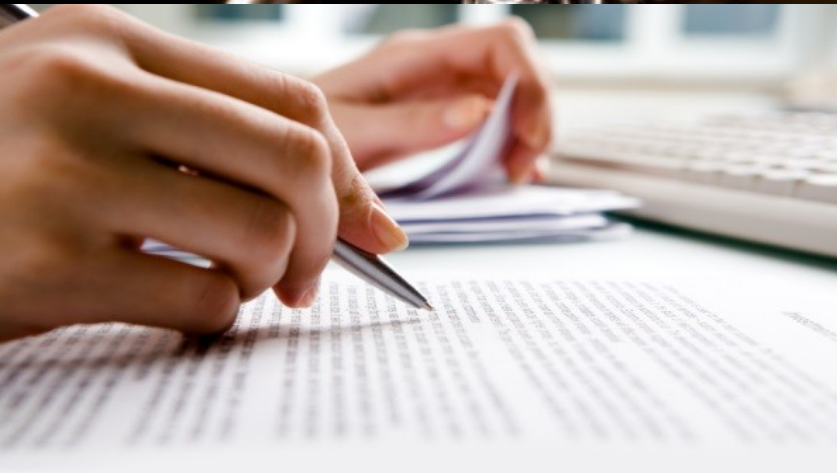




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Recent developments impacting Export Incentives and International Trade

November 27, 2019

1. Dispute on Export Incentives

On October 31, 2019, the dispute settlement panel of World Trade Organization ('WTO') held that various export incentives offered by India like MEIS, EPCG etc. are violative of WTO's Subsidies and Countervailing Measures Agreement ('SCM Agreement').

1.1. Background

India is a signatory to the WTO and is subject to the SCM Agreement. In 2018, the United States of America ('USA') filed a case in WTO alleging that India is providing export subsidies which are prohibited under the SCM Agreement. The following schemes were challenged by USA:

1. Export Oriented Units ('EOU') and Sector Specific Schemes
2. Export Promotion Capital Goods ('EPCG') Scheme
3. Special Economic Zones ('SEZ') Scheme
4. Duty-Free Imports for Exporter Schemes ['DFIS Scheme'] (certain conditions prescribed under **Notification No. 50/2017-Customs dated June 30, 2017** were put under challenge under this Scheme)
5. Merchandise Exports from India ('MEIS') Scheme

The export subsidies under Point 1 to 4 represent exemptions from customs duties and other import taxes. The export subsidy under Point 5 represent government-issued scrips that can be used to pay for certain liabilities vis-à-vis the Government and are freely transferable.

The following important points were discussed in the ruling:

Time limit for relaxation to developing countries

Article 3.1 (a) of the SCM Agreement provides that subsidies contingent upon the export performance (in law or in fact) are prohibited under the SCM Agreement. Further, Article 3.2 specifically provides that a Member shall not grant nor maintain subsidies referred to in Article 3.1. However, in terms of Article 27.2 read with Annexure - VII of the SCM Agreement, developing countries which are Members of WTO with per capita income of less than US 1,000 \$ were exempted from the prohibition of export subsidies. The list of such developing countries includes India.

Contentions of USA	India had graduated under Annex VII(b) and Article 27.2(a) of the SCM Agreement as of 2017.
Defense of India	Article 3 applies from date of graduation of India by virtue of Article 27.2(b) of the SCM Agreement which provides an eight-year transition period to developing countries <i>from the date of entry into force of the WTO agreement</i> . Eight years should be counted once per capita income crosses US 1,000\$ and the provision should be interpreted contextually and not literally. A failure to do so, would render the mandatory language of Annex VII(b) ineffective.

WTO's ruling	The SCM agreement reflects a balance between constraining certain types of subsidies on the one hand and providing special and differential treatment through clear and unambiguous time-bound flexibilities on the other hand. Thus, a literal interpretation should be given to Article 27.2(b). Basis this, <u>eight years shall be counted from January 1, 1995 (date of implementation of SCM agreement) and not date when each developing country cross per capita income of US 1,000\$.</u>
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Legality of exemption

The SCM Agreement clearly defines the term 'subsidy' under Article 1 and also provides the type of subsidies that a Member State cannot grant. Footnote 1 of the SCM Agreement appended to Article 1, provides that the following measures shall not be deemed to be a subsidy:

- **Exemption** of an exported product from the duties or taxes borne by the like product when destined for domestic consumption
- **Remission** of such duties or taxes in amounts not in excess of those which have accrued

Contentions of USA	Exemptions and benefits granted by India in various schemes are subsidies and not permissible under the SCM Agreement.
Defense of India	Four of the five schemes (i.e. all schemes except the SEZ Scheme) fell within Footnote 1 of the SCM Agreement which carves out exceptions from the definition of a subsidy.
WTO's ruling	1) The first four schemes did not meet the conditions of Footnote 1 because of the nature of the goods for which the duty exemptions were available. 2) As per WTO, <u>capital goods cannot be considered 'inputs consumed' during manufacture as it is not physically incorporated in the final product.</u> The alleged exemption to capital goods is not in alignment of Footnote 61 of the SCM Agreement which contains the definition of 'input'. 3) For these measures and for the exemptions under the SEZ Scheme, USA had established the existence of a financial contribution. This was either in the form of revenue foregone (for exemptions and deductions from duties and other taxes) or in the form of a direct transfer of funds (for provision of scrips under MEIS). 4) Such measures were contingent in law upon export performance. Thus, such export subsidies were inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.

***NITYA's Comments:** The Ruling is not expected to have an immediate impact on the export industry since India is likely to challenge the ruling before an appellate body. The implementation of the ruling will be on hold till the final outcome of such an appeal comes. If the Appellate Body upholds the panel's ruling, India will be required to discontinue the existing export promotion schemes. In any case, the WTO ruling does not impact the application of the export schemes on the raw material i.e. 'inputs' used in manufacture of final products (except limited challenge to DFIS discussed above). Another point to note is that the export promotion schemes of Service Exports from India Scheme ('SEIS'), Advance Authorization Scheme and Duty Free Import Authorization ('DFIA') Scheme were not put under challenge before WTO in the instant case.*

Importantly, India is shortly planning to introduce Remission of Duties or Taxes on Export Product (RoDTEP) to replace various schemes to avoid such disputes in future.

2. India decides not to sign RCEP

- The Regional Comprehensive Economic Partnership ('RCEP') is a proposed [free trade agreement](#) in the [Asia-Pacific](#) region between the ten member states of the [Association of Southeast Asian Nations](#) ('ASEAN') and its FTA Partners including India.
- Recently, India has decided not to sign RCEP due to major economic concerns unaddressed as of now. Such concerns can be broadly divided into following three categories:
 - **Dispute Resolution Mechanism:** RCEP proposes to implement the Investor-State Dispute Resolution Mechanism which allows an investor of a State to bring a claim against another State that is hosting the investment if the latter State alleges breach of a standard in the agreement through international commercial arbitration. Owing to its past unpleasant experiences, India wishes to opt out of this mechanism.
 - **Rules of Origin:** India has proposed a strict Rules of Origin to avoid circumvention of Chinese goods through other member countries. India has demanded specific Rules of Origin to ensure that the non-member countries do not abuse the agreement by routing exports through member countries.
 - **Auto-trigger and Snapback Safeguard Mechanism:** India demanded that an auto-trigger mechanism should be in-built in the Agreement to protect it from surge in import. The proposed mechanism auto-triggers when imports from any member State with respect to identified goods, increase beyond a pre-negotiated trigger level within a specific time period. Additionally, the snapback mechanism is proposed to introduce certain safeguards during the transitional period.

***NITYA's Comments:** India is already running a trade deficit with RCEP members. India feared that without protection measures, its trade deficit will significantly increase, specifically increase in import of goods from China and dairy products from Australia and New Zealand. News report suggest that India will continue negotiations and join RCEP once its concerns are addressed.*

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