

# Analyses

## The Subsidies, Tax and the Calculation of the Margin of Subsidisation

---

GUSTAV BRINK  
*University of Pretoria*

### 1 Introduction

Countervailing investigations are aimed at determining whether subsidised imports cause material injury to a domestic industry producing the like product to the imported product (art VI.6(a) of the General Agreement on Tariffs and Trade (GATT) 1994; art 19.1 of the World Trade Organisation (WTO) Agreement on Subsidies and Countervailing Measures (Subsidies Agreement)). The WTO GATT 1994 contains some rules regarding countervailing investigations (art VI), but most of the rules are contained in the Subsidies Agreement. If it is found that subsidised imports cause material injury to the domestic industry, the importing country may impose countervailing duties to offset the effect of the subsidisation (art VI.6(a) of GATT 1994; art 19.1 of the Subsidies Agreement). South Africa, as a WTO Member and therefore signatory to the Subsidies Agreement, is required to conduct countervailing investigations in line with the Subsidies Agreement (art II.2 of the WTO Agreement; *Degussa Africa (Pty) Ltd and Another v International Trade Administration Commission and Others* (22264/2007) [2007] ZAGPHC 112 (20 June 2007), available at <http://www.saflii.org/za/cases/ZAGPHC/2007/112.html>). The Subsidies Agreement specifically requires Members to indicate in their legislation how the margin of subsidisation will be determined (art 14).

In South Africa, the International Trade Administration Commission (the Commission) is responsible for conducting countervailing investigations (s 16(1)(a) of the International Trade Administration Act 71 of 2002 (ITA Act)). Although the ITA Act provides a basic definition of a subsidy (s 32(2)(c)), that parties may lodge an application for countervailing measures with the Commission (s 26(1)(c)(ii)) and that the Commission is responsible for undertaking countervailing investigations, it does not prescribe investigation procedures. For this purpose, the Minister of Trade and Industry promulgated Countervailing Regulations (hence 'Regulations') (see Government Notice 356 in *Government Gazette* 27475 of 15 April 2005). The Regulations provide for the methodology to be followed in the determination of the margin of subsidy, but fail to take cognisance of costs incurred to obtain

the subsidy. It is submitted that this may result in a finding of a margin of subsidisation higher than the actual benefit received by the recipient of the subsidy.

This analysis considers the requirements of the Subsidies Agreement and the Regulations and determines the effect that corporate tax could have on the determination of the margin of subsidy.

## 2 Margin of Subsidisation

### 2.1 Definition of a Subsidy

To understand countervailing action, it is essential to understand what a subsidy is. No action can be taken unless it is shown that subsidised exports are taking place, that the subsidies in question are actionable and that these exports are causing material injury to a domestic industry (art VI.6(a) of GATT 1994). Subsidised export is defined in the ITA Act (s 32(2)(c)) as

- 'goods exported into the Common Customs Area [of the Southern African Customs Union], in respect of which the government of, or a public body within, any country –
- (i) has provided –
    - (aa) any form of financial aid;
    - (bb) any form of assistance with its production, manufacture, transportation or export; or
    - (cc) any similar assistance; or
  - (ii) has foregone revenue that would otherwise be due to that government or public body'.

The Regulations, however, provide a more detailed definition of a subsidy. This definition accords with the one in the Subsidies Agreement (art 1.1), and sets out the different ways in which financial contributions may be deemed to be made by or on behalf of the exporting country's government (reg 8.1):

- 'For the purpose of these regulations, a subsidy shall be deemed to exist if –
- (a) there is a financial contribution by a government or any public body within the territory of an exporting country; i.e. where:
    - (i) a government practice involves a direct transfer of funds (e.g. grants, loans and equity infusion) potential direct transfers of funds or liabilities (e.g. loan guarantees);
    - (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);<sup>(1)</sup>
    - (iii) a government provides goods or services other than general infrastructure, or purchases goods;
    - (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or
  - (b) there is any form of income or price support by government; and
  - (c) a benefit is thereby conferred.
    - (1) The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.'

This analysis specifically considers the effect of corporate tax on the calculation of the benefit under provision (c).

### 2.2 Countervailability of Subsidy

Once it has been shown that the exported goods are subsidised, the Commission must determine whether the subsidies in question are actionable subsidies. In this regard the Regulations (reg 9.1) provide that

‘A subsidy shall be countervailable *only if*:

- (a) such subsidy is specific, i.e. if the granting authority explicitly limits access to a subsidy to an enterprise or industry or group of enterprises or industries, or if the Commission finds in fact that the subsidy is used by a limited number of enterprises or industries or a disproportionately large amount of the subsidy is granted to a limited number of enterprises or industries; and
- (b) it causes material injury to the SACU industry producing the like product’.

Specificity is determined on the basis of the limited availability of the particular subsidy, whether on the basis of enterprises, industries or regions. Specificity can be determined on the basis of either the language of the enabling provision (*de jure*) or the actual availability (*de facto*) of the subsidy (art 2 of the Subsidies Agreement). Export subsidies are automatically deemed to be specific subsidies (reg 9.2). At the same time, subsidies must exceed one per cent of the export price for developed countries (reg 9.4; art 11.9 of the Subsidies Agreement) and two per cent for developing countries (reg 9.5; art 27.10(a) of the Subsidies Agreement) before they can be countervailed. Note that art 8 of the Subsidies Agreement, which provided for certain subsidies to be regarded as non-specific, has lapsed, indicating that those subsidies can now also be deemed specific.

## 2.3 Margin of Subsidy

The Regulations set out how the margin of subsidy should be determined with reference to a wide variety of different types of subsidies. They state, for example, that the calculation of the subsidy margin shall take cognisance of the time value of money (reg 11.1), and then provide guidance with regard to the determination of the margin of subsidisation for grants, loans, the forgoing of revenue, tax holidays and rebates, input subsidies, the over-reimbursement of customs duties and preferential interest rates for export purposes (reg 11.2). As regards grants, cognisance must be taken of the amount of the grant, the number of years that have lapsed since the grant was paid, the average life cycle of the plant or equipment and the interest rate payable in the country of origin (reg 11.2(a)), while the same applies in respect of loans to the extent that cognisance must be taken of the difference in the interest rate extended by government and the applicable market rate (reg 11.2(b)). As regards any subsidy not specifically referred to in reg 11.2(a) to (g), reg 11.2(h) provides that the Commission

‘will determine the margin or amount of subsidy for any subsidy not indicated under subparagraphs (a) through (f) with reference to the facts pertaining to each such subsidy, taking cognisance of –

- (i) the time value of money;
- (ii) the duration of the subsidy;
- (iii) whether the subsidy is linked to exports or to all sales or production; and
- (iv) any other relevant information at the Commission’s disposal’.

Although these provisions appear straightforward, in practice it may be difficult to determine the actual margin of subsidy for a specific programme, product or exporter (see Gustav F Brink *Anti-Dumping and Countervailing Investigations in South Africa: A Practitioner’s Guide to the Practices and*

*Procedures of the Board on Tariffs and Trade* (2002) at 286–308 for a more detailed discussion on the actual calculations). Even though the government of the exporting country may provide exactly the same subsidy to each producer or exporter in its territory, the effect thereof on each recipient will differ as a result of, inter alia, the production volume and costs and the export price of each recipient. Depending on the nature of the subsidy, the margin of subsidy will have to be determined as the actual benefit received on the product exported, either as the specific amount for each unit exported or on all units produced. It may also be derived from a fixed amount paid to a producer that produces different products or even a subsidy paid to an upstream supplier. The value of a subsidy may also vary, depending on when a subsidy was granted, because the time-value of the subsidy must be taken into consideration (reg 11.1 and 11.2(h); art 2.1(c) of the Subsidies Agreement). Thus, the subsidy value of a grant is higher in the first year after it was granted than in the fifth year. The margin of subsidy for a loan can be determined though the following formula:

$$S_k = \{y/n + [y - (y/n)(k-1)](i_m - i_a) - y/n\} / [1 + (i_m - i_a)]$$

where  $S_k$  = the amount of subsidy countervailable in year  $k$ ;  $k$  = the year under investigation;  $y$  = the face value of the loan;  $n$  = the period over which the loan has to be repaid,  $i_m$  = the market interest rate;  $i_a$  = the actual interest rate paid on the loan (see Brink op cit 292–4 for an example of the calculations). To determine the ad valorem value of the subsidy, this amount would first have to be divided by the total units produced or exported (depending on whether the subsidy relates to all or only export production) to obtain the subsidy per unit, and then by the export price.

Several authors have published research on countervailing investigations and subsidies (see, eg, Konstantinos Adamantopoulos & Maria J Pereyra *EU Anti-Subsidy Law and Practice* 2 ed (2007); Brink op cit (2002); Brink 'A Nutshell Guide to Countervailing Action' (2008) 71 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 396; GF Brink *Proposed Amendments to the Countervailing Regulations: Moving Forward or a Missed Opportunity?* Tralac Working Paper 2/2009 (2009); Shi-Ling Hsu 'Input Dumping and Upstream Subsidies: Trade Loopholes which need Closing' (1986) 25 *Columbia Journal of Transnational Law* 137–67; Gary Clyde Hufbauer & Joanna Shelton Erb *Subsidies in International Trade* (1984); Niall P Meagher 'The Sound of Silence: Giving Meaning to Omissions in Provisions of World Trade Organization Agreements: A Note on the World Trade Organization Appellate Body Decision in United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Flat Steel Products from Germany' (2003) 37 *Journal of World Trade* 417; Paul C Rosenthal et al 'Panel II E: Antidumping Agreement (AD) and Agreement on Subsidies and Countervailing Measures (SCM)' (2000) 31(3) *Law & Policy in International Business* 907; UNCTAD *Impact of Anti-Dumping and Countervailing Duty Actions* (2000) TD/B/COM.1/EM.14/2; Ivo Van Bael & Jean-François Bellis *EU Anti-Dumping and Other Trade Defence Instruments* 5 ed (2011) at 667–714; and several WTO

dispute settlement reports). However, less work has been done on the determination of the margin of subsidy (see Brink op cit (2002) at 286–308; Hsu op cit at 137–67; WTO (2002a) *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany* WT/DS213/AB/R in pars 58–97; WTO (2002b) *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada* WT/DS236/R in pars 7.39–7.79; WTO (2004a) *United States – Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada* WT/DS257/AB/R in pars 77–122; WTO (2004b) *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada* WT/DS277/R in pars 7.71–7.75; WTO (2008) *Mexico – Definitive Countervailing Measures on Olive Oil from the European Communities* WT/DS341/R in pars 7.170–7.176).

Most of these analyses focused on specific investigations or provided an evaluation of a country’s countervailing system. Considerable effort has been made to investigate the effect of a subsidy to an upstream producer on the product exported (Hsu op cit; WTO op cit (2002b) in pars 7.60–7.79; WTO op cit (2004a) in pars 123–66; WTO op cit (2008) in pars 7.130–7.169) or the subsidy received by the private buyer after a subsidised government-owned entity has been privatised (WTO (2002c) *United States – Countervailing Measures Concerning Certain Products from the European Communities* WT/DS212/R in pars 7.18–7.91; WTO (2002d) *United States – Countervailing Measures Concerning Certain Products from the European Communities* WT/DS212/AB/R in pars 87–153). This is especially true in respect of subsidies granted by the Canadian government on softwood lumber that were countervailed in the United States of America and where some of the subsidies were granted to lumber producers that may or may not have been related to the exporter of the processed lumber (WTO op cit (2002b) in pars 7.60–7.79; WTO op cit (2004a) in pars 123–66).

Yet the calculation of the margin of subsidy does not end with the determination of the amount received by the recipient or waived by government. Instead, the calculation must consider the costs incurred by the exporter to avail itself of the subsidy, because it is important to determine the actual ‘benefit’ received by the exporter.

## 2.4 Costs to Obtain and Net Margin of Subsidy

The questions that must be answered are the extent to which the exporter has benefited from the subsidy, and to which extent this has or may have affected the export prices. The reason is that the WTO Appellate Body has held that

‘the word “benefit”, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no “benefit” to the recipient unless the “financial contribution” makes the recipient “better off” than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a “benefit” has been “conferred”, because the trade-distorting potential of a “financial contribution” can be identified by determining whether the recipient has received a “finan-

cial contribution” on terms more favourable than those available to the recipient in the market’ (WTO *Canada – Measures Affecting the Export of Civilian Aircraft* WT/DS70/AB/R (1999) in par 157).

An analysis of previous research shows that investigating authorities have mostly focused on the primary subsidy granted to the recipient. Although these authorities have sometimes determined the total value of the subsidies received by the producer or exporter, it is required that, in the determination of the actual benefit received, any costs incurred to avail it of the subsidy have to be deducted from the benefit received. Thus, if a company has to spend R50 000 on application and consultancy fees to obtain a subsidy of R1 000 000, the net benefit will be only R950 000; and it is submitted that this is the maximum amount that can be countervailed. It is not clear from the Commission’s reports whether it has ever considered parties’ costs to obtain a subsidy in its determination of the margin of subsidy, because the reports simply do not contain sufficient information to determine whether the exporters submitted any information in this regard.

One cost on which no details appear in any analysis that I have seen is the effect of corporate income tax on the value of a subsidy: that is, where the tax burden has increased as a result of the subsidy. This follows despite several investigations considering the decreased tax burden on a company as a result of a tax holiday or a waiver of corporate tax on export earnings (see, eg, Board on Tariffs and Trade (Board) Report 4137: *Investigation into the Alleged Subsidised Export of Printed and Dyed Bed Linen Originating in or Imported from Pakistan: Preliminary Determination (05/11/2001)*; and Board Report 4159: *Investigation into the Alleged Subsidised Export of Polymers of Vinyl Chloride (PVC) Based Roll Goods Originating in or Imported from India: Final Determination (18/02/2002)*).

The following practical example illustrates the effect of corporate tax on the value of a subsidy. A foreign producer, F, receives the following subsidies:

- a R10 000 000 loan extended by the government bank at an interest rate three percentage points lower than the market rate;
- R2 000 000 per annum for five years to assist F to pay employees, on condition that F does not retrench any employees during the period of subsidisation.

The cost to apply for the government loan is the same as that of applying to a private bank, while the compliance cost for the employment subsidy is R100 000 per annum. F produces 2 000 000 units of the product each year and sells the products for R50 per unit both on its domestic and export markets, for total annual sales of R100 000 000. To determine the benefit received by F, and the duty that can be imposed by the importing country, the following calculations will have to be made (note that this is a simplistic calculation without taking into consideration the time value of the loan):

- (a) Subsidy value of loan:  $R10\,000\,000 * 3\% = R300\,000$  per annum
- (b) Subsidy value of wage support: R2 000 000 less compliance cost of R100 000 = R1 900 000 per annum.

The total value of the subsidy is therefore R2 200 000 or 2.2 per cent. Note that de minimis subsidy margins of 1 per cent and 2 per cent apply in respect of developed countries (reg 9.4; art 11.9 of the Subsidies Agreement) and developing countries (reg 9.4; art 11.9 of the Subsidies Agreement), respectively: that is, no countervailing duties may be imposed at lower levels. This is where most, if not all, authorities stop their determination of the margin of subsidy, and most countries would impose a countervailing duty of 2.2 per cent, provided that all other requirements for this imposition (including those of material injury experienced by the domestic industry and a causal link between the subsidised imports and such injury) have been met. However, the effect of corporate tax on the subsidy should also be considered. If the corporate tax rate in F's country is 30 per cent, it could have the following effect on the actual benefit that F received:

- (a) F is operating profitably even without the subsidy. The wage support and the lower interest rate assist F to decrease its costs and increase profit by R2 200 000. This additional profit is subject to corporate tax of  $(R2\ 200\ 000 * 30\%)$  R660 000. Accordingly, the net benefit received by F is only  $(R2\ 200\ 000 - R660\ 000)$  R1 540 000, which equates to a subsidy margin of 1.54 per cent. If F is situated in a developing country, this would render the subsidy de minimis and no countervailing duties could be imposed, whereas a countervailing duty of 1.54 per cent could be applied if F was situated in a developed country.
- (b) If F would have been operating at a loss of R900 000 without the subsidies, it will now show a net profit of R1 300 000; this amount is taxable by  $(R1\ 300\ 000 * 30\%)$  R390 000. The benefit to F would therefore decrease by R390 000, leaving a benefit of  $(R2\ 200\ 000 - R390\ 000)$  R1 810 000 or 1.81%.
- (c) If F is still operating at a loss despite the subsidies, then there are no tax implications as a result of the subsidy and the full amount of R2 200 000 or 2.2 per cent would be countervailable.

These simplified calculations do not take into consideration issues such as deferred tax, but they still show that corporate tax could significantly affect the actual benefit that a company receives as a result of government subsidies.

### 3 Conclusion

The determination of the margin of subsidy is a complicated process that has to take into consideration the nature and time value of each subsidy. In this process, it must clearly be determined whether the subsidy is provided on the exported product only, on all domestic production of the like product, or on all production by a company, regardless of the products produced. The costs incurred to obtain subsidies should be deducted from those subsidies.

Not considered by investigating authorities to date, however, is the impact of corporate tax on the margin of subsidy in cases where the exporter or

foreign producer is operating profitably. It is submitted that the effect of additional corporate tax should be set off against the subsidy received to determine the actual benefit received, and that only this net benefit can be countervailed.

---