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MASTER THESIS

THE BRAZILIAN INOVAR-AUTO PROGRAM UNDER WTO LAW: A TAX MEASURE IN GLOBAL TRADE COMPETITION

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Para minha amada vovó Valéria Elisa Seabra Tristão, minha eterna gratidão, carinho e admiração, por inspirar minha vida com dedicação integral, lealdade de coração e sacrifício generoso.

LIST OF ABBREVIATIONS

DETRAN *Departamento de Estado de Transporte* – Department of Transport Affairs

DSB Dispute Settlement Body

DSU Understanding on Rules and Procedures Governing the Settlement of Disputes

FDI Foreign Direct Investment

GATS General Agreement on Trade in Services

GATT General Agreement on Tariffs and Trade

ICMS *Imposto sobre Operações relativas à Circulação de Mercadorias e sobre Prestações de Serviços de Transporte Interestadual e Intermunicipal e de Comunicação*- State Value Added Tax

INMETRO *Instituto Nacional de Metrologia, Qualidade e Tecnologia* – National Institute of Metrology, Quality and Technology

IMF International Monetary Fund

INPI *Instituto Nacional de Propriedade Intelectual* – National Institute of Intellectual Property

IPI *Imposto sobre Produtos Industrializados* – Tax on Industrial Products

MDIC *Ministério de Desenvolvimento, Industria e Comércio Exterior* –Ministry of Development, Industry and Foreign Trade

MNEs Multinational Enterprises

OECD Organization for Economic Co-operation and Development

SCM Agreement on Subsidies and Countervailing Measures

SPS Sanitary and Phytosanitary Measures Agreement

TBT Technical Barriers to Trade Agreement

TRIMs Agreement on Trade Related Investment Measures

TRIPS Agreement on Trade-Related Aspects of Intellectual Property Rights

UNCTAD United Nations Conference on Trade and Development

WTO World Trade Organization

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ABSTRACT

The Inovar-Auto Program rationale encourages actual or potential accredited automobile manufacturers to invest in research on technology development, innovation, safety, environmental protection, energy efficiency and quality of vehicle and auto parts produced in Brazil. To achieve this, the Inovar-Auto Program grants tax benefits up to 30% on the monthly expenditures cost of inputs and materials applied in those projects. As a reaction to this measure, in October 2014, the delegation of the EU requested the establishment of a panel to settle the dispute under the WTO system. The overall motivation to perform this research is to evaluate whether international trade law should be a more powerful instrument to fight against harmful tax competition due to the prevalence of world economic growth. It is the objective of this study to analyse the aspects of the Inovar-Auto Program, to explore and test the international trade and tax law principles against this case, and to assess the legitimacy and validity of the aforementioned program. As a result, the master thesis considers that the Inovar-Auto Program should not be deemed as a prohibited measure mainly because it does not offer different treatment among product originating from the WTO Member nor favour national good over the foreign products from the viewpoint of the Principle of Non-Discrimination. The Program is also in line with the TRIMs Agreement, the SCM Agreement and the Sustainable Development Goals enacted by the UNCTAD in 2014.

KEYWORDS: Tax incentives, International Trade, Harmful Tax Competition, Sustainable Development

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RESUMO

O Programa Inovar-Auto incentiva os fabricantes atuais ou potenciais de automóveis credenciados para investir em pesquisa sobre o desenvolvimento tecnológico, a inovação, segurança, proteção ambiental, eficiência energética e qualidade de veículos e autopeças produzidas no Brasil. Para alcançar este objetivo, o Programa Inovar-Auto concede benefícios fiscais de até 30% sobre o custo dos gastos mensais de insumos e materiais aplicados nesses projetos. Como reação a essas medidas, em Outubro de 2014, a delegação da UE solicitou a criação de um painel de disputa para resolver o litígio no âmbito do sistema da OMC. A motivação geral para realizar esta pesquisa é avaliar se o direito de comércio internacional deve ser um instrumento mais poderoso para lutar contra a guerra fiscal que atualmente ocorre no âmbito internacional devido à prevalência do crescimento econômico mundial. É o objetivo de este estudo analisar os aspectos do Programa Inovar-Auto, para explorar e testar os princípios do comercio internacional e de Direito Tributário Internacional contra este Programa, e para avaliar a legitimidade e validade do referido benefício fiscal. Como resultado, a dissertação de mestrado considera que o Programa Inovar-Auto não deve ser considerado como uma medida restritiva ao livre comércio, principalmente porque não é oferecido um tratamento diferenciado entre produto originário do membro da OMC, nem favorece produtos nacionais sobre os produtos estrangeiros, sob o ponto de vista do Princípio da Não-Discriminação. Por fim, o Programa também está em linha com o Acordo sobre TRIMs, do Acordo sobre SMC e os Objetivos de Desenvolvimento Sustentável decretado pela UNCTAD em 2014.

PALAVRAS-CHAVE: Incentivos Fiscais, Tributação Internacional, Guerra Fiscal, Desenvolvimento Sustentável

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1 INTRODUCTION

A. Motivation of Study

The Brazilian market represents an extensive share of the Europe Union (‘**EU**’) trade at the Latin American region. In 2014, the EU's overall exports to Brazil were worth more than €36 billion[1] of which nearly €18 billion for machinery and transport equipment, including motor vehicles and its parts. Notwithstanding, over the past few years the export to Brazil of EU vehicles and parts have decreased on average 11.4% per year from 857,900 units in 2011 to 788,100 units in 2012 and 581,700 units in January-October 2013, according to the European Commission (‘**EU Commission** or **Commission**’).[2]

On the effort to counteract the decrease of the European vehicles exported to the Brazilian market, the EU initiated consultations under provisions of the World Trade Organization (‘**WTO**’) regarding research and development (‘**R&D**’) programs[3] set forth by the Brazilian Government. The EU alleged that Brazil enacted discriminatory measures towards imported goods and prohibited support to its exporters. As a reaction to those measures, in October 2014, the delegation of the EU requested the establishment of a panel to settle the dispute[4] under the WTO system (Dispute Settlement Body – ‘**DSB**’) concerning Brazilian taxation and charges on R&D programs, such as the Program of Incentive to the Technological Innovation and Densification of the Automotive Supply Chain. This program, also known as the ‘**Inovar-Auto Program**’, is object of this study.

Briefly, the Inovar-Auto Program rationale encourages actual or potential accredited automobile manufacturers to invest in research on technology development, innovation, safety, environmental protection, energy efficiency and quality of vehicle and auto parts produced in Brazil. [5] To achieve this, the Inovar-Auto Program grants tax benefits up to 30% on the monthly expenditures cost of inputs and materials applied in those projects. Under certain conditions[6] the mentioned benefit can be used to offset the tax on manufactured products, hereinafter referred to as ‘**IPI**’ (*Imposto sobre*

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[1] Compare European Union, Trade in goods with Brazil Report, European Commission, Directorate-General for Trade, 10/04/2015 < http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113359.pdf> accessed 12 May 2015

[2] Ibid (2015).

[3] The request for the establishment of a panel by the European Union also listed other Brazilian programs as such Program of Incentives for the Semiconductors Sector (PADIS), Program of Support to the Technological Developments of the Industry of Digital TV Equipment (PATVD), Program of Digital Inclusion, Special Regime for the Purchase of Capital Goods for Exporting Enterprises (RECAP) and tax benefit with regard to goods produced in Free Trade Zone. These specific programs and tax measures fall out of the scope of this master thesis, therefore they will not be dealt with in this study.

[4] Pursuant to Article 6 of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

[5] Compare Dispute Settlement WT/DS472/1 < https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds472_e.htm> accessed 11 April 2015.

[6] Pursuant Article 40 §2 of Law (*Lei*) n. 12,715 of 17 September 2012, as amended; Article 2 of Decree (*Decreto*) n. 7,819 of 3 October 2012, as amended. There are three types of accreditation (i) for domestic manufacturers; (ii) for local distributors without manufacturing activities in Brazil; and (iii) for investors in domestic manufacturing capacity. In order to be accredited, eligible operators must fulfil certain conditions which concern, depending on the accreditation sought, in particular a minimum number of manufacturing activities in Brazil and/or minimum levels of expenditure in Brazil on research and development, engineering, basic industrial technology and capacity-building of actual and potential suppliers.

Produtos Industrialzados[7]), that is due on the import of inputs and materials as well to the sales of motor vehicle within the limitations of the program.

In the request for consultation filed by the EU to the DSB, the delegation of the EU defends that the Inovar-Auto Program is based on predilection of domestic inputs over imported goods. In addition, the EU sustains that, opposed to distributors of imported vehicles of automakers with manufacturing activities in Brazil; those of car assemblers without factory plant in the country cannot earn any sizeable tax credit to offset the IPI tax. Moreover, the request argues that the conditions for use of the tax benefit earned by automakers participants in the Inovar-Auto Program limits the possibilities to offset the IPI tax on imported goods and that the system is geared to favour the use of Brazilian-made components by domestic manufacturers.

Brazil did not respond to the consultation sent out by the EU until December 2014. As a result, the constitution of the panel was only authorised on 26 March 2015, in accordance with Article 6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ('**DSU**'). Other countries have reserved their rights to participate in the Panels proceedings as third parties. [8] Until this present moment, no follow up in the proceeding has been found and therefore the ruling of the case is still to come.

The Dispute Settlement of the Inovar-Auto Program involving EU and Brazil can be compared to several other global conflicts involving tax measures.[9] As illustration, it has been observed that countries present tax arrangements to attract foreign investments and to increase the national source of tax revenue, mainly due to the recent financial crises. [10] Taking those events into consideration, one may question what would be the relation between international taxation and global trade competition? In addition to that, how would world trade law be able to respond to the challenges posed by the different tax regimes enforced by countries? These and other correlated questions motivate the research performed in this master thesis.

[7] The IPI is established under the provisions of Law (*Lei*) n. 5,172 of 25 October 1966 (*Código Tributario Nacional*), as amended, in particular in Chapter IV, Section I; and of Law (*Lei*) n. 4,502 of 30 November 1964, as amended. The provisions of those laws are further developed in Decree (*Decreto*) n. 7,212 of 15 June 2010. The IPI is levied on transactions involving manufactured products including imports of goods from abroad. Tax rates vary depending on the nature of the product and its tax classification and are in line with the constitutional principles of necessity and selectivity. The imposition of IPI follows the non-cumulative principle, under which the tax considered due in prior transactions (including import of products) may be offset against the tax due on subsequent transactions involving the product manufactured by the taxpayer. Compare BDO (2013) < http://bdo.ee/static/DBI-Brazil-2013.pdf> accessed 12 April 2015.
[8] Argentina, Australia, Canada, China, Colombia, India, Japan, the Republic of Korea, the Russian Federation, South Africa, Chinese Taipei, Turkey and the United States.
[9] Compare Schön (2003), Stewart (2003), Avi-Yonah (2001). All dealing with aspects of tax and international trade for International Tax Policy and harmful tax competition avoidance.
[10] The tax rulings in Luxemburg benefiting several MNEs, amongst IKEA, Amazon and Fiat established in that country has been widely broadcasted by work of the International Consortium of Investigative Journalists (ICIJ) < http://www.icij.org/project/luxembourg-leaks/leaked-documents-expose-global-companies-secret-tax-deals-luxembourg> accessed 5 May 2015.

In the intersection between international taxation and global trade competition, ROSEMBUJ states that the world trade system and tax law are based around three axes (i) the unconditional obligation of the most-favoured nation, (ii) the obligation of the national treatment, and (iii) the prohibition of state aid that may alter or falsify the commercial competence or affect the fiscal interest of other states.[11] These three axes will be used as benchmarks to check and test the object of this study in order to answer the research question. Additionally, the Inovar-Auto Program is used as an object of study in order to understand the interaction between tax law and global trade. Therefore, the program will be tested against the benchmarks of the regulatory framework and under principles of law ruling international relations.

In conclusion, the overall motivation to perform this research is to evaluate whether international trade law should be a more powerful instrument to fight against harmful tax competition due to the prevalence of world economic growth. It is the objective of this study to analyse the aspects of the Inovar-Auto Program, to explore and test the international trade and tax law principles against this case, and to assess the legitimacy and validity of the aforementioned program.

B. Research Question and Limitations

It is the aim of this thesis to conduct a research and to answer the following research question:

'Under WTO Law, should the tax regime of the Brazilian Inovar-Auto Program be considered a prohibited measure from the viewpoint of the Principle of Non-Discrimination?'

This main question is answered by first answering the following sub-questions:

a.To what extent can international trade law be used as an instrument to mitigate abusive tax competition?

b.How much does international trade law influence developing countries' grants of tax benefits in order to attract investments?

The focus of the research question is exclusively on the Brazilian Inovar-Auto Program dispute settlement framework under the WTO System, *i.e.* its wording, as well as related case law and legal literature. The master thesis does not deal in depth with any other provisions or trade agreements not correlated to tax incentives or subsidies, but it does merely briefly touch upon them where found necessary.

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[11] Compare Rosembuj (2007), page 348.

In order to analyse the research question this study is pursued as followed. **Chapter 2** deals with the development of the normative framework that is used as a benchmark against which the research question is tested. For the purpose of the research, the principle of non-discrimination is used as a benchmark. The reason for the choice lies not only in the fact that the principle of non-discrimination is considered to be one of the key principles underlying international trade law under the WTO System, but also in the fact that especially this principle offers the best possible basis for the assessment of the Brazilian Inovar-Auto Program. **Chapter 3** discusses the current treatment of imported goods under the Brazilian Tax System through the prism of the Inovar-Auto Program, as well as the most relevant legal and economic consequences produced by its current wording. The aim of this part of the thesis is to discuss the most relevant legal sources related to the current treatment and its consequences with a view to developing the answer to the research question. **Chapter 4** investigates whether international trade law can be used as an instrument to mitigate abusive tax competition and to what extent international trade law influences developing countries' grants of tax benefit in order to attract investments. **Chapter 5** is reserved for analysis of the findings under Chapters 3 and 4, and their evaluation in the light of the normative framework developed in Chapter 2. In this sense, the current regime of Inovar-Auto is tested against the benchmark set in Chapter 2. Finally, **Chapter 6** provides for a summary the conclusions, and the answers to the research questions.

C. Methodology

The methodology used for assessing the research question is based on description and analysis of different sources of law as well as on a review of relevant legal academic literature. In this case the applying WTO Agreements, the Brazilian Law n. 12.715/12, the Brazilian Decree n. 7.819/12 and Dispute DS472/WTO are considered. It is also used in the research data on public bodies accessible through the WTO Research Platform and news on virtual media regarding the Inovar-Auto Program. It is understood that this research method is best suited for providing necessary information for analysis of this particular research and making conclusions thereon. Specialized legal literatures, both by books or articles are consulted to substantiate the discussion.

2. PRINCIPLE OF NON-DISCRIMINATION

2.1 Introduction

Within foreign commercial exchange, principles and rules are applied in order to harmonize the global trading system and to secure countries' acquisition of their equitable share of the gains.[12] The law of the WTO is designed to cover trade distortions and international trade related issues from tariffs, import quotas and customs formalities to compulsory licensing, food safety regulations and intellectual property rights.[13]As a result of this, six fundamental rules and principles practiced inside the WTO system are identified in the legal framework by BOSSCHE:[14]

i. the principle of non-discrimination;
ii. the rules on market access;
iii. the rules on unfair trade;
iv. the rules on conflicts between trade liberalisation and other social values and interests; including the rules on special and differential treatment for developing countries;
v. the rules promoting harmonization of national regulation in specific fields;
vi. the rules relating to institutional and procedural issues.

Put short, the rules on market access bind WTO Members to negotiate mutually reduction of custom duties, eliminate non-tariffs barriers and prohibit quantitative restrictions.[15] The rules on unfair trade aim to guarantee an international fair market by avoiding economic market failures[16], for example, anti-dumping regulations. The conflict between trade liberalisation and others social values and interests is tackle by specific WTO rules and disciplines which takes into account economic and non-economic values including the protection of the environment, public health, public morals, national treasures and national security.[17] Those social values and interest permit WTO Members to deviate from the trade liberalisation obligations.[18] The international trade rules also deal with others non-tariff barriers to trade such as technical regulations, standards and conformity assessment procedures, as one can see in the TBT Agreement, the SPS Agreement and the TRIPS Agreement.[19] Finally, institutional and procedural rules guide the decision-making and dispute settlement in the multilateral trade within the WTO System.

[12] Compare Bossche (2008), page 34.
[13] Ibid (2008), page 37.
[14] Ibid (2008), page 37.
[15] Article XXVIII GATT (1994).
[16] Compare Micheau (2014), page 34.
[17] Compare Bossche (2008), page 41.
[18] Ibid (2008), page 41.
[19] Ibid (2008), page 41.

Among this set of rules, the principle of non-discrimination is considered in the literature as key under WTO law. [20] BOSSCHE recognize that discrimination measures between, as well as against, other countries "distorts the market in favour of products and services that are more expensive and/or of lower quality"[21] and therefore must be avoided due to trade liberalization. For this reason, it is the principle taken to be the best basis for the assessment of the research question over the others rules. In addition to that, the rationale of this principle is materialised by the application of the most-favoured nation ('**MFN**') treatment obligation and the national treatment ('**NT**') obligation. More detailed analysis of the principle of non-discrimination and its obligations will follow in section 1.3.

2.2 Principle of non-discrimination in the context of taxation in global trade

Over the past seventy years selling and buying practices have been shifting from local supply chains (*i.e.* territory of a country representing a particular "market" [22]) to multilateral international trade. [23] Aspects of this multilateral trade are often grasped by the current high-speed means of transport, the increase in production and distribution, the accessibility for consumers to purchase goods online and the availability of render services put on offer through cross-border transactions, among others. Another side of this economic integration, usually referred in the literature as effect of globalization[24], is Foreign Direct Investment ('**FDI**') that emerged as one of the most frequent used methods to invest in cross-border economic activities through Multinational Enterprises ('**MNEs**') over the 1990s. [25] In addition to that, MNEs also engage in international structure planning and outsource of their productions and operations aiming increase in profits and lower costs. [26] Furthermore, MNEs have been currently under the eyes of the governments and of the public opinion due to leaks in the news concerning their aggressive tax planning resulting in little or no effective taxes payments on their worldwide profit. [27]

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[20] Ibid (2014), page 33. In this regard, the author also indicates a vast list of contributions in the study of principles of WTO law, for example, Noonan C., *The emerging principles of international competition law,* Oxford University Press, 2008; Michell A., *Legal principles in WTO disputes,* Cambridge University Press, 2008 and so on.

[21] Compare Bossche (2008), page 321. It is relevant to elucidated that the author indentifies that discrimination among national product and others countries was a characteristic of the protectionist trade policies pursued by many countries during the Great Depression of the 1930s. In addition to that, the author sustains that those discrimination measures contributed to the economic and political crises that resulted in the Second World War. For that reason, eliminating discrimination in the context of the WTO is to be considered the paramount value under the trade liberalization conducted under the WTO Agreements.

[22] Compare Schön (2009), page 67.

[23] Compare, for example, Mazumder (2008), page 5. He writes: "The increase in world trade has been due to a number of factors. In the post World War II period, vigorous expansion of the world economy, partly due to Government policies aimed at ensuring economic growth, has provided the principal impulse for the growth of world trade. The increase in overall growth rates also resulted in a vast and widely disseminated increase in personal incomes, which gave rise to an increased demand for imports. Gradual liberalization of trade restrictions and import controls, reduction in customs tariffs and the vigorous export promotion activities have also contributed in the growth of world trade. The increased flow of funds from the economically advanced countries to the developing ones have also helped in the growth of world trade."

[24] Compare Schinkel (2009) and Schön (2009).

[25] Compare Correa and Kumar (2003).

[26] Ibid (2003). They also analyse that comparing to the total exports of goods and services of the order of US$ 7.4 trillion in 2001, the sales of affiliates of multinational enterprises (MNEs) totalled $ 18.5 trillion in 2002, while in 1990 sales of foreign affiliates were only marginally higher than those of global exports.

[27] See note 10.

At the same time, one should note that national governments (legitimized by principle of national sovereignty) have the ability to impose tax either to secure revenue for its public-social purposes or to influence behaviour decisions made by individuals and companies while designing their tax systems. By doing the latter, it is undeniable that the government ends up interfering with the forces of the market – shifting part of the demand for goods and services from the private sector to the government or distorting the natural consumption and investment behaviour. [28] Although autonomy of legal jurisdiction assures to governments the power to tax, to determine the taxable event, the exemptions or the concession of tax credits, tax benefits or incentives within its territory towards the respective resident taxpayer, one should note that the national legal system must comply to its commitments signed under international law in order to maintain the coherence and effectiveness due to the rule of law principle.[29]

Regarding the role of the government's interference within global trade, economists are usually of the opinion that countries should encourage international trade and exchange of goods and services on the basis of their comparative advantage.[30] In essence, countries would produce international economic welfare by applying their natural advantages in producing particular commodities while performing transactions with a foreign country. [31] Nonetheless, countries frequently attempt to undertake trade protectionist measures to protect domestic industry, employment, sustainable environment and revenue collection from foreign competition. As a result of this practice, DEARDORFF and STERN reflect that trade protective intervention, also known as exploitative intervention, "is likely to find countries in the classic position of the Prisoner's Dilemma; that is, each country has available a policy that will benefit itself at the expense of others, but if all countries simultaneously pursue that policy, all are likely to lose."[32] Subsequently, international trade law developed its legal framework aiming on the avoidance of harmful protectionist measures in order to safeguard trade liberalization.

Taking a step back in history, these developments and discussions concerning world economic growth, international tax and globalization are in many ways remarkable. The post-Second World War period was heavily influenced by the intense global effort to consolidate international trade business and also it was driven by the ideal of peace through commercial exchange. Moreover, the need to attract investments due to the collapse of the productive system caused by the allocation of war efforts and by the devastation left in Europe appealed to the reestablishment of the international trade order. In response to this ultimate need to reorganise this order, the General Agreement on Tariffs and Trade ('**GATT**'), signed in 1947 and revised in 1994, came to conduct trade and economic relations "with a view to raising standards of living, ensuring full employment and a large and steadily growing volume

[28] Ibid (2003), page 285.
[29] Ibid (2003), page 286.
[30] Compare Bossche (2008), page 20.
[31] Compare Helpman (2011), page 18.
[32] Ibid (2011), page 23.

of real income and effective demand, developing the full use of resources of the world and expanding the production and exchange of goods."[33] As the result from Uruguay Round (1986-1994) negotiations, the WTO was created to encompass all multi-lateral agreements in trade and services, including[34] GATT, to establish a dispute settlement process to solve conflicts between the WTO Members and to facilitate the negotiation of trade agreements among governments.[35] The WTO Appellative Body ('**AB**') ruled in the *Brazil – Desiccated Coconut* case understanding that the WTO Agreements are to be considered as an entire piece, obtaining a "single undertaking"[36] nature. In addition to that, the agreements represent "an inseparable package of rights and disciplines which have to be considered in conjunction"[37] and therefore they are preeminent to rule the international trade transactions.

The way in which governments impose their taxes can also influence international trade. In this respect, SCHÖN illustrates it as when the national tax system choose to charge the amount of income earned from the export of goods and not give exemption for the export activity or whether the tax on profits takes into consideration the using of domestic products over the imported ones.[38] According to the preamble of the GATT, the WTO Members intend to strengthen their trade and economic relations by "entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs – custom and excise duties[39] – and other barriers and to the elimination of discriminatory treatments in international commerce."[40] Ultimately, governments impose customs duties on international trade to generate revenue and in addition to that countries often intervene in the world market.

Looking now more closely at the principle of non-discrimination as avoidance of distortion in international trade, the WTO system sets forth limitations on the WTO Members' sovereignty concerning taxation. On this ground, provisions on tax incentive measures are found through the Articles I: 1, III: 2, III: 4 and III: 5 of the GATT, Articles 3.1 (b) and 3.3 of the SCM Agreement and Article 2.1 of TRIMS Agreement, as set in Annex 1 of this study. Subsequently, countries are enforced to design their national tax regimes without generating any protective effect in favour of local products

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[33] Preamble of GATT (1994).
[34] Note that the WTO System is mainly made of the General Agreement on Tariffs and Trade (GATT), General Agreement on Trade in Services (GATS), Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Agreement on Subsidies and Countervailing Measures (SCM Agreement), Agreement on Trade Related Investment Measures (TRIMs Agreement) amongst others agreements. <https://www.wto.org/english/docs_e/docs_e.htm> accessed 10 April 2015.
[35] World Trade Organization < https://www.wto.org/english/thewto_e/whatis_e/who_we_are_e.htm> accessed 10 April 2015.
[36] See Appellate Body Report, Brazil – Desiccated Coconut, page 12.
[37] See Appellate Body Report, Argentina – Footwear (EC), para. 81 and Appellate Body Report, Korea – Dairy, para. 74.
[38] Compare Schön (2003), page 283.
[39] Compare Schön (2003), page 287. He writes that even though the law of WTO does not provide a general definition of tax, it recognizes the difference between customs duties, direct taxes and indirect taxes. Thus, footnote 58 to the Subsidies Agreement distinguishes between customs duties (" tariffs, duties, and other fiscal charges that are levied on imports"), indirect taxes ("sale, excise, turnover, value-added, franchise, stamp, transfer, inventory and equipment taxes") and direct taxes ("taxes on wages, profits, interest, rents, royalties and all other forms of income, and taxes on the ownership of property"). The author also defends that it is generally assumed that this detailed definition can also be applied in other areas of world trade law.
[40] Preamble of GATT (1994).

over foreign ones due to competition[41] or any other trade-discriminatory measure among WTO Members. Henceforth, it can be conclude that tax legislation and other burdens should not deviate from the most-favourite nation and national treatment obligations in line with the principle of non-discrimination.

2.3 Principle of non-discrimination treatment obligations

Eliminating discriminatory treatment in international trade transactions is one of the two main objectives set forth under the WTO system.[42] Pursuant Article I and III of the GATT, discriminatory measures are challenged against the Most-Favoured Nation treatment that prevents discrimination between like products among WTO Members and the National Treatment Obligation that restrain a country from discriminating foreign products against local goods, respectively. In accordance with the said, the rest of this section is directed to comprehend these two treatment obligations in which the principle of non-discrimination can be observed, so it can conclude how these treatments are to be used as the benchmark against which the evaluation is performed in Chapter 5.

2.3.1 Most-Favoured Nation Treatment in the context of the WTO

The MFN treatment is more often than not considered to be the keystone of non-discrimination in the international trade. It prohibits discrimination regarding the national origin or destination of a product or service among WTO Members.[43] MAVROIDIS notes that MFN treatment is divided into two main functions.[44] The first concerns the relation between governments and the private sector by preventing opportunistic taxation due to the setting of tariffs unilaterally. The second regards the multilateral trade liberalization and tariff negations among countries by avoiding concessions erosion. This hinders WTO Members from contracting "better terms of market access to a third country. As a result of this, trade agreements become more credible"[45].Moreover, MFN treatment simplifies the countries' customs procedures by giving the same treatment to like products from all their trade partners also reducing the number of possible bids and outcomes within tariff negotiations. [46] Nevertheless, the MFN clauses are becoming the exception in the trade relations between countries due to several preferential treatment, customs unions, free trade areas, common markets experienced in the current global trade transactions. However, the MFN remains a principal obligation for WTO Members.[47]

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[41] Compare Schön (2003),page 283.
[42] Compare Bossche (2008), page 321.
[43] Ibid (2008), page 321.
[44] Compare Mavroidis (2013), page 130.
[45] Ibid (2013), page 131.
[46] Ibid (2013), page 132.
[47]Compare Bossche (2008), page 324

Pursuant Article I:1, of the GATT, measures that confer any advantage, favour, privilege or immunity granted by any WTO Member to another country must immediately and unconditionally be given to the like product originating in or destined for all other Members. In this perspective, the MFN treatment is enforced not only against *de jure* discriminations which are considered as a clear favouritism from the law, regulation or policy; but also concerning *de facto* discriminations carried out within the trade practice.[48] In *Canada-Autos*, the Appellate Body ruled that the Canadian exemptions measures which by their wording were to be considered "origin-neutral" were deemed to be discriminatory due to the exemption was in fact given to certain small number of countries.[49] Other than that, discriminations between like products originating in, or destined for, different countries are prohibit.[50]

Put simply, the MFN treatment obligation is set forth against measures representing a better treatment granted from a WTO Members to another country over the others WTO Members. These advantages concerns any (i) customs duties and charges of any kind imposed on or in connection with importation and exportation, (ii) rules and formalities affecting the sale, distribution and use of products and (iii) internal taxes. Moreover, in the *Spain – Unroasted Coffee* the Panel clarified that the MFN treatment is equally applied to bound and unbound tariffs items.[51] As result of that, the interpretation of the concept of "any advantage" was also applied to additional bonding requirements[52], tax and customs duty benefits[53], concessions to tariff rate quotas[54] and so on. In this scenario, it can be conclude that tax measures affecting international trade are reached by the MFN treatment and therefore evaluated under the non-discrimination test.

Another aspect of the MFN treatment concerns the non-discrimination regarding advantages granted to products originated in or destined for any country in relation to like products from all other WTO Members. Admitting that the concept of "like products" is still controversial in the WTO DSU system[55], the Appellate Body in *EC – Asbestos* "considered that the dictionary meaning of "like" suggests that "like products" are products that share a number of identical or similar characteristics.[56] This concept was challenged in the GATT Panel on *Spain – Unroasted Coffee* that applied the essentiality criteria for defining likeness. In this scenario, the Panel understood that process-based distinctions were not relevant to define likeness and therefore the characteristics of the products taking into account their end-use and also the tariff regime of other WTO Members should be considered in

[48] Compare Bossche (2008), page 324.
[49] See Appellate Body Report, *Canada – Autos*,para. 78
[50] See Appellate Body Report, *Canada – Autos,* para. 84.
[51] See GATT Panel Report, *Spain – Unroasted Coffee,* para.4.3
[52] See Panel Report, *US – Certain EC Products*, para. 6.54.
[53] See Panel Report, *Indonesia – Autos,*para 14.147
[54] See Appellate Body Report, *EC – Poultry,* para. 99.
[55] The concept of "like products" is found in several discussions. For instance, compare Appellate Body Report, *Canada – Aircraft*, para. 91; Appellate Body Report, *Japan – Alcoholic Beverages II,* para. 114 and GATT Panel Report, *EEC – Animal Feed Proteins,* para. 4.2.
[56] See Appellate Body Report, *EC-Asbestos,* para. 91.

order to demonstrate the likeness among products.[57] Thus, the extension of the concept of like products is more often than not defined in case by case level due to the absence of case law directly addressing this issue.[58]

Finally, the MFN treatment requires that any advantage granted by a WTO Member to imports from any country must be granted "immediately and unconditionally" to imports from all other WTO Members.[59] In this sense, the GATT Panel ruled in the *Indonesia – Autos* that tax and customs duty benefits could not be made conditional on any criteria that are not related to the imported product itself.[60] However, in *Canada – Auto* the Panel made distinctions considering that the imposition of conditions that do not discriminate between products on the basis of their origin is consistent with the MFN treatment.[61] Henceforth, one should note that the MFN treatment aims to insure an equal treatment among WTO Members and therefore in case that the condition to like products is applied to all the others Members it shall not be deemed discriminatory.

2.3.2 National Treatment in the context of the WTO

Besides the prohibition of discrimination among products from different WTO Members as aforementioned in the MFN treatment, the WTO system also constrains a WTO Members to enforce discriminations between their national products and like products from abroad due to the National Treatment obligation (NT). As consequence of that, countries should not enact domestic instruments to treat national products better than foreign ones only because of their different origin.[62]

Pursuant Article III:1, of the GATT, domestic policy measures are deemed discriminatory whereas applied as to afford protection to the national products. MAVROIDIS alerts that national protection is meant to be interpreted as a "shield from competition" and refers to measures giving rise to negative international externalities.[63] This represents a distortion on competition due to the increase of cost burden for foreign product accessing the national market. Hereof, internal measures should not protect domestic production with regard to internal taxation of "like products", directly competitive products or substitutable products and considering the internal regulations.[64]

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[57] See GATT Panel Report, *Spain – Unroasted Coffee,* para.4.6 – 4.9.
[58] Compare Mavroidis (2013), page 149.
[59] See Article I:1, GATT (1994).
[60] See GATT Panel Report, *Indonesia – Autos,* para. 14.146.
[61] Compare Bossche (2008), page 333.
[62] Compare Mavroidis (2013), page 300.
[63] Ibid (2013), page 300-301.
[64] Compare Bossche (2008), page 348.

In reference to the scope of internal charge, the NT concerns all the taxes applied directly or indirectly on domestic products. Direct taxes[65] on the products are to be considered as, for example, value added taxes (VAT), sales taxes and excise duties. Moreover, this is also understood as any other charge applied on or in connection with products.[66] Indirect charges relates to taxes applied on the processing of the product as well those imposed on inputs.[67] In this scenario, the Appellate Body stated in *Argentina – Hides and Leather* that even tax administration measures take the form of an internal charge when applied to products.[68] By doing do, such measures also must be submitted to the NT obligation. Hence, in accordance to Article III:2, of the GATT, internal taxes on imported products should not be in excess of the internal taxes applied to like domestic products.

The NT application on directly competitive or substitutable products set the comparison between the imported product and the like domestic product within the marketplace being "able to satisfy a particular need or taste of the consumer".[69] This ensures a competitive level field within the domestic market taking into account the international trade. Therefore, national measures shall not discriminate foreign products due to domestic market protection by inducing the demand for the national products by freezing the offers of foreigner goods. Moreover, according to the Panel in *US- Section 337,* "effective inequality of opportunities for imported goods in respect of the application of laws, regulations and requirements affecting internal sale" represents treatment no less favourable within the domestic market competition. As a result of that, a country must refrain to issue internal regulations or requirements that set less favourable treatment between national and foreign like products due to afford protection to domestic production.

Having seen the most-favourite nation and national treatment obligations meanings of the non-discrimination concept in the previous section, the author is of the opinion that a combination of those two obligations best fits the discussion on the assessment of the Inovar-Auto Program in compliance to the WTO law. In that sense, the principle of non-discrimination, in this particular dual-aspect of the MFN treatment and the National Treatment Obligation, is taken as the benchmark against which the current tax regime of the Inovar-Auto Program is observed in Chapter 3, and the alternative approaches to the investments incentives by tax measures dealt with in Chapter 4, is evaluated in Chapter 5.

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[65] Ibid (2008), page 349. The author also alerts that income taxes or import duties are not covered since they are not internal taxes, per say, on products. However, income tax regulation can be considered to be an internal regulation and thus to fall within the scope of article III:4, of the GATT, according to the Panel Report,*US-FSC,* para. 8.145.
[66] Ibid (2008), page 350.
[67]Ibid (2008), page 350 and see GATT Panel Report, *Japan – Alcoholic Beverages I,* para. 5.8.
[68] See Panel Report *Argentina – Hides and Leather,* para. 11.144.
[69] See Appellate Body Report, *Korea – Alcoholic Beverages,* para. 114.

2.4 Recovery of Tax Incentives under WTO law

Following the analyses of the aspects and relevant issues correlated to the Principle of Non-Discrimination, the author is of the opinion that it is essential to go deeper in the discussion of tax incentive under the WTO law looking at the method of recovery of such measure once ruled as prohibited by the DSB System. But first, the general aspects of the dispute settlement are outlined taking the view point of the involvement of the WTO Member and the private sector in the dispute. BOSSCHE states that the dispute settlement system is designed to deal only with WTO Members, which means that it is a 'government-to-government' system of dispute resolution.[70]As a result of that, non-State actors, such as companies, NGOs and others taxpayers, are in principle excluded from the dispute settlement mechanism even though they may have strong interests in the pledge.[71] Such understanding can be seen in the *US-Shrimp* case when the Appellate Body recalled expressly, "it may be well to stress at the outset that access to the dispute settlement process of the WTO is limited to Members of the WTO. This access is not available, under the WTO Agreement and the covered agreements as they currently exist, to individuals or international organizations, whether governmental or non-governmental."[72] It can be sensed by the strong lobby groups, powerful companies or significant associations influencing the governments in the dispute. In that respect, the SCM Agreement provides that investigation should be initiated at the request of domestic industry of the WTO Member. Henceforth, although WTO law is not regarded to individuals it is very common to see the involvement of the private sector in the disputes.

In case of any tax measure is to be found a prohibited subsidy, the panel may rule that the subsidizing Member must perform the withdrawal of the subsidy without delay[73]. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.[74]LUJA observes that "one must keep in mind that repayment of prohibited subsidies is still an undiscovered area in the context of international trade law and that it is far from becoming an accepted part of WTO remedy procedure."[75] In contrast with the State Aid Regulations in the EU which enforces the Member State to recover the aid from the company[76], there is no legal basis in the WTO law for punishing private companies by repayment.[77] In that sense, it is mostly common for the winner Member to make use of the Appellate Body ruling as a bargain in further trade negotiations instead of actually enforce the measures imposed by the DSB against the beneficiary company. In conclusion, the author is of the opinion that although the private companies are not directly affected by the Appellate Body ruling, it

[70] Compare Bossche (2008), page191.
[71] Compare Micheau (2014), Page 358.
[72] See Appellate Body Report, United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, circulated 12 October 1998.
[73] See Article 3(7) and 22(1),DSU.
[74] Compare Article 4.7, of the SCM Agreement.
[75] Compare Luja (2003), page 147.
[76] See Article 107 and 108 of the TFEU.
[77] Compare Luja (2003), page 146.

is to be note the impact of the dispute settlement in the investment flow and overall losses influenced by the withdrawal of the prohibited tax measure in the economic climate of the losing Member.

2.5 Preliminary conclusions

The principle of non-discrimination is one of the key principles under WTO law. It is a pillar to the international trade liberalization ensuring elimination of discriminatory measures. In order to do that, such discriminatory measures are challenged against the MFN treatment obligation and the national treatment obligation. In addition, the principle of non-discrimination is seen in a dual-concept approach in different contexts. For the purpose of this master thesis, the author assigns continuously the MFN treatment obligation or the national treatment obligation on proper occasion that it is needed. The non-discrimination framed this way concludes the discussion on normative framework that will serve as a foundation for the evaluation performed subsequently. Moreover, the impact of the eventual withdrawal of a tax measure in conflict with the WTO law have big effect in the economic welfare of the subsidizing Member, even though it is not enforced by WTO law the repayment of the prohibited subsidy by the private company.

3. THE BRAZILIAN IMPORT TAX SYSTEM AND THE INOVAR - AUTO PROGRAM

3.1 Introduction

This section will focus on the current treatment of import under the Brazilian Tax System through, firstly, the general aspects of this system and its legal sources. Subsequently, the relevance of international treaties and conventions to the Brazilian Tax System and their place in the national legal system is screened. Then, a brief overview of the Brazilian import system in light of the Principle of Non-Discrimination is given a look. Afterwards, the legal and economic corollaries of the current Greater Brazil Plan are examined. The section concludes with a reference in depth to the specific regulations and criteria of the Inovar-Auto Program and its application in a pragmatic approach.

The aim of this section is to, by analyzing the Brazilian Import Tax System issues and the detailed terms and conditions of the Inovar-Auto Program, set up the basis for the evaluation that is going to take place in section 5.2, against the benchmark put forward in section 2.3.

3.2 General Aspects of Brazilian Tax System

The Brazilian tax system is designed in the Federal Constitution ("**Constitution**") of 1988 in which are found general principles, definitions of taxes, competences to tax, procedures, and limitations concerning the power to tax in the national tax system. Brazil is a Federal Republic, comprised of the Federal District, 26 States, and more than 5,564 Municipalities. In the vast national territory, the power to tax is shared by competence (right to tax) and jurisdiction (legitimacy to tax) of each one of these administrative spheres individually. Moreover, SCHOUERI explains that the Constitution also presents the conditions and limits of tax as used as instrument to *economic intervention*.[78] In that sense, each of those administrative spheres of the Federation is obliged to comply with the constitutional principles and restrictions while exercising their power to tax. Subsequently, the National Tax Code (*Código Tributário National – CTN)*, enacted by the Law n. 5,172/1966, regulates constitutional limitations on the power to tax, establish general rules concerning tax legislation and provide for conflicts of competence concerning tax matters between the Federative spheres.[79]

The Brazilian tax system is articulated by supplementary and ordinary federal laws, resolutions issued by administrative authorities and State or Municipal laws in their respective tax competence. More often than not, " legislation is frequently introduced and changed by laws and provisional measures,

[78] Compare Schoueri (2012), page 68.
[79] Pursuant Article 146, Federal Constitution, although the National Tax Code was consolidated in 1966 formally as an ordinary law it is materially faced as supplementary law due to the nature, function and application of the provisions set forth in the Code within the Brazilian tax system.

but retroactive legislation is not permitted, except when it benefits the taxpayer and when the taxable event affected has not yet been completed".[80] Another aspect of this tax system is that the Ministry of Finance has the responsibility for implementing tax statutes which represent the tax authority interpretation on tax affairs within the Federal sphere. This is done through the Brazilian Revenue Service (*Receita Federal do Brasil – RFB*) which is bound to those tax interpretative regulations in the fiscal practice as tax authority. Moreover, tax rulings are often issued and practiced considering specifics facts and situations. In the end, judicial case law interpretations on tax matters usually play relevant "influence over other comparable cases as well as the decisions of the tax authorities".[81]

3.3 Sources of Brazilian Tax Law

The Brazilian tax law regulates the relationship between the taxpayer and the State as tax authority within the national jurisdiction. In this scenario, the taxable event, the taxable object, the taxable rate, exemptions, tax credits and so on must be foreseen in the law in order to constitute the tax relation between those two poles. [82] The source of the tax legislation in the Brazilian tax system is dictated pursuant Article 96, of the National Tax Code, read as follow:

> *"The expression "tax legislation" is conceived as the law, the* ***international treaty and convention****, the decree and the complementary norms that deal, whatsoever, about tax and its respective juridical relation."* (emphasis added).

From the wording of Article 96, it is clear that the international treaty and conventions ratified by Brazil are part of the national tax system and represent a crucial source of law to regulate the internal tax in consonance with the international law. Henceforth, it also indicates how WTO Agreements should be perceived in the Brazilian tax system due to their competence to regulate tax affairs in the national jurisdiction as further discussed in section 3.4.

3.4 International treaties and conventions in Brazilian Tax Law

There are no questions whether international treaties and conventions, of which GATT and other agreements within the WTO System are representatives, are sources of the Brazilian tax law. However, it is worth the thought over how the rules and provisions established in those international legal instruments are internalized in the Brazilian legal system and, after that, which legal hierarchy the treaties and conventions receive once they are ratified and implemented in the national legal

[80] Compare Doing business and investing in Brazil – PwC (2013), page 102. Accessed 15 June 2015 < http://www.pwc.de/de/internationale-maerkte/assets/doing-business-and-investing-in-brazil.pdf>
[81] Ibid (2013), page 102.
[82] Compare Nogueira (1986), page 57.

system. Henceforth, it is notable that the international treaty is meant to set limits to the Brazilian jurisdiction; in that respect, the national legal system must only act within such borders.

To explain the international treaties and conventions in Brazilian tax law, SOUZA states that these international agreements are especially determinant on customs and double taxation related issues.[83] For that author, in accordance with the Constitution, the international treaties agreed by the Executive Branch may only be enforced within the national jurisdiction after being approved by the Legislative Branch. This legislative act would be in essence considered as Law and therefore it would be granted a higher hierarch degree for these treaties and conversions internalised in Brazil.[84] On the other side, AMARO reflects that the legal system might be regarded dysfunctional in case of treaties were to be considered higher in hierarch than internal legislation[85]. This author presents the problem of consider the treaty and convention to be higher in hierarch by explaining the conflict between the international and internal norms, as follows below:

> The apparent normative conflict is resolved by the application of the provision of the treaty, which, in this case, is for the domestic law as well as the special rule is to the general rule. It is obvious that the treaty, in these circumstances, does not abolish, nor totally (abrogation) nor partially (derogate), domestic law. Insofar, compared to other non-contractors countries, Brazil's domestic law still applied in its entirety.[86] (*Translated extract*)

Going further in the theory of international treaties in the Brazilian tax law, this thesis affiliates with the understanding of SCHOUERI which explains that international treaties and conventions actually do not conflict with the domestic legislation but yet these international legal instruments deal with difference competences than the internal ones.[87] For this reason, the argument that the international treaties and conversion are to be considered standing in superior hierarchy in comparison with the domestic law is not valid. It is because an international treaty or convention in essence reflects compromise in jurisdiction due to the power to tax and not the establishment of a new taxable event, which is only reserved to the domestic law. In the end, it would not be a relation of hierarchy between international treaties and national law, but simply of legal competence.

3.5 The Brazilian Import System in the context of the Principle of Non-discrimination

[83] Compare Souza (1975), page 35.
[84] Ibid (1975). In this same aspect Xavier (2012), page 85, argues that, pursuant Article 178, of the Constitutional and Article 52 of the Temporary Constitutional Provisions Act, it is unequivocal that international treaties and conventions are embodied with a superior hierarch compared to the internal legislation.
[85] Compare Amaro (2005), page 179.
[86] Ibid (2005), page 179.
[87] Compare Schoueri (2012), page 97.

Pursuant Article 1, of the Decree n. 37/1966, the import duty (*Imposto de Importação – I.I.)* is imposed on the import of foreign products which are manufactured abroad and brought into Brazil. The Import duty rate, which is considered a customs duty, may be changed by the Executive Branch, as long as such changes are determined within the limits previously provided for by law. The tax basis (*ad valorem*) of the import duty should be in accordance with the rules contained in the Customs Pricing Agreement that Brazil joined pursuant to Section VI of the GATT. In general, such rules intend to set forth equitable criteria as regards prices of products traded among signing countries, aiming at preventing the possible practice of tax and commercial evasion.

According to the introductory notions explored in this thesis, countries are obliged to treat national and foreign products in a non- discriminatory manner. As a result of that, other taxes as such the IPI[88] and the ICMS[89] are levied on the foreign product at the same moment of the import duty. That is because those taxes represent a burden to products manufactured and commercialized within Brazil. In *Canada – Wheat Exports and Grain Imports*, the Panel recognized that Canada was allowed to impose additional regulatory requirement on imported grain due to the fact the same burden was borne by like domestic grain.[90] Such Canadian measure were to be considered non-discriminatory and in compliance with the WTO System. It can be concluded, that the extra burden imposed by the Brazilian tax authority on the import of foreign good is not discriminatory due to the notion of National Treatment embodied in Article III:2, of the GATT.

Finally, the import duty is levied on the Cost, Insurance and Freight (‘**CIF**’) value of the imported product. Subsequently, the IPI is levied on the CIF value plus the import duty. Later, the ICMS is levied on the CIF value plus Import duty, the IPI and the ICMS itself. As a remark, the taxpayer is allowed to offset the input credit from the IPI and ICMS due to the non-cumulative value added nature of those taxes. Import duty, however, is a final cost to the importer.

3.5.1 Brief overview of the IPI levied on Import

Article 153, IV, of Brazil’s Federal Constitution of 1988 empowered the federal government to create an excise tax to be levied on industrialized (manufactured) products and on the clearance of import goods, known as the IPI. Based on the general rule, the IPI is to be levied whenever certain inputs have been transformed or imported, with a subsequent legal deal that involves the transfer of their property. An input is understood herein to be any raw material submitted to a manufacturing process

[88] Compare Doing Business in Brazil - BDO (note 7).
[89] The ICMS (*Imposto sobre Operações relativas à Circulação de Mercadorias e sobre Prestações de Serviços de Transporte Interestadual e Intermunicipal e de Comunicação)* is a type of non-cumulative value-added tax and levied on transactions involving distribution of goods, the rendering of any type of intrastate or interstate transport services and communication services. The taxable base for ICMS in the import of foreign good is the CIF value of the import. Because it is a state tax, each state determines the rates of ICMS for transactions performed within its territory, varying from 7% to 25%, according to the import product.
[90] See Panel Reports, *Canada – Wheat Exports and Grain Imports,* para. 6.187.

from which a new industrialized product originates. The Federal Constitution also set forth, with respect to this tax, that it would be levied in a non-cumulative manner; that is, compensation of the amount owed for each transaction would be offset against the amount already charged on previous transactions. In other words, the acquisition of inputs on which the IPI is levied gives their acquiring party the right to account for the amount corresponding to it (a credit) so that at a later date it can be used to offset against the IPI that is levied on future transactions (a debit).

Note that it is when the inputs on which the IPI has already been levied come "in" that the right to said registration (credit) occurs. This credit, for its part, may then be used when the manufactured product goes 'out', at which point there is an obligation to pay the IPI (debit). Thus, during a certain period of time set forth by law, the taxpayer calculates the credit to which it is entitled and the registration in its accounting, doing the same with the debits that it has to pay. Note that these are the so called registered credits, which should not be confused with tax credits. The registered credits are not incorporated into the taxpayer's equity and do not have any monetary value, that is, they are merely an instrument to perform the non-cumulative tax system. Said tax system, for its part, occurs through offset between the registered credits and debits calculated and accounted for in records kept. In other words, whenever the taxpayer analyzes its bookkeeping during the legal period and calculates that the debits registered exceed the amount of credits, then it will be obliged to collect the amount corresponding to the difference between the two, as IPI, on behalf of the federal government. On the other hand, when it finds that the credits registered exceed the amount of the debits during the legal period, the taxpayer will make the offset between them and will keep a credit balance registered in its accounting.

3.6 Greater Brazil Plan

Innovation policy has been the top mind aim for the Brazilian Government since 2007.[91] Several measures were taken due to incentive investments in science, technology and innovation under the description to promote the level plain field of the national industry upon the foreign competition. In August 2011, the Brazilian Government launched the industrial policy Greater Brazil Plan 2011-2014 (*Plano Brasil Maior*) aimed "to spur Brazil's capability to develop innovative products and services, and prosper from exporting its technology skills rather than agricultural and mineral commodities."[92] In that scenario, Brazil set the target on increasing national competitiveness through incentives for

[91] This reference point was the launch of the Action Plan for Science, Technology and Innovation (PACTI 2007-2010).

[92] Compare Pro Inno Europe Report (2011), page 1. "Mini Country Report/Brazil" under Specific Contract for the Integration of INNO Policy TrendChart with ERAWATCH (2011-2012). Accessed 17 June 2015 <http://ec.europa.eu/enterprise/policies/innovation/files/countryreports/brazil_en.pdf>

technical innovation, research, added value in production, as well as on providing advantages for exporters.[93]

For clarity purposes about the context in which it appears that government plan, it is relevant to transcribe as it appears from the explanatory memorandum to the Provisional Measure 540/11, subsequently enacted into Law n. 12,546 / 11, the Greater Brazil Plan:

> Since the international financial crisis in 2008, the global economy has been going through a lot of turmoil which cast doubt on the ability of developed countries to recover and return to display a robust and sustainable economic growth. This framework not only has enabled the increased weight of emerging countries, but also has allowed acting as the engine of world economy. (...)
> A major difficulty for domestic companies to access the international market is the tax burden that increases the cost of production in the domestic market penalizing employment and production. Reduce tax costs in production is a major mechanism to ensure the competitiveness of domestic industry and the generation of employment and income. (...)

Above one can see that the explanatory memorandum of a generic explanation of the measures included in its body text. The competitiveness of Brazilian industries in the international context is highlighted, and reducing the "tax burden that increases the cost of production" would be the key to ensuring the competitiveness of domestic industry.

Economists are of the opinion that such innovations incentive plans represent national industry protectionism[94]. For CAMARGO, this protectionism “causes two distortions (i) if the domestic product is more expensive but the same quality as the imported one, it becomes less competitive in terms of price. But if it is more expensive and of substandard quality (which is very likely), it becomes less competitive because of both higher price and decreased productivity in the industry as a whole.”[95]On the other side, KUPFER sustain that “policies to incentivize domestic content are a decisive factor for reintegrating Brazilian industry into the global production chain due to the effects of globalization translated in the fragmentation of world production.”[96] In spite of these two arguments, we are of the opinion that, although the presence of innovation and industry policies, the Brazilian infra-structural costs (‘**Brazil cost**’) remain the most influential factor that jeopardize domestic industry which becomes unable to compete in the international trade field.

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[93] Compare Doing business and investing in Brazil – PwC (2013), note 72.
[94] Compare Accioli (2012), page 11.
[95] Compare Camargo, *apud* Accioli (2012), page 13.
[96] Compare Kupfer, *apud* Accioli (2012), page 15.

3.7 The Inovar-Auto Program

In the context of the Greater Brazil Plan, the Brazilian Government established the Inovar-Auto Program under the Law n. 12,715 of September 2012, as aforementioned described in the Introduction Chapter of this thesis. This program has been further developed in Decree n. 7,819/2012, as amended, and in acts subsequently adopted by the relevant authorities. In this section, the author presents the outline of the program, the detailed criteria required from its beneficiary and the application of this program in a pragmatic approach. It must be borne in mind that the evaluation of the Inovar-Auto Program in light of the WTO Law is done under Chapter 5.

3.7.1 The beneficiaries

Pursuant Article 2, of the Decree n. 7,819/2012, as amended, there are three types of eligible beneficiaries to accreditation under the Inovar – Auto Program, as follow:

> (i) Manufacturers established in the country that produce lorry, truck, vehicles for passengers, parts and pieces, as well their undercarriage;
>
> (ii) Local distributors without manufacturing activities in Brazil of those products aforementioned; and
>
> (iii) Manufacturers holding approved project to build an industry plant in the country or, in case of already established automakers, projects of new plants due to production of new models and goods.

3.7.2 The conditions to accreditation

The accreditation is expired 12 months after the concession of the benefit. This concession may be renewed for the same period of time as long as all the conditions and commitments are accomplished, as one can read under Article 3:II, of the of the Decree n. 7,819/2012, as amended.

General conditions are required regarding all three types of accreditation. In this sense, the undertakings must provide regular status prove before the Administrative Authority concerning the collection of Federal taxes and the commitment to match the minimal level of efficiency of energetic sources as provided under the Decree n. 7,819/2012.

Specifics conditions, also set forth the Decree n. 7,819/2012, are presented as described below:

(i)Automakers that produce vehicles or sale companies that commercialize them in the country: The accreditation for these both undertakings is conditional upon directly or indirectly investment in the country in industrial activity, infrastructure, R&D, engineering, base industrial technology and training. As from 20 January 2014, the Provisional Measure n. 638/14 increased the means of investment in R&D, engineering and base industrial technology as all expenditure in import of inputs for labs, software with no national like product, equipment and their reposition pieces. The Executive branch enacts the terms and conditions in which the like products are verified.

(ii)Manufactures that present projects to build a industry plant in the country: Regarding the project to build a industry plant, the undertaking must apply for an specific accreditation for each unity planned to install in the country. This accreditation may be renewed only once, only if the chronogram of the project is performed in its entirely and on time. Although those manufactures are subject to the general conditions, the building project itself is not conditioned to meet the specific investments criteria described above. Those investment conditions are reserved only to produce and sale of vehicles in the domestic market. The building project of the new plant must only meet the criteria of annual production capacity determined by the MDIC[97] office.

3.7.3 The benefit

The Inovar-Auto Program grants tax credit of the IPI based on the monthly expenditure in R&D, technological innovation, strategic inputs, machinery, deposit to the National Scientific and Technologic Fund, training, engineering and basic industrial technology performed by accredited undertaking that commercialize vehicles in the country, as one can read under the Article 12, of the Decree n. 7,819/2012, as amended.

In the case of strategic inputs and machinery, the tax credit is based on the result of the application of a factor established by the Executive branch over the monthly expenditures. In the case of R&D , technological innovation and deposit for the National Scientific and Technologic Fund, the tax credit shall be equal to 50% of the expenditures, limited to 2% of the gross revenue of the overall sales of goods and services, excluded the ICMS tax and social contributions levied on the respective sale. Lastly, in the case of training, engineering and basic industrial technology, the tax credit shall be equal to 50% of the expenditures that exceed between 0.75% and 2.75 of the gross revenue of the overall sales of goods and services, also excluding the tax on these sales.

[97] This is the Ministry of Development, Industry and Foreign Trade in charge to verify investments, research and developments and international trade policies under the Executive branch.

Besides the methods of accrued the IPI tax credit aforementioned, the manufactured that produce vehicles in the country may benefit from a reduction of 30% of the IPI due in the import of vehicles from the MERCOSUR[98] and Mexico based on the number of import vehicles purchased by the undertakings between 2009 and 2011, however not exceeding 4,800 vehicles, pursuant Article 21 of the Decree n. 7,819/2012, as amended.

The automakers that introduce a project to build an industry premises in the country are authorized on the following 24 months of their accreditation to (i) accrued IPI tax credit up to 30% on the import of vehicles, which is offset against the IPI due on sale of that product and (ii) suspend the IPI due on the custom clearance of import vehicles for accredited manufactures. However, the number of import vehicles allowed to accrue the IPI tax credit is limited to the ratio of 1:24 of the annual production capacity expected in the approved investment project within the calendar year. The result of that proportion is then multiplied by the number of the upcoming months of that respective calendar year. By the end of those 24 months, the company is authorized to accrued IPI tax credit on the same terms and conditions regarding innovation and R&D applied to automakers that already produce vehicles or sale companies that commercialize them in the country

3.7.4 The effective time spam

The Inovar-Auto Program is valid until 31 December 2017. On this date, all concessions will be deemed canceled as well as the effects of the benefit, remaining valid the accomplishment of the previous commitments agreed upon.

Moreover, in the case of rupture on the terms and conditions set forth by the provision of the Inovar-Auto Program during the beneficiary period, the accredited undertaking is obliged to pay back the amount of tax otherwise due if there were no IPI tax credit since the first concession of the benefit.

3.7.5 The regulation

The Law n. 12,715 of September 2012, expressly delegated the power to the Executive branch to set the terms, limits and conditions to the accreditation on the Inovar-Auto Program. In addition to that, to regulate the accruement of the IPI tax credit in light of the benefit set forth in the Program. Henceforth, the respective Decree n. 7,819/2012 is the norm that deals with the subject of the Inovar-

[98] Mercosur was established by the Asunción Treaty and internalized in the Brazilian law system under the Decree n. 350/1991 foreseen the constitution of a Common Market among Brazil, Argentina, Paraguay, Uruguay and Venezuela.

Auto Program regulation. Thus, it is presented below the summarized topics provided by this regulation for a better understanding of the Inovar-Auto Program.

(i) The project for the installation of new plants or industrial projects must include the development of activities that result in production capacity boost of the accredited company due to the production model not manufactured in the country.

(ii) For the manufactures that have projects to set industry plant in the country, the accreditation is subject to compliance with the terms established by the MDIC. In that sense, the MDIC enacted the Ordinance n. 297/2013 that foresees as follows:

> (1) The applicant company must submit evidence demonstrating the beginning of the investment project and the fulfillment of physical and financial schedule presented.
>
> (2) If the applicant is not the holder of the industrial technology, shall submit, within 6 months from its license, the contract on transfer or licensing of technology or technical cooperation recorded at INPI[99].
>
> (3) The accredited company under the application of the installation project must file the application to the MDIC adding the Operation License issued by the Government and Brand Code / model / version with the DETRAN[100] in order to prove the vehicle production in the country.

(iii) For automakers that assemble vehicles in the country[101], the accreditation is conditional upon:

> (1) performing in the country, directly or through third parties, the minimum amount of manufacturing activities and engineering infrastructure[102] activities, at least 80% of vehicles manufactured, according to the following schedule (year / number of activities) : 2013/8, 2014/9, 2015/9, 2016/10 and 2017/10;
>
> (2) matching at least two of the following requirements:

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[99] INPI (*Instituto Nacional da Propriedade Industrial*) is the national institute that regulates the intellectual property in Brazil.

[100] DETRAN is the autarchy that regulates, supervise and control the vehicle within the respective state territory wherein the vehicle is licensed and registered.

[101] For the companies that have settled in the country after the year 2013, the requirements for the accreditation are shifted in time as follows: requirements for 2013 are postponed for the calendar year of the accreditation; requirements for 2014 are postponed to the next calendar year to the accreditation; requirements for 2015 are postponed for the second following calendar year to the accreditation; requirements for 2016 are postponed for the third year following the calendar of accreditation; requirements for 2017 are postponed for the fourth year calendar to the accreditation.

[102] Stamping, welding, anti-corrosion treatment and painting, plastic injection , motor manufacturing , gearbox manufacturing and transmission ; Mounting brakes and axles systems; production of oneblock ; assembly, final review and compatible trials ; own infrastructure of laboratories for product development and testing.

(a) performing in the country, corresponding expenditures in research and development, at least the percentage, as follows (year / percentage) levied on the total gross revenues from sales of goods and services, excluding taxes and contributions on sale: 2013 / 0.15% 2014 / 0.3% 2015 / 0.5% in 2016/2017 and 0.5% / 0.5%;

(b) carrying out in the country, expenditures in engineering, basic industrial technology and training of corresponding suppliers, at least the percentage, as follows (year / percentage) levied on the total gross revenues from sales of goods and services, excluding taxes and contributions levied on the sale: 2013 / 0.5%; 2014 / 0.75%; 2015/1%; 2016/1%; 2017/1%;

(c) adherence to Labeling Program Vehicular defined by MDIC and established by INMETRO, with the following minimum percentage of models: 2013/36% 2014/49% 2015/64% 2016/81%, 2017/100%.

(iv) For the undertakings which commercialize but do not assemble vehicle in the country, the accreditation is conditional upon:

(1) performing in the country, corresponding expenditures in research and development, at least the percentage, as follows (year / percentage) levied on the total gross revenues from sales of goods and services, excluding taxes and contributions on sale: 2013 / 0,15%, 2014 / 0,30%, 2015 / 0,50% in 2016/2017 and 0.50% / 0.50%;

(2) realization in the country, expenditures in engineering, basic industrial technology and training of corresponding suppliers, at least the percentage, as follows (year / percentage) levied on the total gross revenues from sales of goods and services, excluding taxes and contributions levied on the sale: 2013 / 0.5%; 2014 / 0.75%; 2015/1%; 2016/1% and 2017/1%; and

(3) adherence to Vehicle Labeling Program defined by MDIC and established by INMETRO, with the following minimum percentage of models: 2013/36% 2014/49% 2015/64% 2016/81%, 2017/100%.

(v) The amounts under the expenditure on research and development must be applied in the activities of:

(1) directed basic research (activities performed in order to acquire knowledge about the understanding of new phenomena, with a view to developing products, processes or innovative systems);

(2) applied research (activities performed in order to acquire new knowledge, aiming at the development or improvement of products, processes and systems);

(3) experimental development (systematic activities outlined from pre-existing knowledge, in order to prove or demonstrate the technical and functional feasibility of new products, processes, systems and services, or even an obvious improvement of already produced or established); and

(4) technical support services (services required for the implementation and maintenance of premises and equipment intended exclusively for the implementation of research projects, development and technological innovation, and the training of human resources devoted to them, directly linked to above activities).

(vi) The amounts under the expenditure on engineering, basic industrial technology and training of corresponding suppliers must be applied to activities of:

(1) Engineering Development (development of new product or manufacturing process, and the addition of new functionality or features to product or process involving incremental improvements and effective gain in quality or productivity, resulting in greater competitiveness in the market);

(2) basic industrial technology (measurement and calibration of machines and equipment, design and fabrication of specific measuring instruments, compliance certification, including the corresponding tests, standardization or generated technical documentation and patenting the product or process developed);

(3) training of personnel dedicated to research, development, product and process innovation and implementation;

(4) development of products, including vehicles, systems and components, auto parts, machinery and equipment;

(5) Building laboratories for the development of the activities provided for in (1) and (2);

(6) the development of tools, molds and models for molds, tools and industrial equipment and quality control, new, and its accessories, spare parts and spare parts, used in the production process; or

(7) training providers in accordance with the provisions of Act Development State Minister, Industry and Foreign Trade.

(vii) The expenditures referred to in items (v) and (vi) must be carried out in the country directly by the beneficiary through contracted supplier or university, research institution, specialized company or independent inventor hired.

(viii) The expenditures referred to in item (v) subject to Ordinance MDIC / MCT n. 772/13, under which the company must "maintain a formalized program of these activities, composed of one or more individual projects, specifying and control of all your expenditures and account for management, control and resulting intellectual property of these projects, as well as take responsibility and business risk of the use of their results."

(ix) In order to be accredited under the Inovar-Auto Program, the company must undertake to fulfill, until 1 October 2017, the demand for lower energy consumption. This aims to improve the performance of new cars in Brazil by 12-19% by the end of the Program in 2017[103], using a formula based on energy consumption more than or equal to the maximum value (EC1), calculated according to the following mathematical expression:

EC1 = 1,155 + 0.000593 x (accredited Mcompany), whereas:

Accredited Mcompany means the average mass, in operating order in kg, of all the vehicles described in the Decree n. 7,819/2012 and commercialized in Brazil by accredited company, weighted by sales occurred in the 12 months preceding the calculation.

3.8 Preliminary conclusions

The above overview portrayed the current treatment of the Inovar-Auto Program under the Brazilian tax system and its most pressing consequences. It showed that the accredited manufacture under the

[103] Compare Stansfield (2014), page 1.

criteria of present a project to install an industry plant in the country, which is not required any investment in R & D but the mere fulfillment of the project schedule, shall be entitled in 24 months counted from the benefit concession to import of vehicles by suspending the IPI due in customs clearance and IPI tax credit accrued of 30%. Henceforth, in the opinion of the author attention should, for the moment, be directed to what extent such treatment does not apply to identical or similar goods imported by companies that perform only trade or companies that already produce vehicles in the country. It may be argued violation of the principle of non-discrimination of Articles I and III of the GATT. The Chapter 5 is committed to evaluate this statement.

Moreover, the question is whether the incentive to set up a factory in the country for local production would violate the Principle of Non – Discrimination or be considered promotion of investment, economic welfare and development in light of the WTO Law concerning trade-related investment and subsidies measures. The next section is committed to that goal.

4. INVESTMENT INCENTIVES BY TAX MEASURES UNDER GLOBAL TRADE COMPETITION

4.1 Introduction

In Chapter 3 the regulation of the Inovar-Auto Program and related issues were presented. The analysis of both, its legal and economic consequences, showed that this tax benefit is designed to attract FDI in the automobile sector due to the promotion of the level playing field of the national industry upon the foreign competition. As such, it appears this tax measures may produce negative consequences by discriminate foreign goods, and as a result of that, provoking distortion in the international trade competition. These unwanted legal and economic spillovers essentially should be eliminated, or in the slightest, mitigated regarding the objective to foster foreign investment, and more importantly, provide for more non-discriminated global trade.

In accordance with the said, in the Chapter 4, first, the relationship between trade, investment and taxation will be examined. To this end, the focus will be directed to tax measures steering investment towards emerging economies to increase welfare and productivity. Special attention here is paid to the effects of tax incentives in the context of global trade competition. Secondly, a look will be taken at the TRIMs Agreement and the SCM Agreement that strive to regulate foreign investment in the context of the trade liberalization within the WTO System. Unlike the spirit of these Agreements, the interpretation of some of their provisions still open to clarification to whether tax incentive should promote development in the emerging economies. In that framework, one could already anticipate why the Inovar-Auto is a good example of how to assess the use of tax measures to attract FDI in the current global investment scenario.

However, before going further with analysis, foreign investment notion is laid down due to the reasonable understanding of its role in global competition. In addition to that, one can notice that MNEs play relevant role in the financing and investment of the global economy. In that respect, tax has become a pivot in the location decisions for investment within the MNEs corporate practices namely, ownership and control, intra-corporate financing, transfer pricing, transfer of technology. Therein, the harmful tax competition is discussed. Thus, by analyzing the coherence of international tax and investment climate in the Inovar-Auto Program scenario, this chapter aims to contribute as a benchmark to the evaluation performed in the section 5.3.

4.2 Investment in the context of the global trade competition

According to the OECD, the definition of the Foreign Direct Investment (**FDI**) is as follows:

> Direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The "lasting interest" is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise. Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do. The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.[104]

FDI is a key component for the development of countries in the current global economy. Moreover, it is deducted from the definition abovementioned that cross-border investment improves the host economy competition position by encouraging the transfer of technology and know-how between companies.[105] Still, policymakers often lack to find the right tune to increment trade throughout investment policies.[106] To this end, several international organizations (OECDE, UNCTAD, WTO, IMF etc) have been developing agendas to increase the intersection between trade and investment mostly due to the activity performed by the MNEs in the global chain. In that respect, the United Nations sealed the Sustainable Development Goals ('**SDGs**')[107] which are a set of actions that must be achieved worldwide concerning three mainstreams namely, economic, social and environmental until 2030. Due to the limitations of this thesis, it is analyzed the actions of the SDGs that only take into account the highly involvement of the MNEs in the today's global trade.

Herein, the following sections are aimed to assess the practices performed by the countries while organizing their policy regimes due to attract FDI with incentives and other preferences to achieve the

[104] Compare OECD - Benchmark Definition Of Foreign Direct Investment (2008).
[105] Ibid (2008).In this paperwork, the OECD also points out that large MNEs are traditionally the dominant players in such cross-border FDI transactions. This development has coincided with an increased propensity for MNEs to participate in foreign trade.
[106] Compare UNCTAD in its World Investment Report 2013 observing that to increase the "synergy between trade and investment policymakers – where necessary, with the help of international organizations – should carefully review the policy instruments due to simultaneously affect investment and trade in the Global Value Chains, *i.e* trade measures affecting investment and investment measures affecting trade".
[107] Compare UNCTAD – World Investment Report 2014, page 195.

desirable of development, productivity and social welfare as perceived though the Brazilian Inovar-Auto Program.

4.3 Relationship between investment, trade and taxation

The relationship between investment and trade has been outlined in the above section. As one could see, it is a challenge for policymakers around the word to converge investment and trade. The author is of the opinion that international institutions represent a big stakeholder in this field and plans like SDGs are more likely to succeed due to their international relevance. Even as trade and taxation are jointly connected bearing in mind trade is one of the economic activities that profit can be verified and then it can be submitted to taxation, the issue remain in the intersection between investment and taxation. In that respect, OWENS[108] is clear to signalise that tax is not the main determinant of FDI, but it is increasing in importance in the global economy due to the MNEs business around the world. As a result of this scenario, the World Investment Report 2015 (‘**WIR 2015**’) released by the UNCTAD sets some figures on the investment climate and also the role of taxation in the decision-making process of investments performed in the global trade environment.

Pursuant the WIR 2015, companies engaging in cross-border direct investment often take into account the economic factors of determinant entering market. This economic factor may be represented by the size of the entering market, access to resources or strategic assets, and the cost of factors of production, *e.g* labour force. Moreover, it is also determinant the rule of the law and the stability of the legal system of the market, mostly verified by the measurement of the predictability of the business climate and the legal enforcement of contracts and regulations. In the end, doing business abroad used to be steered by other factor than the taxation itself. However, as noticed by the WIR 2015, this phenomenon is changing rapidly. Taxation is becoming more relevant to steer investment location decision and the international institutions are aware of that[109].

In this scenario, tax is a sensitive cost factor and companies investing abroad tend to drive their operations towards a tax-efficient environment. The investments, therefore, may be classified as (i) resource-seeking, whereas the cost factors are negotiable in a trade-off mechanisms between the investor and the hosting country also stability and predictability in the fiscal treatment of the investment are crucial, given their long-term nature and long payback periods; (ii) market-seeking, tending to be the least sensitive to tax type of investment given that the source and production rely in local or imported value added assets; and (iii) efficiency-seeking, whereas the investment is driven towards location in special economic zones or given by special tax regimes that solely aim low taxes

[108]Compare Owens (2012), page 1.

[109] Mostly clear represented by the efforts made by the OECD concerning the BEPS Projects and also the recent released by the UNCTAD of the World Investment Report 2015 which brings the alert of the taxation used to steer the investment competition worldwide.

on their international transactions. This last one modality of tax-sensitive investment often is seen part of the considered harmful tax competition whereas transfer pricing plays a prominent role, as described in the OECD BEPS Project Action 5.

Going further on the relationship between investment, trade and taxation, business most often spread their commercial operations worldwide. For this reason sustained investment considered as fair competition and elimination tax avoidance in order to support domestic resource mobilization and to continue to facilitate productive investment, as set forth in the SDGs, is one of the main targets for the world for 2030. Therefore, one could question how to structure an international tax climate that preserves the fair tax among countries while maintaining tax-efficient climate in order to attract investment? The WIR 2015 argues that the fiscal climate for investor must be balanced for local and foreign companies alike to ensure sufficient revenues to support public investment and sufficient returns to promote private investment.[110]

International organizations, as seen on the OECD example, are consistently enacting guidelines and regulations on the subject of investment and taxation. The main targets are still the action against double-taxation and tax avoidance. However, the question of how far a country can steer investment through taxation remain unsolved when comes to the malleability that emerging and least developed economies have to attract FDI and develop their productivity and economies. The author is of the opinion that indeed that is not an easy nor a fast answered situation.

International tax and investment policies must be coherent due to promote sustainable development, tackle tax avoidance and facilitate productive investment.[111]Fiscal advantages or tax incentives are often given to attract investors or to support investment overseas; these have been an essential tool to kick-start economic activities and to bring in the necessary technology and know-how to developing countries, as observed by the WIR 2015. In this aspect, on the point of view of the UNCTAD, an efficient and effective tax incentive should be focusing on priority activities for development and on underdeveloped regions, and associating them with sustainable development impacts.[112]This would be met by a designed and administered incentives schemes which should be sector specific, time-bound, transparent and conditional, *e.g* on sustainable development contributions, within the boundaries of existing international commitments.[113]

In the context of the WTO System, investment and tax incentives have been closely monitored and subjected to the DSB panel board. The reason for that is most of the times the tax incentive scheme

[110] Compare UNCTAD (2015), page 176
[111] Ibid (2015), page206.
[112] Ibid (2015), page 208.
[113] Ibid (2015), page 207.

offered by the determinant countries is to be found inefficient and ineffective, in addition to that, such fiscal advantages breach the NT and MFN treatment required by the principle of non-discrimination. The provisions set forth by the TRIMs Agreement and SCM Agreement generally attempt to regulate how WTO members should grant such benefits in compliance to the WTO law. However, as opposed by the UNCTAD "the WTO rules on subsidies and countervailing measures, and the gradual expiry of exceptions, have somewhat blunted the incentive tool for developing countries, making it less suitable as an instrument of industrial development (at least for export-oriented industrial development)" [114].In that sense, the United Nations considers that the promotion of sustainable development is the key to stimulate attraction of investments and preserve a fair taxation climate. For this reasons, this thesis bring some critical thoughts on that issue concerning the provision on investment, trade and taxation as seem as follow.

4.4 The TRIMs Agreement

The Trade-Related Investment Measures ('**TRIMs**') Agreement was designed to regulate the requirements employed by host countries while attracting foreign investments in order to achieve their development policy objectives.[115] The Preamble of the TRIMs Agreement express the desire of promoting "the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country Members" while ensuring free competition.[116]Moreover, the Preamble points out that "the particular trade, development and financial needs of developing country members" is taken into account in terms of transitional periods rather than of differential or preferential treatment thereof.[117] This provision certainly is open for discussion in further research bearing in mind it is clearly diminish the framework of investments the emerging economies should be entitled to in a sustainable development climate. As a good sign in the right direction, the assessment on the investment measure is made on the circumstances of case by case approach.

Pursuant Article 2, of the TRIMs Agreement, trade-related investment measures must comply with the NT treatment on internal taxation (Article III, GATT) and with the general elimination of quantitative restrictions (Article XI, GATT). As one can note from the *Indonesia – Autos*[118] case, the Panel interpreted that the TRIMs does not innovate in the meaning of those two GATT articles mentioned. That means a holistic approach given by the Panel when analysing the practice of the TRIMs in correlations with the GATT.

[114] Compare UNCTAD (2015), page 208.
[115]Compare Correa and Kumar (2003), page 69.
[116] Ibid (2003), page 75.
[117] Ibid (2003), page 75.
[118] Compare Panel Report on Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54, 55, 59, 64R, adopted on 23.8.98.

Trade-related investment measures that are inconsistent with the WTO System are those listed in the illustrative list set forth in the Annex of the Agreement. Those undesirable measures are translated as mandatory or enforceable advantages under domestic law or under administrative rulings which result in one of the distortions, read as follow:

(i) Local content requirement, the purchase or use by an enterprise of products of domestic origin or from any domestic source;
(ii) Trade balancing requirement, the limitation on the benefit in relation to the volume or value of local products that a company exports;
(iii) Trade balancing *lato sensu*, the importation of products to an amount related to the quantity or value of local products exported;
(iv) Exchange restrictions, the importation of products by restricting an enterprise's access to foreign exchange to the amount of foreign exchange inflows attributable to the enterprise; and
(v) Domestic sales requirement, the exportation of products specified in terms of volume or value of local production

In contrast with the import-substitution measures and the illustrative list of inconsistent investment measures aforementioned, several performance requirements can be offered in order to attract FDI. Such measures can relate to technology transfer, R&D, local participation in equity, employment of local personnel, localization in a given area and training of personnel.[119]In the same sense, the TRIMs Agreement also permits the establishment of export performance requirements, *e.g* in relations to investments in free trade or exclusive economic zones.[120] That is caused by the export-neutrality objected under the WTO System. In conclusion, those performance requirements must also comply with the SCM Agreement in case of export subsidies, as extensively analysed in the section 4.5.

Besides, it is worth to mention that the same exceptions applied to the GATT are also enforced in the TRIMs Agreement, as such measures necessary to protect public morality, human, animal or plant life or health, the conservation of exhaustible natural resources and national security, as one can read from the Article XX, a, b, g and Article XXI of the GATT.

In the end, the research have found several criticism concerning the provisions of the TRIMs Agreement most often arguing that the scope and coverage of the agreement actually diminish the investment flow by blocking the sustainable development of the emerging economies due to pressure

[119] Compare Correa and Kumar (2003), page 83
[120] Ibid (2003), page 83.

of the developed countries in the WTO negotiation rounds.[121] In that respect, the Article 9 of the TRIMs Agreement establish that the provisions were meant to be reviews no later than five years after the date of entry into force of the WTO Agreements. However, by the time of the deadline in 2000 no submission was made by the members except for a "joint submission by Brazil and India in 2002 seeking flexibility for implementing development provisions by amendment of TRIMs Agreement."[122] Unfortunately, the submission has not been fruitful due to any explicit consensus for that purpose.

4.5 The SCM Agreement

The Agreement on Subsidies and Countervailing Measures ('**SCM Agreement**') was designed to deal with the multilateral disciplines regulating the provision of subsidies, and the use of countervailing measures to offset injury caused by subsidized imports.[123] The SCM Agreement applies only to subsidies that are specifically provided to an enterprise or industry or group of enterprises or industries, and defines both the term "subsidy" and the concept of "specificity." Moreover, the Agreement divides all specific subsidies into one of two categories: prohibited and actionable, and establish certain rules and procedures with respect to each category. Also, in the SCM Agreement it can be found the establishment of the substantive and procedural requirements that must be fulfilled before a Member may apply a countervailing measure against subsidized imports. It establishes the institutional structure and notification/surveillance modalities for implementation of the SCM Agreement. Furthermore, the SCM Agreement contains special, differential treatment rules for various categories of developing country Members, transition rules for developed country and former centrally-planned economy Members. By the end, SCM Agreement establishes dispute settlement and final provisions concerning the subject.[124]

Developing countries which were not eligible for special and differential treatment are allowed three years from the date on which for them the SCM Agreement enters into force to phase out prohibited subsidies. These subsidies must be notified within 90 days of the entry into force of the WTO Agreement for the notifying Member.[125] In that scenario the SCM Agreement considers least-developed Members ("LDCs"), Members with a GNP per capita of less than $1000 per year which are listed in Annex VII to the SCM Agreement which are exempted from the prohibition on export subsidies. Other developing countries Members have an eight-year period to phase out their export subsidies (they cannot increase the level of their export subsidies during this period). With respect to import-substitution subsidies, LDCs have eight years and other developing country Members five

[121] Compare Correa and Kumar (2003), page 79.
[122] Ibid (2003), page 80.
[123] Compare WTO – Subsidies and countervailing measures overview, <https://www.wto.org/english/tratop_e/scm_e/subs_e.htm> accessed 13 July 2015.
[124] Ibid (2015).
[125] Ibid (2015).

years, to phase out such subsidies.[126] “There is also more favourable treatment with respect to actionable subsidies. For example, certain subsidies related to developing country Members' privatization programmes are not actionable multilaterally. With respect to countervailing measures, developing country Members' exporters are entitled to more favourable treatment with respect to the termination of investigations where the level of subsidization or volume of imports is small”.[127]

The SCM Agreement aims to regulate and control all subsidies within the WTO System.[128] Such statement was the intention of the negotiations that resulted in the SCM Agreement, but the truth is that countervailing measures, anti-dumping and subsidies are also dealt within the Articles III §8, VI §§3-7 and XVI of the GATT, respectively. Although the countervailing and anti-dumping measures also play a relevant role in the production of goods and in the global trade competition, this thesis only lays eyes on the phenomenon of the subsidies. For this reason, the next section provides “an overview of the different sets of rules on subsidies classified in subsidized activity (good, service or agricultural product), in subsidizing (developed or developing country) and in type of subsidy (prohibited and actionable subsidies)”.[129]

4.5.1 Subsidy and tax incentive

Pursuant Article 1, of the SCM Agreement, subsidies consists in financial contributions by the government to an undertaking that benefits from such measure resulting in distortion in the international trade.[130] LUJA observes that the SCM Agreement “explicitly states that fiscal incentives like direct tax credits are to be considered a financial contribution for the purpose of its subsidy definition by referring to government revenue that is otherwise due is foregone or not collected”[131]. Moreover, the Appellate Body when dealt with the concept of benefit in the case *Canada – Aircraft* understood that it does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient.[132] The SCM Agreement was designed only for trade in goods; therefore, subsidies on cross-border services are not dealt in the Agreement. In addition to that, subsidies related to agriculture are

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[126] Compare WTO – Subsidies and countervailing measures overview, <https://www.wto.org/english/tratop_e/scm_e/subs_e.htm> accessed 13 July 2015.
[127] Ibid (2015).
[128] This is the interpretation given by the Panel Body in the Panel Report, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55R, WT/DS59/R, WT/DS64/R, circulated2 July 1998.
[129] Compare Micheau (2014), page103.
[130] This two separate legal elements were analysed by the Appellate Body Report, Brazil – Export Financing Programme for Aircraft, WT/DS46/AB/R, adopted 20 August 1999, paragraph 157..However, “it does not follow from those statements, however, that every government intervention that might in economic theory be deemed a subsidy with the potential to distort trade is a subsidy within the meaning of the SCM Agreement. Such an approach would mean that the "financial contribution" requirement would effectively be replaced by a requirement that the government action in question be commonly understood to be a subsidy that distorts trade. The legal meaning of the term "subsidy" must, however, be derived from an analysis of the text and context of Article 1 of the SCM Agreement”, pursuant Panel Report, United States – Measures Treating Exports Restraints as Subsidies, WT/DS194/R, adopted 23 August 200, paragraph 8.62.
[131] Compare Luja (2003), Page 126.
[132] Compare Appellate Body Report, Canada – Measure Affecting the Export of Civilian Aircraft, WT/ DS70/ AB/ R, adopted 20 august 1999, paragraph 154.

covered by the WTO Agreement on Agriculture. Regarding the subsidies in the trade of goods, it is worth to step into the classification and types of subsidies as following.

In the SCM Agreement, subsidies can be classified as (i) prohibited subsidies which are systematically banned, (ii) actionable subsidies which may be challenged against the subsidizing country and (iii) non-actionable which is no longer enforced due to any further multilateral negotiations concerning such subsidies. Therefore, it is worth the elaboration on the first two valid types of subsides. The prohibited subsidies, also referred as red lights subsidies, are aimed to eradicate export performance and import performance subsidies. MICHEAU says that "it covers subsidies which purport to reduce imports of good from other countries or to favour exports of domestic goods so that they directly favour domestic production to the detriment of foreign production."[133]Pursuant Article 3:1(a) of the SCM Agreement, the Illustrative List of prohibited subsidies is brought by its Annex I which includes *de jure* and *de facto*, tax and non-tax subsidies, *e.g* currency retention schemes, provisions of export credit guarantee or insurance programmes. Subsequently, the actionable subsidies, also described as yellow light subsides, brought by Articles 5 and 6 of the SCM Agreement, are those which only cause adverse effects to the interests of another WTO Member, therefore, being challenged under the WTO regulations. The adverse effect test rely on the (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT; and (c) serious prejudice to the interests of another Member. Henceforth, there are still issues concerning tax measures in the prohibited subsidies zone that are discussed below.

Tax import subsidies are determined, in law or in fact, when national products are put in favour position to the detriment of foreign products, as derogated from Article III: 4 and III: 8b of the GATT. This is a clear a provision in line with the NT treatment extensively elaborated in the Chapter 1. In that sense, the simple fact that the tax measures require that certain percentage of the value added to goods must be of domestic origin would not characterise a tax import subsidy depending also the other factors like labour costs, for example. This was the interpretation of the Appellate Body when dealing with the *Canada – Auto* case, read as follow:

> 130. The Panel's reasoning implies that under no circumstances could any value-added requirement result in a finding of contingency "in law" upon the use of domestic over imported goods. We do not agree. We noted that the definition of "Canadian value added" in the MVTO 1998 requires a manufacturer to report to the Government of Canada the aggregate of certain listed costs of its production of motor vehicles, and that the first such cost item specified is the cost of Canadian parts and materials used in the production of motor vehicles in its factory in Canada. It seems to us that whether or not a particular

[133] Compare Micheau (2014), Page 111.

> manufacturer is able to satisfy its specific CVA requirements without using any Canadian parts and materials in its production depends very much on the level of the applicable CVA requirements. For example, if the level of the CVA requirements is very high, we can see that the use of domestic goods may well be a necessity and thus be, in practice, required as a condition for eligibility for the import duty exemption. *By contrast, if the level of the CVA requirements is very low, it would be much easier to satisfy those requirements without actually using domestic goods; for example, where the CVA requirements are set at 40 per cent, it might be possible to satisfy that level simply with the aggregate of other elements of Canadian value added, in particular, labour costs*. The multiplicity of possibilities for compliance with the CVA requirements, when these requirements are set at low levels, may, depending on the specific level applicable to a particular manufacturer, make the use of domestic goods only one possible means (means which might not, in fact, be utilized) of satisfying the CVA requirements.[134](emphasis added)

From the wording of the Appellate Body Report it can be deducted that in practice tax import subsidies should be understood in case by case analyses where is possible to make the real assessment of the measure and its effects in the market. With that in mind, the fair competition must be the outline principle to determine whether the subsidy should be considered prohibited or not.

Tax export subsidies are contingent, in law or in fact, whether solely or as one of several conditions, upon export performance, according to Article 3:1(a), of the SCM Agreement. That means the beneficiary would be entitled to the subsidy only if achieve determinant index of export performance. As for the footnote 4 of the SCM Agreement, the tax incentive must be tied to actual or anticipated exportation or export earnings. In that respect LUJA analyses the following:

> The existence of this relationship must be inferred from all relevant facts; which facts are relevant will depend on the circumstances of a case. The export orientation of a recipient may be relevant, but it is by itself insufficient to conclude that a subsidy is tied to exportation or export earnings. For de facto export contingency to be fulfilled, it is not necessary that the recipient oneself had a reasonable knowledge of the existence of such contingency since the prohibition focuses on the granting WTO Member State.[135]

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[134] Compare Appellate Body Report, Canada – Measures Affecting the Automotive Industry, WT/DS139/AB/R, WT/DS/142/AB/R, adopted 19 June 2000, paragraph 130.
[135] Compare Luja (2003), Page 129.

Note that the most discussion around the tax export subsidies lies on the Unite State-FSC case[136] which dealt on the issue of transfer pricing and double taxation considering the incomes earned outside the US territory. The Panel in this case applied the 'But For' test in order to assess the whether the American government have applied export subsidies to facilitate the trade performance from their territory. This test aimed to check if the revenue otherwise due would be considered an advantage and, therefore, submitted as financial contribution for those American undertakings. Although the unfold of the outcomes of the FSC Case are interesting for the study of prohibited tax export subsidies, it is not the purpose of this thesis to exhaustively analyze this case, mainly because it deals with income tax which is not the object of this study.

4.6 OECD perspective on harmful tax competition in global trade

According to the OECD, international investors and MNEs, by the nature of their international operations and trade, have particular opportunities for tax arbitrage between jurisdictions and tax avoidance.[137]This scenario is known as tax competition which countries engage in order to attract investment to their territory resulting in a race to the bottom of taxation. In this respect, MNEs often aim to allocate their operation under special tax rulings in order to manipulate transfer prices to shift profits from a higher tax regime to a lower tax regime. Such behaviours are under the OECD watch and they are part of the BEPS Project, as aforementioned in the section 4.3. Given these differences in corporate strategy and decision-making, countries tend to wish their national production in order to elevate their undertakings in the foreign competition. From this point, it is clear to realise the trade related measures play a role in the harmful tax competition in the attraction of investments towards. Henceforth, the alternative laid down by the international community, by the example of the BEPS Project, is to promote sustainable development, tackle tax avoidance and facilitate productive investment. The author foresees this approach as a way to go on the direction of the fair international taxation which fosters investment and development.

4.7 Preliminary Conclusion

A new approach of the tax incentives has been offered above. From the trade related investments perspective, tax incentives were understood as a relevant tool to attract investments, mainly for the emerging economies and development countries. On the other hand, tax incentives were analysed within the investment and tax competition climate. In order to establish whether the Inovar-Auto Program should be deemed prohibited subside a reference is made to Chapter 5 below, where evaluation of the Program is made against the benchmark set in the Chapter 2. This is subsequently

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[136] Compare Panel Report, United States – Tax treatment for foreign Sales corporations, WT/DS108/AB/RW, circulated 14 January 2002.
[137] Compare OECD, Harmful Tax Competition. An emerging global issue (1998), page 13. Also, UNCTAD, WIR 2015, page 176.

followed by the evaluation of the Inovar-Program against the Sustainable Development Goals benchmark.

5. EVALUATION

5.1 Introduction

In this Chapter the aim is to confront the Brazilian Inovar-Auto Program to the benchmark set in Chapter 2 and Chapter 4, and provide for the conclusion whether the Program should be deemed a prohibited measure under the WTO law. Additionally, from the viewpoint of sustainable development, it is addressed the issue of non-discrimination in connection with the Inovar-Auto Program.

5.2 Testing the Inovar-Auto Program against the WTO system benchmark

The principle of non-discrimination described in Chapter 2 entails that WTO Members should not favour national products in detriment of foreigner a like product (NT Treatment) and not treat different one products originated in other Member State over the another country. In other words, there should not be any difference in the treatment given to products traded among WTO Members in the international exchange. Ultimately, this equal treatment would guarantee that the competition is not distorted among countries.

On this basis, the evaluation of the Brazilian Inovar-Auto is presented as from the allegations of the Delegation of the European Union presented to the Presidency of the Dispute Settlement Body of the WTO. In relation to this, this thesis brings the assessment, in a methodical approach, of the points of the arguments sustained by the EU therein and the respective evaluations performed by this author regarding the benchmarks explored in Chapter 2, as elaborated below:

(i) the conditions imposed on expenditure on R&D would be based "on the criterion that penalizes imported goods";

Primarily, this thesis has showed that the Program does not draw any discrimination between the goods on which the R&D can be performed. The main aspect of the R&D requirement is the expenditure should be made "in the country". In that respect, the "Memorial for Investment Information Provision" set by the Ordinance MDIC / MCT No. 772/13 allows the company to report, in its summary, both the "National Equipment acquisition for R&D" and the "Imported Equipment Acquisition for R & D ". Henceforth, there is no direct or indirect discrimination evidence that should serve as foundation to the EU complaint in this aspect. The author is of the opinion that the condition of investment on R&D the country is in accordance with the sustainable development goals, as extensively showed in Chapter 4, and therefore is more likely to be sustained as a fair measure to increase technological and innovation climate in Brazil.

(ii) undertakings which commercialize but do not assemble vehicle in the country "cannot earn any sizeable tax credit to offset the IPI tax on imported goods";

In Chapter 3, it was analysed that the possibility of tax credits in expenditures with strategic inputs and tooling runs in practice are restricted to those that produce locally cars. In that respect, the 30% IPI presumed credit on imports is exclusive to those who have project for factory installation in the country. However, the credit calculation assumptions are common to all forms of qualifications. Thus, it is also true that undertakings which commercialize but do not assemble vehicle in the country are entitle to claim from credits from expenditures on R&D, gatherings the National Fund for Scientific, Technological, training personnel and basic industrial engineering. The measure embodied in the Program reaches all undertakings that do not assemble vehicle in Brazil. In that way, it is less likely to succeed the argument of discrimination. It is clear from the wording of the Program that the possibility of acquire tax credit for those undertaking is linked to the investment in technology and innovation; the author is of the opinion that is not a trade related restriction. Moreover, the relevant WTO cases law in the subject do not address the understanding to what extent these investments would breach the principle of non-discrimination in the international trade.

(iii) the conditions for the verification of claims by manufacturers in the country would limit the ability "to offset the IPI tax due on imported goods";

The calculation of presumed credits of IPI by companies that produce vehicles in the country follows the same criteria valid for other types of license, and does not seem to bring less favorable condition for crediting against the IPI due on importation. That is because the criteria for the use of the credit of IPI are set on the investment in R&D and not favouring one undertaking over the other. In that respect, the author is of the opinion that the argument of the limitation on the ability to offset the IPI tax due on imported goods would not find grounds to sustain discrimination under the WTO System.

(iv) the system would be designed to encourage "the use of Brazilian-made components by domestic manufacturers";

Unlike the arrangement provided by the former Decree No. 7,567 / 11, which was expressed on the vehicle manufacturing requirement with a minimum of "Sixty-five percent of average regional content", the Innovate-Auto does not bring any reference about aggregation domestic content. For automakers that assemble vehicles in the country is required a realization of a "minimal amount of manufacturing activities and engineering infrastructure activities, at least 80% of vehicles manufactured". There is no requirement, however, that the components used have national origin, but

only that "manufacturing activities" mentioned are carried out in the country. The question that arises is whether the mere requirement to conduct manufacturing activities in the country, albeit by using imported components, would have the power to "afford protection to domestic production" and thus bring offense to Article III of GATT (National Treatment).

This dilemma was addressed in the WTO in the *Canada – Autos* case[138], dealing with tax incentives to the automotive sector conditional on adding value to well in Canada, as referred in Chapter 4.In the Canadian system, they were considered value added in that country (i) the costs of parts produced in Canada and of materials of Canadian origin that are incorporated in the motor vehicles; (ii) direct labor costs incurred in Canada; (iii) manufacturing overheads incurred in Canada; (iv) general and administrative expenses incurred in Canada that are attributable to the production of motor vehicles; (v) depreciation in respect of machinery and permanent plant equipment located in Canada that is attributable to the production of motor vehicles, and (vi) the capital cost allowance for land and buildings in Canada that are used in the production of motor vehicles. In this event, it was argued that such treatment would be inconsistent with Article III: 4 of the GATT, under less favorable treatment given to non-permanent imported parts and parts for use in the production of motor vehicles. The Panel considered that the Canadian automotive regime incompatible with the establishment of rules of the WTO, asserting that:

> 10.82 In light of our interpretation of the word "affecting" in Article III, **we consider that a measure which provides that an advantage can be obtained by using domestic products but not by using imported products has an impact on the conditions of competition between domestic and imported products and thus affects the "internal sale, or use" of imported products, even if the measure allows for other means to obtain the advantage, such as the use of domestic services rather than products**. Consequently, the CVA requirements, which confer an advantage upon the use of domestic products and deny that advantage in case of the use of imported products, must be regarded as measures which "affect" the "internal sale,… or use" of imported products, notwithstanding the fact that the CVA requirements do not in law require the use of domestic products.

Henceforth, it is to see that, although the Canadian argument was rejected, the decision of the Panel anchored mainly on the fact that the legislation of that country, unlike the Brazilian Inovar-Auto Program, have effectively linked the benefit to using domestically produced components, although it was allowed the value added locally in other ways. In that sense, the Inovar-Auto Program represents a

[138] Compare Appellate Body Report, Canada – Measures Affecting the Automotive Industry, WT/DS139/AB/R, WT/DS/142/AB/R, adopted 19 June 2000.

new peculiar case with no similar jurisprudence in that respect. In conclusion, the author is of the opinion that the requirement on investment in the country should not be deemed discriminatory. In reality, the aim of the Program is to attract technology transfer and innovation enhancement for a limited period of time; therefore, being in line with the development goals set forth by the UNCTAD.

(v) the Program confers benefits to goods originating from certain countries without extending them to other WTO members.

In fact, the Inovar-Auto Program allows companies that have factory-installed project (ended the twenty-four months from their first accreditation) and produce in the country to import vehicles from MERCOSUR and Mexico with IPI rate reduced by 30%, favoring the treatment for goods imported from such countries without extending it to identical and similar goods imported from the other member countries of the WTO. The same reduction is not extended to companies only commercialize vehicles in the country. However, customs unions and free-trade zones, by the terms of Article XXIV of GATT, constitute an exception to the principle of non-discrimination embodied in the "most-favored-nation clause" of Article I of that agreement. Thus, the Program does not breach the principle of non-discrimination in order to be in accordance to regional trade treaties signed under the WTO System. In this perspective, this EU argument is less likely to prevail in the dispute settlement due to systematical analyses of the WTO System.

(vi) discrimination of imported goods by a company that has factory-installed project in the country

Although it is not appointed by the consultation document received by the European Union, the fact is that the company accreditated through factory installation project in the country, which do not require any investment in R&D but the mere fulfillment of the project schedule, shall be entitled in twenty-four months counted from the license, the import of vehicles by suspending the IPI due in customs clearance and presumed credit calculation of 30%. To the extent that such treatment does not extend to identical or similar goods imported by companies that only commercialize goods in the country, even by companies that already produce here, it may be argued *prima facie* violation of the principle of non-discrimination of Article I of GATT. At this point, the question is whether the incentive to set up a factory in the country for local production would violate the "most-favored-nation clause", requiring that any privilege "granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties”.[139]

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[139] Compare Article I, of GATT

The *Canada - Autos* case brings interesting example of the debate. At the time, Japan claimed that, by making the customs benefit the criteria that did not keep relationship with the imported product (carrying out activities and adding value in the country), Canada would not be immediately and unconditionally guarantee the same benefit to similar products other WTO members, in violation because Article I: 1 of the GATT. The argument was rejected by the Panel in the sense of the conditions not related to the import product does not imply unlawful discrimination between similar products and different origins. According to the understanding of the Panel, the obligation to extend the benefit unconditionally to others would mean the impossibility of establish requirement on the situation or behaviour of these third countries, read as follows:

> In this context, we consider that the obligation to accord "unconditionally" to third countries which are WTO Members an advantage which has been granted to any other country means that the extension of that advantage may not be made subject to conditions with respect to the situation or conduct of those countries. This means that an advantage granted to the product of any country must be accorded to the like product of all WTO Members without discrimination as to origin. (…)
>
> We therefore do not believe that, as argued by Japan, *the word "unconditionally" in Article I:1 must be interpreted to mean that making an advantage conditional on criteria not related to the imported product itself is per se inconsistent with Article I:1, irrespective of whether and how such criteria relate to the origin of the imported products*. (…) (Emphasis added)
>
> Rather, they accord with the conclusion from our analysis of the text of Article I:1 that whether conditions attached to an advantage granted in connection with the importation of a product offend Article I:1 depends upon whether or not such conditions discriminate with respect to the **origin of products**.[140] (Emphasis added)

According to this case, the author is of the opinion that the Inovar-Auto Program is in line with the Panel understanding in which it does not represent restriction to trade due to the origin of products. Finally, one must not forget other dimension of the problem at hand. That is the interpretation of how far tax measure can influence the international trade. As it has been showed in Chapter 4, the case itself is complex and requires a well established Panel to deal with all its layers. The end result of it is that now there is no precedent case law that deals with the specifics of the Program, but also

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[140] Compare Appellate Body Report, Canada – Measures Affecting the Automotive Industry, WT/DS139/AB/R, WT/DS/142/AB/R, adopted 19 June 2000.

depending of the outcome of the Panel Board ruling it may open new framework for stakeholders within the competition in the international trade.

5.3 Testing the Inovar-Auto Program against the Sustainable Developments Goals benchmark

In Chapter 4 the tax incentives were understood as a relevant tool to attract investments, mainly for the emerging economies and development countries. Besides that, tax incentives were analysed within the investment and tax competition climate. On this basis, evaluation of the Brazilian Inovar-Auto is now presented regarding first the TRIMs Agreement and the SCM Agreement; secondly the Sustainable Developments Goals set forth by the UNCTAD are used as benchmark against Inovar-Auto Program.

TRIMs Agreement

The Brazilian Inovar-Auto Program does not bring any reference about aggregation domestic content, but solely establish the condition to the use of the reduction on the IPI due in the import for those automakers that develop research in R&D and also present a factory-plant project in the country, according to the analyses laid on Chapter 3. For the perspective of the TRIMs Agreement, this Program would not be considered a measure under local content requirement; trade balancing requirement; trade balancing *lato sensu*; exchange restrictions, nor domestic sales requirement. In this scenario, the Brazilian Inovar-Auto Program would fall as a measure under performance requirements, which is not prohibited in the TRIMs Agreement.

SCM Agreement

Pursuant Articles 3.1(b) and 3.2 of the SCM Agreement, the fiscal advantage, in law or in fact, offered by the government must be deemed as a prohibited subsidy in case of export performance conditions or upon the use of domestic over imported goods. As already extensively demonstrated by the law that set forth the Brazilian Inovar-Auto and amendments therein they do not bring any reference about aggregation domestic content. On the other hand, *in facto* the Program does not set the conditions of export performance or the favourable treatment of domestic products over foreign ones. The condition is set upon the installation of factory-plant in the country and the investment in R&D, among other investments performances therein. Henceforth, it is less likely that the Brazilian Inovar-Auto program would be deemed a prohibited subsidy only if the Panel Body do not innovate in their case law interpretation on the subject of subsidies.

Sustainable Development Goals

Under the Sustainable Development Goals set forth worldwide by the UNCTAD, the tax incentive to attract investors or to support investment overseas should be extended through appropriately designed and administered schemes which is (i) sector specific, (ii) time-bound, (iii) transparent and conditional on sustainable development contributions, within the boundaries of existing international commitments.[141]In a holistic approach, the Brazilian Inovar-Auto Program meet the characteristics of a sustainable development incentive bearing in mind that it is designed for the enhancement of the automobile industry, with the time limit until 2017 and manage by the public body responsible for the Innovation and Development (MDIC). From this point, it is defensive to affirm that the Brazilian Inovar-Auto joins in the description of the UNCTAD Sustainable Development Actions Plan.

5.4 Preliminary Conclusion

As argued, the Inovar-Auto Program addresses the principle of non-discrimination by assuring the same treatment to products originating in different WTO Members and not favouring national goods in detriment of the foreign one as described in Chapter 2. Moreover, the Program does not breach the TRIMs Agreement or the SCM Agreement and is in line with the Sustainable Development Goals enacted by the UNCTAD as described in Chapter 4. However, the legal issue still open for the Panel Body to interpret whether the condition upon installation of factory-plant along side with the R&D investments would be enough to characterize discrimination. Henceforth, the author is of the opinion that it should not be deemed prohibited under WTO law.

[141] Compare UNCTAD – WIR 2015

6 CONCLUSIONS

The master thesis conducted this research guided by the following research question:

'Under WTO Law, should the tax regime of the Brazilian Inovar-Auto Program be considered a prohibited measure from the viewpoint of the Principle of Non-Discrimination?'

Following the research, the objective of this thesis is to assess whether the Brazilian Inovar-Auto Program is to be deemed a prohibited tax measure under the WTO law. In this context, the master thesis indentified that the Program is to be found adequate towards the principle of non-discrimination set forth in the WTO System. In that respect, the results of the research showed that the Program meets the dual-concept of the principle of non-discrimination embodied by the MFN treatment obligation and the national treatment obligation. That is because the Program effectively does not draw discrimination among like products originated from the others WTO Member States and neither between national and foreign goods. There is no requirement that the components used have national origin, but only that "manufacturing activities" mentioned are carried out in the country. In that direction, the *Canada - Autos* case brings interesting example of the debate; in this case the Panel ruled that the conditions not related to the import product does not imply unlawful discrimination between similar products and different origins. Henceforth, it can be concluded that the Inovar Auto-Program is in consonance with the WTO law.

Moreover, the thesis also analyses the eventual consequence to the beneficiary in case of the Program would to be deemed prohibited under the WTO System. As the result of the research, investors would not be forced to repayment of the eventual subsidy under WTO law. There is no provision in law that sets forth such obligation. One must bear in mind that the WTO System uses a 'government – to – government' approach. Therefore private companies are not entitled to make complaints also not bound by the Appellate Body ruling. It is relevant to note that the impact of the eventual withdrawal of a tax measure in conflict with the WTO law would have big effect in the Brazilian economic climate or in any other subsiding country.

Beyond the factual and legal aspects indentified from the view point of the principal of non-discrimination, this thesis also brings remarks and conclusion regarding the trade related investments perspective. In this sense, the tax incentives were understood as a relevant tool to attract investments, mainly for the emerging economies and development countries. Moreover, tax incentives were indentified within the investment and tax competition climate. This scenario is known as tax competition which countries engage in order to attract investment to their territory resulting in a race

to the bottom of taxation. Such behaviours identified in this thesis are under the OECD watch and they are part of the BEPS Project, among other international measures against tax harmful competition. As argued in this thesis, the Program does not breach the TRIMs Agreement in the sense of not to be considered a measure under local content requirement; trade balancing requirement; trade balancing *lato sensu*; exchange restrictions, nor domestic sales requirement; nor the SCM Agreement in respect to not require aggregation domestic content, the conditions of export performance or the favourable treatment of domestic products over foreign ones; and, finally, the Program is in line with the Sustainable Development Goals due to be designed towards sector specific, through a time-bound bases, transparent and conditional on sustainable development contributions enacted by the UNCTAD.

From this point, it is arguable whether one should interpret the conditions upon installation of factory-plant along side with the R&D investments of the Program as measures breaching the Principle of Non-Discrimination. The research did not identify any case law under the WTO Agreements that dealt with that specific criterion. It is for sure that the Program does not meet the characteristics of export subsidy and neither import substitution, as it has been seen in the *Canada – Auto* and *Indonesia – Autos* cases-law respectively. Henceforth, the author is of the opinion that the Program should not be deemed prohibited due to lack of legal or jurisprudence reasoning. However, it is clear that the issue still open for the Appellate Body to interpret whether the condition upon installation of factory-plant along side with the R&D investments would be enough to characterize discrimination. For the perspective of this thesis, it is less likely that the Appellate Body would find grounds to rule against the Brazilian Program.

Conclusively, this thesis has argued that the Brazilian Inovar-Auto Program is not to be considered a prohibited measure. Moreover, it is less likely that the Program would be deemed a prohibited measure under the TRIMs Agreement or a prohibited subsidy under the SCM Agreement. Furthermore, the Program presents the criteria set forth the Sustainable Development Goals and is embodied by performance requirements in innovation, technology transfer and research.

Annex

ANNEX 1 – LEGISLATION

General Agreement on Tariffs and Trade

Article I
General Most-Favoured-Nation Treatment

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.(…)

Article III
National Treatment on Internal Taxation and Regulation

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.
2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, 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 otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.(…)
4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded

to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5. No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.(…)

Agreement on Subsidies and Countervailing Measures

Article 3

Prohibition

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

Agreement on Trade-Related Investment Measures

Article 2

National Treatment and Quantitative Restrictions

1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.

2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.

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