

## **ALLOCATION PERIODS FOR SUBSIDY BENEFITS<sup>1</sup>**

### Communication from the United States

The following communication, dated 24 May 2004, is being circulated at the request of the Delegation of the United States.

### **ISSUE**

In our paper on the allocation of subsidy benefits, we noted that, although it is generally accepted that the benefit from certain types of subsidies should be allocated over time, the Agreement on Subsidies and Countervailing Measures (SCM Agreement) does not provide for a specific allocation methodology.<sup>2</sup> Because different methodologies can result in significant differences in the subsidy benefit attributable to a particular year, it is important for the Rules Negotiating Group to clarify and improve the rules in this area.<sup>3</sup> Other Members have raised this issue in the Group earlier in the negotiations.<sup>4</sup> Ideally, the Group would reach a consensus on a single methodology for determining allocation periods to be employed by all Members.

In our earlier paper, we addressed some of the issues relating to how to allocate subsidy benefits over time and, in particular, reviewed the US approach for calculating the amount of subsidy benefit allocable to a given year. We continue that discussion in this paper by considering how to determine an appropriate allocation period, *viz.*, the period over which the benefit of an allocable subsidy should be spread.<sup>5</sup> Over the years, the United States has struggled with numerous issues in this area and has developed a relatively detailed practice, which is described below and which we believe can serve as a good basis for discussion.

### **DISCUSSION**

We start by noting that prior GATT/WTO decisions provide some general guidance on the issue of benefit allocation periods. For example, in a report adopted in April 1985, the GATT Committee on Subsidies and Countervailing Measures promulgated Guidelines on Amortization and Depreciation.<sup>6</sup> In those guidelines, the Committee found that financial and accounting theory and practice do not provide any single acceptable method of determining the appropriate time period over

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<sup>1</sup> The Delegation of the United States has requested that this paper, which was submitted to the Rules Negotiating Group as an informal document (JOB(04)/61), also be circulated as a formal document.

<sup>2</sup> TN/RL/W/148, 22 April 2004.

<sup>3</sup> The United States initially raised the issue of when and how to allocate subsidy benefits over time in TN/RL/W/78, *Subsidies Disciplines Requiring Clarification and Improvement*, 19 March 2003, p.6. Other Members have also raised this as an issue for consideration by this Group, e.g. TN/RL/W/19, 7 October 2002.

<sup>4</sup> TN/RL/W/19, 7 October 2002.

<sup>5</sup> We note that this paper does not address the issue of which types of subsidies should be allocated over time and which types should be attributed entirely to the year of receipt.

<sup>6</sup> SCM/64; BISD 32S/154.

which subsidies should be allocated. It did indicate, however, that the allocation period selected should be based on reasonable and generally accepted financial and accounting principles such as the average life of assets owned by the firm.

Subsequently, the 1994 GATT Panel in Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom concluded that it was not necessarily inconsistent with the Guidelines on Amortization and Depreciation for a signatory to apply a standard period as the average useful life of assets in a given industry, provided that such a standard period was not established on an arbitrary basis and that it was applied with a degree of flexibility, taking into account the circumstances of a given case.<sup>7</sup>

After the Uruguay Round, the Informal Group of Experts (IGE) to the Committee on Subsidies and Countervailing Measures, which was tasked with developing recommendations for clarifying the provisions under Annex IV of the SCM Agreement, considered the issue of allocation periods for subsidy benefits.<sup>8</sup> Although Annex IV, and therefore the IGE's work, specifically related to the valuation of subsidies under the now lapsed Article 6.1(a) provision based on a cost-to-government approach, we believe that some of the key recommendations of the IGE are pertinent to this discussion. Among those recommendations were (1) that the allocation period be based on the average useful life (AUL) of a subsidy recipient's assets, (2) that the AUL be based on the actual expected life of assets and not on tax or other considerations, (3) that there be a hierarchy of data sources for establishing the AUL, taking into account data availability and accuracy, and (4) that a calculated AUL be based on several years of financial data representative of the recipient's normal operations.

Before discussing the specifics of the US approach to this issue, three overarching guiding principles are important to consider. The first is that any allocation period that is chosen is, to an extent, somewhat arbitrary and will be, at best, only an approximation of the actual manner in which a subsidy benefit is enjoyed over time.<sup>9</sup> That said, effective and transparent rules necessitate choosing some reasonable period.

The second point is that, in considering a methodology for determining the appropriate period, the following guiding principles should be paramount: consistency, predictability, accuracy, transparency, and administrability. While it may not be possible to craft a single methodology that is likely to fully satisfy all of these objectives in every instance, any approach must seek to achieve a practical and reasonable balance among them.

Finally, in our view, this is a purely technical issue. It cannot be determined, in the abstract, whether or not a particular approach is more or less advantageous to a subsidy recipient facing an SCM Agreement discipline. Although a shorter allocation period may curtail the time a subsidy recipient is vulnerable, it also compresses the total benefit and, therefore, increases the benefit attributed to each year during the allocation period. Consequently, in choosing an appropriate methodology, it should be kept in mind that the actual impact will differ depending on the facts of the particular case.

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<sup>7</sup> See SCM 185, 15 November 1994. It appears that the Panel accepted the concept of using AUL and focused on the appropriate measurement of AUL.

<sup>8</sup> See G/SCM/W/415/Rev.2, 15 May 1998, page 5.

<sup>9</sup> For example, the duration of the benefit from a grant or equity infusion is arguably indeterminate because such subsidies generally provide capital to a company, and capital in turn makes possible or is the basis for the company's production—the duration of which is indeterminate. There is no financial or accounting theory that can identify, *a priori* and with precision, the expected and foreseeable life of a grant of equity infusion.

Under the United States approach, the period over which subsidies are normally allocated is based on the average of the useful lives of all the renewable physical assets of the subsidy recipient. We believe that such a period is a reasonable approximation of the duration of the benefit that a subsidy recipient enjoys, and is the most practical approach in terms of application.<sup>10</sup> For example, if a government provides a grant to a chair manufacturer to purchase electric saws and wood-carving equipment, it is reasonable to assume that the chair producer continues to benefit from that subsidy throughout the life of the equipment.

However, the average of the useful lives of all a subsidy recipient's renewable physical assets is not necessarily a readily identifiable number, and calculating such a figure can be complex and controversial given that the different depreciation periods of numerous assets generally must be taken into account. This leads to the threshold question of whether such an AUL should be based on the actual (and, therefore, ever-fluctuating) financial position of the individual subsidy recipient, or instead on some other objective measurement or standard. Although the use of company-specific AUL data might appear preferable in terms of accuracy, there are common instances where this may not be the case and, in fact, there can be a considerable downside to relying on company-specific data.

One very common situation where individual company-specific data may not be an appropriate basis for determining the AUL of assets is where a company bases its asset depreciation schedules on estimated asset lives that are based on other financial considerations, such as tax implications, and not on the actual expected operating life of the asset. Similarly, it could be problematic to use company-specific data where the company's depreciation expenses are based on an accelerated depreciation methodology<sup>11</sup> or when a company has written down its assets. Calculating a company-specific AUL can also prove unduly burdensome, often requiring the subsidy recipient to perform an analysis and provide documentation at a level of detail that may be difficult, costly and time consuming. Generally, the United States has found that calculating company-specific AULs can very often produce inconsistent, unpredictable results.

Given the theoretical preference for relying on company-specific data, but the practical problems that such data can entail, the United States has adopted a flexible approach with regard to selection of AULs that allows for the possibility of basing the determination on either the company-specific data or an industry standard value, depending on the facts of a particular situation. The specifics of our methodology are as follows.

Pursuant to our regulations, in a countervailing duty investigation, we initially presume the allocation period for a subsidy benefit to be the AUL of renewable physical assets for the industry concerned as listed in the standard depreciation tables published by the US Internal Revenue Service.<sup>12</sup> In the United States' view, reference to a single set of depreciation tables offers consistency, predictability, and simplicity, and presents a reasonable estimate for the AUL of assets in specific industries. We have found that for most industries and most types of subsidies, these depreciation tables have provided an accurate and fair approximation of the actual AUL of assets in

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<sup>10</sup> One exception to this is that the United States allocates the benefits of certain types of long term loans over the life of the loan as the duration of the benefit is a fixed and known period.

<sup>11</sup> As discussed in greater detail below, averaging the expected useful lives of all a firm's depreciable physical assets involves a calculation that takes into account total annual depreciation charges. A company's annual total depreciation expense can be significantly affected (and distorted) by the choice of depreciation methodology (e.g. accelerated versus straight line depreciation).

<sup>12</sup> The most recent AUL tables are available in US IRS Publication 946, *How to Depreciate Property*. The values in the IRS depreciation tables generally reflect an objective estimate of the average of the useful (economic) lives of all assets by major industrial activity.

the industry in question. However, if a party in a US countervailing duty proceeding believes and can show that the US depreciation tables do not reasonably reflect the AUL of assets of the subsidy recipient, and that the AUL from the US depreciation tables differs by more than one year from the subsidy recipient's actual, properly calculated AUL<sup>13</sup>, the United States will use the company-specific AUL for allocating subsidy benefits.

Because firms often do not calculate the "actual" AUL for all assets in the normal course of business, the United States has adopted a fairly straightforward methodology for calculating company-specific AULs based on information generally contained in the company's regular accounting records, as follows. First, the annual average gross book value of the firm's depreciable renewable physical assets (which is usually based on historical cost) is cumulated over an appropriate period of historical data.<sup>14</sup> Next, the firm's annual charges to accumulated depreciation for the same time period are summed. Finally, the sum of the annual average gross book values is divided by the sum of annual depreciation charges, resulting in an AUL for the company's stock of all physical assets during the historical period.

This calculation is illustrated in the following example:

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Gross Book Value (\$mil)	1.25	1.32	1.10	0.95	1.15	1.20	1.00	1.28	1.20	1.18 = 11.63
Annual Dep. Exp. (\$000)	78.5	77.0	76.5	79.0	79.5	78.0	75.5	78.0	77.0	76.0 = 775

**11,630,000** (*Cumulative Gross Book Value*) / **775,000** (*Cumulative Annual Deprec. Exp.*) = **15 yrs**

**AUL = 15**

In addition to providing for the calculation of a company-specific AUL, in the context of a countervailing duty investigation, the United States also allows the government of the subsidy recipient to demonstrate that it has its own system in place which reasonably reflects the AUL for industries. In such cases, we examine whether the system was set up to determine the AUL of industries in the country, that the government has conducted reliable surveys and/or studies to gather information from companies on their AULs, and that it has ensured the accuracy of any reported information and of any calculations performed. If these criteria are met, and the AUL for the industry under investigation differs by one year or more from the US depreciation tables, we will use the AUL from the government of the subsidy recipient.

## CONCLUSION

We recognize that our approach for determining an appropriate allocation period may not be the only reasonable one. It must be recognized however, that the continued absence of rules in this

<sup>13</sup> The United States requires the objecting party to also demonstrate that the company-specific AUL differs by more than one year from the AUL in the US depreciation tables in order to reduce the burden on all parties in analyzing, commenting on, and challenging claims that, even if ultimately accepted, would have relatively little impact on the benefit calculation.

<sup>14</sup> The average gross book value for a given year is determined by adding the gross book value in the beginning of the year and the gross book value at the end of the year. The sum is then divided by two. Also note that under normal circumstances, the United States will usually consider the 10 years prior to and including the period of investigation or review to constitute an appropriate period.

area will result in disparate treatment of similarly situated exporters. Preferably, the Group would reach a consensus on a single methodology or set of guidelines for determining allocation periods to be employed by all Members. At a minimum, Members should be required to notify the methodology they will use in a countervailing duty investigation and if the notified methodology is not used in a particular case, the Member should be obligated to explain the facts and logic which led it to conclude that the normal methodology was not appropriate.

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