases of raw materials, intermediate goods and packaging materials. Indeed, suspensions or exemptions also apply to manufacturers of certain products when such products are destined for direct public administration bodies; companies accredited under PADIS and PATVD; companies qualified under the Special Tax Regime for the Exportation Platform of Information Technology Services (REPES); companies qualified under the RETAERO; companies qualified under the Special Regime for the Defense Industry (RETID); and companies qualified under REIMCOMP.[1547] However, in the Panel's view, the selection by the Brazilian Government of companies entitled to the suspensions of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, does not seem to be directly linked to the problem of credit-accumulation, so as to create a general rule for structurally or predominantly credit accumulating companies. Other than in the REPES regime, which is also a regime for exporters, nothing in the evidence on the record seems to suggest that the other companies to which the suspensions or exemptions apply are structural credit accumulators, or that the suspensions were created to tackle the problem of structural credit accumulation for these companies.

7.1184. Also, as explained in paragraph 7.1169 above, there are credit-accumulating companies not entitled to the suspensions, which puts further into question the existence of a general rule for credit accumulators.

7.1185. In sum, the Panel is not convinced that the availability of suspensions or exemptions for the companies mentioned in paragraph 7.1183 above is sufficient to prove the existence of a general rule for structurally or predominantly credit accumulating companies.

7.1186. In light of the above, the Panel finds that Brazil has not demonstrated that the tax suspensions are the benchmark treatment for structurally credit-accumulating companies. As the Panel is not convinced by Brazil's proposed benchmark treatment, it will continue with its task of identifying the appropriate benchmark treatment, taking into account the complaining parties' position that the benchmark treatment should include all domestic companies that pay the taxes suspended by this programme.

7.1187. In this respect, the Panel considers that the appropriate benchmark treatment is the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods and packaging materials that will be used by those companies to manufacture their products, i.e. the obligation to pay the full amount of the applicable PIS/PASEP and COFINS, or PIS/PASEP-importation and COFINS-importation contributions, on the purchase of the raw materials, intermediate goods and packaging materials used to manufacture products, subject to the mechanism of credits and debits under the non-cumulative regime. In particular, the accredited and non-accredited companies purchasing the raw materials, intermediate goods and packaging materials used to manufacture products are identically situated, except for the fact of

[1545] Brazil's first written submission, paras. 812-818 and 860-861 (DS472) and 725-729 and 764-765 (DS497).

[1546] European Union's and Japan's response to Panel question No. 41.

[1547] See Brazil's response to Panel question No. 21.

accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential tax treatment with respect to the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, of these products. Thus, the treatment applicable to purchases by non-accredited companies can be considered as the benchmark treatment or normal rule of general application.

Comparison

7.1188. The Panel now compares the suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, granted to accredited companies on the purchases of raw materials, intermediate goods and packaging materials, under the PEC programme, with the treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies of raw materials, intermediate goods and packaging materials.

7.1189. The Panel notes that under the benchmark treatment, the seller of the raw materials, intermediate goods and packaging materials will always charge the PIS/PASEP and COFINS contributions to the non-accredited company buying the products, at the moment of the sale, and the non-accredited company buying the products will accrue a tax credit in the amount of the PIS/PASEP and COFINS contributions paid. The seller then will remit to the Federal Revenue Service the amount of PIS/PASEP and COFINS contributions charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the non-accredited company buying the products will be allowed to use the credit it has accrued to offset its PIS/PASEP and COFINS contributions debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the seller pays the tax to the Brazilian Government.[1548] However, if the non-accredited company buying the products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods.[1549] If the non-accredited company buying the products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement, within five years of the accrual of the credit.[1550] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the non-accredited company buying the products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[1551] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[1552]

7.1190. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the non-accredited company buying the products, the Government will receive the full amount of PIS/PASEP and COFINS contributions due from the seller and the non-accredited company buying the products will be able to offset the amount of PIS/PASEP and COFINS contributions paid during the same taxation period. However, if the non-accredited company buying the products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the seller until the non-accredited company buying the products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the non-accredited company buying

[1548] See paragraphs 2.16 to 2.17 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1549] See paragraphs 2.19 to 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1550] See paragraph 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1551] See paragraph 2.20 above.

[1552] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, paras. 758 (DS472) and 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). Exporters_2012 study on Brazilian exports – delays in refunds (Exhibit JE-186), p. 55.

the products (within 360 days of the date for the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[1553] This cash availability and associated implicit interest can last from one taxation period[1554] (if the non-accredited company is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the non-accredited company requests it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to the non-accredited company buying the products within 360 days after the request, the Brazilian Government will not have to pay the non-accredited company buying the products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the non-accredited company buying the products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[1555]

7.1191. With respect to imported raw materials, intermediate goods and packaging materials, the Panel notes that the PIS/PASEP-importation and COFINS-importation contributions are collected by the customs authorities from the importer during the customs clearance process.[1556] Therefore, the Government will enjoy the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that is collected, from the moment the product is imported until the moment the non-accredited company buying the product is able to offset the credit, or receives compensation or reimbursement (within 360 days of the request). Moreover, the Brazilian Government will enjoy the advantage of having charged the additional 1% of COFINS-importation contribution that does not generate a tax credit.[1557]

7.1192. In contrast, pursuant to the challenged treatment under the PEC programme, whereby the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions are suspended, the seller will not have to charge the contributions to the accredited company buying the products and will not have to remit any amount of tax to the Brazilian Government. The accredited company buying the products, in turn, will not accrue any credit.[1558]

7.1193. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction (in the case of domestic products), or on the date of importation (in the case of imported products). By the same token, it also will not have to allow the accredited company buying the products to offset the amount of tax paid.[1559]

[1553] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[1554] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[1555] See paragraph 2.20 above and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6) (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submissions, para. 780 (DS472) and fn 451 (DS497).

[1556] See paragraph 2.32 above.

[1557] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, paras. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[1558] See paragraph 2.18 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions).

[1559] See paragraph 2.13 above.

7.1194. If the Panel compares the challenged treatment with the best case scenario for the non-accredited company buying domestic products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period (in the case of domestic products), there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the non-accredited company buying the products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from the moment of importation (in the case of imported products) or from one taxation period[1560] (in the case of domestic products) to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used. Moreover, in the case of imported products, the Brazilian Government is foregoing the advantage of the additional 1% of COFINS-importation contribution that does not generate a tax credit.[1561]

7.1195. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17[1562] above, when the accredited company buying the raw materials, intermediate goods and packaging materials sells its finished goods incorporating those products, under normal circumstances the Brazilian Government ultimately will collect the full amount of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, corresponding to both the value added by the seller and the value added by the accredited company buying the products, i.e., the same nominal amount of contributions that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the accredited company buying the products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the seller of the products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

7.1196. Also, although the non-cumulative regime is the general rule for the PIS/PASEP and COFINS contributions[1563], to the extent that the purchases of the raw materials, intermediate goods and packaging materials at issue could be subject to the cumulative regime, there would be no mechanism of credits and debits. In this case, if the Panel compares the challenged treatment, where the Brazilian Government receives none of the PIS/PASEP and COFINS contributions that otherwise would have been due, with the treatment under the cumulative regime, where the Brazilian Government receives the full amount of PIS/PASEP and COFINS contributions due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due under the cumulative regime.

c. The suspensions of the PIS/PASEP and COFINS contributions on purchases of new machinery, apparatuses, instruments and equipment (for purposes of RECAP)

The benchmark treatment

7.1197. As in the case of the IPI tax suspensions, Brazil argues that the suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, are the benchmark treatment for structurally credit-accumulating companies,

[1560] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[1561] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, para. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[1562] Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.

[1563] See paragraph 2.22 above

including the predominantly exporting companies. For Brazil, the suspension of taxes is the rule for credit-accumulating companies, and not an exception to the rule.[1564]

7.1198. The European Union and Japan argue, in turn, that Brazil has failed to prove the existence of a rule in Brazil's taxation system, according to which "predominantly credit-accumulating companies" are not subject to taxation with regard their acquisition of capital goods. The complaining parties argue that the correct benchmark should include all domestic companies that pay the taxes suspended by these programmes.[1565]

7.1199. For the same reasons explained in paragraphs 7.1183 to 7.1185 above, the Panel finds that Brazil has not demonstrated that the tax suspensions are the benchmark treatment for credit-accumulating companies. As the Panel is not convinced by Brazil's proposed benchmark treatment, it will continue with its task of identifying the appropriate benchmark treatment, taking into account the complaining parties' position that the benchmark treatment should include all domestic companies that pay the taxes suspended by this programme.

7.1200. In this respect, the Panel considers that the appropriate benchmark treatment is the treatment applicable to purchases by non-accredited companies of new machinery, apparatuses, instruments and equipment that will be used by those companies to manufacture their products, i.e. the obligation to pay the full amount of the applicable PIS/PASEP and COFINS, or PIS/PASEP-importation and COFINS-importation contributions, on the purchase of the new machinery, apparatuses, instruments and equipment, subject to the mechanism of credits and debits under the non-cumulative regime.[1566] In particular, the accredited and non-accredited companies purchasing the new machinery, apparatuses, instruments and equipment used to manufacture products are identically situated, except for the fact of accreditation. Brazil has not demonstrated the existence of any other difference that could explain the differential tax treatment with respect to the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, of these products. Thus, the treatment applicable to purchases by non-accredited companies can be considered as the benchmark treatment or normal rule of general application.

Comparison

7.1201. The Panel now compares the suspensions of the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, granted to accredited companies on the purchases of new machinery, apparatuses, instruments and equipment, under the RECAP programme, with the treatment identified in the previous paragraph, i.e. the treatment applicable to purchases by non-accredited companies.

7.1202. The Panel notes that under the benchmark treatment, the seller of the new machinery, apparatuses, instruments and equipment will always charge the PIS/PASEP and COFINS contributions to the non-accredited company buying the products, at the moment of the sale, and the non-accredited company buying the products will accrue a tax credit in the amount of the PIS/PASEP and COFINS contributions paid. The seller then will remit to the Federal Revenue Service the amount of PIS/PASEP and COFINS contributions charged, when it pays its monthly liabilities due on the 25th day of the month following the transaction. In turn, the non-accredited company buying the products will be allowed to use the credit it has accrued to offset its PIS/PASEP and COFINS contributions debits when it pays its monthly liabilities due on the 25th day of the month following the transaction, i.e. during the same taxation period where the seller

[1564] Brazil's first written submission, paras. 812-818 and 860-861 (DS472) and 725-729 and 764-765 (DS497).

[1565] European Union's and Japan's responses to Panel question No. 41.

[1566] The Panel notes that Law 11,774/2008, art. 1, as amended by Law 12.546/2011, explicitly allows for the immediate utilization of credits on purchases of capital goods. The Law states as follows: "The legal entities, in case of acquisition in the domestic market or of importation of machines and equipment intended for the production of goods and the provision of services, may opt for the discount of credits of the 'Contribuição para o Programa de Integração Social/Programa de Formação do Patrimônio do Servidor Público (PIS/Pasep)' and of the 'Contribuição para Financiamento da Seguridade Social (Cofins)' addressed in item III of § 1 of art. 3 of Law 10,637, of December 30, 2002, item III of § 1 of art. 3 of Law 10833, of December 29, 2003, and § 4 of art. 15 of Law 10,865, of April 30, 2004, in the following way: …XII - immediately, in the case of acquisitions occurred as of July, 2012." See Brazil's response to Panel's question 23.

pays the tax to the Brazilian Government.[1567] However, if the non-accredited company buying the products is not able to offset the credit accrued with other debits during that taxation period, it will be allowed to offset it during subsequent taxation periods.[1568] If the non-accredited company buying the products is not able to offset the credit after three taxation periods, it will be allowed to ask the Brazilian Government for compensation with other Federal debits, or reimbursement, within five years of the accrual of the credit.[1569] The Brazilian Government has, by law, 360 days to respond to the request for compensation or reimbursement. If the Brazilian Government does not respond within 360 days, the non-accredited company buying the products will be entitled to receive the compensation or reimbursement from the Government, as well as the interests generated.[1570] It is fairly common that companies are not able to offset the full amount of their credits and have to request compensation or reimbursement, so this scenario seems rather frequent.[1571]

7.1203. Thus, from the Brazilian Government's standpoint, and under the best case scenario for the non-accredited company buying the products, the Government will receive the full amount of PIS/PASEP and COFINS contributions due from the seller and the non-accredited company buying the products will be able to offset the amount of PIS/PASEP and COFINS contributions paid during the same taxation period. However, if the non-accredited company buying the products is not able to offset the credit during the same taxation period, the Brazilian Government will retain the amount of tax paid by the seller until the non-accredited company buying the products is able to offset it (during subsequent taxation periods); or until the Brazilian Government compensates or reimburses the face amount of the credit, without interest, to the non-accredited company buying the products (within 360 days of the date for the request for compensation or reimbursement). Under this second scenario, the Brazilian Government thus will hold the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that it has collected from the seller.[1572] This cash availability and associated implicit interest can last from one taxation period[1573] (if the non-accredited company is able to offset the credit during the second taxation period) to 360 days after the request for compensation or reimbursement (if the non-accredited company requests it). During this period, the government is able to make use of the taxes received (i.e., "earning" implicit interest). So long as the compensation or reimbursement is made to the non-accredited company buying the products within 360 days after the request, the Brazilian Government will not have to pay the non-accredited company buying the products any interest on the use of the buyer's money during that period. Only if 360 days are surpassed is the government obligated to compensate or repay to the non-accredited company buying the products not just the face amount of the credit but also the associated interest. Thus, it is only after 360 days that the government would no longer enjoy the implicit interest revenue from the free use of the buyer's money that is blocked in the form of its credit.[1574]

[1567] See paragraphs 2.16 to 2.17 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1568] See paragraphs 2.19 to 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1569] See paragraph 2.20 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1570] See paragraph 2.20 above.

[1571] Brazil acknowledges that "many sectors of the economy have their products subject to low or no taxation, reflecting the selective nature and the extra-fiscal character of indirect taxes in Brazil. These sectors tend to accumulate tax credits, as the tax debits due are lower than the credit acquired in the previous step of the production chain." Brazil's first written submission, paras. 758 (DS472) and 691 (DS497). Also, for instance, according to a 2014 Study by the Brazilian Industry Confederation, "a little more than one third of the surveyed exporting companies (34.3%) possess tax credits under PIS/COFINS, IPI and/or ICMS accumulated and not refunded for a period over three months." (22.5% of the companies possess tax credits under the PIS/COFINS contributions and 18.5% possess tax credits under the IPI tax). Exporters_2012 study on Brazilian exports – delays in refunds (Exhibit JE-186), p. 55; and European Union's first written submission, fn 849.

[1572] According to the European Union, the benchmark rate of the Brazilian Central Bank (available at the website https://www.bcb.gov.br) was, at the time of writing of its first written submission, 13.25%. European Union's first written submission, fn 883.

[1573] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[1574] See paragraph 2.20 above and Appeal Against Split Decision in Interlocutory Appeal No. 1.220.942 – SP (2012/0095341-6), (Exhibit BRA-104), para. 6, stating as follows: "It is a simple logic: if there is a claim

7.1204. With respect to imported new machinery, apparatuses, instruments and equipment, the Panel notes that the PIS/PASEP-importation and COFINS-importation contributions are collected by the customs authorities from the importer during the customs clearance process.[1575] Therefore, the Government will enjoy the advantage of cash availability or cash flow, along with the associated implicit interest income (revenue) that could be generated on the full amount of that tax that is collected, from the moment the product is imported until the moment the non-accredited company buying the product is able to offset the credit, or receives compensation or reimbursement (within 360 days of the request). Moreover, the Brazilian Government will enjoy the advantage of having charged the additional 1% of COFINS-importation contribution that does not generate a tax credit.[1576]

7.1205. In contrast, pursuant to the challenged treatment under the RECAP programme, whereby the PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions are suspended, the seller will not have to charge the contributions to the accredited company buying the products and will not have to remit any amount of tax to the Brazilian Government. The accredited company buying the products, in turn, will not accrue any credit.[1577]

7.1206. Thus, the Brazilian Government will not receive the amount of tax that would have otherwise been due on the 25th day of the month following the transaction (in the case of domestic products), or on the date of importation (in the case of imported products). By the same token, it also will not have to allow the accredited company buying the products to offset the amount of tax paid.[1578]

7.1207. If the Panel compares the challenged treatment with the best case scenario for the non-accredited company buying domestic products at issue under the benchmark treatment, where the tax is paid to the Government and offset during the same taxation period (in the case of domestic products), there would be no revenue foregone by the Brazilian Government, as the government would not earn the implicit interest on unused credits. However, if the Panel compares the challenged treatment with the rather frequent scenario where the non-accredited company buying the products at issue is not able to offset the tax credit it has accrued during the same taxation period in which the tax is paid, then under the challenged treatment the Government will never be able to benefit from the cash availability and implicit interest income, which could have lasted from the moment of importation (in the case of imported products) or from one taxation period[1579] (in the case of domestic products) to 360 days after the request for compensation or reimbursement, under the benchmark treatment. Therefore, under this rather frequent scenario, the Government is foregoing revenue in the form of the implicit interest on the tax revenue collected where the offsetting credits have not (yet) been used. Moreover, in the case of imported products, the Brazilian Government is foregoing the advantage of the additional 1% of COFINS-importation contribution that does not generate a tax credit.[1580]

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for reimbursement of credits of IPI, PIS/COFINS (in cash or by means of offset against other taxes) and these credits are acknowledged by the Federal Revenue Office with delay, then such delay in the reimbursement gives rise to application of monetary restatement." Also, Brazil has explained that "delays in processing reimbursement requests can result in financial costs for the government, which may have to pay interest on the amount overdue at the SELIC overnight lending rate – currently at 14.25% per annum." Brazil's first written submission, para. 780 (DS472) and fn 451 (DS497).

[1575] See paragraph 2.32 above.

[1576] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, paras. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

[1577] See paragraph 2.18 above. (Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions.)

[1578] See paragraph 2.13 above.

[1579] This period would be, for instance, of one month, if the Government receives the payment from the seller on the 25th day of one taxation period and the buyer is able to offset the credit on the 25th day of the next taxation period.

[1580] See paragraph 2.34 above. The Panel notes that Brazil argues that this additional 1% is outside from the scope of the dispute for the European Union. Brazil's first written submission, paras. 788-799 (DS472). However, the European and Japan are not challenging the imposition of the additional 1%, but the suspensions of the applicable rates of COFINS-importation contributions, which includes this 1%.

7.1208. Furthermore, from the buyer's standpoint, as explained in paragraph 2.17[1581] above, when the accredited company buying the new machinery, apparatuses, instruments and equipment sells its finished goods that were produced using the new machinery, apparatuses, instruments and equipment, under normal circumstances the Brazilian Government ultimately will collect the full amount of PIS/PASEP and COFINS contributions, or PIS/PASEP-importation and COFINS-importation contributions, corresponding to both the value added by the seller and the value added by the accredited company buying the products, i.e., the same nominal amount of contributions that it would have received in the absence of the suspensions. This does not, however, diminish or eliminate the advantage to the accredited company buying the products that it (rather than the government) enjoys of the cash availability and associated implicit interest income, due to not having to pay the tax to the seller of the products, from the moment it otherwise would have had to pay that tax until the moment it sells its finished good.

7.1209. Also, although the non-cumulative regime is the general rule for the PIS/PASEP and COFINS contributions[1582], to the extent that the purchases of the new machinery, apparatuses, instruments and equipment at issue could be subject to the cumulative regime, there would be no mechanism of credits and debits. In this case, if the Panel compares the challenged treatment, where the Brazilian Government receives none of the PIS/PASEP and COFINS contributions that otherwise would have been due, with the treatment under the cumulative regime, where the Brazilian Government receives the full amount of PIS/PASEP and COFINS contributions due, it is clear that under the challenged treatment the Brazilian Government foregoes revenue that is otherwise due under the cumulative regime.

7.1210. Finally, with respect to the Panel's obligation to take into consideration the reasons for the difference in tax treatment, the Panel recalls that there is evidence demonstrating that the objective reasons for the tax treatment is to tackle the problem of credit-accumulation, and in so doing to increase the competitiveness of Brazilian companies.[1583] Even if the prevention of credit accumulation may appear reasonable, at least in principle, Brazil did not demonstrate that the concerned programmes reflect the existence of a rule of general application containing the arguably reasonable policy goal of tackling the problem of credit-accumulation, and therefore this cannot impact the Panel's findings with respect to the comparison between the challenged tax treatment and the benchmark treatment.

7.5.1.2.1.3 Conclusion on whether the tax suspensions granted under the PEC and RECAP programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected"

7.1211. In light of the above, the Panel concludes that the tax suspensions granted to registered or accredited companies on its purchases of raw materials, intermediate goods and packaging materials (under the PEC programme) and new machinery, apparatuses, instruments and equipment (under the RECAP programme) constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected".

7.5.1.2.2 Whether the financial contributions granted under the PEC and RECAP programmes confer a benefit

7.1212. Several panels have concluded that, whenever there is revenue foregone by the government, there is a benefit conferred.[1584] Having concluded that the tax treatments at issue constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", the Panel concludes that the subsidies at issue confer a benefit.

7.1213. In fact, with respect to the tax suspensions granted to registered or accredited companies on its purchases of raw materials, intermediate goods, packaging materials, new machinery,

[1581] Although the explanation is given in the context of the IPI tax, the same logic also applies to the PIS/PASEP and COFINS contributions

[1582] See paragraph 2.22 above.

[1583] See paragraph 7.1162 above.

[1584] Panel Report, *US – Large Civil Aircraft (2nd complaint)*, paras. 7.169-7.171. See also: Panel Reports, *Canada – Renewable Energy / Canada – Feed-in Tariff Program*, fn 509; *US – FSC*, para. 7.103; and *US – FSC (Article 21.5 – EC)*, paras. 8.44-8.48; and Appellate Body Reports, *US – FSC*, para. 140; and *US – FSC (Article 21.5 – EC)*, para. 198.

apparatuses, instruments and equipment, it is clear that, by retaining the advantage of the cash availability, along with the associated implicit interest income, the registered or accredited companies under the PEC and RECAP programmes buying raw materials, intermediate goods, packaging materials, new machinery, apparatuses, instruments and equipment are better off with the suspensions than in the scenario of having to pay the full amount of taxes or contributions on their purchases of those products.

7.5.1.2.3 The relevance of footnote 1 of the SCM Agreement for the PEC programme

7.1214. Having concluded that the tax suspensions granted under the PEC programme constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred, the Panel now must consider whether they nonetheless fit within footnote 1 of the SCM Agreement and thus fall outside the scope of the Agreement's disciplines.

7.1215. As previously mentioned, the European Union submits that its challenge brought is not concerned with the question of whether or not WTO Members may, under the SCM Agreement, implement measures to exempt from indirect taxes upstream stages in the supply chain of goods for export.[1585] Brazil, in turn, argues that its tax suspensions are an effective means for applying the "destination principle" under footnote 1 of the SCM Agreement.[1586]

7.1216. Pursuant to footnote 1 of the SCM Agreement, 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. Thus, tax measures that involve the exemption or remission of product-based consumption taxes for exported products do not constitute subsidies. In other words, Members are allowed to exempt from internal taxes exported products. However, if those exemptions or remissions are given in amounts in excess of the accrued taxes, the tax measure will not only constitute a subsidy, but may also be considered a prohibited subsidy.[1587]

7.1217. In this respect, the Appellate Body in *US – FSC* explained that the tax measures identified in footnote 1 as not constituting a subsidy involve the exemption of exported products from product-based consumption taxes.[1588]

7.1218. In the particular context of value-added tax systems, item (g) of Annex I of the SCM Agreement provides relevant context, stating that the exemption or remission of indirect taxes on exported products in excess of the taxes borne by products consumed domestically constitutes an export subsidy. As per footnote 60 of the SCM Agreement, this provision of Annex I is the only provision addressing the problem of excessive remission of value-added taxes. While the measures at issue are suspensions, eventually giving rise to exemptions, on the purchase of raw materials, intermediate goods and packaging materials, the Panel finds this provision relevant in establishing the principle of excessiveness where VAT is excused on exported products.

7.1219. Concerning tax suspensions or deferrals, the SCM Agreement also makes clear that these can give rise to export subsidies. In particular, footnote 59 to item (e) of Annex I to the Agreement states that "deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected", such that the non-collection of interest on deferred taxes could give rise to a subsidy.

7.1220. Annex II of the SCM Agreement also provides relevant context. This annex states as follows:

> Indirect tax rebate schemes can allow for exemption, remission or deferral of prior-stage cumulative indirect taxes levied on inputs that are consumed in the production

[1585] European Union's first written submission, paras. 1166 and 1219.

[1586] Brazil's first written submissions, paras. 827-839 (DS472) and 735-746 (DS497).

[1587] This is confirmed by the following example of an export contingent subsidy explicitly listed in Annex I of the SCM Agreement, and prohibited under Article 3.1(a) of the SCM Agreement: "(g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption."

[1588] Appellate Body Report, *US – FSC*, para. 93.

> of the exported product (making normal allowance for waste). Similarly, drawback schemes can allow for the remission or drawback of import charges levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).

7.1221. This means that tax measures that involve the exemption or remission of product-based consumption taxes for inputs that are consumed in the production exported products also cannot be considered subsidies. In other words, Members are allowed to exempt from internal taxes those inputs that will be consumed in the production of products for export. According to footnote 61 of Annex II of the SCM Agreement, "inputs consumed in the production process are inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product."

7.1222. In respect of the tax suspensions at issue, the Panel notes that these are available in respect of both domestic and export sales. In other words, they are not confined to eliminating the taxes on the purchase of raw materials, intermediate goods and packaging materials used in the production of the products actually exported, but instead do so in respect of all sales of the products in question, domestically and for export, by accredited companies. Therefore, the Panel concludes that the measures at issue are not covered by footnote 1 of the SCM Agreement as they do not apply only to the purchase of raw materials, intermediate goods and packaging materials used in the production for export sales, but also to domestic sales, and thus give rise to excess exemption of taxes in the sense of item (g) of Annex I of the SCM Agreement.

7.5.1.2.4 Conclusion on whether the tax suspensions granted under the PEC and RECAP programmes constitute subsidies within the meaning of Article 1 of the SCM Agreement

7.1223. Having concluded that the tax suspensions granted under the PEC and RECAP programmes constitute financial contributions in the form of "government revenue that is otherwise due is foregone or not collected", through which a benefit is conferred, the Panel concludes that the measures at issue constitute subsidies within the meaning of Article 1 of the SCM Agreement.

7.5.1.3 Whether the subsidies granted under the PEC and RECAP programmes are specific within the meaning of Article 2 of the SCM Agreement

7.1224. The Panel refers to its explanation on the concept of specificity in paragraphs 7.496 to 7.498 above. Based on that explanation, and because the case at issue involves claims of prohibited subsidies, if the Panel concludes, in its analysis below, that the subsidies granted under the PEC and RECAP programmes are prohibited within the meaning of Article 3.1(a) of the SCM Agreement, the Panel will also be able to conclude *ipso facto* that, pursuant to Article 2.3, the subsidies granted under the PEC and RECAP programmes are specific and thus subject to the provisions of Part II of the SCM Agreement.

7.5.1.4 Whether the tax suspensions granted under the PEC and RECAP programmes are contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement and thus prohibited

7.1225. Articles 3.1(a) and 3.2 of the SCM Agreement state as follows:

> 3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact[4], whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I[5];
>
> …
>
> 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.
>
> _____

> [4] This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.
>
> [5] Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

7.1226. Article 3.1(a) of the SCM Agreement prohibits those subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance. Pursuant to Article 3 of the SCM Agreement, subsidies contingent upon export performance are prohibited, and shall not be granted or maintained. To the extent that a measure falls within the scope of this type of contingency, it is inconsistent with both Articles 3.1 and 3.2 of the SCM Agreement.

7.1227. In *EC and certain member States – Large Civil Aircraft*, the Appellate Body recalled its discussion regarding export contingency in *Canada – Aircraft,* as follows:

> The Appellate Body explained in *Canada – Aircraft* that the word "contingent" means "conditional" or "dependent for its existence on something else"[1589], and that the legal standard for export contingency expressed in Article 3.1(a) is the same for both *de jure* and *de facto* contingency.[1590] [1591]

7.1228. With respect to the evidentiary standard to prove an export contingency, the Appellate Body added:

> The Appellate Body found that the evidence that may demonstrate *de jure* export contingency is different from evidence that may reveal *de facto* export contingency. *De jure* contingency "can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure."[1592] Nonetheless, *de jure* export contingency does not have to be set out expressly, but can also be derived by "necessary implication" from the wording of a legal instrument. [1593] By contrast, the evidence needed to establish *de facto* export contingency goes beyond a legal instrument and includes a variety of factual elements concerning the granting of the subsidy in a specific case.[1594]

7.1229. In the case at issue, the complaining parties argue *de jure* contingency only. The Panel will therefore assess whether the complaining parties established the existence of *de jure* contingency on the basis of the words of the relevant legislation, regulations and other relevant legal instruments or on whether such contingency can be derived by necessary implication from the words actually used in those instruments.

7.1230. Annex I of the SCM Agreement includes some examples of subsidies contingent upon export performance. Although this Annex includes very diverse examples, the Appellate Body in *EC and certain member States – Large Civil Aircraft* noted:

> A common feature of the examples provided in items (b) to (l)[1595] of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement* is that the subsidy gives certain advantages to exported products and favours exported products over products

[1589] (footnote original) Appellate Body Report, *Canada – Aircraft*, para. 166.
[1590] (footnote original) Appellate Body Report, *Canada – Aircraft*, para. 167.
[1591] Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1037.
[1592] (footnote original) Appellate Body Report, *Canada – Autos*, para. 100.
[1593] (footnote original) Appellate Body Report, *Canada – Autos*, para. 100.
[1594] Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1037-1038.
[1595] (footnote original) Item (a) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement* refers to "{t}he provision by governments of direct subsidies to a firm or an industry contingent upon export performance."

destined for domestic consumption.[1596] Export-contingent subsidies will indeed favour a recipient's export sales over its domestic sales.[1597]

7.1231. While the European Union and Japan argue that the conditions to be accredited as a predominantly exporting company constitute export contingency[1598], Brazil argues that the requirement that 50% of total revenue be derived from exports for accreditation does not reflect an export contingency, but an objective value for the threshold dividing credit accumulating companies from those that do not accumulate tax credits or, in order words, contingency upon credit accumulation.[1599]

7.1232. The requirement that 50 per cent of a company's gross revenue derives from exports in order to be registered or accredited and, therefore, receive the tax suspensions, is an uncontested fact[1600], and at first sight appears to be clear evidence of export conditionality or dependency. The Panel nevertheless must address Brazil's argument that this export requirement is a threshold for determining whether a firm is a structurally credit-accumulating company.

7.1233. Since exports are exempted from taxes, it is indeed quite probable that exporting companies accumulate tax credits. Thus, there is some merit in Brazil's argument. However, as explained before in the context of identifying the adequate benchmark for the analysis of financial contribution in the form of revenue foregone, there are companies that do not export goods, or that export less than the 50 per cent requirement, which nevertheless accumulate tax credits, and which are not entitled to the tax suspensions.

7.1234. Brazil presents a table to show that the turning point for credit-accumulation is in the 45 to 50 per cent range of share of exports in the revenue of Brazilian companies.[1601] However, Brazil has not fully explained the source or methodology used to obtain the data[1602] and, additionally, the data appears to reflect the situation of 22 companies, which is insufficient for the Panel to be able to reach the conclusion advanced by Brazil. Indeed, the Panel also notes that Brazil has changed the percentage of the export requirement over time, from 80 per cent to 70 per cent, to 60 per cent, and then to 50 per cent[1603], which further puts into question Brazil's argument.

7.1235. In this respect, in the Panel's view, Brazil has not been able to demonstrate that the export requirement does not represent contingency upon export performance, but contingency upon credit-accumulation. Even if the prevention of credit accumulation may appear reasonable, at least in principle, Brazil did not demonstrate that the export requirements in the concerned programmes reflect the existence of a rule of general application addressing the arguably reasonable policy goal of tackling the problem of structural credit-accumulation.

7.1236. However, it is important to note that the Panel's conclusion does not imply that Brazil is not entitled under WTO rules to address the problem of credit-accumulation. In the Panel's view,

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[1596] (footnote original) For example, item (b) refers to currency retention schemes "which involve a bonus on exports". Items (c) and (d) list, respectively, internal transport and freight charges, and government provision of goods and services, for exported products "on terms or conditions more favourable than" those with respect to domestic products. Item (f) concerns allowance of special deductions related to exports "over and above those granted in respect to production for domestic consumption". Item (h) covers exemption, remission, or deferral of indirect taxes on goods and services used in the production of exported product "in excess of" the exemption, remission or deferral of indirect taxes on goods and services used in the production of like products when sold for domestic consumption. Other items, such as items (e), (j), and (k), concern subsidies provided exclusively to exports.

[1597] Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1053.

[1598] European Union's first written submission, paras. 1207-1215 and 1248-1252; Japan's first written submission, paras. 570-572 and 594-595; European Union's second written submission, paras. 523-525 and 549-550; Japan's second written submission, para. 189.

[1599] Brazil's first written submission, paras. 846-852 and 866-867 (DS472); Brazil's first written submission, paras. 752-758 and 768-769 (DS497).

[1600] Brazil's response to Panel question No. 17.

[1601] Brazil's first written submission, paras. 848-849 (DS472).

[1602] In response to Panel question No. 66, Brazil explained that "[t]his table was prepared by the Brazilian Federal Revenue Secretariat in 2012, with data of all Brazilian companies." This, in the Panel's view, is not sufficient for the Panel to be able to fully understand the source or methodology of the data.

[1603] European Union's first written submission, paras. 160-163; Brazil's first written submissions, para. 762.

Brazil could indeed devise a WTO-consistent rule that is effectively aimed at credit-accumulating companies, to avoid the problem of credit-accumulation.[1604]

7.1237. In light of the above, the Panel concludes that the subsidies granted under the PEC and RECAP programmes are contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement, and thus prohibited under Articles 3.1(a) and 3.2 of the SCM Agreement.

7.5.1.5 Conclusion

7.1238. In light of the foregoing, the Panel concludes that the tax suspensions granted under the PEC and RECAP programmes are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.

7.6 Final comments

7.1239. Article 12.10 of the DSU states that: "in examining a complaint against a developing country Member, the panel shall accord sufficient time for the developing country Member to prepare and present its argumentation."

7.1240. Furthermore, Article 12.11 of the DSU requires that:

> Where one or more of the parties is a developing country Member, the panel's report shall explicitly indicate the form in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members that form part of the covered agreements which have been raised by the developing country Member in the course of the dispute settlement procedures.

7.1241. In adopting the timetable for the proceedings, the Panel took into account the need to give all the parties sufficient time to prepare and present their respective arguments. Furthermore, in the course of the proceedings, Brazil raised certain provisions of the Enabling Clause, with respect to preferential treatment through non-tariff measures and regional trade agreements. The Panel took account of these provisions by examining Brazil's arguments in detail, as set out in section 7.4.8above.

8 CONCLUSIONS AND RECOMMENDATIONS

8.1 Complaint by the European Union (DS472)

8.1. With respect to Brazil's assertion that Implementing Order 257/2014 is outside the Panel's terms of reference, the Panel concludes that the rules on calculation of presumed tax credits under the INOVAR-AUTO programme, as contained in Implementing Order 257/2014, are within the Panel's terms of reference.

8.2. With respect to whether Article III of the GATT 1994, the TRIMs Agreement, and the SCM Agreement, are not applicable to measures that regulate pre-market production steps, the Panel concludes that Article III of the GATT 1994, the TRIMs Agreement, and the SCM Agreement, are not *per se* inapplicable to such measures, in particular "pre-market" measures directed at producers.

8.3. With respect to whether Article III of the GATT 1994 and the TRIMs Agreement are not applicable to the challenged measures, or aspects of the challenged measures, because they are payments of subsidies exclusively to domestic producers, pursuant to Article III:8(b) of the GATT 1994, the Panel concludes that measures in the form of subsidies provided exclusively to domestic

[1604] The European Union acknowledges that "Brazil could devise a general rule to prevent tax credit accumulation with respect to companies (as opposed to sectors) whereby e.g. companies accumulating a particular amount of tax credits in the preceding or preceding years could benefit from a suspension on taxes." European Union's second written submission, para. 510.

producers are not for that reason alone exempted from the disciplines of Article III of the GATT 1994 or Article 2.1 of the TRIMs Agreement.

8.4. With respect to whether the incentivised products that are the subject of certain challenged measures are "domestic products" for the purposes of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement, the Panel concludes that the incentivized products are Brazilian domestic products.

8.5. With respect to the European Union's claims in respect of the Informatics, PADIS, PATVD and Digital Inclusion programmes, the Panel concludes that:

a. The production-step requirements under the Informatics, PADIS, PATVD, and Digital Inclusion programme; and the requirement for products to obtain the status of "developed" in Brazil, under the Informatics, PATVD and Digital Inclusion programmes; result in imported products being subject to internal taxes in excess of those applied to like domestic products, inconsistently with Article III:2, first sentence, of the GATT 1994;

b. The production-step requirements under the Informatics, PADIS, PATVD, and Digital Inclusion programme, and the requirement for products to obtain the status of "developed" in Brazil, under the Informatics, PATVD and Digital Inclusion programmes; the aspect of the mechanism for the calculation of the amount of resources required to be invested in R&D under the Informatics and PADIS programmes relating to the deductible part; and the lower administrative burden on companies purchasing domestic incentivised *intermediate* products under the Informatics and PADIS programmes; accord to imported products treatment less favourable than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994;

c. It is not necessary to make findings with respect to the complaining parties' claims under Article III:5 of the GATT 1994 in order to secure a positive solution to this dispute, and the Panel therefore exercises judicial economy with respect to these claims;

d. The Informatics, Digital Inclusion, PATVD and PADIS programmes constitute trade-related investment measures, and the aspects of these programmes found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement;

e. The tax exemptions, reductions and suspensions granted under the Informatics, PADIS, PATVD and Digital Inclusion programmes are subsidies within the meaning of Article 1.1 of the SCM Agreement which are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement; and

f. Those aspects of the PATVD programme found to be inconsistent with the GATT 1994 and the TRIMs Agreement are not justified under Article XX(a) of the GATT 1994.

8.6. With respect to the European Union's claims in respect of the INOVAR-AUTO programme, the Panel concludes that:

a. Certain aspects of the accreditation process, the system of rules on accrual and calculation of presumed tax credits, and the rules on the use of presumed tax credits resulting from expenditure on strategic inputs and tools in Brazil, result in imported products being subject to internal taxes in excess of those applied to like domestic products, inconsistently with Article III:2 of the GATT 1994;

b. Certain aspects of the accreditation process, the system of rules on accrual and calculation of presumed tax credits, and the rules on the use of presumed tax credits resulting from expenditure on strategic inputs and tools in Brazil; the accreditation requirement to perform a minimum number of manufacturing steps in Brazil; that aspect of the rules on accrual of presumed IPI tax credits pertaining to expenditure in strategic

inputs and tools; and those aspects of the accreditation requirements to invest in R&D in Brazil and make expenditures on engineering, basic industrial technology and capacity-building of suppliers in Brazil, pertaining to the purchase of Brazilian laboratory equipment; accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994;

c. It is not necessary to make findings with respect to the complaining parties' claims under Article III:5 of the GATT 1994 in order to secure a positive solution to this dispute, and the Panel therefore exercises judicial economy with respect to these claims;

d. The INOVAR-AUTO programme constitutes a trade-related investment measure, and those aspects of the programme found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement;

e. The tax reductions through presumed tax credits granted under the INOVAR-AUTO programme are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Article 3.1(b) and 3.2 of the SCM Agreement;

f. Those aspects of the INOVAR-AUTO programme found to be inconsistent with the GATT 1994 and the TRIMs Agreement are not justified under Article XX(b) or XX(g) of the GATT 1994;

g. The tax reductions accorded to imported products from MERCOSUR members and Mexico under the INOVAR-AUTO programme are advantages granted by Brazil to products originating in those countries, which are not accorded immediately and unconditionally to like products originating in other WTO Members, inconsistently with Article I:1 of the GATT 1994;

h. The complaining parties were not under a burden to invoke the Enabling Clause in their panel requests, and their claims under Article I:1 of the GATT 1994 are therefore within the Panel's terms of reference; and

i. The tax reductions accorded to imported products from Argentina, Mexico and Uruguay and found to be inconsistent under Article I:1 of the GATT 1994 are not justified under paragraph 2(b) or 2(c) of the Enabling Clause.

8.7. With respect to the European Union's claims under Article 3.1(a) of the SCM Agreement, in respect of the PEC and RECAP programmes, the Panel concludes that the tax suspensions granted under the PEC and RECAP programmes are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.

8.8. Pursuant to Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits accruing under the agreement in question. The Panel therefore finds that, to the extent that Brazil has acted in a manner inconsistent with the provisions of the GATT 1994, TRIMs Agreement, and SCM Agreement, it has nullified or impaired benefits accruing to the European Union under those agreements.

8.9. Pursuant to Article 19.1 of the DSU, to the extent that those aspects of the challenged programmes are WTO-inconsistent, the Panel recommends that Brazil bring the challenged measures into conformity with its obligations under the covered agreements.

8.10. Pursuant to Article 4.7 of the SCM Agreement, the Panel recommends that Brazil withdraw the subsidies identified above without delay.

8.11. Article 4.7 further provides that "the panel shall specify in its recommendation the time-period within which the measure must be withdrawn." In other words, the Panel is required to

specify what period would represent withdrawal "without delay". Taking into account the procedures that may be required to implement our recommendation on the one hand, and the requirement that Brazil withdraw its subsidies "without delay" on the other, the Panel recommends that Brazil shall withdraw the subsidies identified in paragraphs 8.5(e), 8.6(e), and 8.7 above within 90 days.

8.2 Complaint by Japan (DS497)

8.12. With respect to Brazil's assertion that Implementing Order 257/2014 is outside the Panel's terms of reference, the Panel concludes that the rules on calculation of presumed tax credits under the INOVAR-AUTO programme, as contained in Implementing Order 257/2014, are within the Panel's terms of reference.

8.13. With respect to whether Article III of the GATT 1994, the TRIMs Agreement, and the SCM Agreement, are not applicable to measures that regulate pre-market production steps, the Panel concludes that Article III of the GATT 1994, the TRIMs Agreement, and the SCM Agreement, are not *per se* inapplicable to such measures, in particular "pre-market" measures directed at producers.

8.14. With respect to whether Article III of the GATT 1994 and the TRIMs Agreement are not applicable to the challenged measures, or aspects of the challenged measures, because they are payments of subsidies exclusively to domestic producers, pursuant to Article III:8(b) of the GATT 1994, the Panel concludes that measures in the form of subsidies provided exclusively to domestic producers are not for that reason alone exempted from the disciplines of Article III of the GATT 1994 or Article 2.1 of the TRIMs Agreement.

8.15. With respect to whether the incentivised products that are the subject of certain challenged measures are "domestic products" for the purposes of Article III of the GATT 1994, Article 2.1 of the TRIMs Agreement, and Article 3.1(b) of the SCM Agreement, the Panel concludes that the incentivized products are Brazilian domestic products.

8.16. With respect to Japan's claims in respect of the Informatics, PADIS, PATVD and Digital Inclusion programmes, the Panel concludes that:

a. The production-step requirements under the Informatics, PADIS, PATVD, and Digital Inclusion programme; and the requirement for products to obtain the status of "developed" in Brazil, under the Informatics, PATVD and Digital Inclusion programmes; result in imported products being subject to internal taxes in excess of those applied to like domestic products, inconsistently with Article III:2, first sentence, of the GATT 1994;

b. It is not necessary to make findings with respect to Japan's claims under Article III:2, second sentence, of the GATT 1994, and the Panel therefore exercises judicial economy with respect to these claims;

c. The production-step requirements under the Informatics, PADIS, PATVD, and Digital Inclusion programme, and the requirement for products to obtain the status of "developed" in Brazil, under the Informatics, PATVD and Digital Inclusion programmes; the aspect of the mechanism for the calculation of the amount of resources required to be invested in R&D under the Informatics and PADIS programmes relating to the deductible part; and the lower administrative burden on companies purchasing domestic incentivised *intermediate* products under the Informatics and PADIS programmes; accord to imported products treatment less favourable than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994;

d. It is not necessary to make findings with respect to the complaining parties' claims under Article III:5 of the GATT 1994 in order to secure a positive solution to this dispute, and the Panel therefore exercises judicial economy with respect to these claims;

e. The Informatics, Digital Inclusion, PATVD and PADIS programmes constitute trade-related investment measures, and the aspects of these programmes found to be

inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement;

f. The tax exemptions, reductions and suspensions granted under the Informatics, PADIS, PATVD and Digital Inclusion programmes are subsidies within the meaning of Article 1.1 of the SCM Agreement which are contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Articles 3.1(b) and 3.2 of the SCM Agreement; and

g. Those aspects of the PATVD programme found to be inconsistent with the GATT 1994 and the TRIMs Agreement are not justified under Article XX(a) of the GATT 1994.

8.17. With respect to Japan's claims in respect of the INOVAR-AUTO programme, the Panel concludes that:

a. Certain aspects of the accreditation process, the system of rules on accrual and calculation of presumed tax credits, and the rules on the use of presumed tax credits resulting from expenditure on strategic inputs and tools in Brazil, result in imported products being subject to internal taxes in excess of those applied to like domestic products, inconsistently with Article III:2 of the GATT 1994;

b. It is not necessary to make findings with respect to Japan's claims under Article III:2, second sentence, of the GATT 1994, and the Panel therefore exercises judicial economy with respect to these claims;

c. Certain aspects of the accreditation process, the system of rules on accrual and calculation of presumed tax credits, and the rules on the use of presumed tax credits resulting from expenditure on strategic inputs and tools in Brazil; the accreditation requirement to perform a minimum number of manufacturing steps in Brazil; and that aspect of the rules on accrual of presumed IPI tax credits pertaining to expenditure in strategic inputs and tools; accord less favourable treatment to imported products than that accorded to like domestic products, inconsistently with Article III:4 of the GATT 1994;

d. It is not necessary to make findings with respect to the complaining parties' claims under Article III:5 of the GATT 1994 in order to secure a positive solution to this dispute, and the Panel therefore exercises judicial economy with respect to these claims;

e. The INOVAR-AUTO programme constitutes a trade-related investment measure, and those aspects of the programme found to be inconsistent with Article III:2 and III:4 of the GATT 1994 are also inconsistent with Article 2.1 of the TRIMs Agreement;

f. The tax reductions through presumed tax credits granted under the INOVAR-AUTO programme are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Article 3.1(b) and 3.2 of the SCM Agreement;

g. Those aspects of the INOVAR-AUTO programme found to be inconsistent with the GATT 1994 and the TRIMs Agreement are not justified under Article XX(b) or XX(g) of the GATT 1994;

h. The tax reductions accorded to imported products from MERCOSUR members and Mexico under the INOVAR-AUTO programme are advantages granted by Brazil to products originating in those countries, which are not accorded immediately and unconditionally to like products originating in other WTO Members, inconsistently with Article I:1 of the GATT 1994;

i. The complaining parties were not under a burden to invoke the Enabling Clause in their panel requests, and their claims under Article I:1 of the GATT 1994 are therefore within the Panel's terms of reference; and

j. The tax reductions accorded to imported products from Argentina, Mexico and Uruguay and found to be inconsistent under Article I:1 of the GATT 1994 are not justified under paragraph 2(b) or 2(c) of the Enabling Clause.

8.18. With respect to Japan's claim under Article 3.1(a) of the SCM Agreement, in respect of the PEC and RECAP programmes, the Panel concludes that the tax suspensions granted under the PEC and RECAP programmes are subsidies within the meaning of Article 1.1 of the SCM Agreement and contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement, and thus are prohibited subsidies, inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.

8.19. Pursuant to Article 3.8 of the DSU, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment of benefits accruing under the agreement in question. The Panel therefore finds that, to the extent that Brazil has acted in a manner inconsistent with the provisions of the GATT 1994, TRIMs Agreement, and SCM Agreement, it has nullified or impaired benefits accruing to Japan under those agreements.

8.20. Pursuant to Article 19.1 of the DSU, to the extent that those aspects of the challenged programmes are WTO-inconsistent, the Panel recommends that Brazil bring the challenged measures into conformity with its obligations under the covered agreements.

8.21. Pursuant to Article 4.7 of the SCM Agreement, the Panel recommends that Brazil withdraw the subsidies identified above without delay.

8.22. Article 4.7 further provides that "the panel shall specify in its recommendation the time-period within which the measure must be withdrawn." In other words, the Panel is required to specify what period would represent withdrawal "without delay". Taking into account the procedures that may be required to implement our recommendation on the one hand, and the requirement that Brazil withdraw its subsidies "without delay" on the other, the Panel recommends that Brazil shall withdraw the subsidies identified in paragraphs 8.16(f), 8.17(f), and 8.18 above within 90 days.

9 APPENDIX TO THE PANEL REPORT

9.1. This Annex contains the Panel's scrutinization of the production-step requirements that must be met by a particular company in order to be eligible for the tax treatment available under the Informatics, PADIS, PATVD, and Digital Inclusion programmes. This analysis is relevant to the Panel's analysis of the complaining parties' claims under Article III:4 of the GATT 1994 that relate to "*input*" products (which the Panel refers to as "components and subassemblies"[1605]), and Article 3.1(b) of the SCM Agreement. The Panel distinguishes its analyses according to the legal instruments containing the production-step requirements, the vast majority of which are in the form of so-called "Basic Production Processes" ("PPBs").

9.2. The Panel recalls its analyses and conclusions in paragraphs 7.275 to 7.391 of its report, regarding the "outsourcing" scenario for components and subassemblies under the challenged programmes. The Annex is presented in the context of that analysis. In particular, in the Annex, the Panel identifies, on the basis of the production step descriptions, those particular production-step requirements compliance with which appears to result in the creation, from basic raw materials and inputs, of components and subassemblies for the production of the incentivised (finished or intermediate) products receiving certain tax benefits under the relevant programmes. Such production-steps include those that require the production of specific components and subassemblies in accordance with their own specific PPBs. In this context, the Panel indicates whether or not the scrutinized legal instruments allow third parties in Brazil to perform certain production-step requirements, i.e., allow the accredited companies to outsource their performance, while retaining their accreditation for the products in question, and thus their access to the tax benefits in respect of those products. The Panel recalls in this regard its finding at paragraph 7.299 that where the outsourcing provisions, which require that outsourced production steps comply with the respective requirements of the PPBs, apply to production steps for the creation of manufactured components and subassemblies in Brazil from basic components and raw materials, the resulting components and subassemblies are domestic products. Regarding the PPBs that contain such "nested" PPBs, the Panel also recalls that the outsourcing of the components or subassemblies covered by those PPBs is allowed so long as their requirements are respected. The Panel also recalls its finding at paragraph 7.117 that products produced in accordance with PPBs are domestic products. Finally, the Panel recalls its finding that, therefore, outsourcing of the components and subassemblies to import sources would not satisfy the requirements of the PPBs, and the resulting products subject to the PPBs would not qualify for the tax benefits.

9.3. As discussed in paragraphs 7.275 to 7.296 of the Panel Report, in the view of the Panel this demonstrates that the PPBs are generally not targeted exclusively at a single domestic producer, but rather at the domestic industry as a whole.[1606]

9.4. The Panel further notes that certain PPBs contain alternative options to compliance with certain production-steps in the PPBs, in order for a company to obtain the concerned tax treatment. As explained in paragraphs 7.303 to 7.304 and 7.308 of the Panel Report, the Panel does not consider that the existence of potentially WTO-consistent alternative options alters a finding of inconsistency in respect of other options. The Panel therefore does not indicate such alternative options in this Annex.

9.5. The Panel notes that a number of PPBs require specific percentages of specific components and subassemblies to be assembled in Brazil. For the reasons explained in paragraph 7.305 of the Panel Report, the Panel does not consider that these specific percentages are relevant to its assessment of WTO-consistency, and therefore does not generally indicate this aspect in this Annex. However, to the extent that the specific component or subassembly in question is not identified elsewhere in the legal instrument, the Panel does make reference to such percentage-based requirements.

[1605] This document is not intended to be an exhaustive analysis of each and every component and subassembly of each and every product subject to a PPB, but rather reflects the Panel's understanding of the - functioning of each PPB. Also, this document incorporates the relevant language included in the translation of the PPBs presented as exhibits by the parties.

[1606] This is consistent with Brazil's multiple statements that the various ICT programmes are designed to stimulate development of the industry as a whole. See, e.g. Brazil's first written submissions, para. 73 (DS472) and para. 79 (DS497); and Brazil's second written submission, para. 59.

9.6. A number of PPBs also contain exemptions or alternative options that are time-specific. Additionally, certain PPBs contain time-limited exemptions for products or production-steps, including time-limited exemptions that apply to the percentages as described in paragraph 2.63 above. Again, as explained in paragraph 7.305 of the Panel Report, the Panel does not consider that such exemptions are relevant to the Panel's assessment of WTO-consistency in respect of those products, entities or production-steps that are covered by the relevant legal instrument and are *not* exempted, nor do any time-limited exemptions preclude the Panel from being able to reach a conclusion in respect of mandated WTO-inconsistent action in the future. The Panel therefore does not indicate such exemptions or alternative options in this Annex.

9.7. MDIC/MCT Implementing Order No. 132, of 8 August 2002[1607], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product VIDEO DISPLAY WITH PLASMA SCREEN:
>
> I - assembly and welding of all the components on the following boards:
>
> > a) processing board of the plasma module (main board); b) source board; c) line filter board; d) audio and video board; e) switch power board; f) control panel board; and g) remote control board.
>
> II - assembly of the electrical and mechanical parts, fully separate, at the level of components; and
>
> III – integration of the printed circuit boards with the electrical and mechanical parts to build the end product, assembled in accordance with Items I and II above.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages mentioned in this Article provided the Basic Production Process be complied with.

9.8. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step 1 - processing boards, source boards, line filter boards, audio and video boards, switch power boards, control panel boards, and remote control boards; and step II - electrical and mechanical parts. Both steps I and II can be performed by third parties. That is, the accredited producer of VIDEO DISPLAYS WITH PLASMA SCREEN can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.9. MDIC/MCT Implementing Order No. 189, of 14 November 2002[1608], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product ELECTRIC ACCUMULATORS FIT FOR TELECOMMUNICATIONS EQUIPMENT OF POSITIONS NCM 8525.20.21 AND 8517.30 AND STATIC CONVERTERS (UPS) NCM 8504.40 BASED ON DIGITAL TECHNIQUE, manufactured in Brazil:
>
> I - manufacture of the positive and negative grids;
>
> II - manufacture of containers, lids, pockets and separators;
>
> III - filling or pasting of the positive boards;

[1607] Implementing Order 132/2002, (Exhibit BRA-116)
[1608] Implementing Order 189/2002, (Exhibit BRA-116)

IV - pasting of the negative boards;

V - assembly of the boards in the container;

VI - addition of acid;

VII - charge to build the boards (polarization);

VIII - addition of gel, when applicable; and

IX - closing of the container, addition of the valves and charge.

§ 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with.

9.10. The Panel considers that at least steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - positive and negative grids; and step II - containers, lids, pockets and separators. Steps I and II can be performed by third parties. That is, the accredited producer of ELECTRIC ACCUMULATORS FIT FOR TELECOMMUNICATIONS EQUIPMENT OF POSITIONS NCM 8525.20.21 AND 8517.30 AND STATIC CONVERTERS (UPS) NCM 8504.40 BASED ON DIGITAL TECHNIQUE can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.11. MICT/MCT Implementing Order No. 46, of 8 April 1994[1609], Article 1 states in relevant part that:

For purposes of the provisions in article 4 of Law 8248, of October 23, 1991, it is hereby set forth that LARGE DIGITAL PROCESSING UNITS manufactured in Brazil shall have local added value if they comply with the Basic Production Process below, as well as the provisions in article 4 of this Order:

I - assembly and welding of all the components on the set of printed circuit boards implementing at least two of the following five functions:

a) communication channel;
b) memory;
c) central processing;
d) integrated/interface control unit;
e) system support and diagnosis, or, alternatively, the assembly of at least three (3) printed circuit boards implementing either of these functions. This is required in both cases for at least one model of the family of large processors manufactured and sold by the company in Brazil;

II - assembly and integration of the printed circuit boards and of the electrical and mechanical sets to build the end product;

III - management of the quality and productivity of both the process and the end product, involving the inspection of raw materials, intermediate products, secondary materials and packaging, statistical control of the process, tests and measurements and the quality of the end product. Additionally, at least the following operations shall be also performed: functional tests, setup simulation and recording of the product operation code.

[1609] Implementing Order 46/1994, (Exhibit BRA-116).

…

> § 3. The use of subassemblies assembled by third parties in Brazil is acceptable to meet the provisions in this Article, provided their production complies with Items I and II in the head section and in the paragraph above.

9.12. Additionally, Article 5 of Implementing Order No. 46, of 8 April 1994 states in relevant part that:

> The provision of this Order is also applied to control units of peripherals, such as controllers for discs, tapes, printers and optical or magnetic readers and to the expansions of the functions mentioned in Item I of Article 1, even when they are not in the same body or case of the digital processing units.

9.13. The Panel considers that step I involves the creation, from basic raw materials and inputs, of components or subassemblies as follows: printed circuit boards. Pursuant to paragraph 3 of Article 1, Step I can be performed by third parties. That is, the accredited producer of LARGE DIGITAL PROCESSING UNITS can outsource this step and retain the tax benefits in question so long as the requirements of the step (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.14. Also, Article 5 requires that the control units of peripherals, such as controllers for discs, tapes, printers and optical or magnetic readers and to the expansions mentioned in step I, even when they are not in the same body or case, be produced in accordance with this PPB. Therefore, this article as well involves the creation, from basic raw materials and inputs, of components and subassemblies for the LARGE DIGITAL PROCESSING UNITS, and all provisions of the PPB, including the outsourcing provisions, apply. That is, the accredited producer of LARGE DIGITAL PROCESSING UNITS can "use subassemblies assembled by third parties in Brazil", so long as those are produced in accordance with the PPB, and retain the tax benefits.

9.15. MICT/MCT Implementing Order No. 47, of 8 April 1994[1610], Article 1 states in relevant part that:

> For purposes of the provisions in article 4 of Law 8248, of October 23, 1991, it is hereby set forth that MEDIUM DIGITAL PROCESSING UNITS manufactured in Brazil shall have local added value if they comply with the Basic Production Process below, as well as the provisions in article 4 of this Order:
>
> I - assembly and welding of all the components on the set of printed circuit boards implementing at least three (3) of the following five (5) functions:
>
> a) central processing;
> b) memory;
> c) integrated/interface control unit or controllers of peripherals;
> d) system support and diagnosis;
> e) communication channel or interface with units for input and output of data and peripherals, or, alternatively, the assembly of at least four (4) printed circuit boards implementing either of these functions;
>
> II - assembly and integration of the printed circuit boards and of the electrical and mechanical sets to build the end product
>
> III - management of the quality and productivity of both the process and the end product, involving the inspection of raw materials, intermediate products, secondary materials and packaging, statistical control of the process, tests and measurements and the quality of the end product. Additionally, at least the following operations shall

[1610] Implementing Order 47/1994, (Exhibit BRA-116).

> be also performed: functional tests, setup simulation and recording of the product operation code.
>
> …
>
> § 3. The use of subassemblies assembled by third parties in Brazil is acceptable to meet the provisions in the Article, provided their production complies with Items I and II in the head section and in the paragraph above.

9.16. Additionally, Article 5 of Implementing Order No. 47, of 8 April 1994 states in relevant part that:

> The provision of this Order is also applied to control units of peripherals, such as controllers for discs, tapes, printers and optical or magnetic readers and to the expansions of the functions mentioned in Item I of Article 1, even when they are not in the same body or case of the digital processing units.

9.17. The Panel considers that at least step I involves the creation, from basic raw materials and inputs, of components or subassemblies, as follows: printed circuit boards. Pursuant to paragraph 3 of Article 1, step I can be performed by third parties. That is, the accredited producer of MEDIUM DIGITAL PROCESSING UNITS can outsource this step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.18. Also, Article 5 requires that the control units of peripherals, such as controllers for discs, tapes, printers and optical or magnetic readers and to the expansions of the functions mentioned in step I, even when they are not in the same body or case, be produced in accordance with this PPB. Therefore, this article as well involves the creation, from basic raw materials and inputs, of components and subassemblies for the MEDIUM DIGITAL PROCESSING UNITS, and all provisions of the PPB, including step I and the outsourcing provisions, apply. That is, the accredited producer of MEDIUM DIGITAL PROCESSING UNITS can "use subassemblies assembled by third parties in Brazil", so long as those are produced in accordance with the PPB, and retain the tax benefits.

9.19. MDIC/MCT Implementing Order No. 541 of 18 December 2003[1611], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product MICROPROCESSOR-BASED UNINTERRUPTIBLE POWER SUPPLY (UPS OR NO BREAK) and MICROPROCESSOR-BASED VOLTAGE STABILIZING EQUIPMENT:
>
> I - injection of cabinet structural plastic parts;
>
> II - cutting, folding, stamping, treatment and welding of cabinet structural parts;
>
> III - manufacturing of printed circuit boards, according to basic productive process;
>
> IV - assembly and welding of all components in printed circuit boards;
>
> V - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and
>
> VI - integration of printed circuit boards and electrical and mechanical parts to form the final product.
>
> Paragraph 1 The activities or operations described in sections I to IV may be performed by third-parties, provided Basic Production Process is complied with.

[1611] Implementing Order 541/2003, (Exhibit BRA-116).

9.20. Additionally, Article 2 states in relevant part that:

> As of August 1st, 2003, printed circuits, electric cables and electric voltage transformers used in the products microprocessor-based uninterruptible power supply (UPS or no break) and microprocessor-based voltage stabilizing equipment should be manufactured in the country.

9.21. The Panel considers that the following steps involve the creation, from basic raw materials and inputs, of components or subassemblies: step I - cabinet structural parts; steps III and IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I to IV can be performed by third parties. That is, the accredited producer of MICROPROCESSOR-BASED UNINTERRUPTIBLE POWER SUPPLIES (UPS OR NO BREAK) and MICROPROCESSOR-BASED VOLTAGE STABILIZING EQUIPMENT can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.22. Also, Article 2 requires the manufacturing in Brazil of the printed circuits, electric cables and electric voltage transformers used in the MICROPROCESSOR-BASED UNINTERRUPTIBLE POWER SUPPLIES (UPS OR NO BREAK) and MICROPROCESSOR-BASED VOLTAGE STABILIZING EQUIPMENT. Therefore, where these components and subassemblies are outsourced, the accredited producer only retains the tax benefits if the outsourced components and subassemblies are manufactured in Brazil.

9.23. Implementing Order No. 13, of 29 January 2002[1612], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product DIELECTRIC FILTER, manufactured in Brazil:
>
> I - resonator preparation;
>
> II - resonator assembly;
>
> III - printed circuit assembly;
>
> IV - end product assembly;
>
> V - frequency adjustment;
>
> VI - strapping, when applicable;
>
> VII - marking (identification); and
>
> VIII - final test.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with.

9.24. The Panel considers that at least steps I through III involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: steps I and II - resonator; step III - printed circuits. Steps I to III can be performed by third parties. That is, the accredited producer of DIELECTRIC FILTERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1612] Implementing Order 13/2002, (Exhibit BRA-116).

9.25. Implementing Order No. 35, of 8 March 2002[1613], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product PLASTIC CASE FOR SMALL DIGITAL PROCESSING UNITS, manufactured in Brazil:
>
> I – injection of the plastic and external parts of the case;
>
> II - cutting, folding and punching or other stamping process of the metallic parts;
>
> III - assembly of the plastic and metallic subassembly;
>
> IV - assembly and welding of all the components on the printed circuit boards, when applicable; and
>
> V - integration of the printed circuit boards and the plastic and metallic parts to build the end product, in accordance with sections I to IV above
>
> § 1. Third parties can perform the activities or operations inherent in the production stages described in this Article provided the Basic Production Process be complied with.
>
> § 2. It is possible to choose the performance of either stage I or II above when the case has a powering source manufactured in Brazil in accordance with the Basic Production Process set forth by MCT/MICT Implementing Order 101, April 7, 1993, or by a specific Implementing Order.

9.26. The Panel considers that at least steps I, II, III and IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: steps I and II - plastic and external parts of the case; step III - metallic parts; and step IV - printed circuit boards. All of these steps can be performed by third parties. That is, the accredited producer of PLASTIC CASES FOR SMALL DIGITAL PROCESSING UNITS DIELECTRIC FILTERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.27. MDIC/MCT Implementing Order 56, of 28 September 2000[1614], Article 1 states in relevant part that:

> The product MULTILAYER PRINTED CIRCUIT shall have local added value if it meets the Basic Production Process described below, as well as the provisions in Articles 2 and 3 of this Order:
>
> I - superficial treatment;
>
> II - circuit printing with dry film;
>
> III - corrosion;
>
> IV - sandwich assembly;
>
> V - pressing;
>
> VI - punching;
>
> VII - copper metallization;

[1613] Implementing Order 35/2002, (Exhibit BRA-116).
[1614] Implementing Order 56/2000, (Exhibit BRA-116).

VIII - additive corrosion or metallization;

IX - welding mask printing;

X - printing of wording on the welding mask; and

XI - contour routing.

Sole Paragraph. The quality and productivity management of the process and of the end product shall be incorporated into the Basic Production Process described in Article 1 of this Order, involving at least the inspection of raw materials, intermediate products, secondary materials and packaging, the statistic control of the process, the tests and measurement and the quality of the end product, as well as the provisions in Article 3 of this Order.

…

Article 4. Third parties can perform the activities or operations inherent in the production stages in Brazil.

9.28. The Panel notes that in accordance with Article 4, all of the production steps listed in items I to XI can be performed by third parties. It is difficult to determine, from the descriptions of the steps, precisely which of them involve the creation, from basic raw materials and inputs, of components and subassemblies. That said, the reference in the "sole paragraph" of Article 1 to "inspection of raw materials [and] intermediate products" makes clear that this PPB involves such a conversion process (or processes). Thus, the accredited producer of MULTILAYER PRINTED CIRCUITS can outsource the steps involving such processes and retain the tax benefits in question, so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.29. Implementing Order No. 88, of 15 May 2002[1615], Article 1 states in relevant part that:

The following Basic Production Processes are hereby set forth for the manufactured products LIFE SIGN DISPLAY and CABLE WITH SENSOR FOR LIFE SIGNS:

I - LIFE SIGN DISPLAY

a) assembly and welding all the components on the printed circuit boards implementing the functions of central processing, memory, control of peripherals, storage units and communication interfaces, of the serial, parallel and local network type;
b) assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
c) integration of the printed circuit boards and the electrical and mechanical parts to build the end product, assembled in accordance with sub-items "a" and "b" above.

II - CABLE WITH SENSOR FOR LIFE SIGNS

a) cutting and scouring of the cable with sensor; and

b) welding of the cable on the connector terminals.

§ 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with.

[1615] Implementing Order 88/2002, (Exhibit BRA-116).

9.30. Additionally, § 3 of Article 1 of Implementing Order No. 88, of 15 May 2002, states in relevant part that:

> In addition to the assembly of the printed circuit boards, as provided for in Subsection "a", Item I of this Article and other conditions of this Item, the assembly of the boards implementing the functions of electrocardiogram (ECG), invasive pressure, temperature, PH, breathing and oximetry–either separate or combined–is mandatory to manufacture the life sign displays.

9.31. The Panel considers that at least steps I(a) in conjunction with paragraph 3, and I(b), involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I(a) - printed circuit boards with various functions including those listed in paragraph 3; and step I(b) - electrical and mechanical parts. Steps I (a) to (b) can be performed by third parties. That is, the accredited producer of LIFE SIGN DISPLAYS can outsource at least these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.32. MDIC/MCT Implementing Order No. 158, of 24 April 2003[1616], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product DISC UNIT TO READ OR RECORD DATA BY OPTICAL MEANS – OPTICAL DISC UNIT, manufactured in Brazil:
>
> I - plastic injection or stamping of the main base, the case and the tray;
>
> II - assembly and welding of all the components on the printed circuit boards;
>
> III - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> IV - integration of the printed circuit boards and the other electrical and mechanical parts to build the end product, assembled in accordance with Items I to III above.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages described in Items I, II and III of this Article provided the Basic Production Process be complied with.

9.33. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of the following components or subassemblies: step I - main base, case and tray; step II - printed circuit boards; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of DISC UNITS TO READ OR RECORD DATA BY OPTICAL MEANS – OPTICAL DISC UNITS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1616] Implementing Order 158/2003, (Exhibit BRA-116).

9.34. MDIC/MCT Implementing Order No. 160, of 24 April 2003[1617], Article 1 states in relevant part:

> The following Basic Production Process is hereby set forth for the product ELECTRONIC CASH REGISTER, included in item 8470.50.19 of the MERCOSUR Common Nomenclature:
>
> I - insertion and welding of all the components on the printed circuit boards;
>
> II - keyboard assembly;
>
> III - drawer assembly;
>
> IV - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> V - integration of the printed circuit boards and the other electrical and mechanical parts to build the end product, assembled in accordance with Items I to IV above.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages described in this Article provided the Basic Production Process be complied with.

9.35. The Panel considers that at least steps I and IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; and step IV - electrical and mechanical parts. These steps can be performed by third parties. That is, the accredited producer of ELECTRONIC CASH REGISTERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.36. MDIC/MCT Implementing Order No. 163, of 5 July 2004[1618], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product SMART LABEL, manufactured in the Country:
>
> I - assembly of integrated circuit (microchip or chip) in the flexible printed circuit;
>
> II - sticky of bottom part of laminated, with its separate application to a siliconized substrate, as applicable;
>
> III - formation of self-adhesive laminated, as applicable;
>
> IV - application of non-adhesive part of self-adhesive laminated on sticky face (as applicable) of label in paper or film;
>
> V - formation of smart label; and
>
> VI - winding of smart labels in reels, as applicable.
>
> Paragraph 1 All steps of above Basic Production Process should be performed in the Country.

[1617] Implementing Order 160/2003, (Exhibit BRA-116).
[1618] Implementing Order 163/2004, (Exhibit BRA-116).

> Paragraph 2 The activities or operations inherent to the production step described in Section I of this Article may be performed by third-parties, provided the Basic Production Process is complied with.

9.37. Additionally, Article 2 of MDIC/MCT Implementing Order No. 163, of 5 July 2004, states in relevant part that:

> As of August 1st, 2015, the integrated circuit (microchip or chip) mentioned in Section I of Article 1 should comply with following Basic Production Process:
>
> I - assembly of semiconductor, non-encapsulated chip;
>
> II - encapsulation of assembled chip;
>
> III - electric or optoelectronic test; and
>
> IV - marking (identification).

9.38. Further, Article 3 states in relevant part that:

> The separate labels (printed, self-adhesive labels, as applicable), in paper or film, to be used in the product should be manufactured in the Country.

9.39. The Panel considers that step I of Article 1 involves the creation, from basic raw materials and inputs, of components or subassemblies, i.e., flexible printed circuits. This step can be performed by third parties. That is, the accredited producer of SMART LABELS can outsource this step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.40. Furthermore, Article 2 requires that as of 1 August 2015, the integrated circuit (microchip or chip) used in step I (production of the flexible printed circuit) itself be produced in accordance with its own PPB. The Panel notes that all PPBs that include any such "nested PPB" (i.e., requirements that a specific input or component be produced in accordance with its own PPB) allow the outsourcing of such inputs or components so long as the requirements of the nested PPBs are respected.[1619] The Panel recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of SMART LABELS outsources the integrated circuits (microchip or chip) to be incorporated in the flexible printed circuits, it can only retain the tax benefits in question if those integrated circuits are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.41. In addition, Article 3 requires the manufacturing in Brazil of the separate labels to be used in the SMART LABELS. Therefore, to the extent that the labels are outsourced, the accredited producer of SMART LABELS only retains the tax benefits in question if those labels are produced in Brazil.

[1619] Brazil's response to Panel question No. 67: "[W]ith respect to PPBs that include requirements that a specific input or component be produced in accordance with its own PPB, the specific input or component can be produced by third parties in Brazil. The production of a specific input by third parties, in accordance with its own PPB, is still subject to verification by the authorities."

9.42. MDIC/MCT Implementing Order No. 179, of 5 July 2004[1620], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product LIQUID CRYSTAL DEVICES FOR CELLULAR TELEPHONE:
>
> I - physical and chemical processing, including at least following steps:
>
> a) inspection and cleaning of glass plates;
> b) application of photo resistant material;
> c) photolithography;
> d) chemical bath;
> e) application of anti-reflective material, spacers and printing of orientation layer;
> f) generation of alignment layers (rubbing);
> g) junction and sealing of plates;
> h) separation and cutting;
> i) filling of cells with liquid crystal;
> j) closing; and
> l) inspection and electric and optical tests;
>
> II - assembly of semiconductor chip on a layer of glass or on a flexible film;
>
> III - gluing or depositing of polarizers on the layer of glass;
>
> IV – assembly of interconnection through application of a flexible film with components or positioning of a connector, as applicable;
>
> V - assembly of device;
>
> VI - assembly of a printed circuit board, as applicable; and
>
> VII - final assembly of device set, comprising integration of all parts and pieces that form it.
>
> Paragraph 1 The activities or operations inherent to the production step described in Section I to IV, caption of this article may be performed by third-parties, provided the Basic Production Process is complied with.

9.43. The Panel considers that at least step I involve the creation, from basic raw materials and inputs, of components or subassemblies for the incentivized LCD devices, through a range of physical and chemical processing activities involving basic inputs and raw materials including glass plates, liquid crystal, photo-resistant and anti-reflective materials, spacers, and chemicals. Steps I can be performed by third parties. That is, the accredited producer of LIQUID CRYSTAL DEVICES FOR CELLULAR TELEPHONE can outsource this step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.44. MDIC/MCT Implementing Order No. 243, of 15 October 2001[1621], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the manufactured product METALLIC CASE FOR COMPUTER ITEMS:

[1620] Implementing Order 179/2004, (Exhibit BRA-116). (The Panel notes that there is no "k") in the original exhibit).

[1621] Implementing Order 243/2001, (Exhibit BRA-116).

> I - cutting, folding and punching or other stamping process of the metallic parts;
>
> II - welding and/or riveting of the metallic parts;
>
> III - superficial treatment and painting of the metallic parts;
>
> IV - injection of the plastic parts;
>
> V - fixing of LEDs, keys and wiring on the front mask, when applicable; and
>
> VI - assembly and front fixing on the chassis.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages described in this Article provided the Basic Production Process be complied with.

9.45. The Panel considers that at least steps I and IV involve the creation, from basic raw materials and inputs, of components or subassemblies as follows: step I - metallic parts; and Step IV - plastic parts. These steps can be performed by third parties. That is, the accredited producer of METALLIC CASES FOR COMPUTER ITEMS can outsource the steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.46. MDIC/MCT Implementing Order No. 246, of 15 October 2001[1622], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the manufactured product ELECTRONIC SCALE:
>
> I - insertion and welding of components on the printed circuit board;
>
> II - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> III - integration of the printed circuit boards and the other electrical and mechanical parts to build the end product, assembled in accordance with Items I and II above.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages described in this Article provided the Basic Production Process be complied with.
>
> § 2. The load cell shall be manufactured in Brazil from its basic components.

9.47. The Panel considers that steps I and II and paragraph 2 involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; step II - electrical and mechanical parts; and paragraph 2 – load cells. Steps I and II and paragraph 2 can be performed by third parties. That is, the accredited producer of ELECTRONIC SCALES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1622] Implementing Order 246/2001, (Exhibit BRA-116).

9.48. Implementing Order No. 289, of 11 July 2003[1623], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the products DIRECT CURRENT CONVERTER (AC- DC) and POWERING SOURCE FOR INKJET PRINTER AND CABLE MODEM:
>
> I - injection of plastic parts;
>
> II - stamping of the metallic parts, when applicable;
>
> III - assembly of the electrical and mechanical parts, fully separate, at the basic level of components;
>
> IV - assembly and welding of all the components on the printed circuit boards; and
>
> V - integration of the printed circuit boards, when applicable, and the other electrical and mechanical parts to build the end product.
>
> § 1. Third parties can perform the activities or operations described in Items I to IV provided the Basic Production Process be complied with.

9.49. Additionally, Article 2 of Implementing Order No. 289, of 11 July 2003, states in relevant part that:

> The electric cables, connectors and transformers employed in the products direct current converter (AC-DC) and powering source for inkjet printer and cable modem have to be manufactured in Brazil from January 1, 2004 on.

9.50. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of the following components or subassemblies: plastic parts; step II - metallic parts; step III - electrical and mechanical parts; and step IV - printed circuit boards. All of these steps can be performed by third parties. That is, the accredited producer of DIRECT CURRENT CONVERTERS (AC- DC) and POWERING SOURCES FOR INKJET PRINTERS AND CABLE MODEM can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.51. Also, Article 2 requires the manufacturing in Brazil of the electric cables, connectors and transformers employed in the DIRECT CURRENT CONVERTERS (AC- DC) and POWERING SOURCES FOR INKJET PRINTER AND CABLE MODEMS. Therefore, to the extent that these components and subassemblies are outsourced, the accredited producer of DIRECT CURRENT CONVERTERS (AC-DC) and POWERING SOURCES FOR INKJET PRINTER AND CABLE MODEMS will only retain the tax benefits in question so long as the outsourced electric cables, connectors and transformers are produced in Brazil, i.e., are domestic products.

9.52. MDIC/MCT Implementing Order No. 296, of 27 December 2001[1624], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product ELECTRONIC DEVICE TO ACTIVATE LOCKS OF SAFES WITH LATCH:
>
> I - injection of plastic parts, when applicable;
>
> II - stamping of the metallic case;

[1623] Implementing Order 289/2003, (Exhibit BRA-116).
[1624] Implementing Order 296/2001, (Exhibit BRA-116).

> III - insertion and welding of components on the printed circuit board;
>
> IV - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> V - integration of the printed circuit boards and the electrical and mechanical parts to build the end product, assembled in accordance with Items I to IV above.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with.

9.53. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of the following components or subassemblies: step I -plastic parts; step II - metallic case; step III - printed circuit board; and step IV - electrical and mechanical parts. All of these steps can be performed by third parties. That is, the accredited producer of ELECTRONIC DEVICES TO ACTIVATE LOCKS OF SAFES WITH LATCH can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.54. Implementing Order No. 298, of 24 November 2004[1625], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product PULMONARY VENTILATOR (RESPIRATOR) (WITH AND WITHOUT TURBINE TECHNOLOGY) FOR VENTILATORY ASSISTANCE WITH BUILT-IN GRAPHIC MONITORING:
>
> I - stamping, cutting, folding and superficial treatment of the metallic parts of the case;
>
> II - injection of the plastic parts of the case;
>
> III - manufacture of the printed circuit board from laminates;
>
> IV - assembly and welding–or an equivalent process–of all the electronic components on the printed circuit boards;
>
> V - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> VI - integration of the printed circuit boards and the electrical and mechanical parts to build the end product, in accordance with Items I to V.
>
> § 1. Third parties can perform the activities or operations described in Items I to IV in Brazil provided the Basic Production Process be complied with.

9.55. The Panel considers that at least steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metallic parts of the case; step II - plastic parts of the case; and Step III bare printed circuit boards; step IV – complete printed circuit boards; and step V, electrical and mechanical parts. All of these steps can be performed by third parties. That is, the accredited producer of PULMONARY VENTILATORS (RESPIRATORS) (WITH AND WITHOUT TURBINE TECHNOLOGY) FOR VENTILATORY ASSISTANCE WITH BUILT-IN GRAPHIC MONITORING can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1625] Implementing Order 298/2004, (Exhibit BRA-116).

9.56. Implementing Order No. 410, of 4 September 2003[1626], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product CONNECTORS FOR PRINTED CIRCUIT NCM ITEM 8536.90.40:
>
> I - cutting of bars, tubes or pins;
>
> II - machining;
>
> III - thermal treatment;
>
> IV - surface treatment by electrodeposition of copper, gold, silver, nickel, zinc or tin; and
>
> V - assembly of the parts.
>
> § 1. All the stages of the Basic Production Process described above shall be performed in Brazil.
>
> § 2. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with.

9.57. The Panel considers that at least steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I involves the cutting of bars, tubes and pins; and step II involves the machining of the cut pieces. These steps can be performed by third parties. That is, the accredited producer of CONNECTORS FOR PRINTED CIRCUIT NCM ITEM 8536.90.40 can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.58. Implementing Order No. 411, of 4 September 2003[1627], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product FREE-SPACE OPTICAL COMMUNICATION SYSTEM, manufactured in Brazil:
>
> I - stamping, cutting, folding, surface treatment of the metallic parts of the fixing supports;
>
> II - assembly of the metallic case from fully separate mechanic parts, at the level of components;
>
> III - assembly of the mechanic device for elevation and azimuth adjustment, from fully separate mechanic parts, at the level of components;
>
> IV - assembly of the transmission and reception telescopes, from fully separate mechanic and optical parts, at the level of components;
>
> V - assembly and welding of all the components on the printed circuit boards; and
>
> VI - integration of the printed circuit boards, of the electric, mechanic and optical parts to build the end product, as set forth in sections "I" to "V" above.

[1626] Implementing Order 410/2003, (Exhibit BRA-116).
[1627] Implementing Order 411/2003, (Exhibit BRA-116).

§ 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with.

9.59. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metallic parts of the supports; step II - metallic case; steps III - mechanical device for elevation and azimuth adjustment; step IV - transmission and reception telescopes; and step V - printed circuit boards. Steps I to V can be performed by third parties. That is, the accredited producer of FREE-SPACE OPTICAL COMMUNICATION SYSTEMS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.60. Implementing Order No. 429, of 17 September 2003[1628], Article 1 states in relevant part that:

The following Basic Production Process is hereby set forth for the product OPTICAL UNIT OF VIDEO OUTPUT FOR PROCESS MAINTENANCE, CONTROL AND SUPERVISION SYSTEMS:

I - assembly and welding of all the components on the printed circuit boards;

II - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and

III - integration of the printed circuit boards and of the electrical and mechanical parts to build the end product, assembled in accordance with Items I and II above.

§ 1. All the stages of the Basic Production Process described above shall be performed in Brazil.

§ 2. Third parties can perform the activities or operations described in Items I and II provided the Basic Production Process be complied with.

9.61. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I and II can be performed by third parties. That is, the accredited producer of OPTICAL UNITS OF VIDEO OUTPUT FOR PROCESS MAINTENANCE, CONTROL AND SUPERVISION SYSTEMS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.62. Implementing Order No. 446, of 8 October 2003[1629], Article 1 states in relevant part that:

The following Basic Production Process is hereby set forth for the product MONOCHROMATIC LIQUID CRYSTAL DISPLAY, EXCEPT FOR USE IN CELL PHONES:

I - Manufacture of the cells of segment and module displays:

a) cutting of the glass plates;
b) application of the photoresistor;
c) fixing of the photoresistor;

[1628] Implementing Order 429/2003, (Exhibit BRA-116).
[1629] Implementing Order 446/2003, (Exhibit BRA-116). (The Panel notes that there is no "k)" in the original exhibit).

d) photo recording of the photoresistor;
e) chemical bath of the glass plate;
f) cutting of the glass;
g) removal of the photoresistor sensitized by the light with chemical bath;
h) application of the alignment layer;
i) alignment process (rubbing);
j) application of anti-reflective material;
l) application of spacers;
m) alignment and closing of the two glass plates;
n) filling of the cells; and
o) gluing of the polarizers on the two faces of the cells.

II - assembly of the controlling plate, when applicable:

a) gluing of the chip;
b) welding of the chip; and
c) application of epoxy resin.

III - assembly of the connector;

IV - assembly of the glass, rubber connector and metallic frame on the controlling plate; and

V - optical and electric tests.

Sole Paragraph. Third parties can perform the activities or operations described in Items I to IV provided the Basic Production Process be complied with.

9.63. The Panel considers that at least steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - cells of segment and module displays; step II - controlling plates; and step III - connectors. Steps I to III can be performed by third parties. That is, the accredited producer of MONOCHROMATIC LIQUID CRYSTAL DISPLAYS, EXCEPT FOR USE IN CELL PHONES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.64. Implementing Order No. 454, of 8 October 2003[1630], Article 1 states in relevant part that:

The following Basic Production Process is hereby set forth for the products OPTICAL SENSORS, (NCM 8543.89.99):

I - plastic injection of the sensor body, when applicable;

II - assembly and welding of all the components on the printed circuit boards;

III - sensor assembly;

IV - operation tests; and

V - recording.

Sole Paragraph. Third parties can perform the activities or operations described in Items I and II provided the Basic Production Process be complied with.

9.65. The Panel considers that at least steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - sensor body; and step

[1630] Implementing Order 454/2003, (Exhibit BRA-116).

II - printed circuit boards. Steps I to II can be performed by third parties. That is, the accredited producer of OPTICAL SENSORS, (NCM 8543.89.99) can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.66. Implementing Order No. 476, of 7 November 2003[1631], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product TERMINAL FOR INTERNET DIRECT ACCESS:
>
> I - injection of the plastic parts;
>
> II - stamping of the metallic parts;
>
> III - assembly and welding of all the components on the following printed circuit boards, including the remote control:
>
> a) engine board;
> b) audio and video board;
> c) control panel board;
> d) remote control board;
> e) fax-modem board;
> f) processing board; and
> g) memory module.
>
> IV - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> V – integration of the boards and of the electrical and mechanical parts to build the end product, assembled in accordance with stages "III" and "IV".
>
> § 1. Third parties can perform the activities or operations inherent in the production stages set forth in this Article provided the Basic Production Process be complied with.

9.67. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - plastic parts; step II - metallic parts; step III - engine board; audio and video board; control panel board; remote control board; fax-modem board; processing board; and memory module; and step IV - electrical and mechanical parts. Steps I to IV can be performed by third parties. That is, the accredited producer of TERMINALS FOR INTERNET DIRECT ACCESS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.68. MDIC/MCT Implementing Order No. 536 of 18 December 2003[1632], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product METALLIZED PLASTIC PARTS FOR CELLULAR TELEPHONE:
>
> I - plastic injection; and

[1631] Implementing Order 476/2003, (Exhibit BRA-116).
[1632] Implementing Order 536/2003, (Exhibit BRA-116).

> II - metallization.
>
> Paragraph 1 The activities or operations inherent to the production step described in section I of this article may be performed by third-parties in the country.

9.69. The Panel considers that step I involves the creation, from basic raw materials and inputs, of the following components or subassemblies: plastic parts. Step I can be performed by third parties. That is, the accredited producer of METALLIZED PLASTIC PARTS FOR CELLULAR TELEPHONES can outsource this step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.70. MDIC/MCT Implementing Order No. 566, of 23 December 2003[1633], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product PIEZOELECTRIC DEVICE FOR SURFACE ACOUSTIC WAVES, called SAW device, NCM 8529.90.19:
>
> I - assembly of the piezoelectric table, non-encapsulated:
>
> a) preparation of the printed wafer;
> b) wafer cutting;
> c) final assembly of the filter;
>
> II – encapsulation of the assembled tablet;
>
> III - electric test (assay);
>
> IV - strapping, when applicable; and
>
> V - marking (identification).
>
> § 2. Third parties can perform the activities or operations inherent in the production stages set forth in this Article in Brazil provided the Basic Production Process be complied with.

9.71. The Panel considers that step I involves the creation, from basic raw materials and inputs, of the following components or subassemblies: piezoelectric table. Step I can be performed by third parties. That is, the accredited producer of PIEZOELECTRIC DEVICES FOR SURFACE ACOUSTIC WAVES, called SAW devices, NCM 8529.90 can outsource this step and retain the tax benefits in question so long as the requirements of the step (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.72. MDIC/MCT Implementing Order No. 42, of 23 February 2006[1634], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product MEDICAL CASE OF TRANSCEIVER UNITS FOR RADIO BASE STATION - RBS AND FOR CELLULAR REPEATERS:

[1633] Implementing Order 566/2003, (Exhibit BRA-116).
[1634] Implementing Order 42/2006, (Exhibit BRA-116).

I - cutting, folding and punching or other puncturing process, laser cutting or stamping of the metallic plates in the mechanic structure and in the case-closing parts, such as doors, ceilings, sides and lids;

II - welding or riveting of the metallic parts mentioned in item I;

III - surface treatment and painting of the metallic parts mentioned in item I; and

IV - integration of metallic parts to build the end product.

§ 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with, except for IV, which cannot be outsourced.

9.73. The Panel considers that at least step I involves the creation, from basic raw materials and inputs, of components or subassemblies: metallic parts, including metallic plates. This step can be performed by third parties. That is, the accredited producer of MEDICAL CASES OF TRANSCEIVER UNITS FOR RADIO BASE STATION - RBS AND FOR CELLULAR REPEATERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.74. Implementing Order No. 44, of 3 February 2009[1635], Article 1 states in relevant part that:

The following Basic Production Process is hereby set forth for the product PORTABLE SURVEILLANCE RADAR, manufactured in Brazil:

I - moulding, cutting, folding, machining and surface treatment, when applicable, of the following sets:

a) structure, locks and discs;
b) quadripod rods;
c) UPS – Uninterrupted Power Supply box;
d) radiating elements of the primary radar antenna;
e) pedestal box (aluminum);
f) control unit box;
g) battery box;
h) cable coiling support;
i) supporting base for the primary radar antenna;
j) support of the antenna radiating elements;
l) support of the secondary radar antenna;
m) box of the secondary radar antenna; and
n) radiating elements of the secondary radar antenna.

II - assembly and integration of the following SUBASSEMBLIES from the respective operation stages:

a) QUADRIPOD SUBASSEMBLY:

1. integration of the vertical columns;
2. placement of the flanges on the vertical column;
3. integration of the quadripod rods on the flanges;
4. integration among the quadripod rods; and
5. integration of the mechanic elevation device (jack).

[1635] Implementing Order 44/2009, (Exhibit BRA-116). (The Panel notes that there is no "k)" in the original exhibit).

b) PEDESTAL SUBASSEMBLY:

1. assembly of the pedestal box faces;
2. integration of the engine control module;
3. integration of the engine with the reducer;
4. integration of the position sensor (encoder) with the engine/reducer set;
5. integration of the set with the lids;
6. integration of the bubble level with the lid;
7. integration of the sliding ring set with the set;
8. integration of the Hobbs meter with the pedestal face;
9. electric connections;
10. closing of the pedestal box; and
11. electric tests.

c) BATTERY BOX:

1. integration of the batteries with the box;
2. electric connections; and
3. electric tests.

d) UPS - Uninterrupted Power Supply SUBASSEMBLY:

1. manufacture of the printed circuits of the boards in the feeding and power unit, from the laminates;
2. assembly and welding of the components on the printed circuit boards of the feeding and power unit;
3. integration of the printed circuit boards and other components in the feeding unit box; and
4. electric tests.

e) PRIMARY RADAR ANTENNA:

1. assembly of the parts in the supporting base of the primary radar antenna;
2. assembly of the secondary radar antenna support (IFF - Identification Friend or Foe);
3. assembly of the attenuators on the supports of the radiating elements;
4. assembly of the radiating elements of the primary radar in the supports;
5. assembly of the radiating set on the supporting base of the primary radar antenna;
6. assembly of the IFF transponder module on the support of the radiating elements in the primary radar; and
7. electric connectors of the attenuators to the radiating elements.

f) DATA CONTROL AND PROCESSING UNIT:

1. manufacture of the printed circuits from the laminates, of the interface, data processing and signal processing boards;
2. assembly and welding of the components on the interface board;
3. integration of the interface board with the control unit;
4. assembly and welding of the components on data processing and signal processing boards;
5. integration data processing board with the signal processing board;
6. integration of the modules, amplifiers, filters, couplers, mixers and detectors with the control unit;
7. integration of the Hobbs meter with the control unit;
8. integration of the transmitting, switching and receiving module with the control unit;
9. electric connections;
10. setup and electric tests; and
11. closing of the control unit.

g) SECONDARY RADAR ANTENNA:

1. placement of the radiating elements on the insulation support;
2. integration of the set in the secondary radar antenna box;
3. electric connections;
4. electric tests; and
5. closing of the secondary radar antenna box.

h) VIEWING UNIT:

1. setup of the viewing unit (system installation and setup);

i) CABLE COILING SUPPORT SET:

1. integration of the regulating module with the cable coiling support;
2. crimping of the connectors to the cable;
3. welding of the cable on the regulating module;
4. cable coiling; and
5. electric tests.

III - final assembly of the PORTABLE SURVEILLANCE RADAR through the following stages:

a) integration of the pedestal set with the quadripod set;
b) leveling adjustments;
c) integration of the UPS sets and the battery box with the quadripod;
d) integration of the antenna set with the pedestal;
e) integration of the control unit with the antenna set;
f) integration of the secondary radar antenna with the antenna set;
g) electric connections of the radar set;
h) integration of the coiling set with the radar set and viewing unit;
i) radar system tests; and
j) placement of the following units in metallic boxes: primary radar antenna, pedestal, control unit, secondary radar antenna, viewing unit, quadripod, feeding unit and battery boxes and coiling support.

Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages described in this Article provided the Basic Production Process be complied with, with exception of the stages described in Item III, which cannot be outsourced.

9.75. The Panel considers that step I and II involves the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - structure, locks and discs, quadripod rods, UPS – uninterrupted power supply boxes, radiating elements of the primary radar antenna, pedestal boxes (aluminum), control unit boxes, battery boxes, cable coiling supports, supporting bases for the primary radar antenna, supports of the antenna radiating elements, supports of the secondary radar antenna, boxes of the secondary radar antenna, and radiating elements of the secondary radar antenna; and step II –quadripod subassemblies, pedestal subassemblies, battery boxes, UPS - Uninterrupted Power Supply subassemblies, primary radar antennas, data control and processing units, secondary radar antennas, viewing units, and cable coiling support sets. Steps I to II can be performed by third parties. That is, the accredited producer of PORTABLE SURVEILLANCE RADARS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.76. MDIC/MCT Implementing Order No. 52, of 17 February 2005[1636], Article 1 states in relevant part that:

> The Basic Production Process for the product INK CARTRIDGE WITHOUT BUILT-IN PRINTING HEAD FOR INKJET PRINTERS (NCM - 8473.3027), as set forth by MDIC/MCT Implementing Order No. 8, of July 13, 1999, now becomes the following:
>
> I - water treatment by means of demineralization;
>
> II - mixture of the pigments with the demineralized water;
>
> III - plastic injection of the container;
>
> IV - assembly of the parts and pieces; and
>
> V - bottling and sealing.
>
> § 1. All the stages of the Basic Production Process described above shall be performed in Brazil.
>
> § 3. Third parties can perform the activities or operations inherent in the production stages set forth in Items "I", "II" and "III" of this Article provided the Basic Production Process be complied with.

9.77. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I – demineralized water; step II - ink; and steps III - containers. Steps I to III can be performed by third parties. That is, the accredited producer of INK CARTRIDGES WITHOUT BUILT-IN PRINTING HEAD FOR INKJET PRINTERS (NCM - 8473.3027) can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.78. Implementing Order No. 69, of 29 February 2012[1637], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product RADIOFREQUENCY FILTER FOR BROADCAST EQUIPMENT, manufactured in Brazil:
>
> I - stamping, cutting, folding, machining and surface treatment of the metallic parts, when applicable;
>
> II - welding and assembly of the subassemblies constituting the filter;
>
> III - integration of the mechanic parts, fully separate, at the basic level of components to assemble the end product; and
>
> IV - performance of filter tuning.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with, with exception of the stage described in Items III and IV, which cannot be outsourced.

9.79. The Panel considers that steps I and II involves the creation, from basic raw materials and inputs, of the following components or subassemblies: metallic parts; and that step II involves the creation, from basic raw materials and inputs, of the following components or subassemblies: subassemblies constituting the filter. Steps I to II can be performed by third parties. That is, the

[1636] Implementing Order 52/2005, (Exhibit BRA-116).
[1637] Implementing Order 69/2012, (Exhibit BRA-116).

accredited producer of RADIOFREQUENCY FILTERS FOR BROADCAST EQUIPMENT can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.80. Implementing Order No. 72, of 29 February 2012[1638], Article 1 states in relevant part that:

> The Basic Production Process for the product ELECTRIC ACCUMULATOR FIT FOR PORTABLE CELL PHONE TERMINAL, position NCM 8517.12, as set forth by MDIC/MCT Implementing Order 229, of December 24, 2009, now becomes the following:
>
> I - manufacture of charge accumulation cells;
>
> II - injection of the upper and lower plastic lids, when applicable;
>
> III - stamping of terminals and pins, except when strapped or overmolded;
>
> IV - assembly and welding of all the components on the printed circuit boards, when applicable;
>
> V - assembly and welding of the charge accumulation cells; and
>
> VI - integration of the set of charge accumulation cells with the mechanic parts to build the end product.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with, with exception of the stage described in Item VI, which cannot be outsourced.

9.81. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: steps I and V - charge accumulation cells; step II - upper and lower plastic lids; step III - terminals and pins; and step IV - printed circuit boards. Steps I to V can be performed by third parties. That is, the accredited producer of ELECTRIC ACCUMULATOR FITS FOR PORTABLE CELL PHONE TERMINALS, position NCM 8517.12, can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.82. Implementing Order No. 125, of 25 July 2007[1639], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product GLOBAL POSITIONING SYSTEM - GPS ANTENNA:
>
> I - stamping, cutting, folding and surface treatment of the metallic parts, when applicable;
>
> II - injection of the plastic parts;
>
> III - manufacture of the printed circuit from the laminate;
>
> IV - assembly and welding–or an equivalent process–of all the components on the printed circuit boards;

[1638] Implementing Order 72/2012, (Exhibit BRA-116).
[1639] Implementing Order 125/2007, (Exhibit BRA-116).

> V - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> VI - integration of the printed circuit boards with the electrical and mechanical parts to build the end product, in accordance with Items I to V.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages described above provided the Basic Production Process be complied with, with exception of stage VI, which cannot be outsourced.

9.83. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metallic parts; step II - plastic parts; step III – printed circuits; step IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of GLOBAL POSITIONING SYSTEM - GPS ANTENNAS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.84. Implementing Order No. 146, of 1 July 2010[1640], Article 1 states in relevant part that:

> The Basic Production Process for the products DIGITAL TEMPERATURE CONTROLLER, DIGITAL TEMPERATURE INDICATOR, DIGITAL INDICATOR OF ELECTRIC QUANTITIES, DIGITAL DISPLAY OF ELECTRIC QUANTITIES and DIGITAL COUNTER, as set forth by MDIC/MCT Implementing Order 86, of April 2, 2009, now becomes the following:
>
> I - injection or molding of the plastic parts;
>
> II - stamping of the metallic parts, when applicable;
>
> III - manufacture of the printed circuit, from the laminate;
>
> IV - assembly and welding of all the components on the printed circuit boards;
>
> V - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> VI – integration of the printed circuit boards with the electrical and mechanical parts to build the end product.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with, with exception of the stage described in Item VI, which cannot be outsourced.

9.85. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - plastic parts; step II - metallic parts; step III - printed circuits; step IV -printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of DIGITAL TEMPERATURE CONTROLLERS, DIGITAL TEMPERATURE INDICATORS, DIGITAL INDICATORS OF ELECTRIC QUANTITIES, DIGITAL DISPLAYS OF ELECTRIC QUANTITIES and DIGITAL COUNTERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1640] Implementing Order 146/2010, (Exhibit BRA-116).

9.86. Implementing Order No. 157, of 29 August 2007[1641], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product MEMORY CARD with SECURE DIGITAL – SD technology, manufactured in the Duty-Free Zone of Manaus:
>
> I - plastic injection;
>
> II – manufacture of the hard or flexible printed circuit, when applicable;
>
> III - assembly and welding of all the components on the printed circuit boards; and
>
> IV - final assembly of the set.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages set forth in the Article provided the Basic Production Process be complied with, with exception of the stage described in Section IV, which cannot be outsourced.

9.87. Additionally, § 6 of Article 1 of Implementing Order No. 157, of 29 August 2007, states in relevant part that:

> The hard printed circuit has to be manufactured from the laminate and the flexible printed circuit in order to comply with the provisions in Item II, manufactured in accordance with the relevant Basic Production Process.

9.88. Further, Article 2 states in relevant part that:

> The monolithic integrated circuits or microchips employed to assemble the boards shall meet the relevant Basic Production Process for a minimum percentage of fifty percent (50%) of the output in the calendar year as of January 1, 2009.

9.89. The Panel considers that steps I to III, along with paragraph 6 of Article 1, and Article 2, involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - plastic parts; step II and § 6 of Article 1 - hard or flexible printed circuits; and step III - printed circuit boards. Steps I to III can be performed by third parties. That is, the accredited producer of MEMORY CARDS with SECURE DIGITAL – SD technology can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.90. Also, Article 2 requires that 50% of the monolithic integrated circuits or microchips employed to assemble the boards be produced in accordance with their own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1642] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of MEMORY CARDS with SECURE DIGITAL – SD technology outsources the monolithic integrated circuits or microchips to be incorporated in the printed circuit boards, it can only retain the tax benefits in question if a portion of those integrated circuits or microchips are produced in Brazil in accordance with their own PPB, and thus are domestic products.

[1641] Implementing Order 157/2007, (Exhibit BRA-116).
[1642] See footnote 1619 above.

9.91. Implementing Order No. 158, of 22 June 2011[1643], Article 1 states in relevant part that:

> The Basic Production Process for the products NON-IMPACT PRINTERS, INCLUDING THOSE COMBINED WITH OTHER INPUT OR OUTPUT UNITS, as set forth by MDIC/MCT Implementing Order 128, of July 2, 2009, now becomes the following:
>
> I - assembly and welding of all the components on the printed circuit boards implementing the following functions:
>
> a) central processing;
> b) printing carriage control;
> c) memory; and
> d) data communication interface with logic control.
>
> II - assembly of the electrical and mechanical parts, fully separate, at the basic level of components;
>
> III - integration of the printed circuit boards with the other parts to build the end product, assembled in accordance with Items I and II of this Article; and
>
> IV - final setup of the product and operation tests.
>
> § 1. Third parties can perform the activities or operations described in Items I and II provided the Basic Production Process be complied with.

9.92. Additionally, § 4 of Article 1 of Implementing Order No. 158, of 22 June 2011, states in relevant part that:

> The communication interface boards with wireless technology (Wi-Fi, Bluetooth, WIMax, etc.) shall meet the following assembly schedule, based on the quantity of such boards employed in the calendar year:
>
> I - until December 31, 2012: exempted;
>
> II - January 1, 2013 – December 31, 2013: twenty percent (20%); and
>
> III – from January 1, 2014 onwards: fifty percent (50%).

9.93. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards for central processing, printing carriage control, memory; and data communication interface with logic control (subject to a partial, staged exemption pursuant to § 4 of Article 1); and step II -electrical and mechanical parts. Steps I and II can be performed by third parties. That is, the accredited producer of NON-IMPACT PRINTERS, INCLUDING THOSE COMBINED WITH OTHER INPUT OR OUTPUT UNITS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies -- from basic raw materials and inputs) are respected (subject to the partial exemption for certain data communication boards).

9.94. Implementing Order No. 162, of June 22 2011[1644], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product POWERING SOURCE (AC/DC CONVERTER) FOR DEBIT AND CREDIT WIRE TRANSFER TERMINALS, manufactured in Brazil:

[1643] Implementing Order 158/2011, (Exhibit BRA-116).
[1644] Implementing Order 162/2011, (Exhibit BRA-116).

> I - assembly and welding of all the components on the printed circuit board;
>
> II - winding of the transformer coil;
>
> III - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> IV - integration of the printed circuit board with the other parts to build the end product, assembled in accordance with Items I and II above.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with, with exception of the stage described in Item IV, which cannot be outsourced.

9.95. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies: step I - printed circuit boards; step II - transformer coils; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of POWERING SOURCES (AC/DC CONVERTER) FOR DEBIT AND CREDIT WIRE TRANSFER TERMINALS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.96. MDIC/MCT Implementing Order No. 175, of 3 October 2007[1645], Article 1 states in relevant part that:

> The Basic Production Process for the product WIRED TELEPHONE SET TOGETHER WITH WIRELESS TELEPHONE SET, INCLUDING CONTROL BY DIGITAL TECHNIQUES, as set forth by MDIC/MCT Implementing Order 15, of January 22, 2007, now becomes the following:
>
> I - plastic injection of the body or case;
>
> II - manufacture of the direct current converter (AC/DC), of the voltage adapter and the battery charger in compliance with the provisions in Article 3 of this Order, when applicable;
>
> III - assembly and welding of all the components on the printed circuit boards;
>
> IV - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> V - integration of the printed circuit boards with the other parts to build the end product, in accordance with Items I, III and IV above.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages described above provided the Basic Production Process be complied with, with exception of stage V, which cannot be outsourced.

9.97. Additionally, Article 2 of MDIC/MCT Implementing Order No. 175, of 3 October 2007, states in relevant part that:

> At least one of the following criteria has to be met, at the discretion of the manufacturing company:
>
> I - assembly of the transceiver module;

[1645] Implementing Order 175/2007, (Exhibit BRA-116).

> II - manufacture of at least seventy percent (70%) of the total capacitors of the electrolytic, ceramic and multilayer ceramic types for surface assembly - SMD (Surface Mounted Device), in terms of quantity, in the calendar year; or
>
> III - manufacture of the printed circuit from the laminate.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the stages described in this Article in Brazil.

9.98. Additionally, Article 3 of MDIC/MCT Implementing Order No. 175, of 3 October 2007, states in relevant part that:

> The direct current converter (AC/DC), the voltage adapter and the battery charger shall be manufactured in accordance with the minimum stages below:
>
> I - injection of the plastic parts;
>
> II - stamping of the metallic parts, when applicable;
>
> III - manufacture of the voltage power transformer from the coil winding, or the use of domestic capacitors in the converter, at the discretion of the manufacturing company;
>
> IV - assembly and welding of all the components on the printed circuit boards; and
>
> V - integration of the printed circuit boards, when applicable, with the other parts to build the end product.

9.99. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - body or case; step II and Article 3 - direct current converter (AC/DC), voltage adapter and battery charger; step III - printed circuit boards; and step IV - electrical and mechanical parts. Steps I to IV (including the requirements in Article that pertain to step II) can be performed by third parties. That is, the accredited producer of WIRED TELEPHONE SET TOGETHER WITH WIRELESS TELEPHONE SET, INCLUDING CONTROL BY DIGITAL TECHNIQUES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.100. Also, the steps in Article 2 (one of which the accredited company must choose) involve the creation, from basic raw materials and inputs, of the following components or subassemblies: the transceiver module, the total capacitors of the electrolytic, ceramic and multilayer ceramic types for surface assembly - SMD (Surface Mounted Device)of MDIC/MCT, and the printed circuit board. These steps can be performed by third parties. That is, the accredited producer of WIRED TELEPHONE SET TOGETHER WITH WIRELESS TELEPHONE SET, INCLUDING CONTROL BY DIGITAL TECHNIQUES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.101. Implementing Order No. 177, of 28 August 2008[1646], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product AC/DC CONVERTER FOR PORTABLE DIGITAL DATA PROCESSING AUTOMATIC MACHINE (NCM: 8471.30.12 and 8471.30.19) - "LAPTOP":
>
> I - assembly and welding of the components on the printed circuit boards;

[1646] Implementing Order 177/2008, (Exhibit BRA-116).

> II - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and
>
> III - integration of the printed circuit boards with the other electrical and mechanical parts to build the end product, assembled in accordance with Items I and II above.
>
> Sole Paragraph. Third parties can perform the activities or operations inherent in the production stages provided the Basic Production Process be complied with, with exception of the stage described in Item III, which cannot be outsourced.

9.102. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I and II can be performed by third parties. That is, the accredited producer of AC/DC CONVERTERS FOR PORTABLE DIGITAL DATA PROCESSING AUTOMATIC MACHINES (NCM: 8471.30.12 and 8471.30.19) - "LAPTOPS" can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.103. Implementing Order MDIC/MCT No. 184 of 30 October 2006[1647], Article 1 states in relevant part that:

> The Basic Productive Process for product AUTOMATIC MACHINE FOR DATA PROCESSING, DIGITAL DATA, PORTABLE DATA OF WEIGHT NOT HIGHER THAN 1 KG, CONTAINING AT LEAST ONE CENTRAL UNIT FOR PROCESSING AND ONE SCREEN (ÉCRAN), (NCM 8471.30.11, 8471.30.12, 8471.30.19, 8471.41.10 and 8471.41.90) set through Implementing Order MDCI/MTC 414 of September 8, 2003, is the following:
>
> I – assembly and welding of all components in printed circuit boards;
>
> II – assembly of electrical and mechanical parts, fully separated, at basic level of components;
>
> III – assembly of the cabinet; and
>
> IV – integration of printed circuit boards and electrical and mechanical parts in the composition of the final product, assembled according to items I and II above.
>
> Sole paragraph. The activities or operations described in items I, II and III may be performed in the country by third parties, provided that the Basic Productive Process is complied with.

9.104. Additionally, Article 4 of Implementing Order MDIC/MCT No. 184, of 20 October 2006, states in relevant part that:

> Eighty-five per cent of the DC converters (CA/CC), battery chargers or power sources, as well as transformers incorporated in such products, destined to assets to which the main section of Article 1 in this Order refer shall be manufactured in the country.

9.105. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentage in Article 4 for compliance with the performance steps in Article 1), as follows: step I - printed circuit boards; step II - electrical and mechanical parts; and step III - cabinet. Steps I to III can be performed by third parties. That is, the accredited producer of AUTOMATIC MACHINES FOR DATA PROCESSING, DIGITAL DATA, PORTABLE DATA OF WEIGHT NOT HIGHER THAN 1 KG, CONTAINING AT LEAST

[1647] Implementing Order 184/2006, (Exhibit BRA-116).

ONE CENTRAL UNIT FOR PROCESSING AND ONE SCREEN can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.106. Implementing Order No. 196, of 2 October 2008[1648], Article 1 states in relevant part that:

> The Basic Production Process for the product METAL HOUSING, WITH OR WITHOUT POWER SUPPLY, FOR PROCESSING DIGITAL UNIT, established by MDIC/MCT Implementing Order 133 of May 18, 2005, should be as follows:
>
> I - cutting, bending and punching and stamping or extrusion of metallic parts, when applicable;
>
> II - superficial treatment and painting of metallic parts;
>
> III - injection of housing plastic parts with an area above 30cm2;
>
> IV - superficial treatment and painting of plastic parts, when applicable;
>
> V - fixing of light-emitting diodes (LED´s), keys and wiring at front mask, when applicable;
>
> VI - welding and/or riveting of metallic parts, when applicable;
>
> VII - mounting of plastic and metallic sub-assemblies; and
>
> VIII - integration of power supply, when applicable, and of metallic and plastic parts to form the final product.
>
> Sole paragraph. The activities or operations inherent to above production steps may be performed by third-parties, provided the Basic Production Process is complied with, except for steps VI, VII and VIII, which shall not be subject to outsourcing.

9.107. Additionally, Article 3 of Implementing Order No. 196, of 2 October 2008, states in relevant part that:

> When the metallic housing incorporates a power supply, this should be produced according to relevant Basic Productive Process, as determined in an Implementing Order.

9.108. The Panel considers that at least steps I and III involve the creation, from basic raw materials and inputs, of the following components or subassemblies: step I - metallic parts; and step III - plastic parts. Steps I and III can be performed by third parties. That is, the accredited producer of METAL HOUSING, WITH OR WITHOUT POWER SUPPLY, FOR PROCESSING DIGITAL UNITS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.109. In addition, Article 3 requires that, if the METAL HOUSING FOR PROCESSING DIGITAL UNIT incorporates a power supply, this power supply be produced in accordance with its own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1649] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of METAL HOUSING FOR PROCESSING DIGITAL UNIT outsources the power supply, it can only retain the tax benefits in

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[1648] Implementing Order 196/2008, (Exhibit BRA-116).
[1649] See footnote 1619 above.

question if that power supply is produced in Brazil in accordance with its own PPB, and thus is a domestic product.

9.110. MDIC/MCT Implementing Order No. 242, of 11 December 2007[1650], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product MULTI-FUNCTION DISTURBANCE DIGITAL METER:
>
> I - cutting, folding and punching and stamping or extrusion of metallic plates of mechanic structure;
>
> II - welding and/or riveting of cabinet metallic parts, when applicable;
>
> III - superficial treatment and painting of cabinet metallic parts;
>
> IV - assembly and welding of all components in printed circuit boards;
>
> V - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and
>
> VI - integration of printed circuit boards and electrical and mechanical parts to form the final product, assembled according to the steps determined in above sections IV and V.
>
> Sole paragraph. The activities or operations inherent to above production steps may be performed by third-parties, provided the Basic Production Process is complied with, except for one of them, which shall not be subject to outsourcing.

9.111. The Panel considers that at least steps I, IV and V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metallic parts; step IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I, IV and V can be performed by third parties. That is, the accredited producer of MULTI-FUNCTION DISTURBANCE DIGITAL METERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.112. Implementing Order No. 250, of 30 September 2011[1651], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product PLASTIC HOUSING WITHOUT BUILT-IN POWER SUPPLY FOR DIGITAL PROCESSING UNIT, WITH BUILT-IN VIDEO OUTPUT UNIT (ALL IN ONE); PLASTIC HOUSING WITHOUT BUILT-IN POWER SUPPLY FOR PORTABLE DATA PROCESSING UNIT (NOTEBOOK AND NETBOOK); and PLASTIC HOUSING WITHOUT BUILT-IN POWER SUPPLY FOR PORTABLE MICROCOMPUTER, WITHOUT KEYBOARD, WITH TOUCH SCREEN - TABLET PC, industrialized in the Country:

[1650] Implementing Order 242/2007, (Exhibit BRA-116).
[1651] Implementing Order 250/2011, (Exhibit BRA-116).

MOULD:

I - machining comprising following operations:

a) turning;
b) drilling;
c) milling;
d) electro-discharge;
e) grinding; and
f) polishing.

II - thermal treatment;

III - product assembly, comprising following steps:

a) assembly and adjustments; and
b) manual fixation of screws, bushings, pins and others.

IV - adjustments and closing, comprising following steps:

a) calibration and adjustments; and
b) manual closing.

THERMOPLASTIC INJECTION:

I - plastic part injection;

II - superficial treatment and painting of plastic parts;

III - superficial treatment and painting of metallic parts;

IV - adjustment of any non-conformity;

V - fixation of frames in housing body;

VI - assembly and fixation of housing support;

VII - riveting of metallic parts; and

VIII - assembly of final product.

Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the steps contained in sections V to VIII, which shall not be subject to outsourcing.

9.113. The Panel considers that for Mould, at least step I involves the creation, from basic raw materials and inputs, of components or subassemblies, as follows: machined parts; and that for Thermoplastic Injection, at least step I, involves the creation, from basic raw materials and inputs, of the components or subassemblies: plastic parts. These steps can be performed by third parties. That is, the accredited producer of PLASTIC HOUSINGS WITHOUT BUILT-IN POWER SUPPLY FOR DIGITAL PROCESSING UNIT, WITH BUILT-IN VIDEO OUTPUT UNIT (ALL IN ONE); PLASTIC HOUSINGS WITHOUT BUILT-IN POWER SUPPLY FOR PORTABLE DATA PROCESSING UNITS (NOTEBOOKS AND NETBOOKS); and PLASTIC HOUSINGS WITHOUT BUILT-IN POWER SUPPLY FOR PORTABLE MICROCOMPUTERS, WITHOUT KEYBOARD, WITH TOUCH SCREEN - TABLET PCs can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.114. Implementing Order No. 149, of 26 June 2012[1652], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product STATIC CONVERTER WITH ELECTRONIC CONTROL, PROVIDED IT IS BASED ON DIGITAL TECHNIQUE, (NCM: 8504.40), USED AS CONTINUOUS CURRENT CONVERTER (AC/CC) or BATTERY CHARGER FOR CELL PHONE:
>
> I - WHEN THE STATIC CONVERTER OR BATTERY CHARGE HAS BUILT-IN ELECTRIC CABLE:
>
> a) plastic injection of covers or cabinets;
> b) stamping of electrical contacts, when applicable, except in case of metallic parts encapsulated in plastic parts;
> c) assembly and welding of all components of printed circuit boards, when applicable; and
> d) integration of printed circuit boards, when applicable, and of other parts to form the final product.
>
> II - WHEN STATIC CONVERTER OR CHARGER DOES NOT HAVE A BUILT-IN ELECTRIC CABLE, BUT ARE USED WITH DATA CABLE:
>
> a) plastic injection of covers or cabinets;
> b) stamping of electrical contacts, when applicable, except in case of metallic parts encapsulated in plastic parts;
> c) assembly and welding of all components of printed circuit boards, when applicable; and
> d) integration of printed circuit boards, when applicable, and of other parts to form the final product.
>
> Sole paragraph. Provided the Basic Production Process is complied with, the activities or operations inherent to production steps referred to in sections I and II may be performed by third-parties, except for the steps described in item "d" of each section, which shall not be subject to outsourcing.

9.115. Additionally, Article 4 of Implementing Order No. 149, of 26 June 2012, states in relevant part that:

> For manufacturing of CONTINUOUS CURRENT CONVERTER (AC/CC) or BATTERY CHARGER FOR CELL PHONE, WITH BUILT-IN ELECTRICAL CABLE, the transformers and electrical cables assembled with connectors, and used by the company in the calendar year should comply with their respective Basic Production Processes, when they are produced at Manaus Free Trade Zone, or should comply with the production steps described in Exhibits I and II of this Order, when they are produced in other regions of the Country, according to following percentages, in the calendar year and in quantity:
>
> I - transformers: eighty-five percent (85%); and
>
> II - electrical cables: ninety percent (90%).

9.116. Further, Article 5 of Implementing Order No. 149, of 26 June 2012, states in relevant part that:

> For manufacturing of CONTINUOUS CURRENT CONVERTER (AC/CC) or BATTERY CHARGER FOR CELL PHONE, WITHOUT BUILT-IN ELECTRICAL CABLE (USED WITH DATA CABLE), the transformers and data cables used by the company in the calendar year should comply with their respective Basic Production Processes, when they are produced at Manaus Free Trade Zone, or should comply with the production steps

[1652] Implementing Order 149/2012, (Exhibit BRA-116).

> described in Exhibits I and II of this Order, when they are produced in other regions of the Country, according to following percentages, in the calendar year and in quantity:
>
> I - transformers: eighty-five percent (85%); and
>
> II - data cables:
>
> a) from January 1st to December 31, 2011: minimum of forty-five percent (45%);
>
> b) from January 1st to December 31, 2014: minimum of fifty percent (50%); and
>
> c) as of January 1st, 2015: minimum of eighty percent (80%).

9.117. Article 1 of Exhibit I, annexed to Implementing Order No. 149, of 26 June 2012, states in relevant part that:

> Production steps of ELECTRIC TRANSFORMER LOWER THAN 3KVA, WITH FERROMAGNETIC POWDER CORE are as follows:
>
> I - spool plastic injection/mould;
>
> II - winding of bobbins on spools, fitting and welding of winding terminals, when applicable; and
>
> III - assembly.

9.118. Article 1 of Exhibit II, annexed to Implementing Order No. 149, of 26 June 2012, states in relevant part that:

> The production steps of WIRES AND CABLES WITH CONNECTORS OR DATA CABLES DESTINED TO CONVERTER AND BATTERY CHARGER FOR CELL PHONE are as follows:
>
> I - cutting of cable according to specified size;
>
> II - cable stripping;
>
> III - mesh winding, when applicable;
>
> IV - welding or crimping of terminals, when applicable;
>
> V - insertion of terminals in receiver housing, when applicable; or
>
> VI - welding of cable in terminals of connector housing; or
>
> VII - welding of cable in the printed circuit board assembled with components and USB type connector.

9.119. The Panel considers that at least steps I(a)–(c) and II(a)-(c) of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Articles 4 and 5 and Exhibits I and II for compliance with Article 1, on the basis of the production step requirements or own PPBs) as follows: steps I(a) and II (a) covers or cabinets; steps I(b) and II(b) - electrical contacts; and steps I(c) and II(c) - printed circuit boards. Steps I(a)-(c) and II(a)-(c) can be performed by third parties. That is, the accredited producer of STATIC CONVERTERS WITH ELECTRONIC CONTROL, PROVIDED IT IS BASED ON DIGITAL TECHNIQUE, (NCM: 8504.40), USED AS CONTINUOUS CURRENT CONVERTER (AC/CC) or BATTERY CHARGERS FOR CELL PHONE can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.120. Also, Articles 4 and 5 require that specified minimum percentages of the transformers and the electrical cables be produced in accordance with their own PPBs[1653] or the production step requirements in this PPB. Therefore, where the accredited producer of STATIC CONVERTERS WITH ELECTRONIC CONTROL, PROVIDED IT IS BASED ON DIGITAL TECHNIQUE, (NCM: 8504.40), USED AS CONTINUOUS CURRENT CONVERTER (AC/CC) or BATTERY CHARGER FOR CELL PHONE outsources transformers or electric cables, it can only retain the tax benefits in question so long as a portion of these products respect the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs).

9.121. Implementing Order No. 38, of 14 February 2013[1654], as amended by Implementing Order No. 233 of 15 July 2015[1655],Article 1 states in relevant part that:

> Basic Production Process for the product referred to as INTELLIGENT DATA STORAGE SYSTEM, established by MDIC/MCT Implementing Order No. 29 of February 10, 2012, should be as follows:
>
> I - assembly and welding of all components in printed circuit boards;
>
> II - integration of printed circuit boards assembled and other electrical and mechanical subassemblies to form the final product; and
>
> III - formatting, configuration and final tests.
>
> Paragraph 1 Alternatively to the requirement provided for in section I, the company may comply with the steps determined in following sections:
>
> I - cutting, folding and punching, or other punching, laser cutting or stamping of metallic structures used in the mechanical structure and closing parts of cabinet or disk tray, such as doors, top, sides and covers;
>
> II - welding or riveting of metallic parts of cabinet or disk tray;
>
> III - superficial treatment and painting of metallic parts of cabinet or disk tray;
>
> IV - injection of plastic parts of cabinet or disk tray; and
>
> V - investment in research and development (R&D) in addition to that investment provided for in legislation, in a minimum of 5% (five percent) of net invoicing of internal market, resulting from the commercialization of products referred to in this Order.
>
> Paragraph 2 Alternatively to the selection contained in § 1 of this Article, the company may waive the assembly of boards (section I, caption of this article), limited to 10% of units (systems) produced annually, per company, provided following steps are performed:
>
> I - investment in research and development (R&D) in addition to that investment provided for in legislation, in a minimum of 7% (seven percent) of net invoicing of internal market, resulting from the commercialization of products referred to in this paragraph; and

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[1653] The Panel recalls that where a PPB contains any such "nested" PPB, outsourcing of the input or component covered by the nested PPB is permitted. See footnote 1619 above. The Panel further recalls its finding at paragraph 7.117 of its report that products produced in accordance with a PPB are domestic products.

[1654] Implementing Order 38/2013, (Exhibit BRA-116).

[1655] Implementing Order 233/2015, (Exhibit BRA-116).

> II - compliance with other requirements contained in sections II and III of caption of this article.
>
> Paragraph 3 The step determined in section I of caption of this article shall contemplate the assembly and welding of all components in printed circuit board(s) that are necessary to perform at least two of following functions:
>
> I - communication with disk controlling unit;
>
> II - placement of information in reading and writing sets;
>
> III - logic reading and writing of information; and
>
> IV - memory.
>
> Paragraph 4 Provided Basic Production Process is complied with, the activities or operations inherent to production steps defined in caption and in § 1 of Article 1 may be performed by third-parties, except for one step, which may not be subject to outsourcing

9.122. Additionally, Article 3 of Implementing Order No. 38, of 14 February 2013, states in relevant part that:

> The SSD (Solid State Drive) module data storage units, used in assembling the plates shall meet the respective Basic Productive Process, in the percentage of production in the calendar year, according to the following schedule:
>
> I - until December 31, 2016: dismissed;
>
> II – from January 1 to December 31, 2017: forty percent (40%);
>
> III – from January 1 to December 31, 2018: sixty percent (60%);
>
> IV - from January 1, 2019 in view of: ninety percent (90%);

9.123. The Panel considers that step I involves the creation, from basic raw materials and inputs, of components or subassemblies (subject to the additional requirements and alternatives for complying with step I), i.e., printed circuit boards. Step I can be performed by third parties, other than one step to be chosen by the accredited producer. The same holds true if that producer instead opts for the alternative provided for in § 1 of Article 1, which also involves the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - certain metallic structures for the cabinet or disk tray; and step III – plastic parts for the cabinet or disk tray. That is, the accredited producer of INTELLIGENT DATA STORAGE SYSTEMS can outsource these steps and retain the tax benefits in question so long as the requirements of the step (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.124. Also, Article 3 requires that a specific percentage of the SSD (Solid State Drive) module data storage units, used in assembling the plates be produced in accordance with their own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1656] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of INTELLIGENT DATA STORAGE SYSTEMS outsources the referenced SSD (Solid State Drive) module data storage units that will be incorporated in the plates, it can only retain the tax benefits in question if a portion of those integrated circuits or microchips are produced in Brazil in accordance with their own PPB, and thus are domestic products.

[1656] See footnote 1619 above.

9.125. MDIC/MCT Implementing Order No. 21, of 2 September 2010[1657], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product SUBSET PAPER CUTTING KNIFE, APPLIED TO SELF SERVICE TERMINALS:
>
> I - stamping, cutting and machining of metallic parts, as applicable;
>
> II - manufacturing of electric wiring (cable harnesses), according to Basic Production Process;
>
> III - assembly and welding of components on printed circuit boards, as applicable;
>
> IV - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and
>
> V - integration of printed circuit boards, as applicable, and of electrical and mechanical parts, to form the final product.

9.126. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step 1 - metallic parts; step II - electric wiring (according to its own PPB); step III - printed circuit boards; and step IV - electrical and mechanical parts. The Panel notes that step II – electric wiring, is subject to its own PPB. As discussed above, all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1658] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of SUBSET PAPER CUTTING KNIFE, APPLIED TO SELF SERVICE TERMINALS outsources the electric wiring to be incorporated in the paper cutting knives, it can only retain the tax benefits in question if that wiring is produced in Brazil in accordance with its own PPB, and thus is a domestic product.

9.127. Furthermore, although the PPB for SUBSET PAPER CUTTING KNIFE, APPLIED TO SELF SERVICE TERMINALS does not contain explicit outsourcing provisions for any of the other production steps, the Panel considers it reasonable to construe this silence as permission for outsourcing, rather than as a prohibition thereof. In particular, as a general matter the outsourcing provisions in the PPBs explicitly identify where outsourcing is not permitted. This is done either by listing the production steps that can be outsourced, or those that cannot. This interpretation is consistent with Brazil's multiple statements that the various ICT programmes are designed to stimulate development of the industry as a whole.[1659]

9.128. MDIC/MCT Implementing Order No. 24, of 15 February, 2006[1660], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product EQUIPMENT FOR ACCESS TO WIRELESS NETWORK (with WIRELESS MESH technology):
>
> I - assembly and welding of all components in printed circuit boards;

[1657] Implementing Order 21/2010, (Exhibit BRA-116).
[1658] See footnote 1619 above.
[1659] See, e.g. Brazil's first written submissions, para. 73 (DS472) and para. 79 (DS497); Brazil's second written submission, para. 59.
[1660] Implementing Order 24/2006, (Exhibit BRA-116).

II - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and

III - integration of printed circuit boards and other electrical and mechanical parts to form the final product, assembled according to above Sections I and II.

Sole paragraph. The activities or operations inherent to above production steps may be performed by third-parties, provided the Basic Production Process is complied with, except for step III, which shall not be subject to outsourcing.

9.129. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the accredited producer of EQUIPMENT FOR ACCESS TO WIRELESS NETWORK (with WIRELESS MESH technology) can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.130. Implementing Order No. 26, of 7 February 2007[1661], Article 1 states in relevant part that:

The following Basic Production Process is hereby set forth for the product VEHICULAR DATA COMMUNICATION UNIT:

I - stamping, cutting, folding and superficial treatment of the metallic parts, when applicable;

II - injection of plastic parts;

III - manufacture of the printed circuit from laminates;

IV - assembly and welding–or an equivalent process–of all the components on the printed circuit boards;

V - assembly of the electrical and mechanical parts, fully separate, at the basic level of components; and

VI - integration of the printed circuit boards and the electrical and mechanical parts to build the end product, in accordance with sections I to V above.

§ 1. Third parties can perform the activities or operations inherent in the production stages I to V above in Brazil, provided the Basic Production Process be complied with.

…

§ 3. As regards the GSM (Global System for Mobile Communication) communication module employed in the product referred to in the head section of this Article, it shall have parts manufactured in Brazil as of January 1, 2007 under the percentages in accordance with the schedule below, calculated based on the total quantity output in the calendar year.

I - January 1, 2007 - December 31, 2007: minimum percentage of fifty percent (50%); and

II - From January 1, 2008 on: minimum percentage of ninety percent (90%).

[1661] Implementing Order 26/2007, (Exhibit BRA-116).

9.131. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metallic parts; step II - plastic parts; steps III - printed circuits; step IV – printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of VEHICULAR DATA COMMUNICATION UNITS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.132. In addition, § 3 of Article 1 requires that the GSM (Global System for Mobile Communication) communication modules employed in the VEHICULAR DATA COMMUNICATION UNITS have 90% of parts manufactured in Brazil. Therefore, to the extent that the accredited producer of VEHICULAR DATA COMMUNICATION UNITS outsources the GSM (Global System for Mobile Communication) communication modules, it can only retain the tax benefits in question if a portion of the parts of those units are domestic products.

9.133. Implementing Order No. 31, of 7 February 2013[1662], Article 1 states in relevant part that:

> The Basic Production Process for the product NON-VOLATILE DATA STORAGE DEVICES BASED ON SEMICONDUCTORS (PEN DRIVE) NCM 8523.51.90, manufactured in the Country, established by Implementing Order No. 187 of July 19, 2011, should be as follows:
>
> I - manufacturing of plastic or metal casing;
>
> II - assembly and welding of all components in printed circuit boards; and
>
> III - assembly of set.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps described in this Article may be performed by third-parties, except for the step contained in section III, which shall not be subject to outsourcing.

9.134. Additionally, Article 2 of Implementing Order No. 31, of 7 February 2013, states in relevant part that:

> As of July 1st, 2012, monolithic integrated circuits or flash-memory-type microchips, used to assemble the boards should comply with the respective Basic Production Process, at a minimum percentage of fifty percent (50%) of production in the calendar year.

9.135. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - plastic or metal casing; step II - printed circuit boards. Steps I to II can be performed by third parties on the basis of paragraph 1 of Article 1. That is, the accredited producer of NON-VOLATILE DATA STORAGE DEVICES BASED ON SEMICONDUCTORS (PEN DRIVE) NCM 8523.51.90 can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.136. Also, Article 2 requires that at least 50% of monolithic integrated circuits or flash-memory-type microchips, used to assemble the printed circuit boards be produced in accordance with their own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by those PPBs, so long as their requirements are respected.[1663] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited

[1662] Implementing Order 31/2013, (Exhibit BRA-116).
[1663] See footnote 1619 above.

producer of NON-VOLATILE DATA STORAGE DEVICES BASED ON SEMICONDUCTORS (PEN DRIVE) NCM 8523.51.90 outsources the referenced integrated circuits, it can only retain the tax benefits in question if a portion of those integrated circuits are produce in Brazil in accordance with their own PPB, and thus are domestic products.

9.137. Implementing Order No. 253, of 29 December 2010[1664], Article 1 states in relevant part that:

> The Basic Production Process for the product PLASTIC SUBSET FOR CELL PHONES, set forth by MDIC/MCT Implementing Order 113, of July 16, 2007, hereby becomes described as follows:
>
> I - plastic injection of the base, lids, frame and front panel without keys, when applicable;
>
> II - superficial treatment of the plastic parts mentioned in the previous section, when applicable;
>
> III - assembly and welding of all the components on the printed circuit boards, when applicable; and
>
> IV - integration of the printed circuit boards, when applicable, and of the electrical and mechanical parts to build the end product.
>
> § 1. Third parties can perform the activities or operations inherent in the production stages prescribed in this Article provided the Basic Production Process be complied with, except for the stage described in section IV, which cannot be object of outsourcing.

9.138. Additionally, Article 3 of Implementing Order No. 253, of 29 December 2010, states in relevant part that:

> The parts and pieces employed to build the product shall meet the manufacturing conditions set forth in the Basic Production Process of the product CELL PHONE.

9.139. The Panel considers that steps I and III, as well as Article 3, involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - plastic parts; step III - printed circuit boards, and Article 3, (other) parts and pieces. Steps I and III can be performed by third parties on the basis of paragraph 1 of Article 1. Article 3 can be performed by third parties by virtue of being a PPB[1665]. That is, the accredited producer of PLASTIC SUBSET FOR CELL PHONES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.140. Also, Article 3 requires that the parts to build PLASTIC SUBSET FOR CELL PHONES comply with the PPB for the product CELL PHONE. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1666] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the

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[1664] Implementing Order 253/2010, (Exhibit BRA-116).

[1665] The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. See footnote 1619 above. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of PLASTIC SUBSET FOR CELL PHONES outsources the parts and pieces to be incorporated, it can only retain the tax benefits in question if those parts and pieces are produced in Brazil in accordance with their own PPB, and thus are domestic products.

[1666] See footnote 1619 above.

accredited producer of PLASTIC SUBSET FOR CELL PHONES outsources any of the referenced parts, it can only retain the tax benefits in question if a portion of those parts are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.141. Implementing Order No. 256, of 21 August 2013[1667], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product ULTRASOUND MACHINE WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS:
>
> I - manufacturing of transducers, according to their respective Basic Production Process;
>
> II - assembly and welding of all components on printed circuit boards that implement the function for reception of signals or treatment/processing of images or image output;
>
> III - assembly of monitor stands and transducer cable supports, positioning of monitor, including installation and allocation of power and video signal cables, as applicable;
>
> IV - assembly of finishing covers, connection and allocation of power supply cables, signals, controls and grounding;
>
> V - assembly of plates for cabling protection and main board (designated Card Cage), as applicable;
>
> VI - assembly of movement handle and finishing covers, as applicable;
>
> VII - installation of anti-dust filters on equipment internal parts, as applicable;
>
> VIII - installation of software for interaction with equipment user;
>
> IX - complete operation tests (hardware and software), comprising test to check bi-dimensional mode, verification of color Doppler, spectral, pulse or continuous modes, as applicable;
>
> X - general tests of image in real time, axial resolution, lateral resolution, monitor accuracy, movement mode, quality and sensitivity in bi-dimensional mode and interferences;
>
> XI - electric testing of: voltage variation, energy consumption, electric insulation, current leakage, contact resistance;
>
> XII - tests of image documents, involving image storage, examination printing and writing in a digital device; and
>
> XIII - final packaging of equipment.
>
> Paragraph 1 Subject to Basic Production Process, the steps determined in sections "I" and "II" may be performed by third-parties.

[1667] Implementing Order 256/2013, (Exhibit BRA-116).

9.142. Additionally, Article 2 of Implementing Order No. 256, of 21 August 2013, states in relevant part that:

> When ULTRASOUND MACHINE WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS is commercialized with one or more items listed in this article, these should be produced according to the schedule and according to their respective Basic Production Processes, or in compliance with MERCOSUL Rules of origin, as applicable:
>
> I - as of January 1st, 2015:
>
> a) autonomous system of electric energy supply safety (no break); and
>
> b) printer.
>
> II - As of January 1st, 2016:
>
> a) external system of video recording; or
>
> b) data storage unit.

9.143. Further, Article 3 states in relevant part that:

> Subassemblies, parts and components that form the ULTRASOUND MACHINE WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS should be produced according to the schedule and their respective Basic Production Processes, or in compliance with MERCOSUL origin rules, as applicable:
>
> I - as of January 1st, 2015:
>
> a) power supply; and
>
> b) gel heater, as applicable.
>
> II - As of January 1st, 2016:
>
> a) cabinet (structural chassis);
>
> b) caster (movement wheels), when applicable;
>
> c) support arm of monitor, when applicable;
>
> d) operation footswitch, as applicable;
>
> e) image display monitor; and
>
> f) software for image reconstruction.

9.144. The Panel considers that at least steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I – transducers, by virtue of being produced in accordance with their own PPB; and step II - printed circuit boards that implement the function for reception of signals or treatment/processing of images or image output. Steps I to II can be performed by third parties.[1668] That is, the accredited producer of ULTRASOUND MACHINES WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1668] This outsourcing provision is in addition to that inherent in the specific PPB referred to in Article 1. See footnote 1619, above.

9.145. Furthermore, Article 2 requires that when the ULTRASOUND MACHINES WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS are commercialized with autonomous systems of electric energy supply safety (no break), printers, external systems of video recording and/or data storage units, these components and subassemblies be produced in accordance with their respective PPBs, or in compliance with MERCOSUL Rules of origin. Similarly, Article 3 requires that the power supplies, gel heaters, cabinets (structural chassis) casters (movement wheels), support arms of monitor, operation footswitches, image display monitors and software for image reconstruction that form the ULTRASOUND MACHINES WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS be produced in accordance with their respective PPBs, or in compliance with MERCOSUL Rules of origin. The inclusion of the PPB option in Articles 2 and 3 means that these steps can be performed by third parties in Brazil[1669]. Therefore, where the accredited producer of ULTRASOUND MACHINES WITH DOPPLER SPECTRAL ANALYSIS/ULTRASOUND EQUIPMENT WITH DOPPLER SPECTRAL ANALYSIS outsources in Brazil the items listed in Articles 2 and 3 (rather than importing those items pursuant to MERCOSUR rules of origin), it can only retain the tax benefits in question if those items are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.146. Implementing Order No. 262, of 22 November 2012[1670], Article 1 states in relevant part that:

> The Basic Production Process for the product ONBOARD UNIT FOR TOLL STATION AND ACCESS CONTROL, determined by the MDIC/MCT Implementing Order No. 158 of August 27, 2002 should be as follows:
>
> I - manufacturing of printed circuit, from laminated;
>
> II - injection of plastic parts;
>
> III - cutting, folding, stamping, treatment and welding of metallic parts;
>
> IV - assembly and welding of all components in printed circuit boards;
>
> V - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and
>
> VI - integration of printed circuit boards and electrical and mechanical parts to form the final product.
>
> Sole paragraph. Provided the Basic Production Process is complied with, the activities or operations inherent to production steps set forth in this article may be performed by third-parties, except for the step contained in section VI, which shall not be subject to outsourcing.

9.147. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuits; step II - plastic parts; step III - metallic parts; step IV – printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of ONBOARD UNITS FOR TOLL STATIONS AND ACCESS CONTROLS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1669] The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. See footnote 1619. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products.

[1670] Implementing Order 262/2012, (Exhibit BRA-116).

9.148. Implementing Order No. 264, of 23 August 2013[1671], Article 1 states in relevant part that:

> The Basic Production Process for product RADIO FREQUENCY IDENTIFICATION DEVICE - RFID, manufactured in the Country, established by Implementing Order No. 194, of September 30, 2008, should be as follows:
>
> I - manufacturing of conductive circuit (antenna), comprising following steps:
>
> a) cutting and/or metal winding; or
> b) screen printing with conductive ink; or
> c) electrochemical, chemical, pressure with vapor processing; or
> d) chemical metal deposition.
>
> II - manufacturing of monolithic integrated circuits used in identification devices of RFID type, comprising following steps, subject to article 3:
>
> a) physical-chemical processing of chips;
> b) operational test, thinning and cut of processed chips;
> c) assembly of semiconductor, non-encapsulated chip;
> d) encapsulation of assembled chip, as applicable;
> e) electrical or optoelectrical test, as applicable; and
> f) marking (identification), as applicable.
>
> III - separation of integrated circuit/reel, as applicable;
>
> IV - welding of integrated circuit and the antenna;
>
> V - lamination of integrated circuit/antenna set in plastic base, as applicable;
>
> VI - radiofrequency communication test; and
>
> VII - writing and initialization of integrated circuit, as applicable.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps described in this article may be performed by third-parties, except for the steps contained in items of sections III, IV, V and VI, which shall not be subject to outsourcing.
>
> Article 3 The requirement contained in section II, Article 1 shall comply with minimum percentages of following schedules, according to the frequency band of RADIO FREQUENCY IDENTIFICATION DEVICE - RFID use, based on the number of monolithic integrated circuits used in the calendar year:

2012	2013	2014	2015	From 2016 on
Exempted	20%	40%	60%	80%

> Paragraph 1 If percentage is not achieved, the company is required to comply with the residual difference in reference to the minimum percentage established, in units produced until December 31 of subsequent year, without prejudice of current obligations.

[1671] Implementing Order 264/2013, (Exhibit BRA-116).

> Paragraph 2 The residual difference to which § 1 refers may not exceed ten percent (10%), based on the production in a year when it was not possible to reach the limit established.

9.149. The Panel considers that at least steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Article 3 for compliance with Article 1 on the basis of the production step requirements), as follows: step I - conductive circuit (antenna); and step II monolithic integrated circuits. Steps I to II can be performed by third parties. That is, the accredited producer of RADIO FREQUENCY IDENTIFICATION DEVICES - RFID can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.150. Implementing Order No. 269, of 29 November 2012[1672], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product X RAY SCANNER FOR SECURITY SCREENING:
>
> I - project of printed circuit boards for control and operational keyboard (as applicable);
>
> II - project and assembly of electrical board, at component basic level;
>
> III - project and assembly of detection cabinets and operational keyboard;
>
> IV - project and assembly of mechanical cabinets, mechanical structure and installation accessories;
>
> V - manufacturing of printed circuits on the board of operating keyboard, from laminated;
>
> VI - assembly and welding of all components on printed circuit boards;
>
> VII - machining and other manufacturing processes that are compatible with rollers, conveyor belt and lead curtain, as applicable;
>
> VIII - manufacturing of isolation transformer from bobbin winding;
>
> IX - integration of printed circuit boards assembled and other electrical and mechanical subassemblies to form the final product; and
>
> X - electric verification and operational tests, calibration and adjustments.
>
> Sole paragraph. Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the steps contained in sections IX and X, which shall not be subject to outsourcing.

9.151. Additionally, Article 2 of Implementing Order No. 269, of 29 November 2012, states in relevant part that:

> When the X RAY SCANNER FOR SECURITY SCREENING is commercialized with one or more products listed in this article, they should be produced in the Country, according to their respective Basic Production Processes, as applicable:

[1672] Implementing Order 269/2012, (Exhibit BRA-116).

> I - digital processing unit, based on microprocessor and assembled in same body or cabinet;
>
> II - video monitor;
>
> III - video divider;
>
> IV - frequency inverters;
>
> V - micro processed uninterruptible power supply equipment (UPS or no break); and
>
> VI - power supplies.

9.152. The Panel considers that at least steps I to VI and VIII involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: steps I, V and VI – various types of printed circuit boards; step II - electrical board; step III - detection cabinets and operational keyboard; step IV - mechanical cabinets, mechanical structure and installation accessories; and step VIII - isolation transformer. Steps I to VIII can be performed by third parties. That is, the accredited producer of X RAY SCANNER FOR SECURITY SCREENING can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.153. Also, Article 2 requires that, when the X RAY SCANNER FOR SECURITY SCREENING is commercialized with digital processing units based on microprocessor and assembled in the same body or cabinet, video monitors, video dividers, frequency inverters, micro processed uninterruptible power supply equipment (UPS or no break), and/or power supplies, these components and subassemblies be produced in accordance with their own PPBs. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1673]. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of X RAY SCANNER FOR SECURITY SCREENING outsources any of the listed items, it can only retain the tax benefits in question if those items are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.154. Implementing Order No. 91, of 1 April 2013[1674], Article 1 states in relevant part that:

> To establish following Basic Production Process for the product PLANTING MONITORING EQUIPMENT, BASED ON DIGITAL TECHNIQUE and SEED SENSOR, manufactured in the Country:
>
> I - PLANTING MONITORING EQUIPMENT, BASED ON DIGITAL TECHNIQUE:
>
> a) manufacturing of housing;
> b) manufacturing of printed circuit boards, from laminated;
> c) assembly and welding of components on printed circuit boards;
> d) configuration and writing of programs on boards;
> e) integration of electronic boards and mechanic parts;
> f) final assembly of product;
> g) test of product operation; and
> h) packaging of product.
>
> II - SEED SENSOR:

[1673] See footnote 1619 above.
[1674] Implementing Order 91/2013, (Exhibit BRA-116).

a) plastic injection of housing, as applicable;
b) assembly and welding of components on printed circuit board;
c) manufacturing of cable from drawing;
d) final assembly of product;
e) test of product operation; and
f) packaging of product.

Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties in the Country, except for items "f", "g" and "h" of section I and items "d", "e" and "f" of section II, which cannot[1675] be subject to outsourcing.

9.155. The Panel considers that steps I(a) to I(c) involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I(a) - housing; steps I(b) and (c) - printed circuit boards. Steps I(a) to (c) can be performed by third parties. That is, the accredited producer of PLANTING MONITORING EQUIPMENT, BASED ON DIGITAL TECHNIQUE can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.156. The Panel further considers that steps II(a) to II(c) involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step II(a) - housing; step II(b) - printed circuit boards; and step II(c) - cable. Steps II(a) to (c) can be performed by third parties. That is, the accredited producer of SEED SENSORS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.157. Implementing Order No. 270, of 29 November 2012[1676], Article 1 states in relevant part that:

The Basic Production Process for POWER SUPPLY AND CONVERTER OF CONTINUOUS CURRENT FOR SMALL-CAPACITY DIGITAL PROCESSING UNITS (NCM: 8471.50.10), established by MDIC/MCT Implementing Order No. 145 of July 02, 2008 should be as follows:

I - manufacturing of power cable, according to § 2 and 3;

II - assembly and welding of all components in printed circuit boards;

III - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and

IV - integration of assembled printed circuit boards and electrical and mechanical parts to form the final product.

Paragraph 1 The activities or operations inherent to production steps may be performed by third-parties, provided the Basic Production Process is complied with, except for the step determined in Section IV, which may not be subject to outsourcing.

Paragraph 2 The step contained in section I shall be considered complied with when power cable is manufactured according to the Basic Production Process, in case it is

[1675] The English translation submitted by Brazil "which may be subject to outsourcing" contains an error. The original Portuguese version states "que não poderão ser objeto de terceirização", that is "which *cannot* be subject to outsourcing" (emphasis added).

[1676] Implementing Order 270/2012, (Exhibit BRA-116).

> produced at Manaus Free Trade Zone, or manufactured from drawing of copper wire, when they are produced in other regions of the Country.
>
> Paragraph 3 With the purpose of compliance with this Basic Production Process, the step contained in section I should comply with following schedule, considering the percentage that should be calculated on the total number of cables used in the calendar year:
>
> I - from January 1st, 2013 to December 31, 2013: twenty percent (20%);
>
> II - from January 1st, 2014 to December 31, 2014: fifty percent (50%); and
>
> III - as of January 1st, 2015: eighty percent (80%).
>
> Paragraph 4 Alternatively to the requirement contained in section I, the company may opt to manufacture printed circuits from laminated, according to the schedule contained in Paragraph 3.

9.158. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies subject to the options in paragraphs 2 and 4, and the minimum percentages in paragraph 3, for compliance with Article 1 on the basis of the production step requirements, as follows: step I - power cable; step II - printed circuit boards; and step III - electrical and mechanical parts. Compliance with step I is subject to paragraphs 2 and 3, which involve *inter alia* staged implementation of the requirement which as of 2015 applies to at least 80% of the cable used in the calendar year relating to POWER SUPPLIES AND CONVERTERS OF CONTINUOUS CURRENT FOR SMALL-CAPACITY DIGITAL PROCESSING UNITS (NCM: 8471.50.10), or an alternative for compliance with respect to the printed circuit boards (step II). Thus, under this PPB, the accredited producer can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.159. Implementing Order No. 384, of 30 December 2013[1677], Article 1 states in relevant part that:

> The Basic Production Process for the product MAGNETIC HARD DISK UNIT, produced in the Country, established by the MICT/MCT/MC Implementing Order No. 95 of April 1st, 2013 should be as follows:
>
> I - manufacturing of printed circuits, as of laminated, according to article 2;
>
> II - molding or plastic injection of external cabinet at a minimum percentage of fifty percent (50%), based on the production in the calendar year, as applicable;
>
> III - assembly and welding of all components in printed circuit boards;
>
> IV - assembly of electrical and mechanical parts, completely unbundled, at basic component level;
>
> V - integration of printed circuit boards and other electrical and mechanical parts to form the final product, assembled according to sections III and IV above; and
>
> VI - formatting, calibration, adjustment and final tests.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties in the

[1677] Implementing Order 384/2013, (Exhibit BRA-116).

> Country, except for the steps contained in sections V and VI, which shall not be subject to outsourcing.
>
> Article 2 The compliance with the step provided for in section I should observe following schedule, based on the production of calendar year:
>
> I - from January 1st, 2012 to June 30, 2013: ten percent (10%) of production for the period;
>
> II - as of July 1st 2013: exempted.

9.160. The Panel considers that steps I to IV involves the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuits; step II - external cabinets; step III – printed circuit boards; and step IV - electrical and mechanical parts. Steps I to IV can be performed by third parties. The Panel further notes that pursuant to Article 2, step I no longer applies. Thus, the accredited producer of MAGNETIC HARD DISK UNITS can outsource steps II to IV and retain the tax benefits in question so long as the requirements of those steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.161. Implementing Order No. 57, of 17 February 2005[1678], Article 1 states in relevant part that:

> The Basic Production Process for the product MULTILAYER CERAMIC CAPACITOR, IDEAL TO SURFACE MOUNTING (SMD – SURFACE MOUNTED DEVICE) established by Implementing Order MDIC/MCT n. 451, October 8, 2003, is modified as follows:
>
> I – Raw materials blending;
>
> II – Formation of ceramic layers;
>
> III – Printing of the internal electrode and overlaying;
>
> IV - Cut and formation in the firing chamber;
>
> V – External electrodes paint and burn;
>
> VI – Chroming;
>
> VII – Measuring of electric characteristics;
>
> VIII – Thermic treatment for taping; and
>
> IX – Measuring of electric characteristics and taping.
>
> § 1. Third parties can perform the activities or operations inherent to the production stages, provided they comply with the Basic Production Process.
>
> § 2. The compliance of the steps described on items I to V is temporarily exempted.
>
> § 3. The exemption referred in the paragraph above will remain into force until the growth of the internal demand meets levels that enable the execution of the steps on items I to V in the Country.

9.162. The Panel notes that in accordance with § 1, all of the production steps listed in items I to IX can be performed by third parties, and further notes that pursuant to § 2 and 3, at the time this PPB entered into force, compliance with steps I to V were exempted until the growth of internal

[1678] Implementing Order 57/2005, (Exhibit BRA-116).

demand was sufficient to enable these steps to be performed in Brazil, and there is no information on the record as to whether that exemption remains in effect. It also is difficult to determine, from the descriptions of the steps, precisely which of them involve the creation, from basic raw materials and inputs, of components and subassemblies. That said, given that step I refers to raw materials blending, it is clear that this PPB involves such a conversion process (or processes). Thus, the accredited producer of MULTILAYER CERAMIC CAPACITOR, IDEAL TO SURFACE MOUNTING (SMD – SURFACE MOUNTED DEVICE) can outsource the steps involving such processes (in respect of steps I to IV, at such time as the exemption thereof is lifted) and retain the tax benefits in question, so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.163. Implementing Order No. 237, of 11 December 2006[1679], states in relevant part that:

> The following Basic Production Process for the product SUBSET FOR CELL PHONE WITH INCORPORATED LIQUID CRYSTAL DISPLAY, as set forth by Implementing Order MDIC/MCT n. 277, of July 1, 2003, hereby becomes the following:
>
> I – Support, base, frame and panel injection, when applicable;
>
> II - Welding and assembly of all components in the printed circuit boards, when applicable;
>
> III – Assembly of electrical and mechanical parts, non-integrated, in basic components levels;
>
> IV – Integration of the liquid crystal display, of the printed circuit board and of the electrical and mechanical parts into the final product, assembled according to items II and III above.
>
> § 1. Third parties can perform the activities or operations inherent in the production steps established in this Article, in the Country, provided the Basic Production Process be complied with.

9.164. Further, Article 4 states in relevant part that:

> The parts that will constitute the product shall comply with the industrialization conditions established on the Basic Production Process for the product cellphone.

9.165. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - support, base, frame, and panel; step II - printed circuit boards; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of SUBSETS FOR CELL PHONES WITH INCORPORATED LIQUID CRYSTAL DISPLAY can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.166. Also, Article 4 requires that the parts that will constitute the SUBSETS FOR CELL PHONES WITH INCORPORATED LIQUID CRYSTAL DISPLAY comply with the Basic Production Process for the product CELLPHONE. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. See paragraph 7.292 above. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of SUBSETS FOR CELL PHONES WITH INCORPORATED LIQUID CRYSTAL DISPLAY outsources any of the referenced parts, it can only retain the tax benefits in question if a portion of those parts are produced in Brazil in accordance with their own PPB, and thus are domestic products.

[1679] Implementing Order 237/2006, (Exhibit BRA-116).

9.167. Implementing Order No. 165, of 17 June 2014[1680], Article 1 states in relevant part that:

> Basic Productive Process for the product DIGITAL AUTOMATIC MACHINE FOR DATA PROCESSING, WITH BUILT-IN SCREEN - ALL IN ONE, produced in the Country, established by MDIC/MCTI Implementing Order No. 47 of February 20, 2013, should be as follows:
>
> I - assembly and welding of all components in printed circuit boards;
>
> II - assembly of electrical and mechanical parts; and
>
> III - integration of printed circuit boards and electrical and mechanical parts to form the final product.
>
> Sole paragraph. Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the step contained in sections III, which shall not be subject to outsourcing.

9.168. Additionally, Article 2 of Implementing Order No. 165, of 17 June 2014, states in relevant part that:

> In order to comply with provisions of Article 1, following percentages and assembly schedules in the Country, as well as component and part use are determined, when applicable, based on the quantity used in the calendar year, and considering provisions of article 3:
>
> I - printed circuit boards assembled with electric or electronic components that implement central processing function (mother board):

	Percentage
Assembled in the Country:	90%

> II - printed circuit boards assembled with electric or electronic components that implement communication interface function, when these are not integrated to the mother board:

	Percentage
Assembled in the Country:	90%

> III - printed circuit boards assembled with electric or electronic components that implement communication interface function, using wireless technology, according to following schedule:

Calendar year	2013	2014	From 2015 on
Assembled in the Country:	50%	60%	80%

> IV - printed circuit boards assembled with electric or electronic components that implement power supply function, when internal, and Alternate/Continuous Current Converters - AC/CC, when external:

Calendar year	2013	From 2014 on

[1680] Implementing Order 165/2014, (Exhibit BRA-116).

Produced in accordance to specific PPB	45%	80%

V - power cables produced according to specific PPB or, in its absence, from drawing and annealing of its wires, according to following table and paragraph 10:

Calendar year	2013	2014	From 2015 on
Produced in accordance to specific PPB, or from drawing and annealing of its wires	30%	30%	60%

VI - rigid magnetic disk units, when applicable:

Calendar year	2013	From 2014 on
Produced in accordance to specific PPB	30%	50%

VII - printed circuit boards assembled with electric or electronic components that implement memory functions (RAM memory modules):

Calendar year	2013	2014	2015	From 2016 on
Produced in accordance to specific PPB	40%	60%	70%	80%
Assembled in the Country	50%	30%	20%	10%
Total produced in the Country	90%	90%	90%	90%

VIII - other components and parts that have memory function, whether as integrated circuits, or as modules or boards, specified below, as applicable:

a) DRAM integrated circuit component; and

b) Unit of data storage, SSD (Solid State Drive) module.

Calendar year	2013	2014	2015	From 2016 on
Minimum percentage required with specific PPB	30%	50%	60%	80%

9.169. Further, paragraph 10 states in relevant part that:

Power cables referred to in section V of this article should be produced from drawing and annealing of its wires, according to following schedule:

I - from January 1st to December 31, 2013: sixty percent (60%), in weight;

II - as of January 1st, 2014: ninety percent (90%), in weight.

9.170. The Panel considers that steps I and II of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Article 2 for compliance with Article 1 on the basis of the production step requirements or own PPBs), as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Pursuant to the sole paragraph of Article 1, steps I to II can be performed by third parties.[1681] That is, the accredited producer of DIGITAL AUTOMATIC MACHINES FOR DATA PROCESSING, WITH BUILT-IN SCREEN - ALL IN ONE can outsource these steps and retain the tax benefits in question

[1681] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in Article 2. See footnote 1619.

so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.171. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1682] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of DIGITAL AUTOMATIC MACHINES FOR DATA PROCESSING, WITH BUILT-IN SCREEN - ALL IN ONE outsources any of the referenced parts, components or subassemblies, it can only retain the tax benefits in question if a portion of those items are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.172. Implementing Order No. 211, of 18 August 2014[1683], Article 1 states in relevant part that:

> Basic Production Process for products: VOICE AND DATA SWITCHING EQUIPMENT INTEGRATED TO RADIO BASE STATION, SWITCHING AND CONTROL CENTERS - CCC, RADIO BASE STATION CONTROLLERS - BSC, EQUIPMENT FOR NETWORK INTERCONNECTION AND MULTIPLEXING USING MICRO WAVES OR OPTICAL SIGNALS INCORPORATED TO RADIO BASE STATIONS, TRANSCEIVER UNITS FOR RADIO BASE STATIONS – ERB, CELLULAR TRANSPONDERS AND SYSTEMS OF CONTINUOUS CURRENT ENERGY, appropriate for cellular telephony, as set forth by the MDIC/MCT Implementing Order 160 of June 22, 2011, should be as follows:
>
> I - manufacture from laminate ten percent (10%), in quantity, of printed circuits used in transceiver units for radio base station and cellular transponders, according to § 2 of this article;
>
> II - manufacture according to current PPB electric surge protection devices, when applicable.
>
> III - assembly and welding of all components in printed circuit boards;
>
> IV - assembly of electrical and mechanical subassemblies, completely unbundled, at basic component level; and
>
> V - integration of printed circuit boards and electrical and mechanical modules, assembled according to previous items, in order to form the final product.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the step contained in sections V, which shall not be subject to outsourcing.
>
> …
>
> Paragraph 3 In order to manufacture the TRANSCEIVER UNITS FOR RADIO BASE STATION – ERG, CELLULAR TRANSPONDERS, a step corresponding to cabinet manufacturing, according to its specific Basic Production Process, should be added to the steps provided for in caption.
>
> …
>
> Paragraph 4 For the manufacture the SYSTEMS OF CONTINUOUS CURRENT ENERGY, the steps corresponding to manufacture of the cabinet and the electric accumulators , according to their specific Basic Production Processes, should be added to the steps provided for in caption.
>
> …

[1682] See footnote 1619 above.
[1683] Implementing Order 211/2014, (Exhibit BRA-116).

9.173. Additionally, Article 4 of Implementing Order No. 211, of 18 August 2014, states in relevant part that:

> Equipment for point-to-point or multipoint connection using Micro Wave technology should have their TRANSPONDER UNITS produced according to the Basic Production Process determined in this Order.

9.174. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuits; step II – electric surge protection devices step III - printed circuit boards; and step IV - electrical and mechanical subassemblies. Steps I to IV can be performed by third parties. In addition, pursuant to Article 4, the TRANSPONDER UNITS for equipment for point-to-point or multipoint connection using Micro Wave technology must be produced according to this PPB (and thus are subject to its outsourcing provisions). That is, the accredited producer of VOICE AND DATA SWITCHING EQUIPMENT INTEGRATED TO RADIO BASE STATION, SWITCHING AND CONTROL CENTERS - CCC, RADIO BASE STATION CONTROLLERS - BSC, EQUIPMENT FOR NETWORK INTERCONNECTION AND MULTIPLEXING USING MICRO WAVES OR OPTICAL SIGNALS INCORPORATED TO RADIO BASE STATIONS, TRANSCEIVER UNITS FOR RADIO BASE STATIONS – ERB, CELLULAR TRANSPONDERS AND SYSTEMS OF CONTINUOUS CURRENT ENERGY can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.175. Furthermore, paragraphs 3 and 4 of Article 1 require that (i) the cabinet for TRANSCEIVER UNITS FOR RADIO BASE STATION – ERG, CELLULAR TRANSPONDERS and (ii) the cabinet and electric accumulators for SYSTEMS OF CONTINUOUS CURRENT ENERGY be produced in accordance with their own PPBs. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of VOICE AND DATA SWITCHING EQUIPMENT INTEGRATED TO RADIO BASE STATION, SWITCHING AND CONTROL CENTERS - CCC, RADIO BASE STATION CONTROLLERS - BSC, EQUIPMENT FOR NETWORK INTERCONNECTION AND MULTIPLEXING USING MICRO WAVES OR OPTICAL SIGNALS INCORPORATED TO RADIO BASE STATIONS, TRANSCEIVER UNITS FOR RADIO BASE STATIONS – ERB, CELLULAR TRANSPONDERS AND SYSTEMS OF CONTINUOUS CURRENT outsources the referenced cabinets, it can only retain the tax benefits in question if those cabinets are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.176. MDIC/MCT Implementing Order No. 224 of 09 September 2014[1684], Article 1 states in relevant part that:

> The Basic Production Process for the product FIBER OPTICS, produced in the Country, established by the MICT/MCT/MC Implementing Order No. 135 of August 03, 1994, should be as follows:
>
> I - physical and chemical processing that results in obtainment of pre-form;
>
> II - fiber pulling;
>
> III - tests;
>
> IV - packaging.
>
> Paragraph 1 For compliance with provisions set forth hereunder, the step described in Section I may be performed by third parties, provided it is performed in the Country.

[1684] Implementing Order 224/2014, (Exhibit BRA-116).

9.177. The Panel considers that step I involves the creation, from basic raw materials and inputs, of components or subassemblies, i.e., pre-forms. Step I can be performed by third parties. That is, the accredited producer of FIBER OPTICS can outsource this step and retain the tax benefits in question so long as the requirements of the step (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.178. Implementing Order No. 24, of 5 February 2014[1685], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product MOBILE C-ARC X RAY EQUIPMENT, COUPLED, BASED ON DIGITAL TECHNIQUES, produced in the Country, following Basic Production Process:
>
> I - Manufacturing of X ray detectors, when applicable, according to their respective Basic Production Process;
>
> II - Assembly and welding of all components in printed circuit board(s) that is (are) contained in main equipment and that implement following functions:
>
> a) control and actuation of X rays;
> b) control and actuation of movement, as applicable;
> c) control and signal transmission interfaces; and
> d) supply and distribution of energy.
>
> III - Integration of computer and console cabling;
>
> IV - Installation of retaining brackets of computer and covers;
>
> V - Assembly and cabling of monitor set;
>
> VI - Integration of high-voltage generator to X ray equipment;
>
> VII - Integration of components of C-arc set and console;
>
> VIII - Installation of a computer program for equipment configuration and operation;
>
> IX - Execution of mechanic, electric safety, radiation and image tests;
>
> X - Customization of regional configurations for destination country; and
>
> XI - System labeling and final product packaging.
>
> Paragraph 1 Provided the Basic Production Process is complied with, only the steps determined in sections "I", "II", "VI" and "XI" may be performed by third-parties, while others should be performed by manufacturing company, except in cases where outsourcing is part of the technology transfer project for companies installed in the Country.

9.179. Additionally, Article 2 of Implementing Order No. 24, of 5 February 2014, states in relevant part that:

> When the MOBILE C-ARC X RAY EQUIPMENT, COUPLED, BASED ON DIGITAL TECHNIQUES is commercialized with one or more products listed in this article, they should be produced in the Country, according to their respective Basic Production Processes, according to following schedule, as applicable:

[1685] Implementing Order 24/2014, (Exhibit BRA-116).

> I - As of July 1st, 2015:
>
> a) assembly of uninterruptible power supply equipment (no break).
>
> b) mechanical unit for tube support and examination table, as applicable.
>
> II - As of January 1st, 2016:
>
> a) rebuilder or console computer.
>
> III - As of January 1st, 2017:
>
> a) image display monitor; and
>
> b) image and signal processing software.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the parts, components, accessories and software listed in sections I, II and III may be produced by third parties, provided they are part of the project of technology transfer for companies installed in the Country, as applicable.

9.180. The Panel considers that at least steps I and II of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - X ray detectors (on the basis of their own PPB); and step II - printed circuit boards. Pursuant to paragraph 1 of Article 1, steps I and II can be performed by third parties.[1686] That is, the accredited producer of MOBILE C-ARC X RAY EQUIPMENT, COUPLED, BASED ON DIGITAL TECHNIQUES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.181. Also, Article 2 requires that when the MOBILE C-ARC X RAY EQUIPMENT, COUPLED, BASED ON DIGITAL TECHNIQUES is commercialized with uninterruptible power supply equipment (no break); mechanical units for tube support and examination table: rebuilders or console computers; image display monitors; and/or image and signal processing software; these components and subassemblies be produced in accordance with their respective PPBs, or in compliance with MERCOSUL Rules of origin. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the components or subassemblies covered by that PPB so long as its requirements are respected.[1687] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of MOBILE C-ARC X RAY EQUIPMENT, COUPLED, BASED ON DIGITAL TECHNIQUES outsources the referenced items, it can only retain the tax benefits in question if those items are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.182. Implementing Order No. 62, of 31 March 2014[1688], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product EQUIPMENT FOR TRANSMISSION OF DIGITAL TELEVISION SIGNALS, produced in Country:
>
> I - assembly and welding of all components in printed circuit boards;
>
> II - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and

[1686] This outsourcing provision is in addition to that inherent in the specific PPB referred to in Article 1.
[1687] See footnote 1619 above.
[1688] Implementing Order 62/2014, (Exhibit BRA-116).

> III - integration of printed circuit boards and other electric parts to form the final product, assembled according to above Sections I and II.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the steps contained in Section III, which shall not be subject to outsourcing.

9.183. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the accredited producer of EQUIPMENT FOR TRANSMISSION OF DIGITAL TELEVISION SIGNALS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.184. Implementing Order No. 141, of 13 May 2015[1689], Article 1 states in relevant part that:

> Basic Production Process for the product DIGITAL PROCESSING UNIT, WITH SMALL CAPACITY, BASED ON MICROPROCESSOR, AND ASSEMBLED ON SAME BODY OR CABINET (NCM: 8471.50.10), produced in the country, and established by MDIC/MCT Implementing Order No. 80 of April 14, 2014 should be as follows:
>
> I - assembly and welding of all components in printed circuit boards;
>
> II - assembly of electrical and mechanical parts, completely unbundled, at basic component level, except for the cabinet, subject to provisions of section III;
>
> III - assembly of cabinet at basic component level or from its basic structures, unbundled, in at least five parts, according to § 1, 2, 3 of this article; and
>
> IV - integration of printed circuit boards and electrical and mechanical parts to form the final product.
>
> Paragraph 1 For purpose of counting referred to in section II of this article, the front panel may be considered one of five parts of cabinet basic structure, and only the light emitting diode displays (LEDs), speaker (Beeper) and on/off key may be aggregated to it.
>
> Paragraph 2 For purpose of section III of this article, following components and parts are not part of the cabinet: power supply, assembled printed circuit boards, cooling fan, memory card readers, optical disk units, whether magnetic and flexible, being that wiring and fixation elements are not considered as being basic structures.
>
> Paragraph 3 Provided the Basic Production Process established in this Order is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the step contained in section IV, which shall not be subject to outsourcing.

9.185. Additionally, Article 3 of Implementing Order No. 141, of 13 May 2015, states in relevant part that:

> The wireless communication interface boards (Wi-Fi, Bluetooth, WiMax), intended for the SMALL DIGITAL PROCESSING UNITS should comply with minimum assembly percentage of 80%, based on the quantity of these boards used in the calendar year.

[1689] Implementing Order 141/2015, (Exhibit BRA-116).

9.186. Further, Article 4 states in relevant part that:

> The SMALL DIGITAL PROCESSING UNITS should use at least three of following inputs, manufactured according to the respective Basic Production Process:
>
> I - cabinets;
>
> II - rigid magnetic disk units;
>
> III - power supply;
>
> IV - printed circuits (for mother board); and
>
> V - label with radiofrequency identification (RFID) device.

9.187. Article 5 states in relevant part that:

> In order to comply with provisions of Article 1, the following percentages and assembly schedules in the Country, as well as component and part use, are determined, when applicable, based on the quantity used in the calendar year:
>
> I - printed circuit boards assembled with electric or electronic components that implement memory functions (RAM memory modules):

Calendar year	2014	2015	From 2016 on
Produced according to specific PPB	50%	60%	80%
Assembled in Country	40%	30%	10%
Total produced in the Country	90%	90%	90%

> II - other components and parts that have memory function, whether as integrated circuits, or as modules or boards, specified below, as applicable:
>
> a) DRAM or LPDRAM integrated circuit component;
>
> b) Nand Flash integrated circuit component; and
>
> c) unit of data storage, SSD (Solid State Drive) module.

Calendar year	2014	2015	From 2016 on
Minimum percentage required with specific PPB	50%	60%	80%

9.188. The Panel considers that steps I, II and III of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum amounts and percentages in Articles 3, 4 and 5 for compliance with Article 1 on the basis of the production step requirements or own PPBs), as follows: step 1 - printed circuit boards; step II - electrical and mechanical parts; and step III - cabinet. Pursuant to paragraph 3 of Article 1, steps I to III can be performed by third parties.[1690] That is, the accredited producer of DIGITAL PROCESSING UNIT, WITH SMALL CAPACITY, BASED ON MICROPROCESSOR, AND ASSEMBLED ON SAME BODY OR CABINET (NCM: 8471.50.10) can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1690] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in Article 5. See footnote 1619 above.

9.189. More precisely with respect to the own PPBs in, pursuant to Articles 4 and 5, at least three of following inputs: cabinets, rigid magnetic disk units, power supply, printed circuits (for mother board) and label with radiofrequency identification (RFID) devices, and specified minimum percentages of certain printed circuit boards and other electronic parts, used in the SMALL DIGITAL PROCESSING UNITS must be manufactured according to their own PPBs. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of SMALL DIGITAL PROCESSING UNITS outsources the referenced components and subassemblies, it can only retain the tax benefits in question if those components and subassemblies are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.190. Implementing Order No. 185, of 28 May 2015[1691], Article 1 states in relevant part that:

> The Basic Production Process for the product ELECTRONIC FUND TRANSFER TERMINAL – DEBIT AND CREDIT, established by the MICT/MCT/MC Implementing Order No. 35 of February 07, 2013, should be as follows:
>
> I - plastic injection of body or cabinet at a minimum percentage of 85%, based on annual manufacturing with incentives of Electronic Fund Transfer Terminal – Debit and Credit;
>
> II - manufacturing of power supply or AC/CC converter, or battery charger, from assembly and welding of all components on the printed circuit board, and winding of transformer spool, at a minimum percentage of 85%, based on annual manufacturing with incentives of Electronic Fund Transfer Terminal – Credit and Debit;
>
> III - assembly and welding of all components in printed circuit boards;
>
> IV - assembly of electrical and mechanical parts, completely unbundled, at basic component level;
>
> V - manufacturing of GSM (Global System for Mobile Communications) communication modules, according to article 3; and
>
> VI - integration of printed circuit boards and other electrical and mechanical parts to form the final product, assembled according to sections III and IV of this article.
>
> Sole paragraph. Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the step VI, which shall not be subject to outsourcing.

9.191. Article 3 of Implementing Order No. 185, of May 28, 2015, states in relevant part that:

9.192. From the total of communication modules GSM (Global System for Mobile Communications) used to produce the ELECTRONIC FUND TRANSFER TERMINAL – DEBIT AND CREDIT, ninety percent (90%) should be produced according to their respective Basic Production Process, and based on the production, in quantity, in the calendar year.

9.193. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, subject to specified minimum percentages, as follows: step I - body or cabinet; step II - power supply or AC/CC converter, or battery charger; step III - printed circuit boards; step IV - electrical and mechanical parts; and step V - GSM (Global System for Mobile Communications) communication modules, subject to compliance, pursuant to Article 3, with its own PPB in respect of 90% of the modules incorporated into the ELECTRONIC FUND

[1691] Implementing Order 185/2015, (Exhibit BRA-116).

TRANSFER TERMINALS – DEBIT AND CREDIT. Steps I to V can be performed by third parties. That is, the accredited producer of ELECTRONIC FUND TRANSFER TERMINALS – DEBIT AND CREDIT can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs[1692]) are respected.

9.194. Implementing Order No. 188, of 8 July 2014[1693], Article 1 states in relevant part that:

> The Basic Production Process for the product PROGRAMMABLE LOGIC CONTROLLER, produced in the Country, established by the MICT/MCT/MC Implementing Order No. 511 of November 10, 2003, should be as follows:
>
> I - manufacturing of at least seventy percent (70%) of printed circuits, as of laminated;
>
> II - assembly and welding of all components in printed circuit boards;
>
> III - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and
>
> IV - integration of printed circuit boards and electrical and mechanical parts to form the final product.
>
> Paragraph 1 Provided the Basic Production Process provided for in this Order is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the step contained in Section IV, which shall not be subject to outsourcing.

9.195. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuits; step II – printed circuit boards; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of PROGRAMMABLE LOGIC CONTROLLERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.196. Implementing Order No. 26, of 5 February 2014[1694], Article 1 states in relevant part that:

> The following Basic Production Process is hereby set forth for the product POSITRON EMISSION TOMOGRAPHY/COMPUTED TOMOGRAPHY (PET/CT), produced in the Country:
>
> I - assembly of X ray detectors, according to their respective Basic Production Process;
>
> II - assembly of photon detectors, according to their respective Basic Production Process;
>
> III - mechanical assembly of stationary base;

[1692] In the case of GSM communication modules, due to the requirements of the specific PPB for those products.

[1693] Implementing Order 188/2014, (Exhibit BRA-116).

[1694] Implementing Order 26/2014, (Exhibit BRA-116).

IV - mechanic installation and CT Gantry alignment with stationary base;

V - mechanical installation of PET image ring, and mechanic alignment with CT Gantry;

VI - mechanic assembly and alignment of patient table with CT Gantry;

VII - mechanical assembly and connections of data cabling of PET image reconstruction unit;

VIII - mechanical assembly, connections of data cabling, installation of software and execution of operational tests of CT image reconstruction unit;

IX - assembly and connections of the unit of energy distribution to Gantry set, to CT and PET image reconstruction units and to patient table;

X - mechanical alignment and integration tests of stationary base, CT Gantry, PET image ring and table;

XI - tests of electric safety and radiation, comprising grounding impedance test, leakage current, dielectric strength and radiation leakage from PET source, as applicable;

XII - operational tests, including calibration and image quality; and

XIII - packaging of subsystems and accessories forming PET/CT.

Provided the Basic Production Process is complied with, only the steps determined in Sections I, II, XIII may be performed by third-parties, while others should be performed by manufacturing company, except in cases where outsourcing is part of the technology transfer project for companies installed in the Country.

9.197. Additionally, Article 2 of Implementing Order No. 26, of February 5, 2014, states in relevant part that:

When the POSITRON EMISSION TOMOGRAPHY/COMPUTED TOMOGRAPHY (PET/CT) is commercialized with one or more products listed in this article, they should be produced in the Country, according to their respective Basic Production Processes, according to following schedule, as applicable:

I - as of January 1st, 2016:

a) computer for data acquisition or image reconstruction;

b) computer cabinet (metallic rack);

c) printer for printing reports and images in paper;

d) printer for printing examinations in special film.

e) system of high voltage for filtering and control of supply to medical systems;

f) system for high voltage management for control of continued supply for medical systems; and

g) system for low voltage management for control of continued supply for medical systems

II - as of January 1st, 2017:

a) image display monitor; and

b) image and signal processing software.

9.198. The Panel considers that at least steps I and II, by virtue of being subject to their own PPBs, involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step 1 - X ray detectors; and step II - photon detectors. Pursuant to paragraph 1 of Article 1, steps I and II can be performed by third parties.[1695] That is, the accredited producer of POSITRON EMISSION TOMOGRAPHY/COMPUTED TOMOGRAPHY (PET/CT) can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs, on the basis of the applicable PPBs) are respected.

9.199. Also, Article 2 requires that when the POSITRON EMISSION TOMOGRAPHY/COMPUTED TOMOGRAPHY (PET/CT) is commercialized with: computers for data acquisition or image reconstruction; computer cabinets (metallic rack); printers for printing reports and images in paper; printers for printing examinations in special film; systems of high voltage for filtering and control of supply to medical systems; systems for high voltage management for control of continued supply for medical systems; and/or systems for low voltage management for control of continued supply for medical systems; these components or subassemblies be produced in accordance with their respective PPBs. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of POSITRON EMISSION TOMOGRAPHY/COMPUTED TOMOGRAPHY (PET/CT) outsources the referenced items, it can only retain the tax benefits in question if those items are produced in Brazil in accordance with their own PPBs, and thus are domestic products.

9.200. Implementing Order No. 36, of 4 March 2015[1696], Article 1 states in relevant part that:

> Basic Production Process for the product INPUT UNIT, KEYBOARD FOR TRACKER WITH OR WITHOUT BUILT-IN VIDEO OUTPUT, produced in the country, established by MDIC/MCTI Implementing Order No. 24 of February 07, 2007, should be as follows:
>
> I - plastic part injection;
>
> II - manufacturing of printed circuit boards, as of laminated, at a minimum percentage of eighty percent (80%), as of July 1st, 2015;
>
> III - assembly and welding, or equivalent process, of all components in printed circuit boards;
>
> IV - assembly of electrical and mechanical parts, completely unbundled, at basic component level; and
>
> V - final assembly.
>
> Sole paragraph. The activities or operations inherent to above production steps may be performed by third-parties, provided the Basic Production Process is complied with, except for stage V, which shall not be subject to outsourcing.

[1695] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in Article 1. See footnote 1619 above.

[1696] Implementing Order 36/2015, (Exhibit BRA-116).

9.201. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - plastic parts; steps II and III - printed circuit boards; and step IV involves the creation, from basic raw materials and inputs, of the following components or subassemblies: electrical and mechanical parts. Steps I to IV can be performed by third parties. That is, the accredited producer of INPUT UNITS, KEYBOARDS FOR TRACKER WITH OR WITHOUT BUILT-IN VIDEO OUTPUTcan outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.202. Implementing Order No. 188, of 28 May 2015[1697], Article 1 states in relevant part that:

> The Basic Production Process for the product FIXED CELLULAR TELEPHONE, which uses GSM, GPRS, EDGE, W-CDMA, HSPA and LTE technologies, jointly or individually, manufactured in the Country, as set forth by the MCT/MICT Implementing Order No. 356 of September 6, 1996, should be as follows:
>
> I - plastic injection of body or cabinet;
>
> II - assembly and welding of all components in printed circuit boards;
>
> III - assembly of electrical and mechanical parts, completely unbundled, at basic component level;
>
> IV - integration of printed circuit boards and electrical and mechanical parts to form the final product, assembled according to the steps determined in sections I, II and III.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the step contained in section IV, which shall not be subject to outsourcing.
>
> Paragraph 2 Until December 31, 2017, for subassemblies "module of frequency radio" and "cellular interface", the operation described in section II of this article is exempted. After this date, the use of those subassemblies should comply with following schedule:

Calendar year	2018	2019	From 2020 on
Percentage	20%	40%	80%

> Paragraph 3 Until December 31, 2015, for subassembly "power supply" (or continuous current converters – AC-CC or battery chargers), the operation described in section II of this article is exempted. As of January 1st, 2016, power sources should be manufactured according to the steps set forth in caption, at a minimum percentage, based on the total quantity produced in the calendar year, according to following schedule:

Calendar year	2016	2017	From 2018 on
Percentage	30%	50%	80%

9.203. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in paragraphs 2 and 3 for compliance with Article 1 on the basis of the production step requirements), as follows: step I - body or cabinet; step II - printed circuit boards; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of FIXED CELLULAR TELEPHONES, which uses GSM, GPRS, EDGE, W-CDMA, HSPA and LTE technologies can outsource these steps and retain the tax benefits in question so long as the requirements of the

[1697] Implementing Order 188/2015, (Exhibit BRA-116).

steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.204. Implementing Order No. 231, of 5 September 2014[1698], Article 1 states in relevant part that:

> Article 1 The Basic Production Process for the product PHOTOVOLTAIC PANEL OR MODULE, produced in the Country, established by the MICT/MCT/MC Implementing Order No. 274 of December 12, 2001, should be as follows:
>
> I - manufacturing of photovoltaic cells, according to their respective Basic Production Process;
>
> II - welding of terminals in photovoltaic cells forming strings;
>
> III - assembly of cell sets (strings) in glass and welding of cell interconnections (strings);
>
> IV - assembly of coverage (plastic or glass film);
>
> V - panel lamination;
>
> VI - assembly of frame (optional for glass/glass panel);
>
> VII - assembly of electric connector and/or connection box; and
>
> VIII - tests and classification in the simulator.
>
> Paragraph 1 Provided the Basic Production Process provided for in this Order is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the steps contained in sections VII and VIII, which shall not be subject to outsourcing.

9.205. The Panel considers that at least steps I, II, III, IV, and VI involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - photovoltaic cells (according to their own PPB); step II – strings; step III – cell sets and cell interconnections; step IV - coverage (plastic or glass); and step VI - frames. Pursuant to paragraph 1, all of these steps can be performed by third parties. That is, the accredited producer of PHOTOVOLTAIC PANELS OR MODULES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs – for photovoltaic cells, pursuant to the respective PPB) are respected.

9.206. Implementing Order No. 236, of 15 July 2015[1699], Article 1 states in relevant part that:

> It is established following Basic Production Process for the product CONNECTORIZED OPTICAL CABLE, manufactured in the Country:
>
> I - cutting of optical cable;
>
> II - optical cable stripping;

[1698] Implementing Order 231/2014, (Exhibit BRA-116).
[1699] Implementing Order 236/2015, (Exhibit BRA-116).

> III - cleaning of optical fiber;
>
> IV - gluing of optical fiber to ceramic contact;
>
> V - fiber pulling;
>
> VI - fiber polishing, as applicable; and
>
> VII - crimping of connector.
>
> Paragraph 1 For compliance with this article, optical cables should comply with Basic Production Process defined for them, at a minimum percentage of fifty percent (50%).

9.207. Additionally, Article 2 of Implementing Order No. 236, of 15 July 2015, states in relevant part that:

> The activities or operations inherent to the production steps described in Article 1, except for one, may be performed by third-parties, provided the Basic Production Process is complied with.

9.208. The Panel considers that at least step I, with paragraph 1, by virtue of the application of its own PPB, involves the creation, from basic raw materials and inputs, of components or subassemblies, i.e., optical cable. Step I can be performed by third parties. That is, the accredited producer of CONNECTORIZED OPTICAL CABLES can outsource this step and retain the tax benefits in question so long as the requirements of the step (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.209. Implementing Order No. 287, of 11 November 2014[1700], Article 1 states in relevant part that:

> To establish following Basic Production Process for the product NON-VOLATILE DATA STORAGE UNIT, IN SEMICONDUCTOR MEDIA, produced in the Country:
>
> I - assembly and welding of all components in printed circuit boards;
>
> II - molding, encapsulation or plastic injection of plastic parts of external cabinet, as applicable;
>
> III - assembly of electrical and mechanical parts, completely unbundled, at basic component level;
>
> IV - final integration of product, assembled according to previous sections; and
>
> V - formatting, installation of residing computer programs and final tests, as applicable.
>
> Paragraph 1 Provided the Basic Production Process is complied with, the activities or operations inherent to production steps may be performed by third-parties, except for the steps contained in sections IV and V, which shall not be subject to outsourcing.

9.210. Additionally, Article 3 of Implementing Order No. 287, of November 11, 2014, states in relevant part that:

> Integrated circuits or microchips of non-volatile-memory type, used in the assembly of printed circuit boards of product referred to in article 1 shall comply with the relevant

[1700] Implementing Order 287/2014, (Exhibit BRA-116).

Basic Production Process, according to production percentages in the calendar year, as follows:

I - from January 1st, 2013 to December 31, 2014: zero percent (0%); and

II - as of January 1st 2015: forty percent (40%).

9.211. The Panel considers that steps I to III of Article I involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Article 3 for compliance with Article 1 on the basis of an own PPB), as follows: step I - printed circuit boards; step II - plastic parts of external cabinet; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of NON-VOLATILE DATA STORAGE UNITS, IN SEMICONDUCTOR MEDIA can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.212. More precisely with respect to the own PPB in Article 3, at least 40% of the integrated circuits or microchips of non-volatile-memory type used in the assembly of NON-VOLATILE DATA STORAGE UNITS, IN SEMICONDUCTOR MEDIA must be produced in accordance with their own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of NON-VOLATILE DATA STORAGE UNITS, IN SEMICONDUCTOR MEDIA outsources the referenced microchips, it can only retain the tax benefits in question if a portion of those microchips are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.213. Implementing Order No. 323 of 31 December 2014[1701], Article 1 states in relevant part that:

The Basic Production Process for the product PORTABLE TERMINAL OF CELLULAR TELEPHONE produced in the Country, established by MDIC/MCTI Implementing Order No. 306 of December 28, 2012, should be as follows:

I - assembly and welding of all components on printed circuit boards, at minimum percentage of 85%;

II - manufacturing of charger according to its respective Basic Production Process, at minimum percentage of 85%;

III – manufacturing of battery according to its respective Basic Production Process, at minimum percentage of 60%;

IV – manufacturing of MicroSD Card (Secure Digital) and MicroSDHC Card (Secure Digital High Capacity), according to relevant Basic Production Process, when accompanying cellular telephones, according to following schedule:

2014	2015	2016	From 2017 on
10%	20%	40%	50

V – manufacturing of memory integrated circuits, according to their respective Basic Production Process and following schedule:

2014	2015	2016	From 2017 on
5%	25%	40%	50%

[1701] Implementing Order 323/2014, (Exhibit BRA-116).

> VI – manufacturing of data cable according to the terms and percentages set forth in Basic Production Process for "static converter with electronic control, provided it is based on digital technique (NCM: 8504.40), used as continuous current converter (AC/CC) or battery charger for cellular telephone", when they are not manufactured with charger, according to Section II of this Article; and
>
> VII – integration of printed circuit boards, subassemblies and electrical and mechanical parts to form the final product.
>
> …
>
> Paragraph 2 In order to comply with provisions of this article, the use of subassemblies from third-parties in the Country is allowed, provided their production complies with the Basic Production Process established in sections I to VII of this article.

9.214. The Panel considers that steps I to VI involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; step II, by virtue of the application of its own PPB to at least 85% of production - chargers; step III, by virtue of the application of its own PPB to at least 60% of production - chargers; step IV, by virtue of the application of its own PPB in accordance with a phased schedule - MicroSD Card (Secure Digital) and MicroSDHC Card (Secure Digital High Capacity); step V, by virtue of the application of its own PPB in accordance with a phased schedule - memory integrated circuits; and step VI, by virtue of the application of its own PPB and subject to certain other specific conditions - data cables. Pursuant to paragraph 2, Steps I to VI can be performed by third parties. That is, the accredited producer of PORTABLE TERMINAL OF CELLULAR TELEPHONE can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs, for the most part on the basis of their own PPBs) are respected.

9.215. Implementing Order No. 325, of 31 December 2014[1702], Article 1 states in relevant part:

> The Basic Productive Process for the product MAGNETIC RESONANCE IMAGING EQUIPMENT, as established by MDIC/MCT Implementing Order No. 28, of February 10, 2012, should be as follows:
>
> I - magneto assembly, according to following steps:
>
> a) installation of studs and fixation of frontal and back rings on magneto body;
> b) installation of gradient coil on magneto;
> c) installation of mechanic support for fixation of main magneto cabling;
> d) installation of top cover supports;
> e) assembly of power bus between magneto and gradient coil – fixation of supports, screws and insulators;
> f) installation of interface for receiver antennas of magneto signal;
> g) assembly of resistive load assembly for circuits of radio frequency transmission (printed circuit board with electric and electronic components assembled with sink) in magneto support, and connections; and
> h) installation of supports for cable fixation, bridge support brackets (or magneto table support) and connection of suppression filter and its connections.
>
> II - installation of bridge assembly (or magneto table support) in the internal part of equipment;
>
> III - supply of assembled magneto with appropriate coolant;

[1702] Implementing Order 325/2014, (Exhibit BRA-116).

> IV - installation of computer programs for equipment configuration and operation; and
>
> V - test and final packaging of product.
>
> Paragraph 1 Outsourcing is allowed only for the step contained in section V, and other steps shall be performed by the manufacturing company that has tax incentives provided for in Law No. 8,248 of 1991.

9.216. Additionally, Article 2 of Implementing Order No. 325, of December 31, 2014, states in relevant part that:

> When the MAGNETIC RESONANCE IMAGING EQUIPMENT is commercialized with one or more products listed in sections of this article, they should be produced in the Country, according to their respective Basic Productive Processes, as applicable:
>
> I - reconstructive computer or console computer;
>
> II - computer cabinet (metallic rack);
>
> III - transformer with 200 to 480 Volt output;
>
> IV - voltage stabilizer;
>
> V - printer for printing reports and images in paper; and
>
> VI - printer for printing examinations in special film.

9.217. Article 3 states in relevant part that:

> As of August 1st, 2012, refrigeration equipment (chiller) should be produced in the Country, in case it is commercialized together with the MAGNETIC RESONANCE IMAGING EQUIPMENT.

9.218. Article 4 states in relevant part that:

> As of January 1st, 2013, the system for distribution and control of high voltage energy used by the magnetic resonance imaging equipment should be produced in compliance with its respective Basic Productive Process, as applicable.

9.219. The Panel notes that at least step I involves the creation, from basic raw materials and inputs, of components or subassemblies, i.e., magnetos. Although step I cannot be performed by third parties, other outsourcing provisions apply.

9.220. First, Article 2 requires that, when the MAGNETIC RESONANCE IMAGING EQUIPMENT is commercialized with: reconstructive computer or console computers; computer cabinets (metallic rack); transformers with 200 to 480 Volt output; voltage stabilizers; printers for printing reports and images in paper and/or printer for printing examinations in special film; these components and subassemblies be produced in accordance with their own PPBs. Similarly, Article 4 requires that the system for distribution and control of high voltage energy used by the MAGNETIC RESONANCE IMAGING EQUIPMENT should be produced in compliance with its own PPB.

9.221. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of MAGNETIC RESONANCE IMAGING EQUIPMENT outsources the items listed in Articles 3 and 4, it can only retain the tax benefits in question if those items are produced in Brazil in accordance with their own PPBs, and thus are domestic products.

9.222. Furthermore, Article 3 states that refrigeration equipment (chiller) commercialized together with the MAGNETIC RESONANCE IMAGING EQUIPMENT be produced in Brazil. Therefore, where the accredited producer of MAGNETIC RESONANCE IMAGING EQUIPMENT outsources the referenced equipment, it can only retain the tax benefits in question if that equipment is produced in Brazil.

9.223. Interministerial Implementing Order No. 16 of 28 January 2014[1703], Article 1 states in relevant part that:

> Establishes the following Basic Production Process for MACHINES FOR SELECTING AND COUNTING PAPER MONEY (BANK NOTES), produced in Brazil:
>
> I - injection of the housing's plastic parts;
>
> II - stamping of the housing's metal parts, when applicable;
>
> III - manufacture of the power source, in accordance with the respective Basic Production Process (PPB);
>
> IV - assembly and soldering of all components on the printed circuit boards;
>
> V - assembly of the electrical and mechanical parts, totally separate, at a basic component level;
>
> VI - use of power cord produced in accordance with the specific PPB in the Manaus Industrial Centre, or from the drawing and annealing of its wires, in other regions of national territory;
>
> VII - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, assembled in accordance with indents IV and V above; and
>
> VIII - tests (voltage/dielectric strength, insulation resistance and leakage current).
>
> …
>
> § 3 With the exception of stages VII and VIII, all others may be outsourced to third parties in other regions of the country, fully observing the respective Basic Production Processes.

9.224. The Panel considers that steps I to VI involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I – plastic parts; step II - metal parts; step III – power source (on the basis of their own PPB); step IV - printed circuit boards; step V - electrical and mechanical parts; and step VI - power cord produced in accordance with the specific PPB. Steps I to VI can be performed by third parties. That is, the accredited producer of MACHINES FOR SELECTING AND COUNTING PAPER MONEY (BANK NOTES) can outsource this step and retain the tax benefits in question so long as the requirements of the step (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1703] Implementing Order 325/2014, (Exhibit JE-24).

9.225. Interministerial Implementing Order No. 17, of 28 January 2014[1704], Article 1 states in relevant part that:

> The Basic Production Processes for SEMICONDUCTOR COMPONENTS, OPTOELECTRONIC DEVICES, THICK AND THIN FILM COMPONENTS, PHOTOVOLTAIC CELLS and STANDARD VOLATILE MEMORY MODULES, produced in Brazil, established through Interministerial Implementing Order MCT/MICT No 201 of 13 November 2007, shall now observe the following Articles.
>
> Article 2 SEMICONDUCTOR COMPONENTS AND OPTOELECTRONIC DEVICES:
>
> I - wafer cutting;
>
> II - assembly and fastening of the non-encapsulated chip (die);
>
> III - soldering of the wires or solder contacts on the substrate;
>
> IV - moulding or encapsulation of the assembled chip;
>
> V - cutting or fastening of spheres for components with BGA (Ball Grid Array) or FBGA (Fine Ball Grid Array) encapsulation, when applicable;
>
> VI - tinning and folding of components with TSOP (Thin Small-Outline Packages) encapsulation or similar, when applicable;
>
> VII - cutting or making into single units, when applicable;
>
> VIII - electrical, functional and characterisation tests (trials) or optoelectronic tests; and
>
> IX - marking (identification).
>
> Article 3 THICK AND THIN FILM COMPONENTS:
>
> I - physical-chemical processing on the substrate;
>
> II - assembly of the components on the substrate, when applicable;
>
> III - electrical or optoelectronic test (trial); and
>
> IV - marking (identification).
>
> Article 4 PHOTOVOLTAIC CELLS:
>
> I - physical-chemical processing in the diffusion, texturing and metallisation stages;
>
> II - wafer cutting; and
>
> III - test (trial).

9.226. Article 5 of Interministerial Implementing Order No. 17 establishes the following production-step requirements for "STANDARD VOLATILE MEMORY MODULES":

> I - wafer cutting;
>
> II - assembly and fastening of the non-encapsulated chip (die);

[1704] Interministerial Implementing Order 17/2014, (Exhibit JE-25).

III - soldering of the wires or solder contacts on the substrate;

IV - moulding or encapsulation of the assembled chip;

V - cutting or fastening of spheres for components with BGA (Ball Grid Array) or FBGA (Fine Ball Grid Array) encapsulation, when applicable;

VI - tinning and folding of components with TSOP (Thin Small-Outline Packages) encapsulation or similar, when applicable;

VII - cutting or making into single units, when applicable;

VIII - electrical, functional and characterisation tests (trials); and

IX - marking (identification)

X - assembly and soldering of components on the printed circuit boards;

XI - recording of Electrically Erasable Programmable Read-Only Memory - EEPROM type memories or of the controlling integrated circuits; and

XII - electrical and functional tests and labelling to identify the modules, when applicable.

§ 1 The stages set out in indents I to X of this Article may be exempted by up to 2% of the total of STANDARD VOLATILE MEMORY MODULES produced in the calendar year.

§ 2 Up to 20% of imported monolithic integrated circuits of the Random Access Memory - RAM type may be used in the local assembly of STANDARD VOLATILE MEMORY MODULES produced in the calendar year.

9.227. The Panel notes that pursuant to paragraph 2 of Article 5, the accredited producer of STANDARD VOLATILE MEMORY MODULES is permitted to use up to 20% of imported monolithic integrated circuits of the random access memory (RAM) type, meaning both that outsourcing of these integrated circuits is permitted, and that where such outsourcing is used, at least some portion of the referenced printed circuits must be domestic. That is, the accredited producer of STANDARD VOLATILE MEMORY MODULES can outsource the referenced integrated circuits and retain the tax benefits in question so long as a portion of those integrated circuits is made in Brazil.

9.228. Interministerial Implementing Order No. 19, of 28 January 2014[1705], Article 1 states in relevant part that:

Sets out the following Basic Production Process for FIXED X-RAY MACHINES WITH IMAGE ACQUISITION VIA FLAT DIGITAL DETECTOR, produced in Brazil:

I - assembly of the X-ray detectors in accordance with their respective Basic Production Process;

II - assembly and soldering of all components on the printed circuit board(s) which are contained in the main equipment and which employ the following functions:

a) control and activation of X-rays;
b) control and activation of movements, when applicable;
c) control interfaces and signal transmission; and

[1705] Interministerial Implementing Order 19/2014, (Exhibit JE-26).

d) power feed and distribution.

III - assembly and connections from high tension generator which feeds X-ray tube;

IV - mounting and fixing of tube support;

V - mounting and connection of X-ray tube to tube support;

VI - mounting and connection of collimator to X-ray tube;

VII - mounting and fixing of cover on base of examination table;

VIII - mounting and fixing of chassis support and digital detector on the support bucky table with integrated column tube stand;

IX - mounting and fixing of digital detector to the table and column, when applicable;

X - mounting and fixing of control module, when applicable;

XI - electrical and radiation safety tests, including grounding impedance test, leakage current, dielectric strength;

XII - alignment of the collimator light field with the X-ray field;

XIII - installation of operating and processing software;

XIV- functioning, calibration, performance and reliability tests; and

XV- packaging.

§ 1 Provided that the Basic Production Process is complied with, only the stages set out in indents I, II and XV may be carried out by third parties. All other stages shall be carried out by the manufacturer, except in cases where outsourcing forms part of the technology transfer project to companies installed in Brazil.

9.229. Additionally, Article 2 of Interministerial Implementing Order No. 19, of 28 January 2014, states in relevant part that:

When FIXED X-RAY MACHINES WITH IMAGE ACQUISITION VIA FLAT DIGITAL DETECTOR are sold with one or more products set out in this Article, such machines shall be produced in the country, in accordance with their respective Basic Production Processes or in compliance with MERCOSUL rules of origin, fully observing the following schedule, when applicable:

I - from 1 July 2015:

a) mechanical assembly for vertical bucky stand; and

b) mechanical assembly to support tube and examination table, when applicable.

II - from 1 January 2016:

a) reconstruction computer or console computer; and

b) high tension generator.

III - from 1 January 2017:

a) monitor; and

b) image and signal processing software.

§ 1 Provided that the Basic Production Process is complied with, the parts, pieces, components, accessories and software set out in indents I, II and III may be produced by third parties, as long as where such outsourcing forms part of the technology transfer project to companies installed in Brazil, when applicable.

9.230. The Panel considers that at least steps I and II of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies: step I, in accordance with its own PPB - X ray detectors; and step II - printed circuit boards. Pursuant paragraph 1 of Article 1, steps I to II can be performed by third parties. That is, the accredited producer of FIXED X-RAY MACHINES WITH IMAGE ACQUISITION VIA FLAT DIGITAL DETECTOR can outsource this step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs – in the case of step I, pursuant to its own PPB) are respected.

9.231. In addition, Article 2 requires that when FIXED X-RAY MACHINES WITH IMAGE ACQUISITION VIA FLAT DIGITAL DETECTOR are sold with: vertical bucky stands; support tubes and examination tables; reconstruction computers or console computers; high tension generators; monitors; and image and signal processing software; such subassemblies and components be produced in accordance with their own PPBs.

9.232. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of FIXED X-RAY MACHINES WITH IMAGE ACQUISITION VIA FLAT DIGITAL DETECTOR outsources the referenced components and subassemblies, it can only retain the tax benefits in question if those components or subassemblies are produced in Brazil in accordance with their own PPBs, and thus are domestic products.

9.233. Interministerial Implementing Order No. 43, of 14 February 2013[1706], Article 1 states in relevant part that:

The Basic Production Process for COMPUTER PRODUCTS produced in Brazil, established by Interministerial Implementing Order MDIC/MCTI No 161 of 27 June 2012, shall now read as follows:

I - assembly and soldering of all components on the printed circuit boards;

II - assembly of the electrical and mechanical parts, totally separated, at a basic component level; and

III - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, assembled in accordance with indents I and II above;

§ 1 Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties in the country, except with regard to the step set out in indent III which may not be conducted by third parties.

§ 4 As of 1 January 2013, POWER SOURCES, DIRECT CURRENT CONVERTERS (AC-DC) OR BATTERY CHARGERS, when they are external or when they are incorporated in the same body or housing of a COMPUTER PRODUCT, shall be produced in

[1706] Interministerial Implementing Order 43/2013, (Exhibit JE-27).

> accordance with the stages set out in the header paragraph to this Article, at a minimum of 80% of the total produced in the calendar year.

9.234. Additionally, Article 2 of Interministerial Implementing Order No. 43, of 14 February 2013 states in relevant part that:

> § 2 Communication interface boards with Wi-Fi, Bluetooth or WiMax wireless technology, intended for COMPUTER PRODUCTS, shall comply with the following assembly schedule, based on the amount of such boards used in the calendar year:
>
> I - from 1 January 2010 to 31 December 2010: exempted.
>
> II - from 1 January 2011 to 31 December 2011: 20%;
>
> III - from 1 January 2012 to 31 December 2013: 50%; and
>
> IV - from 1 January 2014 onwards: 80%.
>
> …
>
> § 5 Video cameras or assembled printed circuit boards with electrical or electronic components which carry out video camera function used in the production of AUTOMATIC DIGITAL MACHINES FOR DATA PROCESSING WITH SCREEN INCORPORATED - 'ALL IN ONE', shall comply with the following schedule:
>
> I - for the period prior to 16 February 2012: exempted; and
>
> II - for the period after 16 February 2012: It shall follow the specific Basic Production Process established in Interministerial Implementing Order.

9.235. Also, Article 3 of Interministerial Implementing Order No. 43, of 14 February 2013, states in relevant part that:

> The assembled printed circuit boards with electrical or electronic components referred to as High-Speed WAN Interface Cards (HWIC) used exclusively in DIGITAL ROUTERS for wireless networks, and which carry out the function described in the Sole Paragraph, shall be assembled in accordance with the following schedule:
>
> I - from 1 July 2012 to 31 December 2012: exempted;
>
> II - from 1 January 2013 to 31 December 2013: 40%; and
>
> III - from 1 January 2014 onwards: 90%.

9.236. Further, Article 4 of Interministerial Implementing Order No. 43, of 14 February 2013, states in relevant part that:

> Assembled printed circuit boards with electrical or electronic components consisting of digital signal processing (DSP) module for voice and video with capacity equal to or greater than 16 channels, high density (PVDM), specifically for assembly in a DIMM-240 socket, used exclusively in DIGITAL ROUTERS for wireless networks, shall be assembled in accordance with the following schedule:
>
> I - from 1 July 2012 to 31 December 2012: exempted;
>
> II - from 1 January 2013 to 31 December 2013: 40%; and
>
> III – from 1 January 2014 onwards: 90%.

9.237. Article 5 of Interministerial Implementing Order No. 43 of 14 February 2013 states in relevant part that:

> POWER SOURCES used in: DIGITAL ROUTERS for wireless networks; SWITCHES; IP TERMINALS FOR THE TRANSMISSION AND RECEPTION OF VOICE/DATA (IP TELEPHONES); ANALOGICAL TELEPHONE ADAPTERS FOR IP NETWORKS (ATA); and MODULATORS/DEMODULATORS (ADSL), shall be assembled in accordance with the following schedule:
>
> I - from 1 January 2013 to 31 December 2013: 30%; and
>
> II - from 1 January 2014 onwards: 80%.

9.238. The Panel considers that steps I and II of Article 1 involve the creation, from basic raw materials and inputs, of the following components or subassemblies (subject to the minimum percentages in paragraph 4 of Article 1, and in Articles 2, 3, 4 and 5 from compliance with Article 1 on the basis of the production step requirements or own PPBs), as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the accredited producer of COMPUTER PRODUCTS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.239. More precisely with respect to the own PPB in paragraph 5 of Article 2, video cameras or assembled printed circuit boards with electrical or electronic components which carry out video camera function used in the production of AUTOMATIC DIGITAL MACHINES FOR DATA PROCESSING WITH SCREEN INCORPORATED - 'ALL IN ONE' must be produced in accordance with their own PPB.

9.240. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1707] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of AUTOMATIC DIGITAL MACHINES FOR DATA PROCESSING WITH SCREEN INCORPORATED - 'ALL IN ONE' outsources the video cameras or assembled printed circuit boards with electrical or electronic components which carry out video camera function, it can only retain the tax benefits in question if those items are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.241. Implementing Order No. 80, of 14 April 2014[1708], Article 1 states in relevant part that:

> The Basic Production Process for LOW CAPACITY DIGITAL PROCESSING UNITS, BASED ON MICROPROCESSORS AND ASSEMBLED ON A SINGLE BODY OR HOUSING (MCN: 8471.50.10), developed in Brazil, set out in Interministerial Implementing Order MDIC/MCTI No 51 of 20 February 2013, shall now be worded as follows:
>
> I - assembly and soldering of all components on the printed circuit boards;
>
> II - assembly of the electrical and mechanical parts, totally separate, at a basic component level, except the housing, fully observing the provisions of indent III;
>
> III - assembly of the housing at a basic component level or from its basic structures separated into at least five parts, in accordance with the understanding established in §§ 1, 2, 3 of this Article; and

[1707] See footnote 1619 above.
[1708] Implementing Order 80/2014, (Exhibit JE-29).

> IV - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product.
>
> …
>
> § 3 Provided that the Basic Production Process set out in this Implementing Order is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stages set out in indent IV, which may not be conducted by third parties.

9.242. Additionally, Article 3 of Implementing Order No. 80, of 14 April 2014, states in relevant part that:

> Communication interface boards with Wi-Fi, Bluetooth or WiMax technology, intended for LOW CAPACITY DIGITAL PROCESSING UNITS, shall comply with the following assembly schedule, based on the amount of such boards used in a calendar year:
>
> I - from 1 January 2012 to 31 December 2013: 50%; and
>
> II - from 1 January 2014 onwards: 80%.

9.243. Also, Article 4 of Implementing Order No. 80, of 14 April 2014, states in relevant part that:

> The LOW CAPACITY DIGITAL PROCESSING UNITS shall use a minimum of two of the following five options, manufactured in accordance with the respective Basic Production Process, when applicable, with a total minimum of 60%, broken down between the options chosen, with each option chosen limited to a maximum of 30% for purposes of compliance with the PPB, of the total amount of the respective components used in the LOW CAPACITY DIGITAL PROCESSING UNITS produced and sold with tax incentives by the company in the calendar year:
>
> I - housings;
>
> II - magnetic disk units;
>
> III - power sources;
>
> IV - printed circuits (for the mother board); and
>
> V - label with radio-frequency identification (RFID).

9.244. Further, Article 5 of Implementing Order No. 80, of 14 April 2014, states in relevant part that:

> For compliance with the provisions of Article 1 the following percentages and schedules for the assembly in the country and use of components, parts and pieces are hereby established, when applicable, based on the amount used in the calendar year:
>
> I - assembled printed circuit boards with electrical or electronic components which employ memory functions (RAM modules):

Calendar-year	2013	2014	2015	2016 onwards
Produced in accordance with the specific PPB	30%	50%	60%	80%
Assembled in Brazil	60%	40%	30%	10%
Totals produced in Brazil	90%	90%	90%	90%

II - other components, parts and pieces which act with memory function, whether as integrated circuits or as modules or boards, as specified below, when applicable:

a) DRAM or LPDRAM integrated circuit components;

b) Nand Flash integrated circuit components; and

c) Solid State Drives (SSD).

Calendar-year	2013	2014	2015	2016 onwards
Minimum percentage required with specific PPB	30%	50%	60%	80%

9.245. The Panel considers that steps I to III of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Articles 3, 4 and 5 for compliance with Article 1 on the basis of the production step requirements or own PPBs), as follows: step 1 - printed circuit boards; step II - electrical and mechanical parts; and step III housing. Steps I to III can be performed by third parties. That is, the accredited producer of LOW CAPACITY DIGITAL PROCESSING UNITS, BASED ON MICROPROCESSORS AND ASSEMBLED ON A SINGLE BODY OR HOUSING can outsource this step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.246. More precisely with respect to the own PPBs in Article 4, a specified minimum percentage of two of the following five products: housings, magnetic disk units, power sources, printed circuits (for the mother board) and label with radio-frequency identification (RFID) must be produced in a specific percentage in accordance with their own PPBs. Similarly, Article 5 requires that a specific percentage of DRAM or LPDRAM integrated circuit components, Nand Flash integrated circuit components and Solid State Drives (SSD) be produced in accordance with their own PPBs.

9.247. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1709] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of LOW CAPACITY DIGITAL PROCESSING UNITS outsources the referenced components or subassemblies to be incorporated, that producer can only retain the tax benefits in question if a portion of those components and sub-assemblies are produced in Brazil in accordance with their own PPBs, and thus are domestic products.

9.248. Implementing Order No. 85, of 29 April 2014[1710], Article 1 states in relevant part that:

The Basic Production Process for DIGITAL PROCESSING UNITS ASSEMBLED IN A SINGLE BODY OR HOUSING, OF THE SERVER TYPE, developed in Brazil, set out by Interministerial Implementing Order MDIC/MCT No 46 of 20 February 2013, shall now read as follows:

I - assembly and soldering of components on the printed circuit boards which employ central processing (mother board) and memory functions, and when the mother board is of the mono-processed type, the local network boards and fax-modem shall be assembled in accordance with the schedule set out in Article 4, indent III.

II - assembly of the electrical and mechanical parts; and

[1709] See footnote 1619 above.
[1710] Implementing Order 85/2014, (Exhibit JE-30).

III - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product.

Sole Paragraph Provided that the Basic Production Process set out in this Implementing Order, is complied with, the activities or operations required in the production stages may be carried out by third parties in the country, except with regard to the step set out in indent III, which may not be conducted by third parties.

9.249. Additionally, Article 4 of Implementing Order No. 85, of 29 April 2014 states in relevant part that:

For compliance with the provisions of the header paragraph to Article 1 the following schedules are hereby established for use of components, parts and pieces produced in accordance with the respective Basic Production Processes, the percentages for which shall be set based on the total amount of the respective components used in the digital processing units of the server type, produced with incentive in the calendar year:

I - assembled printed circuit boards with electrical or electronic components which employ central processing functions (mother board):

Calendar year	2013	2014 onwards
Percentage assembled (monoprocessed)	90%	90%
Percentage assembled (multiprocessed)	20%	20%

II - assembled printed circuit boards with electrical or electronic components which employ memory functions, produced in accordance with the respective PPBs:

Calendar year	2013	2014 onwards
Percentage assembled	80%	80%

III - Network boards used in monoprocessed servers:

Calendar year	2013	2014 onwards
Network boards: Percentage assembled	80%	80%

IV - Other components, parts and pieces which act with memory function, whether as integrated circuits or as modules or boards, as specified below, when applicable:

a) DRAM or LPDRAM integrated circuit components;

Calendar year	2012	2013	2014	2015 onwards
Minimum percentage required with specific PPB	-	30%	50%	60%

b) Solid State Drives (SSD)

Calendar year	2012	2013	2014	2015	2016 onwards
Minimum percentage required with specific PPB	-	-	-	50%	60%

…

§ 11 Communication interface boards with Wi-Fi, Bluetooth or WiMax technology, intended for DIGITAL PROCESSING UNITS ASSEMBLED IN A SINGLE BODY OR HOUSING, OF THE SERVER TYPE, shall comply with the following assembly schedule, based on the amount of such boards used in a calendar year:

I - from 1 January to 31 December 2011: 20%;

II - from 1 January 2012 to 31 December 2013: 50%; and

III - from 1 January 2014 onwards: 80%.

9.250. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Article 4 for compliance with Article 1 on the basis of the production step requirements or own PPBs), as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I and II can be performed by third parties. That is, the accredited producer of DIGITAL PROCESSING UNITS ASSEMBLED IN A SINGLE BODY OR HOUSING, OF THE SERVER TYPE can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.251. More precisely with respect to the own PPBs in Article 4 a specified minimum percentage of assembled printed circuit boards with electrical or electronic components which employ central processing functions (mother board); assembled printed circuit boards with electrical or electronic components which employ memory functions; network boards used in monoprocessed servers; DRAM or LPDRAM integrated circuit components; and solid state drives (SSD) be produced in accordance with their own PPBs.

9.252. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1711] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of DIGITAL PROCESSING UNITS ASSEMBLED IN A SINGLE BODY OR HOUSING, OF THE SERVER TYPE outsources the referenced components or subassemblies, it can only retain the tax benefits in question if a portion of those components or subassemblies are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.253. Implementing Order No. 93, of 1 April 2013[1712], Article 1 states in relevant part that:

Establishes the following Basic Production Process for OPTICAL SPLICE CLOSURES:

I - manufacture of the moulds for the injection of the plastic parts;

II - injection of the plastic parts;

III - stamping of the metal parts;

IV - assembly of the air valve and closure kit sub-assemblies and base items;

V - final integration of the product; and

VI - product impermeability test.

Sole Paragraph. Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties in Brazil, except with regard to stages V and VI which may not be conducted by third parties.

9.254. The Panel considers that at least steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies: step I - moulds; step II - plastic parts; and

[1711] See footnote 1619 above.
[1712] Implementing Order 93/2013, (Exhibit JE-31).

step III - metal parts. Steps I to III can be performed by third parties. That is, the accredited producer of OPTICAL SPLICE CLOSURES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.255. Interministerial Implementing Order No. 103, of 2 April 2013[1713], Article 1 states in relevant part that:

> The Basic Production Process for PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL industrialized in Brazil, as set out in the Annex to Interministerial Implementing Order MDIC/MCT No 14 of 22 January 2007, shall now read as follows:
>
> I - stamping, cutting, folding and surface treatment of metal parts, when applicable;
>
> II - injection of the housing's plastic parts, when applicable;
>
> III - manufacture of the printed circuits from laminate;
>
> IV - assembly and soldering, or equivalent process, of all components on the printed circuit boards;
>
> V - assembly of the electrical and mechanical parts, totally separated, at a basic component level; and
>
> VI - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, in accordance with indents I to V above;
>
> § 1 Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent VI which may not be conducted by third parties.

9.256. Additionally, Article 2 of Interministerial Implementing Order No. 103, of 2 April 2013, states in relevant part that:

> 90% of the total number of Global System for Mobile Communications (GSM) communication modules used in the production of PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL as set out in the Annex to this Implementing Order shall be produced in accordance with their respective Basic Production Process in the calendar year.

9.257. The Annex states in relevant part that:

> ANNEX
>
> PRODUCTS
>
> Automobile immobiliser with transponder
>
> Automobile immobiliser by FM
>
> Automobile immobiliser by pager
>
> Automobile immobiliser with/without remote control

[1713] Interministerial Implementing Order 103/2013, (Exhibit JE-32).

Vehicle tracker without GPS and communication via satellite

Vehicle tracker with GPS and communication via satellite

Vehicle tracker without GPS and communication via satellite with flat antenna

Vehicle tracker with GPS positioning and communication via GSM/GPRS

Vehicle tracker with Location Based Service (LBS) positioning and communication via GSM/GPRS

Vehicle tracker/immobiliser with GPS and communication via mobile phone

Vehicle tracker/immobiliser with GPS and communication via radio

Vehicle tracker/immobiliser with GPS and communication via satellite

Vehicle tracker/immobiliser with GPS and communication via radio frequency

Electronic tacograph

Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via mobile phone

Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via radio

Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via satellite

Electronic tacograph with automobile tracker/immobiliser, with GPS and communication via radio frequency

Electronic tacograph with automobile tracker/immobiliser, by triangulation and communication via radio frequency

Electronic tacograph immobiliser by pager

Electronic tacograph immobiliser by FM

9.258. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metal parts; step II - plastic parts; steps III – printed circuits; step IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.259. Also, Article 2 requires that 90% of the total number of global system for mobile (GSM) communication modules used in the production of PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL be produced according to their respective Basic Production Process. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected. The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL outsources the GSM communication modules to be incorporated in the PRODUCTS FOR SPEED ALARMS, TRACKING AND CONTROL it can only retain the tax benefits in question if those modules are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.260. Interministerial Implementing Order No. 111, of 29 May 2014[1714], Article 1 states in relevant part that:

> The Basic Production Process for TABLET PCs WITH TOUCH SCREEN, produced in Brazil, set out by Interministerial Implementing Order MDIC/MCT No 53 of 20 February 2013, shall now read as follows:
>
> I - assembly and soldering of all components on the printed circuit boards which employ the functions described in the paragraphs of this Article;
>
> II - assembly of the electrical and mechanical parts, fully observing the provisions of the paragraphs of this Article; and
>
> III - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product.
>
> § 1 Provided that the Basic Production Process set out in this Implementing Order is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the steps set out in indent III, which may not be conducted by third parties.
>
> …
>
> § 4 For compliance with the provisions of the header paragraph to this Article, the following schedules are hereby established for the use of components, parts and pieces produced in accordance with the respective Basic Production Processes, the percentages for which shall be established based on the total amount of the respective components used in the 'TABLET PC', produced in accordance with the PPB and sold with the tax incentives set out in Decree No 5.906 of 26 September 2006, in the calendar year, taking into account the provisions of Article 2:
>
> I - assembled printed circuit boards with electrical or electronic components which employ central processing functions (mother board):

Calendar Year	2012	2013 onwards
Percentage	80%	90%

> II - assembled printed circuit boards with electrical or electronic components which employ the access function to wireless communication networks, when applicable

Calendar Year	2013	2014 onwards
Percentage	50%	80%

> III - communication boards which provide access to the mobile network, when applicable:

Calendar Year	2013	2014 onwards
Percentage	20%	30%

[1714] Interministerial Implementing Order 111/2014, (Exhibit JE-33).

IV - AC/DC battery chargers or converters:

Calendar Year	2013 onwards
Percentage	80%

V - other components, parts and pieces which act with memory function, whether as integrated circuits or as modules or boards, as specified below, when applicable:

a) Nand Flash integrated circuit components;

b) DRAM or LPDRAM integrated circuit components;

c) eMMC (Multi Media Card) components/ PPN (Perfect Page Nand); and

d) uSD memory card, when accompanying the tablet.

Calendar Year	2013	2014	2015	2016 onwards
Minimum percentage required with specific PPB	30%	40%	50%	60%

VI - Battery:

Calendar Year	2014	2015	2016 onwards
Percentage	10%	20%	30%

9.261. The Panel considers that steps I to II of the header paragraph of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in paragraph 4 of Article 1 for compliance with the header paragraph on the basis of the production step requirements or own PPBs), as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the accredited producer of TABLET PCs WITH TOUCH SCREEN can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.262. More precisely with respect to the own PPBs in paragraph 4 of Article 1, specified minimum percentages of assembled printed circuit boards with electrical or electronic components which employ central processing functions (mother board); assembled printed circuit boards with electrical or electronic components which employ the access function to wireless communication networks; communication boards which provide access to the mobile network, when applicable; AC/DC battery chargers or converters; Nand Flash integrated circuit components; DRAM or LPDRAM integrated circuit components; eMMC (Multi Media Card) components/ PPN (Perfect Page Nand); uSD memory card, when accompanying the tablet; and batteries; be produced in accordance with their own PPBs.

9.263. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1715] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of TABLET PCs WITH TOUCH SCREEN outsources the referenced components or subassemblies, it can only retain the tax benefits in question if a portion of those components or subassemblies are produced in Brazil in accordance with their own PPB, and thus are domestic products.

[1715] See footnote 1619 above

9.264. Interministerial Implementing Order No. 119, of 23 April 2013[1716], Article 1 states in relevant part that:

> The following Basic Production Process is hereby established for FIXED/PORTABLE DIGITAL ELECTRICAL SIGNALLING APPARATUS TO CONTROL MOTOR VEHICLE TRAFFIC, industrialized in Brazil:
>
> I - plastics injection of the side covers;
>
> II - moulding of the chamber front protection, chamber rear protection, armoured cover for the scope and protection for the battery support;
>
> III - manufacture of the tripod;
>
> IV - manufacture of the support for mounting the equipment on the tripod;
>
> V - manufacture of the transport case;
>
> VI - manufacture of the battery charger;
>
> VII - integration of the battery and trigger assemblies into the housing;
>
> VIII - integration of the electro-optical-mechanical assembly (capture, reading and image processing) into the housing;
>
> IX - integration of the rear panel assembly;
>
> X - electrical connections;
>
> XI - closure;
>
> XII - placing of the focus/brightness adjustment lens;
>
> XIII - placing of the battery;
>
> XIV - tests; and
>
> XV - integration of the rubber protections.
>
> § 1. Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stages set out in indents VII to XV which may not be conducted by third parties.

9.265. The Panel considers that steps I to VI involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - side covers; step II - chamber front protection, chamber rear protection, and armoured cover for the scope and protection for the battery support; step III - tripod; step IV - support for mounting the equipment on the tripod; step V - transport case; and step VI - battery charger. Steps I to VI can be performed by third parties. That is, the accredited producer of FIXED/PORTABLE DIGITAL ELECTRICAL SIGNALLING APPARATUS TO CONTROL MOTOR VEHICLE TRAFFIC can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

[1716] Interministerial Implementing Order 119/2013, (Exhibit JE-34).

9.266. Interministerial Implementing Order No. 203, of 23 August 2012[1717], Article 1 states in relevant part that:

> The Basic Production Process for LIQUID CRYSTAL DEVICES FOR PRODUCTS WITH MCN code: 8528 and FOR PRODUCTS WITH MCN code: 471, established by Interministerial Implementing Order MDIC/MCT No 189 of 19 July 2011, shall now read as follows:
>
> I - manufacture of the polarised glass cell;
>
> II - plastic injection of the polarised glass frame, when applicable;
>
> III - metal stamping, plastics injection or moulding of the base and frame, as applicable;
>
> IV - assembly and soldering of components on the printed circuit boards;
>
> V - assembly of the electrical and mechanical parts, totally separated, at a basic component level;
>
> VI - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the LIQUID CRYSTAL DEVICE, assembled in accordance with indents IV and V; and
>
> VII - adjustments and calibration.
>
> Sole Paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stages set out in indents VI and VII, which may not be conducted by third parties.

9.267. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - polarised glass cell; step II - polarised glass frame; step III - base and frame; step IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of LIQUID CRYSTAL DEVICES FOR PRODUCTS WITH MCN code: 8528 and FOR PRODUCTS WITH MCN code: 471 can outsource these step and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.268. Interministerial Implementing Order No. 268, of 30 August 2013[1718], states in relevant part that:

> Article 1. The Basic Production Processes for SUPPLIES FOR MULTI-FUNCTIONAL PHOTOCOPIER MACHINES AND LASER PRINTERS (MCN - 8443.31 AND 8443.32), established by Interministerial Implementing Order MDIC/MCT No 61 of 28 February 2012, shall now incorporate the following Articles.
>
> Article 2 The Basic Production Process for TONER:
>
> I - mixing, plastification and homogenising of raw materials;
>
> II - grinding (preparatory mechanical break down for the micronization stage);
>
> III - micronization (fine grinding to obtain powder);

[1717] Interministerial Implementing Order 203/2012, (Exhibit JE-35).
[1718] Interministerial Implementing Order 268/2013, (Exhibit JE-37).

IV - additivation (incorporation of external additives: lubricants or load modifiers);

V - screening (separation of powder into fractions);

VI - plastics injection of the toner container or recipient; and

VII - filling (volumetric or gravimetric filling of containers or recipients with toner).

Sole Paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent VII, which may not be conducted by third parties.

9.269. Article 3 The Basic Production Process for DEVELOPER:

I - coating of different nuclei by applying an isolating layer or additivation;

II - mixing with toner (joining of toner particles to coated nuclei);

III - screening (mechanical separation from agglomerator); and

IV - filling (volumetric or gravimetric dosage of containers or recipients with developer).

Sole Paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent IV, which may not be conducted by third parties.

9.270. Article 4 The Basic Production Process for TONER SETS, DEVELOPER SETS AND TONER AND DEVELOPER SETS:

I - plastics injection, moulding or blow moulding of toner containers or recipients;

II - assembly of the following components: foam and/or sealing felt, toner dosage foam rolls, magnetic rolls, scraper blades, cross mixers, electronic toner density sensors, electrical polarising system, activating gears and bushes, dosage blades, cleaning blades, organic drum cylinders, stoppers, seals, etc, when applicable;

III - filling and sealing of cartridges; and

IV - closing of cartridges or containers.

§ 1 Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stages set out in indents III and IV which may not be conducted by third parties.

9.271. Article 5 The Basic Production Process for CYLINDERS WITH PHOTOSENSITIVE ALLOY

I - plating of the photosensitive layer on the prepared cylinder; and

II - assembly of the parts and pieces, totally separated, at a basic component level, when applicable.

Sole Paragraph Provided that the Basic Production Process is complied with, the activity described in indent I may be carried out by third parties, except with regard to the stage set out in indent II, which may not be conducted by third parties.

9.272. Article 6 The Basic Production Process for ORGANIC DRUM ASSEMBLIES:

I - incorporation of the organic layer on the prepared cylinder, through immersion or painting; and

II - assembly of the plastic or metal parts and pieces, totally separated, at a basic component level;

Sole Paragraph Provided that the Basic Production Process is complied with, the activity described in indent I may be carried out by third parties, except with regard to the stage set out in indent II, which may not be conducted by third parties.

9.273. Article 7 The Basic Production Process for FLEXIBLE ORGANIC DRUM ASSEMBLIES:

I - cutting of the substrate;

II - soldering; and

III - assembly of all the parts and pieces, totally separated, at a basic component level;

Sole Paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent III, which may not be conducted by third parties.

9.274. Article 8 The Basic Production Process for TONER CARTRIDGES, WITH OR WITHOUT MECHANISM INCORPORATED, FOR LASER PRINTERS:

I - plastics injection, moulding or blow moulding of toner containers or recipients;

II - assembly of the following components: foam and/or sealing felt, toner dosage foam rolls, magnetic rolls, scraper blades, cross mixers, electronic toner density sensors, electrical polarising system, activating gears and bushes, dosage blades, cleaning blades, organic drum cylinders, stoppers, seals, etc, when applicable;

III - filling and sealing of cartridges; and

IV - closing of cartridges or containers.

Sole paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indents III and IV, which may not be conducted by third parties.

9.275. Article 9 The stages set out in Article 2, indents I to IV, Article 4, indent I and Article 8, indent I may be exempted provided that the company benefiting from the tax incentives invests at least an additional 1% in R&D to that laid down in legislation, as defined in Articles 11 and 12.

9.276. Article 10 The Basic Production Process for TONER CARTRIDGES, WITH OR WITHOUT MECHANISM INCORPORATED, WITH RADIO FREQUENCY IDENTIFICATION DEVICE - RFID, FOR LASER PRINTERS:

I - the manufacture of the toner cartridge consists of the following stages:

a) plastics injection, moulding or blow moulding of toner containers or recipients;

b) assembly of the following components: foam and/or sealing felt, toner dosage foam rolls, magnetic rolls, scraper blades, cross mixers, electronic toner density sensors, electrical polarising system; activating gears and bushes,

dosage blades, cleaning blades, organic drum cylinders, stoppers, seals, etc, when applicable;

c) filling and sealing of cartridges; and

d) closing of cartridges or containers.

II - manufacture of the RFID in accordance with the respective Basic Production Process; and

III - individual final packaging of the toner cartridges.

9.277. The Panel considers that at least the following steps involve the creation, from basic raw materials and inputs, of components or subassemblies: step VI of Article 2 – plastic toner containers or recipients; steps I and II of Article 4, as follows: step I – plastic toner containers or recipients; and step II – assembled toner cartridges; step I of Article 7 – cut substrate; steps I and II of Article 8, as follows: step I – plastic toner containers or recipients; and step II – assembled toner cartridges; and steps I(a), I(b) and II of Article 10, as follows: step I(a) – plastic toner containers or recipients; step I(b) – assembled toner cartridges or containers; and step II – RFIDs, by virtue of their own PPB.

9.278. These steps can be performed by third parties, as follows. The outsourcing provisions for the referenced steps in Articles 2, 4, 7 and 8 are set forth in the sole paragraphs of Articles 2, 7, and 8, and paragraph 1 of Article 4. For steps I(a) and I(b) of Article 10, given their similarity with their counterparts in Articles 4 and 8, the panel infers that although Article 10 does not contain an explicit outsourcing provision, these steps also can be outsourced. Finally, step II of Article 10 also can be outsourced, as this step requires that the components or subassemblies that it covers - RFIDs – be produced in accordance with their own PPB. The Panel notes in this regard that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1719] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products.

9.279. Therefore, where the accredited producer of products covered by Interministerial Implementing Order No. 268 outsources the components and subassemblies referred to above, it can only retain the tax benefits in question so long as the requirements of the referenced steps and/or the "nested" PPB (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.280. Interministerial Implementing Order No. 278, of 4 September 2013[1720], Article 1 states in relevant part that:

The Basic Production Process for INDUSTRIAL AUTOMATION GOODS set out in the Annex to this Implementing Order[1721], laid down by Interministerial Implementing Order MDIC/MCT No 549 of 18 December 2003, shall now be as follows:

I - stamping, cutting, folding and surface treatment of metal parts;

II - plastic injection of the housing, when applicable;

III - manufacture of the printed circuits from laminate;

[1719] See footnote 1619 above.

[1720] Interministerial Implementing Order 278/2013, (Exhibit JE-38).

[1721] The products listed in the Annex are Electronic frequency converters, for changing the speed of electrical motors; Automatic voltage regulators for activating electrical motors (Soft Starter Keys); Instruments and apparatus to regulate or control the speed of electrical motors through frequency variation; and Devices to regulate and control electrical motors (Servo converters).

IV - assembly and soldering of all components on the printed circuit boards;

V - assembly of the electrical and mechanical parts, totally separated, at a basic component level; and

VI - integration of the assembled printed circuit boards and the electrical and mechanical parts in the formation of the final product.

§ 1 Provided that the Basic Production Process set out in this Implementing Order is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the steps set out in indents V and VI, which may not be conducted by third parties.

9.281. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - metal parts; step II - housing; step III – printed circuits; step IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of INDUSTRIAL AUTOMATION GOODS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.282. Interministerial Implementing Order No. 333, of 16 October 2013[1722], Article 1 states in relevant part that:

Establishes the following Basic Production Process for SELF-SERVICE COIN COUNTING MACHINES, produced in Brazil:

I - manufacture of the following modules/sub-assemblies of the product, in accordance with their respective Basic Production Processes:

a) central processing units (CPU);
b) printers;
c) monitors;
d) relay and communication boards;
e) no-break modules; and
f) power sources.

II - manufacture of the housing, consisting of the assembly of the body, internal structure and doors at a basic input level (steel plates, glass fibre, acrylic, soldering, painting, plastic injection of the front panel, when applicable, and joining of the mechanical and plastic parts);

III - manufacture of the coin storage container: assembly of the body and door at a basic input level (steel plates, soldering and joining of the mechanical parts), when applicable;

IV - manufacture of all other mechanical structures mounted from a basic component level (steel plates, motors and plastic parts);

V - assembly and soldering of all components on the printed circuit boards;

VI - assembly of all the electrical and mechanical parts, totally separated, at a basic component level; and

VII - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product.

[1722] Interministerial Implementing Order 333/2013, (Exhibit JE-39).

> Sole Paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent VII, which may not be conducted by third parties.

9.283. The Panel considers that steps I to VI involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I, by virtue of the requirement to produce the following in accordance with their own PPBs - central processing units (CPUs), printers, monitors, relay and communication boards, no-break modules, and power sources; step II - housing; step III - coin storage containers; step IV - mechanical structures; step V - printed circuit boards; and step VI - electrical and mechanical parts. Pursuant to the sole paragraph of Article 1, steps I to VI can be performed by third parties.[1723] That is, the accredited producer of SELF-SERVICE COIN COUNTING MACHINES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs – those in step I on the basis of compliance with their own PPBs) are respected.

9.284. Interministerial Implementing Order No. 335, of 16 October 2013[1724], Article 1 states in relevant part that:

> Establishes the following Basic Production Process for DOT MATRIX PRINTERS, produced in Brazil:
>
> I - assembly and soldering of all components on the printed circuit boards;
>
> II - assembly of the electrical and mechanical parts, totally separated, at a basic component level; and
>
> III - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, assembled in accordance with indents I and II above;
>
> Sole Paragraph Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stage set out in indent III, which may not be conducted by third parties.

9.285. Additionally, Article 2 states in relevant part that:

> § 2 From 1 January 2014, a minimum of 80% of communication interface boards with wireless technology (Wi-Fi, Bluetooth, WiMax) used in DOT MATRIX PRINTERS shall be assembled in relation to the total amount of such boards used in the calendar year.

9.286. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentage set forth in paragraph 2 of Article 2 for compliance with the production step requirements in Article 1), as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the accredited producer of DOT MATRIX PRINTERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.287. Interministerial Implementing Order No. 382, of 30 December 2013[1725], Article 1 states in relevant part that:

[1723] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in Article 1.
[1724] Interministerial Implementing Order 335/2013, (Exhibit JE-40).

As of 1 July 2013, the Basic Production Process for SELF-SERVICE MACHINES AND TERMINALS AND AUTOMATIC TICKET, BANKNOTE OR COIN DISPENSERS produced in Brazil, established by Interministerial Implementing Order MDIC/MCTI No 41 of 14 February 2013, shall now read as follows:

I - assembly and soldering of all components on the printed circuit boards and the assembly of the electrical and mechanical parts, totally separated, at a basic component level, of the following product modules:

a) ticket and banknote dispensers, when applicable;
b) central processing units (CPU), which shall comply with the respective Basic Production Process;
c) safe: manufacture/assembly of the body and door at a basic input level (steel plates, welding and joining of the mechanical parts), when applicable;
d) housing: manufacture/assembly of the body and door at a basic input level (steel plates, welding; plastics injection of the front panels of the self-service machines, terminal and dispensers, when applicable, except the parts making up the specific functional modules of the product, such as card readers and other peripherals; and the joining of the mechanical and plastic parts);
e) sensor control module, when applicable;
f) envelope deposit module, when applicable, except bar code reader;
g) delivery module for cheques and other documents, when applicable;
h) printer, which shall comply with the respective Basic Production Process;
i) monitor, which shall comply with the respective Basic Production Process;
j) envelope dispenser module, when applicable;
k) security system for detection of card cloning devices (anti-skimming modules) and other spurious objects, when applicable;
l) keyboard, when applicable; and
m) recycling mechanism, when applicable.

II - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, integrated and assembled in accordance with indent I.

§ 1 Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the step set out in indent II which may not be conducted by third parties.

…

§ 5 After time limit set out in § 4 and limited to 4 000 (four thousands) units annually per manufacturer, the recycling mechanism shall comply with the following Basic Production Process:

I - assembly and soldering of all components on the printed circuit boards which employ the function of main controller; and

II - integration of the assembled printed circuit boards and the electrical and mechanical parts in sub-assemblies, in the formation of the recycling mechanism.

§ 6 After the time limit set out in § 4 and for production which exceeds 4 000 (four thousand) units annually per manufacturer, the assembly of the recycling mechanism shall be carried out at a basic component level, except with regard to the bill validator mechanism.

9.288. Additionally, Article 2 of Interministerial Implementing Order No. 382, of 30 December 2013, states in relevant part that:

[1725] Interministerial Implementing Order 382/2013, (Exhibit JE-41).

> As of 1 July 2014, a minimum of 80% of the total number of the power sources used in SELF-SERVICE MACHINES AND TERMINALS AND AUTOMATIC TICKET, BANKNOTE OR COIN DISPENSERS shall be manufactured in the calendar year, in accordance with the production process set out in the Sole Paragraph.
>
> Sole Paragraph Power sources shall comply with the following Basic Production Process:
>
> I - assembly and soldering of all components on the printed circuit boards;
>
> II - assembly of all the electrical and mechanical parts, totally separated, at a basic component level;
>
> III - manufacture of power source transformers from coil winding;
>
> and
>
> IV - use of power cables manufactured from wire drawing and annealing, at a minimum of 90% in weight.

9.289. The Panel considers that step I of the header paragraph of Article 1 involves the creation, from basic raw materials and inputs, of components or subassemblies (subject to the transitional provisions and provisions on product coverage, in the other paragraphs of Article 1, and/or their own PPBs), as follows: printed circuit boards; electrical and mechanical parts; ticket and banknote dispensers; central processing units (CPU) in compliance with their own PPB; safes; housings; sensor control modules; envelope deposit modules; delivery modules for cheques and other documents; printers in compliance with their own PPB; monitors in compliance with their own PPB; envelope dispenser modules; security systems for detection of card cloning devices and other spurious objects; keyboards; and recycling mechanisms in compliance with their own PPB and required production steps, pursuant to paragraphs 5 and 6. Pursuant to paragraph 1, step I can be performed by third parties.[1726] That is, the accredited producer of SELF-SERVICE MACHINES AND TERMINALS AND AUTOMATIC TICKET, BANKNOTE OR COIN DISPENSERS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.290. Also, Article 2 requires that 80% of the total number of the power sources used in SELF-SERVICE MACHINES AND TERMINALS AND AUTOMATIC TICKET, BANKNOTE OR COIN DISPENSERS be manufactured in accordance with their own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1727] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of SELF-SERVICE MACHINES AND TERMINALS AND AUTOMATIC TICKET, BANKNOTE OR COIN DISPENSERS outsources the power sources, it can only retain the tax benefits in question if a portion of those power sources are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.291. Interministerial Implementing Order No. 385, of 30 December 2013[1728], Article 1 states in relevant part that:

> The following Basic Production Process is established for AIR TRAFFIC SURVEILLANCE RADAR produced in Brazil:
>
> I - cutting, bending, welding, milling, surface treatment and painting when applicable of the metal parts and pieces for electromechanical radar assemblies;

[1726] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in Article 1. See footnote 1618 above.

[1727] See footnote 1619 above.

[1728] Interministerial Implementing Order 385/2013, (Exhibit JE-42).

> II - cutting of cables and wires, crimping or welding of connectors, identification and conducting of tests on electrical and electronic wiring;
>
> III - assembly of metal housings from their basic components (parts and pieces);
>
> IV - manufacture of at least 50%, in quantity, of the printed circuits from laminates, fully observing § 2 of this Article;
>
> V - assembly and soldering of all components on the printed circuit boards;
>
> VI - assembly of the electrical and mechanical parts, totally separate, at a basic component level;
>
> VII - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, assembled in accordance with indents I to VI above;
>
> VIII - execution of the factory acceptance tests on the final product;
>
> IX - final integration and full installation of the product, at a site indicated by the client, consisting of the following activities:
>
> a) mounting of the antenna and protection radome from its basic components;
> b) installation of the radar at final local site;
> c) interconnection of the radar with the antenna, power systems and monitoring and data transmission systems;
> d) adjustments and customisation of the radar using passing flights;
> e) adjustments and final performance testing of the radar with approved flights; and
> f) execution of the final acceptance tests on the product;
>
> § 1 Provided that the Basic Production Process set out in this Implementing Order is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to those described in indents VI, VII and VIII, which may not be conducted by third parties.

9.292. In addition, Article 4 of Interministerial Implementing Order No. 385 of 30 December 2013 states in relevant part that:

> Digital processing units (industrial computers incorporated into radar) which perform digital processing and tracing functions shall be mounted, in Brazil, in accordance with their respective Basic Production Process.

9.293. The Panel considers that at least steps I to V of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step 1 - metal parts and pieces for electromechanical radar assemblies; step II - electrical and electronic wiring; step III - metal housings; step IV – printed circuits; and step V - printed circuit boards. Steps I to V can be performed by third parties. That is, the accredited producer of AIR TRAFFIC SURVEILLANCE RADARS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.294. Also, Article 4 requires that the digital processing units (industrial computers incorporated into radar) be produced in Brazil, in accordance with their own PPB. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1729] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of AIR TRAFFIC SURVEILLANCE RADARS outsources the referenced digital processing units, it can only retain the tax benefits in question if units are produced in Brazil in accordance with their own PPB, and thus are domestic products.

[1729] See footnote 1619 above.

9.295. Implementing Order No. 388, of 30 December 2013[1730], Article 1 states in relevant part that:

> The Basic Production Processes for SMART CARDS, industrialized in Brazil, established through Interministerial Implementing Order MDIC/MCTI No 36 of 10 February 2012, shall now be as follows:
>
> I - CONTACT SMART CARDS - LAMINATE
>
> a) milling of the plastic card cavity;
> b) separation and preparation of the monolithic integrated circuit module or microchip;
> c) application of the adhesive to the card cavity; and
> d) setting of the microchip module in the card.
>
> II - CONTACT SMART CARDS - INJECTED:
>
> a) plastic injection of the card;
> b) separation and preparation of the microchip module;
> c) application of the adhesive to the card cavity; and
> d) setting of the microchip module in the card.
>
> III - CONTACTLESS SMART CARDS:
>
> a) milling of the PVC sheet (forming of the shim), when applicable;
> b) printing of PVC sheets, when applicable;
> c) assembly of the microchip to the antenna; and
> d) fusion (lamination) of the shim assembly, antenna, PVC sheets and PVC crystal film.
>
> § 1 Provided that the Basic Production Processes are complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the stages set out in indents I and II, c) and d) and indent III, d) which may not be conducted by third parties.

9.296. Additionally, Article 2 of Implementing Order No. 388 of 30 December 2013 states in relevant part that:

> From 1 January 2010, the monolithic integrated circuits mentioned in Article 1, indents I, II and III shall comply with the following Basic Production Process, for a minimum of 50% of production in the calendar year.
>
> I - assembly of the non-encapsulated semiconductor wafer;
>
> II - encapsulating of the semiconductor wafer, when applicable;
>
> III - electrical or optoelectronic test (trial); and
>
> IV - marking (identification), when applicable.
>
> § 1 The monolithic integrated circuits or microchips set out in this Article may be acquired from third parties, provided that the Basic Production Process established in this Article is complied with.

9.297. The Panel considers that at least steps I(b), II(a) and (b), and III(a) of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows:

[1730] Implementing Order 388/2013, (Exhibit JE-43).

step I(b) - monolithic integrated circuit module or microchip; step II(a) - plastic card; step II(b) microchip module; and step III(a) – milled PVC shim. Steps I(b), II(a), II(b) and III(a) can be performed by third parties. That is, the accredited producer of SMART CARDS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.298. In addition, Article 2 requires that 50% of the monolithic integrated circuits used in the production of SMART CARDS be produced in accordance with their own PPB which is set forth in Article 2. The Panel notes that pursuant to paragraph 1 of Article 2, outsourcing of the monolithic integrated circuits or microchips covered by the PPB is allowed, so long as the requirements of the PPB are respected.[1731] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of SMART CARDS outsources the referenced monolithic integrated circuits or microchips, it can only retain the tax benefits in question if those integrated circuits or microchips are produced in Brazil in accordance with their own PPB, and thus are domestic products.

9.299. Interministerial Implementing Order No. 266, of 7 October 2014[1732], Article 1 states in relevant part that:

> The Basic Production Process for MAGNETIC CARD READER AND SMART CARD, CONNECTED TO THE AUDIO CHANNEL FOR MOBILE DEVICE, industrialized in the country, is the following:
>
> I - manufacturing the printed circuit board from the laminate;
>
> II - assembly and welding of all components on printed circuit boards;
>
> III - installation of electrical and mechanical parts, fully unbundled, entry-level components;
>
> IV - integration of printed circuit boards and other electrical and mechanical parts in the formation of the end product, assembled in accordance with the items "II" and "III";
>
> V - recording the cryptographic key and final tests.
>
> § 1. Since met the Basic Productive Process, activities or operations inherent to the production steps described in items I, II, III and IV may be subject to outsourcing.

9.300. The Panel considers that steps I to III involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I printed circuit boards; step II – assembled printed circuit boards; and step III - electrical and mechanical parts. Steps I to III can be performed by third parties. That is, the accredited producer of MAGNETIC CARD READERS AND SMART CARDS, CONNECTED TO THE AUDIO CHANNEL FOR MOBILE DEVICE can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.301. Interministerial Implementing Order No. 60, of 25 February 2013[1733], as amended by Interministerial Implementing Order No. 184, of 7 July 2014[1734], Article 1 states in relevant part that:

[1731] See footnote 1619 above.
[1732] Interministerial Implementing Order 266/2014, (Exhibit JE-44).
[1733] Interministerial Implementing Order 60/2013, (Exhibit JE-28).

Basic Production Process for the AUTOMATIC MACHINE FOR DIGITAL DATA PROCESSING, PORTABLE (NCM: 8471.30.12 AND 8471.30.19.) - NETBOOK, NOTEBOOK AND ULTRABOOK, industrialized in the country, established by the Interministerial Ordinance MDIC / MCTI No. 60 of February 25, 2013, shall now read as follows:

I - assembly and soldering of all components on the printed circuit boards which perform the functions of central processing and memory, fully observing the provisions of this Article;

II - assembly of the electrical and mechanical parts, fully observing the provisions of the paragraphs of this Article; and

III - integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product.

§ 1. Provided that the Basic Production Process set out in this Implementing Order is complied with, the activities or operations required in the production stages may be carried out by third parties, except with regard to the step set out in indent III, which may not be conducted by third parties.

…

§ 3. For compliance with the provisions of the header paragraph to this Article, the following schedules are hereby established for use of components, parts and pieces produced in accordance with the respective PPBs, the percentages for which shall be set based on the total amount of the respective components used in the NETBOOKS, NOTEBOOKS and ULTRABOOKS (MCN codes: 8471.30.12 and 8471.30.19), produced in the calendar year, taking into account the provisions of Articles 2 and 3:

I - assembled printed circuit boards with electrical or electronic components which perform central processing functions (mother board):

Calendar year	2013	2014 onwards
Percentage assembled	80%	90%

II - assembled printed circuit boards with electrical or electronic components which perform communication interface functions, when such interfaces are not connected to the mother board:

Calendar year	2013	2014 onwards
Percentage assembled	50%	80%

III - AC/DC battery chargers or converters:

Calendar year	2013	2014	2015 onwards
Produced in accordance with the specific PPB	45%	70%	80%

IV - batteries or charge accumulators:

Calendar year	2013	2014	2015 onwards
Produced in accordance with the specific PPB	10%	20%	30%

V- magnetic disk units, when applicable;

[1734] Interministerial Implementing Order 184/2014, (Exhibit JE-45).

Calendar year	2013	2014 onwards
Produced in accordance with the specific PPB	30%	50%

VI - assembled printed circuit boards with electrical or electronic components which perform memory functions (RAM modules):

Calendar year	2013	2014 onwards
Produced in accordance with the specific PPB	60%	80%
Assembled in Brazil	30%	10%
Totals produced in Brazil	90%	90%

VII - DRAM integrated circuits which perform RAM functions:

Calendar year	2013	2014	2015	2016 onwards
Produced in accordance with the specific PPB	0%	50%	80%	90%

VIII - Solid State Drives (SSD) of the NAND Flash type, when applicable, (whether in modules or integrated circuit):

Calendar year	2012	2013	2014 onwards
Produced in accordance with the specific PPB	40%	30%	40%
Assembled in Brazil	50%	40%	40%
Totals produced in Brazil	90%	70%	70%

IX – LPDRAM memory component, when applicable:

Calendar year	2013	2014	2015 onwards
Produced in accordance with the specific PPB	30%	50%	60%

X - eMMC memory component (embedded Multi Media Card), when applicable:

Calendar year	2014	2015	2016	2017 onwards
Produced in accordance with the specific PPB	0%	30%	40%	50%

§ 6. Communication interface boards with wireless technology (Wi-Fi, Bluetooth, WiMax, Active NFC (Near Field Communication), intended for NETBOOKS, NOTEBOOKS and ULTRABOOKS (MCN codes: 8471.30.12 and 8471.30.19), shall comply with the following assembly schedule, based on the amount of such boards used in the calendar year:

I - from 1 January 2012 to 31 December 2013: 50%; and

II - from 1 January 2014 onwards: 80%.

9.302. The Panel considers that steps I and II of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in paragraph 3 of Article 1 for production in compliance with the listed production steps, and/or their own PPBs) as follows: step I printed circuit boards; and step II - electrical and mechanical parts. Pursuant to paragraph 1 of Article 1, steps I to II can be performed by third parties.[1735] That is, the accredited producer of NETBOOKS, NOTEBOOKS and ULTRABOOKS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in

[1735] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in paragraph 3 of Article 1. See footnote 1619 above.

Brazil of the respective components and subassemblies from basic raw materials and inputs, including where respective PPBs are applicable) are respected.

9.303. More precisely in respect of Article 1, § 3 specified minimum percentages of: AC/DC battery chargers or converters; batteries or charge accumulators; magnetic disk units; assembled printed circuit boards with electrical or electronic components which perform memory functions (RAM modules); DRAM integrated circuits which perform RAM functions; Solid State Drives (SSD) of the NAND Flash type, when applicable, (whether in modules or integrated circuit); LPDRAM memory component, when applicable; and eMMC memory component (embedded Multi Media Card) used in the production of NETBOOKS, NOTEBOOKS and ULTRABOOKS must be produced in accordance with their own PPBs.

9.304. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1736] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of NETBOOKS, NOTEBOOKS and ULTRABOOKS outsources the referenced components or subassemblies, it can only retain the tax benefits in question if a portion of those components or subassemblies are produced in Brazil in accordance with their own PPBs, and thus are domestic products.

9.305. Interministerial Order No. 165, of 17 June 2014[1737], Article 1 states in relevant part that:

> The Basic Production Process (BPP) for the DIGITAL AUTOMATIC MACHINE FOR DATA PROCESSING, WITH BUILT-IN SCREEN – "ALL IN ONE", manufactured in Brazil, established by the Interministerial Order MDIC/MCTI No 47 of 20 February 2013, is replaced by the following:
>
> I – assembly and soldering of all of the component parts onto the printed circuit boards;
>
> II – assembly of electrical and mechanical parts; and
>
> III – adding of the printed circuit boards and the electrical and mechanical parts to the manufacture of the final product.
>
> Sole Paragraph. Provided that the Basic Production Process established in this Order is followed, the activities or operations inherent in the production stages may be performed by third parties, with the exception of the stage referred to in sub-paragraph III, which may not be outsourced.

9.306. Additionally, Article 2 of Interministerial Order No. 165 of 17 June 2014 states in relevant part that:

> In order to comply with the provisions of Article 1, the following percentages and timescales for manufacture in Brazil and use of components, parts and pieces, where applicable, are hereby established, based on the quantity used in the calendar year and having regard to Article 3:
>
> I – printed circuit boards assembled with electrical or electronic components that implement the central processing function (motherboard):

	Percentage
Assembled in Brazil	90 %

[1736] See footnote 1619 above.
[1737] Interministerial Order 165/2014, (Exhibit JE-66).

II – printed circuit boards assembled with electrical or electronic components that implement the communication interface function, where these are not part of the motherboard:

	Percentage
Assembled in Brazil	90 %

III – printed circuit boards assembled with electrical or electronic components that implement the communication interface function with wireless technology, in accordance with the following timescale:

Calendar year	2013	2014	from 2015 onwards
Assembled in Brazil	50 %	60 %	80 %

IV – printed circuit boards assembled with electrical or electronic components that implement the voltage source function, where these are internal, and Alternating Current and Direct Current - AC/DC converters, where these are external:

Calendar year	2013	from 2014 onwards
Produced in accordance with the specific BPP	45 %	80 %

V – power cables produced in accordance with the specific BPP or, in the absence thereof, through wire drawing and annealing, as referred to in the table below and in item § 10º:.

Calendar year	2013	2014	from 2015 onwards
Produced in accordance with the specific BPP or through wire drawing and annealing	30 %	30 %	60 %

VI – magnetic hard disk drives, where applicable:

Calendar year	2013	from 2014 onwards
Produced in accordance with the specific BPP	30%	50 %

VII – printed circuit boards assembled with electrical or electronic components that implement the memory functions (RAM):

Calendar year	2013	2014	2015	From 2016 onwards
Produced in accordance with the specific BPP	40 %	60 %	70 %	80 %
Assembled in Brazil	50 %	30 %	20 %	10 %
Total produced in Brazil	90 %	90 %	90 %	90 %

VIII – other components, parts and pieces that operate with the memory function, either as integrated circuits or as modules or boards, specified below, where applicable:

a) DRAM integrated circuit component; and

b) SSD (Solid State Drive) data module storage drive

Calendar year	2013	2014	2015	From 2016 onwards
Produced in accordance with the specific BPP	30 %	50 %	60 %	80 %

9.307. The Panel considers that steps I and II of Article 1 involve the creation, from basic raw materials and inputs, of components or subassemblies (subject to the minimum percentages in Article 2 for compliance with the production step or own PPB requirements in Article 1), as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Pursuant to Article 1, steps I and II can be performed by third parties.[1738] That is, the accredited producer of DIGITAL AUTOMATIC MACHINES FOR DATA PROCESSING, WITH BUILT-IN SCREEN – "ALL IN ONE" can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs, including, where applicable, pursuant to their own PPBs) are respected.

9.308. More precisely with respect to the own PPBs in Article 2, specified minimum percentages of some components and subassemblies (printed circuit boards assembled with electrical or electronic components that implement the central processing function (motherboard), printed circuit boards assembled with electrical or electronic components that implement the communication interface function, where these are not part of the motherboard, printed circuit boards assembled with electrical or electronic components that printed circuit boards assembled with electrical or electronic components that implement the voltage source function, where these are internal, and Alternating Current and Direct Current - AC/DC converters, where these are external; power cables; magnetic hard disk drives, where applicable; printed circuit boards assembled with electrical or electronic components that implement the memory functions (RAM); DRAM integrated circuit components and SSD (Solid State Drive) data module storage drives); for the DIGITAL AUTOMATIC MACHINES FOR DATA PROCESSING, WITH BUILT-IN SCREEN – "ALL IN ONE" must be produced in accordance with their own PPBs.

9.309. The Panel recalls that all PPBs that include any such "nested PPB" allow the outsourcing of the inputs or components covered by that PPB so long as its requirements are respected.[1739] The Panel also recalls its finding, at paragraph 7.117 of its report, that products produced in accordance with PPBs are domestic products. Therefore, where the accredited producer of DIGITAL AUTOMATIC MACHINES FOR DATA PROCESSING, WITH BUILT-IN SCREEN – "ALL IN ONE" outsources the referenced components or subassemblies, it can only retain the tax benefits in question if a portion of those components or subassemblies are produced in Brazil in accordance with their own PPBs, and thus are domestic products.

9.310. Interministerial Implementing Order MCT/MICT/MC No. 273, of 17 December 1993[1740], Article 1 states in relevant part that:

> To define as levels of local added value for INFORMATION TECHNOLOGY GOODS manufactured in Brazil as applicable to telecommunications, for the effects of article 4 of Law No. 8248, dated October 23, 1991, the following Basic Production Process (PPB), as well as provided for in article 4 of this Ordinance:
>
> I - assembly and welding of all components on printed circuit boards;
>
> II - installation of electrical and mechanical parts totally not integrated in basic level of components;
>
> III - integration of printed circuit boards and electrical and mechanical parts in the formation of the final product, assembled/installed according to items I and II above;
>
> IV - management of quality and productivity of the process and final product, involving inspection of raw materials, intermediate products, secondary and packing

[1738] This outsourcing provision is in addition to that inherent in the specific PPBs referred to in Article 2. See footnote 1619 above.

[1739] See footnote 1619 above.

[1740] Interministerial Implementing Order 273/1993, (Exhibit BRA-28).

> materials, statistic control of the process, testing and measurement, and quality of final product.
>
> Sole Paragraph. For compliance with the provisions of this article, the use of subsets assembled in Brazil by third parties shall be permitted, so long as the production thereof meets the requirements under items I and II of this article.

9.311. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the accredited producer of INFORMATION TECHNOLOGY GOODS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.312. Interministerial Implementing Order No. 214, of 20 November 2006[1741], Article 1 states in relevant part that:

> The Basic Production Process for ASSEMBLED PRINTED CIRCUIT BOARDS, established by MDIC/MCT Interministerial Ordinance 205, of December 03rd, 2002, is as follows:
>
> I – assembling and welding, or similar process, of all components in printed circuit boards; and
>
> II – configuration, recording of computer programs, when applicable, and test.
>
> § 1 The subcontracting of any of the operations described in art. 1 hereof shall be permitted, provided that made in Brazil.

9.313. The Panel considers that step I involves the creation, from basic raw materials and inputs, of a component or subassembly, i.e., printed circuit boards. Step I can be performed by third parties. That is, the accredited producer of ASSEMBLED PRINTED CIRCUIT BOARDS can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.314. Interministerial Implementing Order No. 68, of 29 February 2012[1742], Article 1 states in relevant part that:

> Establish for the CA/CC CONVERTER FOR PORTABLE COMPUTER, WITHOUT KEYBOARD, AND TOUCH SCREEN - TABLET PC, manufactured in Brazil, the following Basic Production Process:
>
> I – manufacturing of the transformer as from the coil rolling;
>
> II - manufacturing of power cables and data cable, when applicable, at a minimum percentage rate of ninety percent (90%) in quantity, in the calendar year;
>
> III – plastic injection of the covers or cabinet;
>
> IV – assembling and welding of all components in printed circuit boards;

[1741] Interministerial Implementing Order 214/2006, (Exhibit BRA-29).
[1742] Interministerial Implementing Order 68/2012, (Exhibit BRA-30).

> V - assembling of electrical and mechanical parts, fully separated, at basic component level; and
>
> VI – integration of printed circuit boards and other electrical and mechanical parts in the final product, assembled according to items IV and V above.
>
> § 1- The activities or operations inherent in the production stages can be performed by third parties, provided that the Basic Production Process is followed, except for the stage described in item VI which cannot be outsourced.

9.315. The Panel considers that steps I to V involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - transformers; step II - power cables; step III - covers and cabinets; step IV - printed circuit boards; and step V - electrical and mechanical parts. Steps I to V can be performed by third parties. That is, the accredited producer of CA/CC CONVERTER FOR PORTABLE COMPUTER, WITHOUT KEYBOARD, AND TOUCH SCREEN - TABLET PC can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.316. Interministerial Implementing Order No. 165, of 22 June 2011[1743], Article 1 states in relevant part that:

> Establish for RECHARGEABLE BATTERY FOR PORTABLE EQUIPMENT, USE FOR IT-RELATED PURPOSES, manufactured in Brazil the following Basic Production Process:
>
> I – manufacturing of charge accumulation cells;
>
> II – injection of plastic parts, when applicable;
>
> III – stamping of terminals and coils, except when trimmed or overmolded;
>
> IV – assembling and welding of all components in the printed circuit boards, when applicable, except when the printed circuit board is made of flexible film;
>
> V - assembling and welding of charge accumulation cells; and
>
> VI – integration of printed circuit boards, when applicable, of the set of charge accumulation cells and mechanical parts in the final product.
>
> Sole paragraph. The activities or operations inherent in the production stages can be performed by third parties, provided that the Basic Production Process is followed, except for the stage described in item VI which cannot be outsourced.

9.317. The Panel considers that steps I to IV involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I - charge accumulation cells; step II - plastic parts; step III - terminals and coils; and step IV - printed circuit boards. Steps I to IV can be performed by third parties. That is, the accredited producer of RECHARGEABLE BATTERIES FOR PORTABLE EQUIPMENT, USE FOR IT-RELATED PURPOSES can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.318. Interministerial Implementing Order No. 254, of 11 August 2013[1744], Article 1 states in relevant part that:

[1743] Interministerial Implementing Order 165/2011, (Exhibit BRA-31).

> The Basic Production Process for the product INK CARTIDGE WITH OR WITHOUT INCORPORATED PRINTING HEAD WITH IDENTIFICATION BY RADIO FREQUENCY DISPOSITIVE – RFID (Radio-Frequency Identification), FOR INK-JET PRINTER (NCM – 8443.32 and 8443.31) , as set forth by MDIC/MCT Implementing Order 211, of October 27, 2010, hereby becomes the following:
>
> I – the manufacture of ink cartridge, comprehends the following stages:
>
> a) Water treatment by means of demineralization;
>
> b) Blend of pigments with demineralized water;
>
> c) Recipient plastic injection;
>
> d) Parts and pieces assembly; and
>
> e) Bottling and Sealing.
>
> II – Identification dispositive of RFID manufacturing, according to the respective Basic Production Process;
>
> III – Installation of the RFID dispositive on the ink cartridge package; and
>
> IV – Final cartridge package.
>
> § 1º Third parties can perform the activities or operations inherent in the production stages described in this article, provided the Basic Production Process be complied with, except for steps III and IV, which cannot be outsourced..

9.319. The Panel considers that at least steps I to II involve the creation, from basic raw materials and inputs, of components or subassemblies, as follows: step I(a) – demineralized water; step I(b) - ink; step I(c) – recipient; and step II RFID (in accordance with their own PPB). Steps I to II can be performed by third parties. That is, the accredited producer of INK CARTIDGE WITH OR WITHOUT INCORPORATED PRINTING HEAD WITH IDENTIFICATION BY RADIO FREQUENCY DISPOSITIVE – RFID (Radio-Frequency Identification), FOR INK-JET PRINTER (NCM – 8443.32 and 8443.31) can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.320. Law 11,484, of 31 May 2007[1745], Article 2, as amended by Law 12,715, of 17 September 2012[1746], Article 57, states in relevant part that:

> The beneficiary under the PADIS [Programa de Apoio ao Desenvolvimento da Indústria de Semicondutores e Displays (Programme for the Development of the Semiconductor and Display Industry)] shall be a legal person who makes investments in Research and Development – R&D in accordance with Article 6 and who engages either alone or jointly, in connection with:
>
> I – electronic semiconductor devices classified under 85.41 and 85.42 of the Mercosur Common Nomenclature – NCM, in the following activities:
>
> a) concept, development and design;
>
> b) diffusion or physical-chemical processing; or

[1744] Interministerial Implementing Order 254/2013, (Exhibit BRA-116).
[1745] Law 11,484/2007, (Exhibit JE-71). See also Decree 6,233, (Exhibit JE-73).
[1746] Law 12,715/2012, (Exhibit JE-95).

c) cut, encapsulation and testing;

II – information displays (displays) provided for in Paragraph 2 of this Article, in the activities of:

a) concept, development and design;

b) manufacture of photosensitive, photo or electroluminescent elements and light emitting diodes; or

c) final assembly of displays and electrical and optical testing.

III - dedicated inputs and equipment intended for the manufacture of the products described in subparagraphs I and II of the header paragraph, set out in an act of the Executive Power and manufactured according to the Basic Production Process established by the Ministries of Development, Industry and Foreign Trade and of Science, Technology and Innovation.

Paragraph 1. For the purposes of this Article, it shall be considered that the legal entity engages in the activities:

I – solely, when performing all the steps provided in the qualifying subparagraph; or

II – jointly, when performing all the activities provided in the qualifying indent.

9.321. The Panel considers that step II(b) involves the creation, from basic raw materials and inputs, of components or subassemblies, as follows: photosensitive, photo or electroluminescent elements and light emitting diodes. The different activities in step II(b) can be performed by third parties. That is, the accredited producer of information displays (displays) can outsource these activities and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.

9.322. Interministerial Implementing Order MDIC/MCTI No. 62, of 31 March 2014[1747], Article 1 states in relevant part that:

Establishes the following Basic Production Process for TRANSMISSION EQUIPMENT FOR DIGITAL TV, produced in Brazil:

I - assembly and soldering of all components on the printed circuit boards;

II - assembly of the electrical and mechanical parts, totally separated, at a basic component level; and

III- integration of the printed circuit boards and the electrical and mechanical parts in the formation of the final product, assembled in accordance with indents I and II above;

§ 1. Provided that the Basic Production Process is complied with, the activities or operations required in the production stages may be carried out by third parties in the country, except with regard to the stage set out in indent III, which may not be outsourced.

9.323. The Panel considers that steps I and II involve the creation, from basic raw materials and inputs, of the following components or subassemblies: step I - printed circuit boards; and step II - electrical and mechanical parts. Steps I to II can be performed by third parties. That is, the

[1747] Interministerial Implementing Order 62/2014, (Exhibit JE-89).

accredited producer of TRANSMISSION EQUIPMENT FOR DIGITAL TV can outsource these steps and retain the tax benefits in question so long as the requirements of the steps (production in Brazil of the respective components and subassemblies from basic raw materials and inputs) are respected.