

Background

A WTO Panel has issued its [report in the dispute India – Export Related Measures \(DS 541\)](#) on 31 October 2019. The dispute was initiated by the United States in March 2018 challenging several of India's export promotion schemes as violative of Article 3 of the Agreement on Subsidies and Countervailing Measures (**SCM Agreement**). The Panel has found that India acted inconsistently with its obligations under the SCM Agreement with respect to all the challenged export promotion schemes. In this note, we summarise the key findings of the Panel and implications of the same.

Measures at issue

The United States alleged that India provided prohibited subsidies to its exporters, inconsistent with its obligations under Articles 3.1(a) and 3.2 of the SCM Agreement through the following schemes (collectively, **India's export subsidies**):

- The Export Oriented Units (EOU) Scheme and Sector-Specific Schemes, including the Electronics Hardware Technology Parks (EHTP) Scheme and the Bio-Technology Parks (BTP) Scheme (collectively, the **EOU/EHTP/BTP Schemes**);
- The Merchandise Exports from India Scheme (**MEIS**);
- the Export Promotion Capital Goods (EPCG) Scheme;
- the Special Economic Zones (**SEZ**) Scheme; and
- the Duty-Free Imports for Exporters Scheme (**DFIS**).

Together these measures, upon fulfilment of stipulated conditions, allow eligible Indian producers to avail of:

- Exemptions from customs duties on importation of various goods (including capital goods) in case of EPCG, EOU/EHT/BTP, DFIS and SEZ
- Duty credit scrips adjustable against customs duties, central excise duties and certain other charges owed to the Indian Government in case of MEIS
- Exemptions from IGST and deduction of export earnings from corporate income taxes in case of SEZ

Legal issues before the panel

- **Whether the Export Oriented Units and Sector-Specific Schemes meet the conditions of footnote 1?**

India argued that the exemptions from customs and excise duties under the EOU/EHTP/BTP Schemes meet the conditions of footnote 1 of the SCM Agreement. Specifically, according to India, the exemption from customs duties met the conditions of footnote 1 read together with Annex I(i) or, alternatively, with Annex I(g). And the exemption from central excise duties meets the conditions of footnote 1 read together with Annex I(h).

In terms of footnote 1 to the SCM Agreement, the Panel identified four factors to ascertain whether the challenged customs duty exemption under the EOU/EHTP/BTP Schemes is not "deemed to be a subsidy". These factors are: (a) a remission, drawback, exemption or deferral; (b) of import charges; (c) on imported inputs that are consumed in the production of the exported product; and (d) not in excess of those levied on those inputs.

The Panel found that the EOU/EHTP/BTP Schemes did not fulfil the third factor i.e. "on imported inputs that are consumed in the production of the exported product". The Panel reasoned that these schemes offered exemption from payment of customs duties on a variety of goods including capital goods that are not "inputs consumed in the production of the exported product".¹ On this basis, the Panel rejected India's argument under paragraph (i) of Annex I read with footnote 1 to the SCM Agreement.

With respect to India's alternative argument on paragraph (g) of Annex I, the Panel noted that exemption from customs duties does not qualify as exemption from "indirect taxes". Customs duties are in the nature of "import charges" and accordingly, Annex I(g) does not apply.²

¹ Para. 7.204 of the Panel Report.

² Para. 7.222 of the Panel Report

Regarding India's reliance on paragraph (h) of Annex I with respect to exemption from excise duty, the Panel noted it qualified as an exemption from prior-stage cumulative indirect tax. The Panel noted that the exemption applied to procurement of "excisable goods" defined in the Central Excise Act as tobacco products, mineral products and oils obtained from bituminous minerals and gaseous hydrocarbons and salt and held the US did not demonstrate that such goods were not in the nature of inputs consumed in the production of exported products.³

- **Whether the customs duty exemption under the Export Promotion Capital Goods Scheme meets the conditions of footnote 1**

The Panel rejected India's arguments that exemption from payment of customs duties on import of capital goods fell within paragraph (i) of Annex I read with footnote 1 of the SCM Agreement. Similar to its assessment of India claims under the EOU and Sector Specific schemes, the Panel noted that capital goods cannot be qualified as inputs consumed in the production of exported product and hence ruled that

- **Whether Duty Scrips granted under the MEIS were justified under Annexes I(g), I(h) and I(i)?**

India argued that the scrips issued under the MEIS constituted refunds for past payments of indirect taxes, under footnote 1 read together with Annexes I(g) and I(h). The US argued that there was no connection with the taxes actually paid and the value of the scrips.⁴

The Panel rejected India's arguments noting that, as per the Foreign Trade Policy, duty credit scrips were granted as a "reward" for exports.⁵ The Panel further noted that the basis for calculating the reward was the FOB value of past exports of notified goods to notified markets which was then multiplied by a variable applicable rate of reward for each product-country combination. This did not indicate that indirect taxes paid in connection with the exported products were the basis of the award of MEIS scrips.⁶ The Panel also relied on the objective of the scheme as listed in the FTP to argue that there was no actual or intended remission or refund of indirect taxes.⁷

Alternatively, India argued that duty scrips granted under the MEIS and their use resulted in the remission of import charges, under Annex I(i). However, the Panel found that MEIS in no way limits the import charges that may be paid for with the scrips to import charges on inputs consumed in the production of exported products.⁸ Furthermore, the FTP allowed for the use of such scrips on import charges on capital goods which are not inputs.⁹ Therefore, the Panel found that the award of scrips under the MEIS was not justified under Annex I (i).

- **Whether the customs duty and central excise exemptions under EOU/EHTP/BTP Schemes, the EPCG Scheme, the SEZ Scheme, and DFIS constituted Revenue Foregone by the Indian Government?**

In respect of the EOU/EHTP/BTP Schemes, the EPCG Scheme, the SEZ Scheme, and DFIS, the United States argued that India foregoes government revenue because each of these schemes provides certain exemptions or deductions from taxes and customs duties.¹⁰ Identifying the Customs Tariff Act as the appropriate benchmark for analysis the Panel found that by allowing imports of goods into India without payment of customs duty leviable under the Customs Act, India foregoes that revenue in case of the customs duty exemptions granted by these schemes.¹¹ Similarly, in the case of exemption from corporate income tax to SEZ Units, the Panel found that India forgoes revenue otherwise due under the Income tax Act. The Panel further considered the objective reasons underlying these schemes and found that the objectives further confirmed that the promotion of export performance was the central reason behind the fiscal treatment provided therein.¹²

- **Whether the Duty Scrips granted under the MEIS constituted a Direct Transfer of Funds by the Indian government?**

³ Para. 7.229 of Panel Report.

⁴ Para. 7.277 of the Panel Report.

⁵ Para.7.272 of the Panel Report.

⁶ Para. 7.281 of the Panel Report.

⁷ Para. 7.288 of the Panel Report.

⁸ Para. 7.293 of the Panel Report.

⁹ *Id.*

¹⁰ Para. 7.295 of the Panel Report.

¹¹ Para. 7.325 of the Panel Report.

¹² Para. 7.401 of the Panel Report.

The US challenged scrips awarded under the MEIS as direct transfers of funds. The Panel found that because scrips can be used to pay for customs duties and other liabilities *vis-à-vis* the Government, and because they can be sold to third party recipients for consideration, they were "financial resources and/or financial claims", i.e. "funds" within the meaning of Article 1.1(a)(1)(i).¹³

The Panel also rejected India's argument that the scrips were not direct transfers as they did not fall within the examples in Article 1.1(a)(1)(i), namely "grants, loans, and equity infusions". The Panel held that such examples were illustrative and not exhaustive of "direct transfer of funds".¹⁴ Moreover the Panel found that the scrips MEIS scrips had significant commonalities with grants had sufficient commonalities with grants (which can be conditional) thereby further confirming their conclusion.

▪ **Whether India's export subsidies are export contingent within the meaning of Article 3.1 (a) and inconsistent with Article 3.2 of the ASCM?**

The Panel found that the EPCG, EOU/EHTP/BTP, DFIS and MEIS were export contingent due to the conditions set out for availing benefits therein. Specifically, with respect to the SEZ and EOU/EHTP/ BTP Schemes the Panel discussed at length the requirement of attaining positive net foreign exchange. While India had argued that this requirement could be achieved through domestic sales as well, the Panel found that when a subsidy is available on the condition of export performance, the fact that the same subsidy can also be obtained under a different set of circumstances, not involving export contingency, does not prevent a finding that the subsidy is export contingent within the meaning of Article 3.1 (a) and inconsistent with Article 3.2 of the ASCM.¹⁵

Conclusions of the Panel

Based on the above analysis, the Panel concluded that:

- Exemptions of customs duty on importation of capital goods under the EOU/EHTP/BTP Scheme, the EPCG Scheme and the DFIS are inconsistent with Articles 3.1 (a) and 3.2 of the ASCM.
- Exemptions of customs duty, IGST and deductions from taxable income under the SEZ Scheme are inconsistent with Articles 3.1 (a) and 3.2 of the ASCM.
- Duty credit scrips under MEIS are inconsistent with Articles 3.1 (a) and 3.2 of the ASCM.

The Panel recommended that India withdraw the prohibited subsidies under DFIS within 90 days from adoption of the Report; that it withdraw the prohibited subsidies under the EOU/EHTP/BTP Schemes, EPCG Scheme, and MEIS, within 120 days from adoption of the Report; and that it withdraw the prohibited subsidies under the SEZ Scheme within 180 days from adoption of the Report.

Implications

While India would most likely appeal the report of the Panel, it is unclear and when and whether the report would be adopted given the impending deadlock of the Appellate Body. Be that as it may, media reports suggest that the Government of India is in the process of rejigging its export promotion schemes. Therefore, it is time that businesses make reasoned representations to the Government of India on the nature of support they wish to receive and how the same can be structured in a WTO-compliant manner. Further, the businesses may consider taking into account the loss of revenue (or increase in cost to manufacture and sell) resulting from scrapping of these export promotion schemes while making representations to the Government of India.

Further, the Panel's ruling on Special Economic Zones scheme is likely to have impact on the legality of export processing zones/ free trade zones maintained by several Member Countries in South-East Asia which provide similar tax benefits. In recent past, several industries have shifted manufacturing in these export processing zones in countries such as Vietnam, Malaysia, Indonesia. Businesses operating from such export processing zones may need to revisit their global value chain strategies in order to mitigate any adverse impact.

Disclaimer: The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein. This update is not intended to address the circumstances of any particular individual or corporate body. There can be no assurance that the judicial/ quasi-judicial authorities may not take a position contrary to the views mentioned herein.

¹³ Para. 7.432. of the Panel Report.

¹⁴ Para. 7.435. of the Panel Report.

¹⁵ Para. 7.524. of the Panel Report.