

**VERIFICATION SYSTEM OF DUTY REBATE SCHEMES AND  
DEFINITION OF INPUTS CONSUMED UNDER ASCM**

Submission by India

The following communication, dated 27 November 2007, is being circulated at the request of the Delegation of India.

1. India in its earlier submissions<sup>1</sup> to the NGR had raised certain issues relating to the ASCM for improvement and clarification. This paper presents textual proposal on two of the issues raised in these submissions, namely **(a) verification system for drawback and substitution drawback schemes, and (b) capital goods and consumables to be included in the definition of inputs consumed.**

**I. VERIFICATION SYSTEM FOR DRAWBACK AND SUBSTITUTION DRAWBACK SCHEMES**

**Issue**

2. Annex II to the ASCM specifies the guidelines on consumption of inputs in the production process, while Annex III provides guidelines in the determination of substitution drawback systems as export subsidies. These guidelines, *inter alia*, stipulate that the government of the exporting member has in place and applies a verification system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. **This can, at times, practically require verification of consumption of imported inputs in respect of each consignment.** Further, such verification would need to be undertaken in respect of each unit availing duty concessions. It has been India's experience that a separate verification of the inputs that are actually consumed in the production process in each transaction for every unit is impracticable and places an onerous burden due to the prevalence of a large number of small and medium enterprises which are not concentrated in and around certain cities but are dispersed all over the country including remote areas. The administrative machinery required for such verification of inputs would be prohibitive in terms of costs which may not be commensurate with the extent of duty concessions extended by the government. Absence of such a verification system may result in a finding of "subsidy" when no benefit may, in fact, have been conferred.

3. During the discussions on Implementation Related Issues and Concerns India had raised this concern in G/SCM/W/430 and had suggested a system of generalised and aggregate rate of remission of customs duty to take into account the problems faced due to large number of small and medium enterprises in developing countries. Taking note of the concerns raised by certain Members during the discussions on this Implementation proposal, India suggests following textual amendments in

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<sup>1</sup> TN/RL/W/4 (April 2002) & TN/RL/W/120 (June 2003)

Annex II and III. This proposal would not represent a departure from existing practice of certain investigating authorities that have treated adherence to standard input-output norms as representing a reasonable verification system. Such a presumption would not have effects that could be argued to be trade-distorting as the investigating authority would be entitled under Article 12.6 of the ASCM to examine the records of each exporter to find whether the application of standard procedures has resulted in over-rebate in a particular instance. In those cases in which over-rebate is found the countervailing duty must be limited to the extent of over-rebate. This is not an alien concept to GATT/WTO as Members would recall that the report L/1141, adopted by the GATT Contracting Parties on 27 May 1960, provides that

*"... Countervailing duties should not be imposed on a product by reason of the exemption of such product from duties or taxes imposed on the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes. If, however, it were established that the exemption or the reimbursement exceeded the real charge which the product would have to pay in the exporting country, the difference could be considered as constituting a subsidy" (underline added).*

4. Addressing these issues would require changes in FN 1 of the ASCM, Annexes I, II & III of the ASCM as suggested in textual proposal below.

## **II. CAPITAL GOODS AND CONSUMABLES TO BE INCLUDED IN THE DEFINITION OF INPUTS CONSUMED**

### **Issue**

5. WTO rules allow exemption or remission of indirect taxes and import charges levied on "inputs consumed in the production of the exported product". Such exemption or remission does not constitute an export subsidy (or even a subsidy) and is therefore not countervailable. Annex II of the ASCM defines "inputs consumed in the production process" as "inputs physically incorporated, energy, fuels and oils used in the production process and catalysts consumed in the course of their use". Thus capital goods and consumables have been left out even though they can be said to have been used to the extent of their depreciation and actual consumption.

6. India had raised this issue and made a proposal in (G/SCM/W/430) during the discussions on Implementation Related Issues and Concerns. Suggestions were made by certain members that this problem could be addressed if the customs duty on capital goods were to be reduced. In India's view this does not take into account the reality in certain developing countries in which customs tariff contribute significantly to government revenue and are necessary for meeting crucial developmental expenditure.

7. Capital goods and consumables must be included in the list of goods that are consumed in the process of production. A fundamental rule of GATT 1947 was that no product must be subject to countervailing duty "by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes." The basis of this rule was the destination principle of indirect taxation. By excluding capital goods and consumables from the list of goods deemed to be consumed in the production process the ASCM unjustifiably abridged the pre-existing GATT rights of the contracting parties. The improvement can be brought about by an appropriate amendment of footnote 61 of the ASCM.

## 8. Textual proposal

### Footnote 1 of the ASCM:

<sup>1</sup> 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. **For the purposes of countervailing measures under Part V, if it is established that the exemption from, or remission of, such duties or taxes exceeded those which have accrued, the difference could be deemed to be a subsidy.**

### ANNEX I

(g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes<sup>58</sup> in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption. **For the purposes of countervailing measures under Part V, if it is established that the exemption from, or remission of, such taxes exceeded those levied in respect of the production and distribution of like products when sold for domestic consumption, the difference could be deemed to be a subsidy.**

(h) The exemption, remission or deferral of prior-stage cumulative indirect taxes<sup>58</sup> on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).<sup>60</sup> This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II. **For the purposes of countervailing measures under Part V, if it is established that the exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products exceeded the amounts of exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption, the difference could be deemed to be a subsidy. For the purposes of countervailing measures under Part V, if it is established that the prior-stage cumulative indirect taxes exempted, remitted or deferred on inputs that are consumed in the production of the exported product exceeded the amounts of those which have accrued, the difference could be deemed to be a subsidy.**

(i) The remission or drawback of import charges<sup>58</sup> in excess of those levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste); provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, not to exceed two years. This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II and the guidelines in the determination of substitution drawback systems as export subsidies contained in Annex III. **For the purposes of countervailing measures under Part V, if it is established that the remission or drawback of import charges levied on imported inputs that are consumed in the production of the exported product exceeded the amounts of those which have accrued, the difference could be deemed to be a subsidy.**

## ANNEX II

GUIDELINES ON CONSUMPTION OF INPUTS IN THE PRODUCTION PROCESS<sup>61</sup>

1. 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 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).

2. The Illustrative List of Export Subsidies in Annex I of this Agreement makes reference to the term "inputs that are consumed in the production of the exported product" in paragraphs (h) and (i). Pursuant to paragraph (h), indirect tax rebate schemes can constitute an export subsidy to the extent that they result in exemption, remission or deferral of prior-stage cumulative indirect taxes in excess of the amount of such taxes actually levied on inputs that are consumed in the production of the exported product. Pursuant to paragraph (i), drawback schemes can constitute an export subsidy to the extent that they result in a remission or drawback of import charges in excess of those actually levied on inputs that are consumed in the production of the exported product. Both paragraphs stipulate that normal allowance for waste must be made in findings regarding consumption of inputs in the production of the exported product. Paragraph (i) also provides for substitution, where appropriate.

## II

In examining whether inputs are consumed in the production of the exported product, as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. Where it is alleged that an indirect tax rebate scheme, or a drawback scheme, conveys a subsidy by reason of over-rebate or excess drawback of indirect taxes or import charges on inputs consumed in the production of the exported product, the investigating authorities should first determine whether the government of the exporting Member has in place and applies a system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the system or procedure to see whether it is reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export.<sup>(x)</sup> The investigating authorities may deem it necessary to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the system or procedure is being effectively applied.

2. Where there is no such system or procedure, where it is not reasonable, or where it is instituted and considered reasonable but is found not to be applied or not to be applied effectively, a

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<sup>61</sup> Inputs consumed in the production process are inputs physically incorporated, energy, fuels and oil used in the production process, **consumables, capital goods** and catalysts which are consumed in the course of their use to obtain the exported product.

<sup>(x)</sup> (Footnote to be added) **There shall be a presumption that a reasonable and effective verification system is in place and is applied wherever standard input-output norms or similar averaging procedures are : (i) developed fairly and systematically for determining the average amount of various inputs consumed in the production of one unit of the exported product; and (ii) used to determine the exemption, remission or deferral of prior stage cumulative indirect taxes or remission or drawback of import charges levied on inputs consumed in the production of the exported product ).**

further examination by the exporting Member based on the actual inputs involved would need to be carried out in the context of determining whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 1.

3. Investigating authorities should treat inputs as physically incorporated if such inputs are used in the production process and are physically present in the product exported. The Members note that an input need not be present in the final product in the same form in which it entered the production process.

4. In determining the amount of a particular input that is consumed in the production of the exported product, a "normal allowance for waste" should be taken into account, and such waste should be treated as consumed in the production of the exported product. The term "waste" refers to that portion of a given input which does not serve an independent function in the production process, is not consumed in the production of the exported product (for reasons such as inefficiencies) and is not recovered, used or sold by the same manufacturer.

5. The investigating authority's determination of whether the claimed allowance for waste is "normal" should take into account the production process, the average experience of the industry in the country of export, and other technical factors, as appropriate. The investigating authority should bear in mind that an important question is whether the authorities in the exporting Member have reasonably calculated the amount of waste, when such an amount is intended to be included in the tax or duty rebate or remission.

### ANNEX III

#### GUIDELINES IN THE DETERMINATION OF SUBSTITUTION DRAWBACK SYSTEMS AS EXPORT SUBSIDIES

##### I

Drawback systems can allow for the refund or drawback of import charges on inputs which are consumed in the production process of another product and where the export of this latter product contains domestic inputs having the same quality and characteristics as those substituted for the imported inputs. Pursuant to paragraph (i) of the Illustrative List of Export Subsidies in Annex I, substitution drawback systems can constitute an export subsidy to the extent that they result in an excess drawback of the import charges levied initially on the imported inputs for which drawback is being claimed.

##### II

In examining any substitution drawback system as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. Paragraph (i) of the Illustrative List stipulates that home market inputs may be substituted for imported inputs in the production of a product for export provided such inputs are equal in quantity to, and have the same quality and characteristics as, the imported inputs being substituted. The existence of a verification system or procedure is important because it enables the government of the exporting Member to ensure and demonstrate that the quantity of inputs for which drawback is claimed does not exceed the quantity of similar products exported, in whatever form, and that there is not drawback of import charges in excess of those originally levied on the imported inputs in question.

2. Where it is alleged that a substitution drawback system conveys a subsidy, the investigating authorities should first proceed to determine whether the government of the exporting Member has in place and applies a verification system or procedure. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the verification procedures to see whether they are reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export.<sup>(x1)</sup> To the extent that the procedures are determined to meet this test and are effectively applied, no subsidy should be presumed to exist. It may be deemed necessary by the investigating authorities to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the verification procedures are being effectively applied.

3. Where there are no verification procedures, where they are not reasonable, or where such procedures are instituted and considered reasonable but are found not to be actually applied or not applied effectively, there may be a subsidy. In such cases a further examination by the exporting Member based on the actual transactions involved would need to be carried out to determine whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 2.

4. The existence of a substitution drawback provision under which exporters are allowed to select particular import shipments on which drawback is claimed should not of itself be considered to convey a subsidy.

5. An excess drawback of import charges in the sense of paragraph (i) would be deemed to exist where governments paid interest on any monies refunded under their drawback schemes, to the extent of the interest actually paid or payable.

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<sup>(x1)</sup> (Footnote to be added) There shall be a presumption that a reasonable and effective verification system is in place and is applied wherever standard input-output norms or similar averaging procedures are : (i) developed fairly and systematically for determining the average amount of various inputs consumed in the production of one unit of the exported product; and (ii) used to determine the exemption, remission or deferral of prior stage cumulative indirect taxes or remission or drawback of import charges levied on inputs consumed in the production of the exported product ).