FOREIGN OPERATIONS, EXPORT FINANCING, AND RELATED AGENCIES APPROPRIATIONS ACT, 1995 (Senate - July 13, 1994)

Mr. CRAIG. Let me read the first paragraph. It says:

Dear Senator Craig: We are writing to explain our concern about the power over state and local taxes that the new General Agreement on Tariffs and Trade (GATT) will give the World Trade Organization (WTO). Unless modified significantly, these provisions of the new GATT will undermine state and local fiscal sovereignty and likely favor foreign business over U.S. taxpayers.

Let me repeat:

* * * will undermine State and local fiscal sovereignty and likely favor foreign businesses over U.S. taxpayers.

If that is true, Mr. President, this can simply not be allowed. I say if it is true. That is why the amendment as proposed by Senator **Thurmond** and that is why the State attorneys general have asked that this Government stop, bring its people together, examine these critical issues before we move toward fast track and implementation.

Mr. President, there are also problems with the language of the Uruguay round agreement, which has the potential of infringing on State sovereignty.

The phrasing of provisions to prevent State discrimination against foreign businesses is dangerously vague and would favor foreign entities over American taxpayers in the resolution of disputes.

I cannot imagine that this Senate, blinded as we often times are and urged to promote world trade, would not have the willingness to stop and look and listen to authorities who can flesh out and explain for us these important provisions.

Both GATT and GATS are worded in a far less precise manner than existing State tax laws.

A vague agreement opens the door for unfair and conflicting interpretation.

For example, under GATT, prohibiting unjustified discrimination against foreign businesses in the United States does not clearly define a specific standard.

A State law which fulfills the requirements of the U.S. Constitution, may not meet the broader standard under GATT and GATS.

The national treatment provision under

GATS requires the United States to ensure that foreign services and service providers receive `treatment no less favorable than that it accords to its own like services and service suppliers.'

Under the provision, only foreign businesses receiving a negative economic impact resulting from a State law could seek corrective action by the WTO while domestic businesses which are economically harmed by a State guideline would have no similar avenue of redress. This grants foreign businesses a significant advantage which their domestic counterparts would not enjoy.

The national treatment provision on the surface looks and sounds like the foreign commerce clause of the U.S. Constitution, but it is significantly different.

Mr. President, I would like to share some information that was included in a memorandum to State tax administrators from two organizations, the Federation of Tax Administrators and the Multistate Tax Commission:

It reads:

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The standards for proving a violation of national treatment are lower than for proving a violation of the foreign commerce clause.

Because only foreign taxpayers can benefit directly from the `national treatment' provision, they will have access to a more favorable set of rules than U.S. taxpayers.

State tax provisions that might well meet the requirements of the U.S. Constitution may be found to violate GATS.

The memorandum goes on to cover dispute settlement panels:

The rulings of trade panels--`dispute settlement bodies'--may become legally binding on the States and local governments even though they are not legally binding on the Federal Government.

The Federal Government can decide to comply or not comply with an adverse trade panel ruling.

However, the dormant foreign commerce and national supremacy clauses of the Constitution are binding on States and localities.

Thus, foreign taxpayers may use the trade panel ruling as evidence in suits against States or localities and could seek enforcement trade panel rulings in our courts on the basis that they reflect the foreign commercial policies of the United States.

The memorandum also states that:

Because of these interactions between trade agreements and the U.S. constitutional law, we think that State and local tax authority will be undermined, tax burdens may increasingly shift from foreign taxpayers to U.S. taxpayers, and desisionmaking authority over State and local taxes will increasingly shift from the U.S. Supreme Court to `dispute settlement bodies.'

For these reasons, we have sought protection for all State and local tax practices that conform to Federal law or that are determined by the domestic courts of the United States to be nondiscriminatory under the Constitution.

These arguments and concerns cannot be summarily dismissed, Mr. President. The problems are real and need to be resolved. I hope that today's discussion on the World Trade Organization will lead to a more thorough discussion as is outlined in the amendment offered by Senator Thurmond.

Mr. President, there is another document that I would like to have become part of the Record.

I highly recommend it to my colleagues who support States rights.

This testimony was delivered by Dan Bucks, the Executive Director of the Multistate Tax Commission, at the House Subcommittee on Trade hearing last February. The title, interestingly, is `Free Trade, Federalism and Tax Fairness.'

I ask unanimous consent that his testimony before that subcommittee of the House be printed in the

Record.

There being no objection, the testimony was ordered to be printed in the **Record,** as follows:

Free Trade, Federalism and Tax Fairness

(TESTIMONY BY DAN R. BUCKS)

The Multistate Tax Commission is an interstate compact agency that works to ensure that multistate and multinational businesses pay a fair share--but not more than a fair share--of taxes to the states and localities in which they operate. We encourage states to adopt uniform tax laws and regulations in the interest of tax fairness as well as administrative ease and efficiency for businesses that operate in several states and nations.

This testimony substantially draws on a larger report prepared by the staffs of both the Multistate Tax Commission and the Federation of Tax Administrators, the latter being the professional association of state tax officials. The Commission appreciates and acknowledges the efforts of the Federation in helping to analyze the impact of international trade agreements on state taxation.

The Commission views the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS) from this perspective of fundamental fairness and efficiency. States are committed to treating foreign taxpayers as well as they treat U.S. taxpayers who do business in their borders, and the Commission fully supports this principle of equal taxation. Equality of tax treatment provides a level playing field for the expansion of international trade.

The U.S. Constitution established a foundation for our nation based on the principles of free trade and federalism. It has created the most successful free trade area known in modern times and establishes the ideal pursued by other nations in international trade agreements. The Constitution also establishes a successful system of federalism. In a world where other nations are beset with social tension, and even civil war, over issues of balancing the aspirations of local communities with central governments, the U.S. system is a model for balancing local and national interests.

Over the past two centuries, our nation has enhanced and developed an effective balance between free trade and federalism--a balance that flourishes today. However, GATT and GATS, which do not recognize principles of federalism and the sovereignty of state governments, threaten to destroy that balance. Thus, the Commission proposes measures that would restore, in the context of GATT and GATS, a proper balance between free trade and federalism and ensure tax fairness.

The Constitution, as noted, guarantees that states and localities will treat foreign taxpayers equally as compared to domestic taxpayers. Unfortunately, without significant adjustment through the exemption and reservation process and implementing legislation, GATT and GATS will violate the principle of equality under the Constitution by granting rights and privileges in state and local taxation to foreign

taxpayers that are not available to domestic taxpayers. Without adjustments, GATT and GATS will over the long-term:

Reduce state and local taxes paid by foreign taxpayers and unfairly shift that tax burden to U.S. businesses and ordinary citizens,

Transfer authority to determine state and local tax policy from the states, subject to the review of Congress and the U.S. Supreme Court, to international trade panels with little or no expertise in state and local tax policy or constitutional law relating to federalism, and

Erode the ability of states to perform their role as `laboratories of democracy' in our system of federalism--fashioning local solutions to local problems.

These problems will arise from the interaction of GATT and GATS with state and federal laws. The key features of this interaction are as follows:

First, GATT and GATS establish special rules and appeal procedures that are available only to foreign taxpayers and that are more favorable than the rules and procedures available to U.S. taxpayers under state and federal law and the Constitution. If a special class of taxpayers has access to rules and procedures that are more favorable to them than other taxpayers, those taxpayers will ultimately receive tax benefits at the expense of those less favored.

Second, unless Congress enacts appropriate provisions of implementing legislation, rulings to international trade panels may be legally binding on state and local governments, even though they are not legally binding on the federal government. States are subject to the foreign commerce and national supremacy clauses of the Constitution. Unless an international trade panel ruling is specifically rejected by the federal government, foreign parties may seek enforcement of that ruling.

Third, states base many of their tax policies on either the federal tax laws or on mandates imposed by the federal government. The federal law may not conform to the trade agreements, and states may find their taxes vulnerable under the agreements simply because they are following federal law.

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HOW GATT AND GATS FAVOR FOREIGN TAXPAYERS

The special rights and privileges that taxpayers will enjoy under GATT and GATS arise from the broad and ambiguous terms used in the agreements and the `dispute settlement mechanisms' established by the agreements. Specifically, the following features of the agreements create problems for state and local taxation:

The agreements use broad language that is much less precise than tax law and create the potential for unpredictable, unintended and unfortunate decisions. For example, `unjustified discrimination' is an ill-defined, ambiguous standard in the agreements, and the limited history of GATT authorities applying that standard to state taxation is disturbing.

Foreign companies seeking to reduce their state or local tax bills would no longer be required to bring an action in the domestic courts of the U.S., but they could instead recruit their government to lodge a GATT complaint against the state or locality. `Dispute Settlement Bodies' comprised of private sector persons from other nations who are trade experts, but most likely have little or no tax or federalism experience, would rule on complaints by foreign nations against a state or local tax practice. The Dispute Settlement Bodies would not be bound by U.S. court precedents or any other body of law.

States have no guaranteed standing before Dispute Settlement Bodies. Absent Congressional action, states cannot be assured that their views will be presented or protected by the U.S. government at any time in the future. The federal government may defend the states' legitimate interests--or it may decline to, at its sole discretion.

Because GATT and GATS, unlike the U.S. Constitution, do not recognize federalism, and more specifically the rights of state governments, which are otherwise constitutionally restricted from discriminating against foreign and interstate commerce, as a positive value, Dispute Settlement Bodies will be under no obligation to balance the claims of trading interests with subnational governmental rights.

These features combine to create opportunities for tax benefits for foreign taxpayers that are more favorable than any U.S. taxpayer can attain. This fact is illustrated by the one case involving state taxes that has been subject to a dispute settlement ruling under GATT. This case is commonly referred to as Beer II and involved a Canadian-U.S. dispute over federal and state taxes and regulations affecting beer production and distribution.

THE UNFORTUNATE LESSONS OF BEER II

A GATT panel issued a report on February 7, 1992, on Canada's challenge to federal and state laws affecting the beer industry. (This GATT panel decision is commonly referred to as `Beer II.') The Beer II decision provides ample evidence that states are justified in fearing decisions that will likely flow from Dispute Settlement Bodies under GATT and GATS. Beer II ignores federalism entirely and fails to acknowledge the sovereign right of states in a federal system to establish different, but non-discriminatory, laws that reflect local conditions that do not necessarily pertain in all states. Finally, Beer II creates tax benefits in states for foreign breweries that no U.S. brewery could obtain in the U.S. court system.

Specifically, there are at least three features of Beer II that are unacceptable to the U.S. constitutional framework of federalism. The three troubling features of Beer II are the panel's (i) employment of an

arbitrarily broad notion of `discrimination;' (ii) application of the `least restrictive measure' standard to define the GATT obligation of `national treatment;' and (iii) elevation of GATT above the U.S. Constitution.

Overly Broad Concept of Discrimination Used to Benefit Foreign Taxpayers: The Beer II panel ruled against certain state tax laws that do not discriminate against either interstate or foreign commerce. In particular,
Minnesota offers favorable excise tax treatment for microbrewery production that is conditioned only on the size of the brewery and is completely neutral with respect to the national origin or location of the brewery, its product or its inputs. No microbrewery located in Canada is denied access to the favorable tax treatment. (The Minnesota law is distinguishable from some of the other state laws considered in Beer II that condition favorable tax treatment on geographic location.) Yet, the Beer II panel was unwilling to make that distinction. Employing a `beer is beer' standard, the panel swept the Minnesota-type laws into the scope of its disapproval. Under `beer is beer' reasoning, no government would ever be able to make reasonable or rational distinctions between beer produced under different circumstances unrelated to geographic location. The `beer is beer' standard negates the ability of states to make rational policy choices where there is no evidence of an intent to discriminate against foreign or interstate commerce or to promote local, economic protectionism.

Unless rejected by the federal government or otherwise resolved to the contrary, the original GATT ruling may well provide large Canadian brewers with a special tax benefit in at least one state that is unavailable to large American brewers. This ruling illustrates that GATT and GATS can undermine the equality of treatment between foreign and domestic taxpayers that is guaranteed under the U.S. Constitution. Unless adjusted, GATT and GATS tilt an otherwise level state and local tax playing field in favor of foreign business and against the interests of U.S. businesses and taxpayers.

Classifying taxpayers on the basis of size is a common and acceptable practice that generally poses no problems of discrimination against commerce flowing across political boundaries (e.g., in federal law, S Corporations which may not have non-resident alien shareholders can be distinguished from C Corporations on the basis of number of shareholders). Under the U.S. Constitution, state laws like Minnesota's that classify brewers on the basis of size would most likely be upheld. Other state laws that condition favorable tax treatment on in-state location of the activity, inputs or product would most likely fail a constitutional test. The domestic courts of the U.S. would make careful, well-informed, well-reasoned and justified distinctions between these different types of tax laws. The Beer II panel did not.

Ignoring Federalism: Even more disturbing is the Beer II panel's use of a `least restrictive measure' standard for defining national treatment in order to determine whether discrimination exists. Using the least restrictive measure standard, the panel ruled against higher regulatory standards of some states on the basis that other states had lower standards. Some states impose requirements on the methods of distributing beer as an effective and efficient means of collecting excise taxes. Other states, however, do not impose the same requirements. The Beer II panel's ruling allowed no room for different requirements based on different circumstances confronted by various states, nor did the panel allow any room for differing judgments by separate sovereigns as to the most appropriate requirements to impose to effect

collection of taxes.

By imposing on all states the least restrictive measure standard among the states for assessing whether a neutrally structured and intended measure operates on a de facto basis to discriminate under the national treatment obligation of GATT, the Beer II panel struck at the very heart of federalism. The panel's reasoning leaves no room for different laws based on different local circumstances, nor for any range of judgment, regardless of the absence of any discriminatory intent in those judgments, to be exercised by different state sovereigns. Indeed, the combination of the least restrictive measure standard and the acceptance of de facto arguments leaves all state law potentially at risk of being subject to challenge under the aegis of GATT and GATS. Higher taxes levied by a state in which a company from one nation does business could be challenged as discriminatory simply because a competitor does business in another state with lower taxes. The following examples illustrate the potential problems created by the Beer II reasoning, if applied to state taxation:

If Chilean wine is sold primarily in states with low wine taxes, while French wine is sold more often in states with higher wine taxes, the French firms could win a de facto MFN judgment for a GATT panel against states with higher wine taxes.

If the gross receipts tax on a foreign-owned long distance telephone company is higher in the states in which it operates than the tax rates on American-owned long distance (or local) phone companies in other states, the foreign-owned company could win a de facto `national treatment judgment' against the higher tax states.

If a foreign-owned bank pays higher property taxes in the one state in which it operates (for example, NY) than do banks, on average, in other states, it could win a national treatment judgment against the high tax state. (This result would potentially disrupt the billions in revenues realized from property taxation, a form of taxation that is covered by GATS.
Property taxes are the primary source of support for education in the United States.)

Since GATT/GATS, as drafted, does not recognize federalism and looks at `discrimination' on a national basis, differences among states in tax treatment of similar economic activity could be used by foreign multinationals to win tax breaks from GATT/GATS panels using the `least restrictive measure' reasoning of the Beer II panel. The obvious result of such rulings would be to destroy America's federal system. Each state would be barred by GATT/GATS panels from setting its own tax policy, settling instead to the lowest level of taxation by any state.

GATT Overrules the U.S. Constitution: The Beer II panel decision does not recognize governmental powers that are reserved to the States under the U.S. Constitution. The panel found in Beer II the States' alcohol regulatory practices, which could not be described intended to discriminate against foreign or interstate commerce or to promote economic protectionism, to violate GATT obligations. This violation was found even in the face of the central government's (federal government's) lack of power to require the States to change their alcohol regulatory practices that are reserved to the States under Twenty-First

Amendment of the U.S. Constitution. In essence, the panel has used a congressionally approved international trade agreement to overrule the U.S. Constitution--something the U.S. Supreme Court cannot even do.

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