

BUSINESS DAY

U.S. Loses Trade Case to Europeans on Offshore Tax Havens

By DAVID E. ROSENBAUM WITH ELIZABETH OLSON JAN. 15, 2002

The United States lost its final appeal today in a dispute with Europe over tax policies. The ruling is considered all but certain to renew trans-Atlantic trade tensions and could cost American companies billions of dollars in higher taxes.

Affirming earlier rulings, an appeals panel of the World Trade Organization, the Geneva-based group that regulates trade, held that the offshore tax havens allowed by United States tax law amounted to an illegal trade subsidy and must be scrapped.

The dispute between the United States and the European Union over tax havens has been going on for years, but negotiations were suspended while the case was before the appeals board.

Robert B. Zoellick, the United States trade representative, said that today's ruling was not unexpected but that he was "disappointed by the outcome."

"We will be consulting closely with Congress and affected U.S. interests regarding next steps," he added.

The next step is for a W.T.O. arbitration panel to determine the level of trade sanctions the Europeans will be allowed to impose. That will probably occur in April.

Under American law, exporters can avoid paying taxes on some overseas sales by channeling profits through subsidiaries in places like Guam and the

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Electric, General Motors, Microsoft and Boeing -- more than \$4 billion a year in taxes.

In dollar terms, that makes this the largest trade case in history.

The European Union contends that the tax breaks give American exporters an unfair edge in international commerce. The United States holds that the tax advantage is no greater than comparable tax breaks in Europe. European companies, for example, do not have to pay value-added taxes on exported goods. There is no difference between the Clinton and Bush administrations' positions on the issue.

Many academic tax experts have argued for years that it was bad policy to lower companies' taxes simply because they have subsidiaries overseas. But lawmakers have accepted the argument that tax havens are necessary to allow American companies to compete in international trade, and the law has strong support in both parties in Congress.

Companies will continue to receive the breaks unless the law is changed.

United States trade authorities say they think that the European Union brought this case primarily out of bitterness against Washington for using the W.T.O. to pry open European markets for bananas and hormone-treated beef. But European officials say that is not the case, and they point in particular to the advantage the tax break gives Boeing in its competition with the European consortium Airbus Industrie for global aircraft sales.

The W.T.O. first ruled against the United States in February 2000. In response, Congress tinkered with the law that fall. But the European Union said the new law was no better than the old one, and last August, the World Trade Organization agreed. Today's ruling came on an appeal of the decision last August.

"Now it is up to the U.S. to comply with the W.T.O.'s findings to settle this matter once and for all," said Pascal Lamy, trade commissioner of the European Union.

The Europeans have threatened to impose tariffs as high as 100 percent on a broad list of American goods including iron, steel and aircraft. If that were to

happen, the United States would surely retaliate with stiff sanctions of its own.

But few people who follow trade matters expect an all-out trade war. "Trans-Atlantic trade is so vast and so beneficial that neither side can afford a breakdown," an American trade official said today.

The issue, therefore, is what concessions Washington will have to make to mollify the Europeans and comply with world trade rules.

"The United States respects its W.T.O. obligations, which serve America's interests," Mr. Zoellick said, "and we intend to continue to cooperate with the E.U. in order to manage and resolve this dispute. This is an especially sensitive dispute that, at its core, raises questions of a level playing field with regard to tax policy."

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