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Theodore L. Banks

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Keywords

Economics, Corporations, Sales, Tax Relief

GATT, ALTERED ECONOMICS, AND DISC: A LEGITIMATE APPLICATION OF *Rebus Sic Stantibus*

I. INTRODUCTION

The Domestic International Sales Corporation (DISC) provisions of the Internal Revenue Code operate to defer a certain percentage of the income tax on foreign sales made through a DISC. Arguably, this deferral constitutes a subsidy on exports prohibited by the General Agreement on Tariffs and Trade (GATT). It is the position of this paper that, for the reasons enumerated below, while the DISC provisions may be interpreted as a technical violation of certain sections of GATT which prohibit export subsidies, general international practice and current international economic needs operate to make such a technical violation fully justified.

1. GATT depends upon consensus and retaliation for its enforcement, as does public international law in general. Since many countries utilize direct and indirect subsidy programs, and rebate or impose border taxes, the operation of DISC would be justified as an equivalent act by the United States. Since many provisions of GATT are ignored now, it may be argued also that a de facto "amendment" has been made, based on the desires of the CONTRACTING PARTIES.

2. Since the indirect taxes (such as an excise tax), as well as the direct taxes (such as an income tax) are both carried forward and reflected, to a certain extent, in the ultimate sales price, there is no longer any economic reason to justify an interpretation of GATT allowing the rebate of indirect, but not direct, taxes.

3. Any attempt at economic regulation rests upon a set of goals articulated for a certain set of economic problems. When the economic problems change, there is no justification for retaining old solutions which may be regressive in the new situation. This is an appropriate place for an application of the maxim *rebus sic stantibus*.¹ GATT should be allowed to adjust to current economic

1. "The maxim *Conventio omnis intelligitur rebus sic stantibus* is held to apply to all cases in which the reason for a treaty has failed, or there has been such a change in circumstances as to make its performance impracticable except at an unreasonable sacrifice." Hooper v. United States, 22 Ct. Cl. 408 (1887), citing WHARTON'S COM. AM. LAW §161 (1880). It is the position of this Comment that the economic conditions that exist in 1975 are such that certain sections of GATT are regressive or inequitable in the modern context. The goals and problems considered when GATT was drafted are significantly different from those that exist today, and thus the situation would fit the requisites of Article 62 of the Vienna Convention on the Law of Treaties, U.N. Doc. A/Conf. 39/27, 23 May 1969; 63 AM. J. INT'L L. 875 (1969), which effectively allows the use of a *rebus sic stantibus* argument if the existence of the original circumstances

needs, and not be bound by the problems and solutions of 1947.

II. DISC

U.S. Export Incentives

The Revenue Act of 1971 created a new device aimed at the encouragement of exports of American goods. The Domestic International Sales Corporation (DISC) provisions² enable exporters, when channeling their sales through a DISC, to effectively reduce their tax rate to as low as 24 percent in some instances.³

The DISC provisions are a part of a history of attempted tax incentives for exports. Beginning with the China Trade Act Corporations, for which provisions were established in 1922,⁴ Congress has subsequently authorized the establishment of Western Hemisphere Trade Corporations,⁵ and Export Trade Corporations,⁶ to promote exports.

Outflows of American capital in the 1960's led to the establish-

constituted an essential basis of the consent of the parties to be bound by the treaty, and the effect of the change is radically to transform the extent of obligations still to be performed under the treaty. Much of the controversy surrounding an application of the *rebus maxim* arises in the case of a changed government, and such a situation is not present here. See also the following discussions of *rebus sic stantibus*: W. BISHOP, *INTERNATIONAL LAW* 213-23 (3d ed. 1971); J. BRIERLY, *LAW OF NATIONS* 244 (4th ed. 1949); G. HILL, *THE DOCTRINE OF REBUS SIC STANTIBUS IN INTERNATIONAL LAW* (1934); HUANG, *DOCTRINE OF REBUS SIC STANTIBUS IN INTERNATIONAL LAW* (1935); KAUFMAN, *DAS WESEN DES VOLKERRECHTS UND DIE CLAUSULA REBUS SIC STANTIBUS* (1911); POURITCH, *DE LA CLAUSE "REBUS SIC STANTIBUS"* (1918); B. SCHMID, *DIE VOLKERRECHTLICHE CLAUSULA REBUS SIC STANTIBUS* (1906); 1 E. VATTEL, *LE DROIT DES GENS*, ch. 17, §296 (1758); *Harvard Research in International Law*, 29 AM. J. INT'L L. SUPP. 1097-1101 (1935); Hill, *The Doctrine of Rebus Sic Stantibus in International Law*, 9 U. MO. STUDIES, No. 3 (1934); Lissitzyn, *Treaties and Changed Circumstances (Rebus Sic Stantibus)*, 61 AM. J. INT'L L. 895 (1967); Williams, *The Permanence of Treaties*, 22 AM. J. INT'L L. 89 (1926).

It should be noted at the outset that this Comment takes the position that the United States should behave as, and should be treated as, an equal in the community of nations, and should not be expected to assume the position of economic invincibility that was present in 1948 when GATT was ratified. Assuming this position, and applying the arguments discussed herein, this Comment reaches a conclusion opposite from that reached by Anninger, *DISC and GATT: International Trade Aspects of Bringing Deferral Home*, 13 HARV. INT'L L.J. 391 (1972) [hereinafter cited as Anninger] and Note, *Domestic International Sales Corporation as a Subsidy Under Gatt: Possible Remedies*, 5 CASE W. RES. J. INT'L L. 87 (1972) [hereinafter cited as Note], both of which determined that the DISC program was an unjustified violation of GATT.

2. INT. REV. CODE OF 1954, § 995 *et seq.* [hereinafter cited as CODE].

3. Hyde & Murphy, *The Domestic International Sales Corporation in Perspective and Operation*, 28 BUS. LAW. 43 (1972).

4. CODE § 943.

5. CODE § 992, established in 1942.

6. CODE § 951.

ment of Voluntary Foreign Credit Restraint Guidelines by the Federal Reserve Board,⁷ and jawboning by President Johnson for the nation's businesses to restrict their foreign investments.⁸

It soon became apparent that more stringent measures were needed, and, in 1968, the Office of Foreign Direct Investments was established to regulate the transfer and retention of capital abroad by U.S. businesses.⁹ Yet, within two years of the imposition of these measures, their ineffectiveness became apparent.¹⁰ With a growing balance of trade deficit, and an inability to otherwise reverse that trend with other methods, the Treasury Department in 1970 proposed the enactment of the DISC provisions.

First falling to defeat when it was attached to a textile quota bill,¹¹ DISC returned in the next session of Congress to be passed amidst the general atmosphere of uncertainty that surrounded the President's imposition of a 10 percent surcharge on imports and the floating devaluation of the dollar in 1971. The DISC provisions, as enacted, provided for the deferral of tax payments, as opposed to the outright remission of taxes that would have been achieved by the original DISC proposal.¹² This deferral was believed to be (without, perhaps, being given adequate consideration)¹³ acceptable under pro-

7. Hyde, *supra* note 3, at 50.

8. See Federal Reserve Press Release, dated February 18, 1965, Remarks of J. L. Robertson, member of the Board of Governors of the Federal Reserve System, to representatives of banks and other financial institutions with respect to the President's Balance of Payments Program, cited in Hyde, *supra* note 3, at 50 n. 30.

9. Executive Order 11,387 (Jan. 1, 1968), cited in Hyde, *supra* note 2, at 50 n. 30. According to Manley Hudson, Jr., although the Foreign Direct Investments Program was the principal balance of payments program, it was directed at the very component of the balance of payments account that has most consistently produced a profit. Hudson, *Current Developments in Balance of Payments Restraints*, in PRIVATE INVESTORS ABROAD — PROBLEMS AND SOLUTIONS IN 1969 at 191, 206.

10. Although the ineffectiveness of these provisions is generally conceded, Hudson insisted that the programs prior to 1969 were quite successful, although more could have been done. *Id.* at 201.

11. H.R. 20, 92nd Cong., 1st Sess. (1969). The Treasury's original DISC proposal was incorporated in a separate bill introduced by Representative Byrnes on July 9, 1970, as H.R. 18392, 91st Cong., 2d Sess. (1970). This bill was subsequently incorporated, with considerable modification, in a bill that was intended to become the "Trade Act of 1970," H.R. 18970, 91st Cong., 2d Sess. (1970). It was reported out of the Ways and Means Committee favorably, H.R. Rep. No. 91-1435, 91st Cong., 2d Sess. (1970), was passed by the House, but died in the Senate Finance Committee when Congress adjourned. Brudno, *The DISC Proposal*, in PRIVATE INVESTORS ABROAD — PROBLEMS AND SOLUTIONS IN 1971 at 151, 154.

12. *Id.*

13. Patrick, *Domestic International Sales Corporation (DISC) — The 1971 Legislation*, in PRIVATE INVESTORS ABROAD — PROBLEMS AND SOLUTIONS IN 1972 at 323, 327.

visions of the General Agreement on Tariffs and Trade (GATT),¹⁴ which controls the deferral or rebate of taxes on exports. The DISC provisions additionally had the ostensible appeal of creating an export incentive without the need for establishing a new "tax haven."¹⁵

The provisions of the DISC, although uncertain in their ultimate effects in regard to stimulating additional exports, still represent one valid attempt in this direction. While it may be argued that DISCs were only utilized by those companies that were already in the export business, and thus encouraged no *new* export activity,¹⁶ there is also evidence that the provisions did encourage some corporations, who were otherwise reluctant, to establish export operations.¹⁷ Even if the DISC provisions did nothing more than increase exports from already established exporters, the intended function arguably was then accomplished by encouraging more foreign sales of U.S. goods.

Provisions of DISC

Briefly, the DISC provisions of the Internal Revenue Code require that, in order to avoid the normal rates of federal taxation, the DISC must confine its activities almost exclusively to export selling and related activities; the DISC cannot act as a manufacturer.¹⁸

14. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. pt. 5 at A11; T.I.A.S. No. 1700; 55 U.N.T.S. 194 effective Jan. 1, 1948 [hereinafter cited as GATT]. Although GATT has not been ratified by the Senate, it is valid and enforceable in the U.S. as an executive agreement as long as it does not conflict with any legislation. Jackson, *The General Agreement on Tariffs and Trade in United States Domestic Law*, 66 MICH. L. REV. 249, 250 (1967).

15. The purpose of the Export Trade Corporation (subpart F) and Western Hemisphere Trade Corporation provisions was to make exporting at least as profitable from the tax standpoint as manufacturing abroad. Subpart G gave deferrals on income to businesses whose activities improved the balance of payments. But prior to the enactment of DISC, all of these provisions shared one common fault: excess complexity. Note, *supra* note 1, at 101. For a brief outline of the development of U.S. attitudes in regard to foreign income, see J. PECHMAN, *FEDERAL TAX POLICY* 139 (Rev. Ed. 1971).

16. Professor Stanley Surrey suggested the dropping of the DISC provisions entirely, asserting that the same goals could be accomplished in other ways which would avoid the "ludicrous windfalls now being obtained under DISC." Statement of S. Surrey, *Panel Discussion before the House Comm. on Ways and Means* 93d Cong., 1st Sess., at 24 (1973). In another hearing, a witness asserted that DISCs lost \$1 billion per year in revenue, and that 90 percent of the tax deferral was going to 10 percent of the exporters. DISC allegedly helps medium sized manufacturers as opposed to medium sized exporters, and was no help at all to the small manufacturer or exporter. Testimony of C. McKay, *Hearings Before the Subcomm. on Government Procurement*, 92d Cong., 2d Sess., H. Res. 5 and 19, at 29 (1972) [hereinafter cited as *1972 Hearings on Gov. Procurement*].

17. See e.g., Norton, *DISC Helps Toro Boost Sales Abroad*, JOURNAL OF COMMERCE, Nov. 18, 1974, at 13A, col.1; according to S. Buchmer, DISCs help small companies. *1972 Hearings on Gov. Procurement supra* note 16, at 36.

18. This summary of the DISC provisions is adapted from Anninger, *supra* note 1, at 397-400.

Under section 992, 95 percent of the assets and receipts of the DISC must be export related, and it must maintain at all times the minimum capital of \$2500.¹⁹

There are four potential areas of tax saving through utilization of a DISC. Most obvious is that federal tax is deferred on one-half of the taxable income until it is distributed to the shareholders as a dividend.²⁰ The tax free profits may be retained by the DISC and reinvested in its export activities, they may be invested in Export-Import Bank obligations, or may be used as "producer's loans" to related or unrelated U.S. manufacturers for their export operations. The shareholders are treated as receiving the other one-half of the DISC income whether or not it was actually distributed.²¹

The second DISC benefit is the ability of the parent corporation to borrow income from a DISC in five-year "producer's loans."²² These loans are, in effect, interest free, "assuming the interest is actually distributed as a dividend by the DISC. The reason for this is that the interest is not taxed to the DISC and is a deduction for the borrower-shareholder and the dividend is taxed to the borrower-shareholder."²³ Producer's loans can be renewed indefinitely for five-year periods, as long as three conditions are met at each renewal: (1) the producer's loans cannot exceed an amount equal to the value of all U.S. assets multiplied by the percentage of export receipts to total receipts; (2) the borrower must increase his investment during the year the loan is made in U.S. assets or in research and development;²⁴ (3) the shareholders of a DISC are treated as receiving dividends to the extent that an increase in foreign investment is attributable to these loans.²⁵ This rule, the "fugitive capital" limitation, was imposed with the balance of payments in mind, in order to deter outflows of the DISC's tax-deferred profits.

A third advantage arises in that special inter-company pricing rules are granted which allow for more profit than would be possible under a section 482 "arm's length" arrangement. The safe haven rules allow a DISC to earn on sales either four percent of the qualified export receipts on the sale, or 50 percent of the combined taxable income of the DISC, whichever is greater; plus, in both cases, ten percent of the export promotion expenses. Thus, the DISC's profits

19. DISC, A HANDBOOK FOR EXPORTERS 3 (1972) [hereinafter cited as DISC HANDBOOK]; Rev. Rul. 72-166, 1972-1 CUM. BULL. 220.

20. CODE § 995(b)(1).

21. *Id.*

22. CODE § 993(1).

23. DISC HANDBOOK, at 21; CODE § 995(b)(1)(A).

24. DISC HANDBOOK, at 21-22.

25. CODE § 995(b), (d).

will include at least some of the manufacturing profits in addition to its own.²⁶

When liquidation or permanent disqualification of the DISC occurs, the fourth benefit is realized. Although previously untaxed profits are taxable to the manufacturer as a dividend, the tax is payable over as many years (up to ten) as the DISC had been in existence.²⁷

The 50 percent tax deferral and the special inter-company pricing rules result in an effective reduction of current federal income tax liability from 48 percent to 36 percent, and, in some cases, to 24 percent. If a manufacturer had a normal rate of return on export sales of four percent or less, the DISC inter-company pricing rules contained in section 994 would enable attribution of all of the profits to the DISC. Since only 50 percent of the DISC income is deemed distributed, the parent would only be taxed on one-half of the gain, for an effective rate of 24 percent.²⁸

As of June, 1974, there were over 5000 DISCs, which was an increase from the 2000 in operation at the end of 1972.²⁹ But they have not been operating without some cost in terms of lost tax revenue. Initial estimates of DISC operating costs ran from \$600 million to \$1.1 billion,³⁰ and Treasury Secretary Simon recently stated that the revenue costs of the first year of DISC operation (1972) were somewhat higher than expected due to the high DISC profits in that year.³¹ Any immediate loss to the government, however, is somewhat compensated by the eventual increase in revenue due to the "multiplier" effect as the profits are spread throughout the economy, and this point is emphasized by the proponents of DISC.³²

Although the overall value of DISC is unclear, the provisions remain in force, and their potential, as well as actual, international effects continue to be debated. As indicated previously, one question that was raised from the outset was whether a DISC operation would violate the prohibition of certain types of export subsidies enumerated in Article XVI of GATT.³³ In order to understand the purposes

26. Statement by S. Surrey, *Hearings on H.R. 10947 Before the Senate Comm. on Finance*, 92d Cong., 1st Sess., at 733 (1971) [hereinafter cited as *1971 Hearings Before the Senate Comm. on Finance*].

27. CODE § 995(b)(2)(B).

28. Anninger, *supra* note 1, at 400 n. 42.

29. Statement by W. Simon, *Hearings Before the Senate Comm. on Finance*, 93d Cong., 2d Sess., at 15 (1974) [hereinafter cited as *1974 Hearings Before the Senate Comm. on Finance*].

30. Anninger, *supra* note 1, at 406.

31. *1974 Hearings Before the Senate Comm. on Finance*, *supra* note 29.

32. Anninger, *supra* note 1, at 406.

33. Article XVI(4) of GATT reads as follows:

Contracting parties shall cease to grant either directly or indirectly

of GATT, and how the DISC provisions might run afoul of the tariff treaty, a brief examination of the history and major provisions of GATT is necessary.

III. GATT

After World War Two, GATT was drafted as a first step toward the creation of an International Trade Organization (ITO), and the elimination of tariffs that were then the major cause of distorted trade patterns.³⁴ The ITO was never created due to political squabbles, and instead the GATT treaty was institutionalized to take its place. The United States was apparently not unduly concerned about the entrenching of GATT (along with certain provisions it contained which were not entirely favorable to the U.S.) after World War Two, since at that time the U.S. had the dominant economy. The U.S. also accepted, on a de facto basis, certain restrictive practices by other countries; since the U.S. economy was so strong in relation to the rest of the world, these "obstacles" to free trade actually served to return world trade to some sort of balance, and were not considered disequilibrating factors.³⁵

Although restrictive tariffs are the most well known barriers to

any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.

GATT, annex I, ad. art. XVI, Interpretative Note to Art. XVI reads as follows:

The exemption of an exported product from duties or taxes borne by the like product when destined for domestic production, 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.

Article III reads:

The contracting parties recognize that internal taxes and other internal charges . . . should not be applied to imported or domestic products so as to afford protection to domestic production The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject . . . 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 apply otherwise internal taxes or other charges to imported or domestic products in a manner contrary to the principles set forth [above]

IV GATT: BASIC INSTRUMENTS AND SELECTED DOCUMENTS (1969) [hereinafter cited as GATT: BISD]. No threats of countervailing duties have been made as a result of DISC, although the European Economic Community did request consultations under Art. XXIII concerning the consistency of DISC with GATT. The United States in turn requested consultation regarding the tax system of the European countries. Testimony of R. Cole, 1972 *Hearings on Gov. Procurement*, *supra* note 16, at 163-64.

34. Jackson, *supra* note 14, at 250.

35. Hemmendinger, *Non-Tariff Trade Barriers*, 63 AM. SOC'Y. INT'L L. PROCEEDINGS 204, 206 (1969).

free trade, many non-tariff trade barriers can be implemented, and have been assuming a role of greater importance. For example, quantitative restrictions on imports are considered the most effective, although somewhat cumbersome to administer. Also possible are "buy national" programs for government procurement, artificially high valuation of imports for customs purposes, subsidization of internal agricultural production to lessen the influence of more efficiently produced imports, use of countervailing duties, use of anti-dumping duties, manipulation of size and quality controls, and tax incentives for exporters, to name just a few.³⁶

GATT itself did not contain an enforcement procedure to be applied to those states who chose to violate its provisions, but relied instead on individual self-help in the form of retaliation.³⁷ Although it was the goal of GATT to eliminate distortions in the normal pattern of international trade created by non-tariff barriers such as subsidies, the GATT members could not decide on a specific course of action in regard to these practices.³⁸ In fact, there was even some difficulty at the outset in defining precisely what constituted a forbidden subsidy,³⁹ although Art. III (8)(b) provided a clue by allowing subsidies on production but not on exports.⁴⁰

The original GATT contained a provision (Art. XVI) calling for consultations if a forbidden subsidy were employed, and it was not until 1955 that it was significantly strengthened.⁴¹ By 1961, a GATT working party was able to produce a non-exclusive list of eight forbidden practices under Art. XVI.⁴² From this list, two forbidden practices are important for the purposes of DISC:

(c) The remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;

(d) The exemption, in respect of exported goods, of charges or taxes, other than charges in connection with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connection with importation or in both forms.

36. Metzger, *Non-Tariff Trade Barriers: New Liberalization or New Protectionism?*, 63 AM. SOC'Y. INT'L L. PROCEEDINGS 203 (1969).

37. K. DAM, *THE GATT — LAW & INTERNATIONAL ECONOMIC ORGANIZATION* 81 (1970); Comment, *Attacks on the United States Import Surcharge under Domestic & International Law: A Pragmatic Analysis*, 6 J. INT'L. L. & ECON. 269, 271 (1972).

38. Anninger, *supra* note 1, at 394-95.

39. GATT: BISD *supra* note 33, (9th Supp.), at 185-201 (1961); GATT: BISD *id.*, (10th Supp.) 208 (1962).

40. Note, *supra* note 1, at 89.

41. See *supra* note 16.

42. GATT: BISD *supra* note 33, (9th Supp.), at 185-87 (1961).

In order to determine whether DISC should be considered a violation of Art. XVI, a closer examination of the provisions of the treaty and the statute, in terms of current economic needs, is necessary.

IV. THE ARGUMENTS FOR DISC

Economics: Theory and Practice

If we apply the adage that "taxes delayed are taxes saved," it would appear that a DISC tax deferral might be considered a subsidy.⁴³ The 95 percent rule contained in DISC clearly would provide the benefits for exporting and not for manufacturing, and could not thus be allowed as a subsidy on production. Furthermore, the fact that producer's loans can be indefinitely renewed effectively makes the tax liability so remote as to be almost nonexistent.⁴⁴ Although Art. XII allows use of certain measures to act as temporary remedies for balance of payments problems, it is argued that since DISC provisions are arbitrary in terms of their size and impact, and since they are not a temporary measure, they would not fall under the exception granted by this article.⁴⁵

The major objection to this approach is the fact that GATT allows member countries to relieve exports of indirect taxes (such as value added taxes) as they leave the country, and to impose on imports a tax equal to that borne by similar domestic items.⁴⁶ "Border taxes" are not considered to be either a tariff or a subsidy, since, at the time GATT was promulgated, it was assumed that indirect taxes were fully reflected in the price of the goods, while direct taxes (such as an income tax) were not, and therefore were not entitled to an export rebate or an import add-on.⁴⁷

Since the United States does not rely on indirect taxes to any significant extent, and since, as will be seen, the theory that indirect taxes are fully reflected in the price of the item is open to serious doubt, it would appear that this provision of GATT is indeed inequitable.

This distinction in treatment developed because the GATT provision allowing a rebate at the border of taxes "borne by the product"

43. Similar tax deferral provisions contained in the WHTC provisions might be due for similar challenge but for the "grandfather" clause which provided that GATT would be applied to "the fullest extent not inconsistent with existing legislation." GATT Protocol, para. 2(b), 61 Stat. A2051 adopted Oct. 30, 1947.

44. The Accounting Principles Board has taken the position that the contingent tax liability, related to DISC tax-deferred income, need not be considered in the compilation of annual earnings. Anninger, *supra* note 1, at 404.

45. *Id.* at 413.

46. *See supra* note 16.

47. Nolan, *The Impact of the Federal Tax Structure on Exports and the DISC Proposal*, in PRIVATE INVESTORS ABROAD — PROBLEMS & SOLUTIONS IN 1971 127, 136.

was interpreted to include a tax on the product itself, such as an excise or value-added tax, and not a corporate income tax (for example).⁴⁸ As mentioned above, the theory behind this practice is that direct taxes, such as a corporate income tax, is fully shifted back to the producer, by reducing after-tax corporate profits. An indirect tax would, under this formulation, be fully shifted forward and paid by the customer.⁴⁹ Unfortunately, though this view is in serious doubt today, it still derives much strength from a tradition wherein income taxes were not sufficiently important to justify the administrative machinery for border tax adjustments, and the feeling that the calculations necessary for such rebates would be too complex to utilize regularly.⁵⁰

In fact, the opposite situation may be true. It is often difficult to calculate the total amount of cascade turnover taxes or indirect taxes on multifunction capital equipment.⁵¹ It is also frequently difficult to categorize a tax as either direct or indirect since they may contain elements of both.⁵² Value added taxes are considered indirect, but they often fall on both the costs and the profits of the producer. To the extent they fall on the profits, it is difficult to distinguish them from an income tax. On the opposite side, corporate taxes are usually classified as direct. However, it is possible for a corporate tax reduction to stimulate increased spending, which would lead to increased demand, and, eventually, increased prices.⁵³

In reality, the ability to shift forward either an indirect or direct tax depends not upon a rule of economics, but rather upon the product itself, attitudes toward taxation, general economic conditions, the percentage of market control exercised by the seller, and the ease or restrictiveness of the monetary policy at the time of the transaction.⁵⁴ Under one theory, the general trend for capital concentration that leads to oligopolies in productive industries tends to negate the theory of marginal pricing and total direct tax absorption. If any tax is considered as a cost of doing business, which would be true of all

48. K. DAM, *supra* note 37, at 211; Anninger, *supra* note 1, at 402.

49. Anninger, *supra* note 1, at 416.

50. K. DAM, *supra* note 37, at 214.

51. *Id.* at 211, 214.

52. King, *Countervailing Duties: An Old Remedy with New Appeal*, 24 BUS. LAW. 1179, 1188 (1969).

53. Staff Analysis of Certain Issues Raised by the General Agreement on Tariffs and Trade, *Hearings Before the Senate Subcomm. on International Trade of the Comm. on Finance*, 92d Cong., 1st Sess., at 921, 926 (1971) [hereinafter cited as *1971 Hearings Before the Subcomm. on Int'l. Trade*]; M. VON STEINAECHER, *DOMESTIC TAXATION AND FOREIGN TRADE: THE UNITED STATES-EUROPEAN BORDER TAX DISPUTE* 27 (1973); J. JACKSON, *WORLD TRADE & THE LAW OF THE GATT* 298 (1969).

54. Nolan, *supra* note 47, at 138.

businesses except monopolies (which would be able to pass the cost along), the tax must be included in the income and the price.⁵⁵

Reduced taxes on exports could result in either lower prices (if the competition was present to force down the price, or if lack of demand accomplished the same thing) or more profit to the seller. The possibility of high profits due to a tax incentive could attract other firms even if the end result was not lower prices to the foreign consumer.⁵⁶ One suggested test for the rebate of taxes is the extent to which prices are altered by the tax,⁵⁷ but, as can be seen, in the normal economic world the combination of pressures is such that it would be difficult if not impossible to determine what portion of a given price was actually influenced by a tax. From a theoretical standpoint, however, if *any* of the tax (whether direct or indirect) is absorbed by the seller, who then receives a rebate of all taxes paid, the extent to which the tax was absorbed is essentially a subsidy.⁵⁸

It would therefore appear that value added or similar taxes are not entirely deserving of the treatment they receive, and that rebates of border taxes place goods from a country that does not depend on indirect taxes to a significant extent at a comparative disadvantage.

Changed Conditions

By 1975, major changes had occurred which made many of the 1948 assumptions, which were still operative in GATT, obsolete. In addition to the changes in economic theory noted above, the five-year "Kennedy Round" of GATT negotiations had effectively eliminated tariffs as major barriers to world trade. With tariffs out of the way, non-tariff trade barriers, such as direct and indirect subsidies to exports are receiving more attention. Also, the pattern of world trade has been significantly altered, with the U.S. in a negative balance of trade posture, and no longer in the comfortable role of leading exporter. Thus, it would appear that the U.S. can no longer afford to be "generous" in regard to the restrictive practices of other countries; nor can it confine its attention to only tariff-type restraints.

Finally, the petroleum situation has markedly changed the outlook of most industrial countries to the point where balance of payments deficits, instead of resulting in "mere" inflation, now threaten

55. Lindholm, *National Tax Systems and International Balance of Payments*, 19 NAT'L TAX. J. 163, 167 (1966).

56. J. GASTON & W. SMITH, *BORDER TAXES & INTERNATIONAL ECONOMIC COOPERATION* 86 (1969).

57. R. MUSGRAVE, *FISCAL SYSTEMS* 277 n. 9 (1969).

58. Note, *supra* note 1, at 96. It is difficult to ascertain the exact extent to which reliance on a direct or indirect system of taxation will prejudice a country when dealing with another country using a different system of taxation.

to bankrupt the economies of several countries. Although the United States is not yet at this point, the importance of maintaining exports, to at least partially offset currency flowing out to support oil purchases, has received renewed emphasis.

It is for these reasons that the application of *rebus sic stantibus* should be considered appropriate. No grand moral principles or peremptory norms of international law are sought to be avoided. Rather, the use of *rebus sic stantibus* would make a relatively successful international agreement fair and functional in its current setting. Retention of a familiar framework, albeit with a slightly different interpretation, would ultimately promote international trade, and avoid the need to scrap GATT and begin anew.

CONCLUSION

As has been shown, both the economic conditions and economic theories that prevailed in 1948, when GATT was promulgated, no longer obtain. While these two points are the strongest arguments in support of DISC, other points have been raised in various forums which should be considered briefly.

One of the cornerstones of the Treasury's initial presentation of DISC was that, in strict terms, GATT nowhere forbids a deferral of taxes, as opposed to an outright rebate.⁵⁹ While ostensibly appealing, this argument loses much of its force when one realizes that, as noted previously, the present value to a corporation of 15 years of tax deferral is approximately equal to the tax itself.⁶⁰

Another argument that has been raised is the fact that since GATT has never been ratified by the Senate, it carries only the status of an executive agreement in the United States, and cannot contradict any U.S. laws.⁶¹ This is certainly true, but it would seem to do violence to the entire concept of executive agreements (which are unquestionably a valuable tool of international relations), if Congress felt inclined to prove its point by legislatively "flexing its muscles" without considering adequately the underlying problems.

More important is the consideration of the overall economic framework in which the CONTRACTING PARTIES must attempt to utilize the GATT provisions. Currently, many countries in the world face a sudden balance of payments crisis not only as a result of profligate consumption, but due also to the sudden acceleration of petroleum prices. In this context, narrow legalistic readings of GATT

59. Letter from Roy T. Englert to Hon. Wilbur D. Mills, June 16, 1970, found in Anninger, *supra* note 1, at 393 n. 12.

60. Statement by S. Surrey, 1971 *Hearings Before the Senate Comm. on Finance supra* note 26.

61. 1971 *Hearings Before the Subcomm. on Int'l Trade, supra* note 53.

provisions regarding the right of a member nation to attempt to offset some of its balance of payments problems are inappropriate.

It may be proper to justify the use of DISC as a currency stabilization program, to aid the U.S. balance of payments. Since the dollar still serves as a reserve currency in the international monetary system, it would therefore be in the interest of all parties to stabilize the dollar.

In addition to the unique role played by the dollar, DISC may also serve a valuable function as a compensatory export subsidy and as a means to counteract the border tax adjustments. The number of countries that, directly or indirectly, grant export subsidies is rather large,⁶² and, since these practices are arguably also violations of GATT, these countries should have some difficulty in justifying their own programs if they choose to challenge DISC.

The U.S. does have the option of imposing countervailing duties, and court cases have unanimously reaffirmed U.S. domestic power to do this.⁶³ This, however, would be a drastic measure, and would probably be perceived as a more aggressive tactic than the DISC program, so it should be reserved for a last resort or for uniquely egregious individual cases.

It would then seem that the only possible long range solution, short of a major re-write of GATT, is to adopt a *rebus sic stantibus* position in regard to changed economic circumstances, and the invalidization of economic theories upon which the original document was based. Such an adaptation of GATT has already occurred: the use of temporary import surcharges by the U.S., Canada, and Great Britain would possibly indicate a de facto amendment to at least that provision of GATT when other members failed to take any action.⁶⁴

Rebus sic stantibus is seen by many as an extreme position, adopted as a last resort, legalistic method to maintain at least the facade of adherence to principles of international law while at the same time attempting to be relieved of treaty burdens that are unwanted. But the position of the U.S. has not been to adopt this posture flippantly, for they just as well could have stated that since

62. A summary of some of the tax incentives used by major trading partners of the U.S. is found at *Hearings on S.2754 Before the Subcomm. on Foreign Commerce & Tourism of the Senate Comm. on Commerce*, 92d Cong., 2d Sess., ser. 92-83, at 149 (1972). A table providing a summary of export incentives offered by the major industrial countries is found at INCENTIVES FOR INDUSTRIAL EXPORTS, U.N. Doc TD/B/C.2/89 Rev. 1 (1967). The existence of these subsidy programs is not seriously questioned, and they have therefore not been extensively covered in this Comment.

63. King, *supra* note 52, at 1179-85.

64. K. DAM, *supra* note 37, at 32; Comment, *supra* note 37, at 274.

GATT was never ratified by the Senate it cannot bind the U.S. as against contrary domestic legislation.

Adoption of the *rebus* argument by the U.S. would be the appropriate middle ground between going along with outdated and unfair provisions of GATT or calling for its total revision and encountering the predictable political impossibility of drafting a new document. The current dispute is primarily between the U.S. and Europe. The two sides have shown they abide by the generally accepted principles of international law. In that framework, a solution can be found.

Theodore L. Banks