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Investigation
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MEMORANDUM

DATE: August 23, 2002

TO: Faryar Shirzad
Assistant Secretary for
Import Administration

FROM: Richard W. Moreland
Deputy Assistant Secretary, Group I
Import Administration

SUBJECT: Issues and Decision Memorandum for the Final Determination in the
Countervailing Duty Investigation of Carbon and Certain Alloy Steel Wire Rod
from Brazil

Background

On February 8, 2002, the Department of Commerce (“the Department”) published the preliminary determination in this investigation. See Preliminary Negative Countervailing Duty Determination: Carbon and Certain Alloy Steel Wire Rod from Brazil, 67 FR 5967 (February 8, 2002) (“Preliminary Determination”). The “Analysis of Programs” and “Subsidies Valuation Information” sections below describe the subsidy programs and the methodologies used to calculate the benefits from these programs. We have analyzed the comments submitted by the interested parties in their case and rebuttal briefs in the “Analysis of Comments” section below, which also contains the Department’s responses to the issues raised in the briefs. We recommend that you approve the positions we have developed in this memorandum. Below is a complete list of the issues in this investigation for which we received comments and rebuttal comments from parties:

- Comment 1: Usina Siderurgica da Bahia S.A. (“Usiba”) and Cia Siderurgica do Nordeste (“Cosinor”) Privatizations
- Comment 2: Government of Brazil (“GOB”) Financing for the Purchase of Usiba
- Comment 3: Benchmarks for Long-Term, Brazilian Currency Denominated Loans and Discount Rates

- Comment 4: Financing for the Acquisition or Lease of Machinery and Equipment through the Special Agency for Industrial Financing (“FINAME”) Loans
- Comment 5: National Bank for Economic and Social Development (“BNDES”) Export Financing
- Comment 6: Reduction of the Urban Building and Land Tax (“IPTU”)
- Comment 7: BNDES Financing for Companhia Siderurgica Belgo-Mineira’s (“Belgo Mineira”) Acquisition of Dedini Siderurgica de Piracicaba (“Dedini”)
- Comment 8: Program of Social Integration (“PIS”) and Social Contributions of Billings (“COFINS”) - Direct Taxes vs. Indirect Taxes
- Comment 9: PIS and COFINS - Excessive Remission
- Comment 10: Programa de Financiamento as Exportacoes (“PROEX”) Equalization Program
- Comment 11: BNDES Financing of Belgo Mineira’s Acquisition of Mendes Junior Siderurgica S.A. (“MJS”)

Changes in Ownership

On February 2, 2000, the U.S. Court of Appeals for the Federal Circuit (“CAFC”) in Delverde Srl v. United States, 202 F.3d 1360, 1365 (Fed. Cir. 2000), reh’g granted in part (June 20, 2000) (“Delverde III”), rejected the Department’s change-in-ownership methodology as explained in the General Issues Appendix of the Final Affirmative Countervailing Duty Determination: Certain Steel Products from Austria, 58 FR 37217, 37268-37269 (July 9, 1993). The CAFC held that “the {Tariff Act of 1930, as amended by the Uruguay Round Agreements Act effective January 1, 1995 (“the Act”)} does not allow Commerce to presume conclusively that the subsidies granted to the former owner of Delverde’s corporate assets automatically ‘passed through’ to Delverde following the sale. Rather, the Tariff Act requires that Commerce make such a determination by examining the particular facts and circumstances of the sale and determining whether Delverde directly or indirectly received both a financial contribution and benefit from a government.” Delverde III, 202 F.3d at 1364.

Pursuant to the CAFC finding, the Department developed a new change-in-ownership methodology. This new methodology was first announced in a remand determination on December 4, 2000, and was also applied in Grain-Oriented Electrical Steel from Italy: Final Results of Countervailing Duty Administrative Review, 66 FR 2885 (January 12, 2001) (remanded on other grounds in Acciai Speciali Terni S.p.A. and Acciai Speciali Terni USA v. United States, 206 F.Supp. 2nd 1344 (Court of International Trade (“CIT”) 2002), affd., Slip. Op. 2002-82 (CIT 2002) (“AST - GOES”). We have applied this methodology in analyzing the changes in ownership in this determination. See Comment 1, below.

The first step under this methodology is to determine whether the legal person (entity) to which the subsidies were given is, in fact, distinct from the legal person that produced the subject merchandise exported to the United States. If we determine the two persons are distinct, we then

analyze whether a subsidy has been provided to the purchasing entity as a result of the change-in-ownership transaction. If we find, however, that the original subsidy recipient and the current producer/exporter are the same person, then that person benefits from the original subsidies, and its exports are subject to countervailing duties to offset those subsidies. In other words, we will determine that a “financial contribution” and a “benefit” have been received by the “person” under investigation. Assuming that the original subsidy has not been fully amortized under the Department’s normal allocation methodology as of the beginning of the period of investigation (“POI”),¹ the Department would then continue to countervail the remaining benefits of that subsidy.

In making the “person” determination, where appropriate and applicable, we analyze factors such as (1) continuity of general business operations, including whether the successor holds itself out as the continuation of the previous enterprise, as may be indicated, for example, by use of the same name; (2) continuity of production facilities; (3) continuity of assets and liabilities; and (4) retention of personnel. No single factor will necessarily provide a dispositive indication of any change in the entity under analysis. Instead, the Department will generally consider the post-sale person to be the same person as the pre-sale person if, based on the totality of the factors considered, we determine that the entity in question can be considered a continuous business entity because it was operated in substantially the same manner before and after the change in ownership.

We have determined that Gerdau S.A. (“Gerdau”) is the only respondent with changes in ownership requiring this type of analysis because no other respondent (or its subsidiary or affiliate) received subsidies prior to a change in ownership that were not fully expensed or allocated prior to the POI. For Gerdau, the two changes in ownership relate to Gerdau’s acquisition of Cosinor and Usiba. Our analyses of the changes in ownership for Usiba and Cosinor are included in Comment 1 in the “Analysis of Comments” section, below.

Subsidies Valuation Information

Allocation Period

Pursuant to 19 CFR 351.524(b), non-recurring subsidies are allocated over a period corresponding to the average useful life (“AUL”) of the renewable physical assets used to produce the subject merchandise. Section 351.524(d)(2) of the Department’s regulations creates a rebuttable presumption that the AUL will be taken from the U.S. Internal Revenue Service’s 1977 Class Life Asset Depreciation Range System (“IRS Tables”). For carbon and certain alloy steel wire rod (“wire rod” or “subject merchandise”), the IRS Tables prescribe an AUL of 15 years. None of the responding companies or interested parties disputed this allocation period. Therefore, we have used the 15-year allocation period for all respondents.

¹The POI in this investigation is calendar year 2000.

Attribution of Subsidies

Section 351.525(a)(6) of the Department's regulations directs that the Department will attribute subsidies received by certain affiliated companies to the combined sales of those companies. Based on our review of the responses, we find that "cross ownership" exists with respect to certain companies, as described below, and we have attributed subsidies accordingly.

Belgo Mineira: Belgo Mineira, the parent company, is responding on behalf of itself and its four manufacturing facilities at Montevade, Vitoria, Sabara, and Piracicaba (formerly Dedini). Belgo Mineira is also responding on behalf of one of its subsidiaries, Belgo Mineira Participacao Industria e Comercio S.A. ("BMP"), which was formerly MJS. Belgo Mineira is a manufacturing company that is involved in all stages of steel production, including wire rod. BMP also produces wire rod. In accordance with 19 CFR 351.525(b)(6)(ii) we are attributing any subsidies received by Belgo Mineira (including its above-noted production facilities) and BMP to the combined sales of these entities.

Belgo Mineira also reports that it has numerous other subsidiaries and affiliations with various companies. However, we find no basis to attribute any subsidies received by these other subsidiaries or affiliates to the production of the subject merchandise. Specifically, although cross-ownership may exist with these other companies, they do not produce the subject merchandise as required in 19 CFR 351.525(b)(6), nor do they meet any of the other criteria specified in 19 CFR 351.525(b)(6).

Gerdau: Gerdau, the parent company, is responding on behalf of itself and its four manufacturing facilities at Aconorte, Cosigua, Riograndense, and Usiba, all of which produce the subject merchandise as described in 19 CFR 351.525(b)(6). Gerdau is also reporting on behalf of its parent company, Metalurgica Gerdau S.A., a holding company that owns 82.97 percent of Gerdau's shares. In accordance with 19 CFR 351.525(b)(6)(ii), we are attributing subsidies received by all of these entities to the combined total sales of Gerdau.

Gerdau produces a wide variety of products, such as civil construction products, industrial products, agricultural products, nails, metallurgy products, and specialty steel products, including wire rod. We find no basis to attribute any subsidies received by any other subsidiaries or affiliates to the production of the subject merchandise. Specifically, although cross-ownership may exist with these other companies, they do not produce the subject merchandise as required in 19 CFR 351.525(b)(6), nor do they meet any of the other criteria specified in 19 CFR 351.525(b)(6).

Gerdau has reported that it has an affiliate, Aco Minas Gerais S.A. ("Acominas"), which supplies billets to Cosigua for use in its wire rod production. Gerdau contends that, although Acominas provides inputs into the production process of the subject merchandise, cross-ownership does not exist between the two companies. Specifically, Gerdau argues that its equity holding in Acominas does not position Gerdau to "use or direct the individual assets of" Acominas "in

essentially the same way its uses its own assets” as required for cross-ownership pursuant to 19 CFR 351.525(b)(6)(vi). We determine that, because of Gerdau’s minority percentage of ownership of Acominas, Gerdau is not in a position to “use or direct” Acominas’ individual assets as required by 19 CFR 351.525(b)(6)(vi). Thus, we have determined that cross-ownership does not exist between Gerdau and Acominas pursuant to 19 CFR 351.525(b)(6)(vi).

Discount Rates and Benchmarks for Loans

Pursuant to 19 CFR 351.505(a) and 19 CFR 351.524(d)(3)(i), the Department will use as a long-term loan benchmark and a discount rate the actual cost of comparable long-term borrowing by the company, when available. Section 351.505(a)(2) of the Department’s regulations defines a comparable commercial loan as one that, when compared to the government-provided loan in question, has similarities in the structure of the loan (e.g., fixed interest rate v. variable interest rate), the maturity of the loan (e.g., short-term v. long-term), and the currency in which the loan is denominated. In instances where no applicable company-specific comparable commercial loans are available, 19 CFR 351.505(a)(3)(ii) allows the Department to use a national average interest rate for comparable commercial loans.

For discount rates used to allocate non-recurring benefits, because the respondents have not reported any long-term, fixed rate commercial loans, we are using interest rates charged by private lenders in Brazil for U.S. dollar, long-term, non-guaranteed loans as published in the World Bank Debt Tables: External Finance for Developing Countries (“World Bank Debt Tables”). We have converted the benefits allocated with these interest rates to U.S. dollars to make the benefit calculations. Use of these U.S. dollar discount rates is consistent with past practice (see Final Affirmative Countervailing Duty Determination: Certain Cold Rolled Flat-Rolled Carbon-Quality Steel Products from Brazil, 65 FR 5536, 5546 (February 4, 2000) (“Brazil Cold-Rolled Steel”); Final Affirmative Countervailing Duty Determination: Certain Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from Brazil, 64 FR 38741, 38745 (July 19, 1999) (“Brazil Hot-Rolled Steel”); and Final Affirmative Countervailing Duty Determinations: Certain Steel Products from Brazil, 58 FR 37295, 37298 (July 9, 1993) (“Brazil Certain Steel”). As noted in these past cases, although it is the Department’s preference to use a discount (or benchmark) rate that is denominated in the same currency as the government-provided loan (see 19 CFR 351.505(a)(2)), there are no long-term, fixed-rate commercial loans made in Brazilian currency.

For benchmark rates for loans to creditworthy companies, both Gerdau and Belgo Mineira have reported that they have loans from commercial lending institutions. Specifically, both Belgo Mineira and Gerdau report that they have commercial loans that can be used as benchmarks in certain years for their long-term, variable interest rate, Brazilian currency-denominated loans. As discussed in detail in Comment 3, below, we are continuing to use Gerdau’s and Belgo Mineira’s reported commercial loans as benchmarks for these companies’ long-term, variable interest rate, Brazilian currency-denominated loans in the final determination.

Belgo Mineira has also reported short-term commercial loans to be used as the benchmark for its short-term U.S. dollar-denominated BNDES Export Financing loan. Belgo Mineira's short-term, commercial loans were also made in U.S. dollars, and have maturities and structures similar to the BNDES Export Financing loan. Therefore, because the Belgo Mineira short-term, commercial loans are comparable to Belgo Mineira's outstanding BNDES Export Financing U.S. dollar loan, we are using these commercial loans as the benchmark for Belgo Mineira's outstanding U.S. dollar-denominated BNDES Export Financing loan pursuant to 19 CFR 351.505(a)(2).

Finally, because we found one of Gerdau's subsidiary companies, Usiba, to be uncreditworthy in 1986 through 1988 (see, infra, section on "Creditworthiness"), in accordance with 19 CFR 351.524(c)(3)(ii), we have calculated for Usiba only a long-term uncreditworthy discount rate for 1986 through 1988. Pursuant to 19 CFR 351.524(d)(3)(ii), the discount rate for companies considered uncreditworthy is the rate described in 19 CFR 351.505(a)(3)(iii). According to 19 CFR 351.505(a)(3)(iii), to calculate that rate, the Department must specify values for four variables: (1) the probability of default by an uncreditworthy company; (2) the probability of default by a creditworthy company; (3) the long-term interest rate for creditworthy borrowers; and (4) the term of the debt. For the probability of default by an uncreditworthy company, we have used the average cumulative default rates reported for the Caa- to C-rated category of companies as published in Moody's Investors Service, "Historical Default Rates of Corporate Bond Issuers, 1920-1997" (February 1998). For the probability of default by a creditworthy company, we used the cumulative default rates for investment grade bonds as published in Moody's Investor Service, "Statistical Tables of Default Rates and Recovery Rates" (February 1998). For the commercial interest rate charged to creditworthy borrowers, we used the World Bank Debt Tables, discussed above. For the term of the debt, we used 15 years because all of the non-recurring subsidies examined were allocated over a 15-year period.

Equityworthiness

Section 771(5)(E)(i) of the Act and 19 CFR 351.507 state that, in the case of a government-provided equity infusion, a benefit is conferred if an equity investment decision is inconsistent with the usual investment practice of private investors. Section 351.507(a)(2) of the Department's regulations states that the first step in determining whether an equity investment decision is inconsistent with the usual investment practice of private investors is examining whether, at the time of the infusion, there was a market price for similar newly-issued equity. If so, the Department will consider an equity infusion to be inconsistent with the usual investment practice of private investors if the price paid by the government for newly-issued shares is greater than the price paid by private investors for the same, or similar, newly-issued shares.

If actual private investor prices are not available, then, pursuant to 19 CFR 351.507(a)(3)(i), the Department will determine whether the firm funded by the government-provided infusion was equityworthy or unequityworthy at the time of the equity infusion. In making the equityworthiness determination, pursuant to 19 CFR 351.507(a)(4), the Department will normally determine that a firm is equityworthy if, from the perspective of a reasonable private

investor examining the firm at the time the government-provided equity infusion was made, the firm showed an ability to generate a reasonable rate of return within a reasonable time. To do so, the Department normally examines the following factors: (1) objective analyses of the future financial prospects of the recipient firm; (2) current and past indicators of the firm's financial health; (3) rates of return on equity in the three years prior to the government equity infusion; and 4) equity investment in the firm by private investors.

Section 351.507(a)(4)(ii) of the Department's regulations further stipulates that the Department will "normally require from the respondents the information and analysis completed prior to the infusion, upon which the government based its decision to provide the equity infusion." Absent an analysis containing information typically examined by potential private investors considering an equity investment, the Department will normally determine that the equity infusion provides a countervailable benefit. This is because, before making a significant equity infusion, it is the usual investment practice of private investors to evaluate the potential risk versus the expected return, using the most objective criteria and information available to the investor.

The individual equityworthiness analyses relating to the equity programs being examined in the instant investigation are discussed on a program-specific basis in the "Analysis of Programs" and "Analysis of Comments" sections, below.

Creditworthiness

The examination of creditworthiness is an attempt to determine if the company in question could obtain long-term financing from conventional commercial sources. See 19 CFR 351.505(a)(4) (2002). According to 19 CFR 351.505(a)(4)(i), the Department will generally consider a firm to be uncreditworthy if, based on information available at the time of the government-provided loan, for example, the firm could not have obtained long-term loans from conventional commercial sources. In making this determination, according to 19 CFR 351.505(a)(4)(i), the Department normally examines the following four types of information: (1) the receipt by the firm of comparable commercial long-term loans; (2) present and past indicators of the firm's financial health; (3) present and past indicators of the firm's ability to meet its costs and fixed financial obligations with its cash flow; and (4) evidence of the firm's future financial position. With respect to item number one, above, it is the Department's practice not to consider the receipt of comparable commercial loans as being dispositive of a firm's likely ability to obtain long-term commercial credit if the recipient of the commercial loans is government owned. This is because, in the Department's view, in the case of a government-owned firm, a bank is likely to consider that the government will repay the loan in the event of a default. See Countervailing Duties; Final Rule, 63 FR 65348, 65367 (November 25, 1998).

In the Notice of Initiation of Countervailing Duty Investigations: Carbon and Certain Alloy Steel Wire Rod from Brazil, Canada, Germany, Trinidad and Tobago, and Turkey, 66 FR 49931, 49933 (October 1, 2001) ("Initiation Notice"), we initiated a creditworthiness investigation for Usiba for 1988 only. In its questionnaire responses, Gerdau did not challenge the creditworthiness

of Usiba in 1988, and did not provide a response to the Department's questions relating to Usiba's creditworthiness in 1988. Therefore, based on the evidence on the record of this proceeding, we determine that Usiba was uncreditworthy in 1988. Thus, any non-recurring benefits received by Usiba in 1988 which are also attributable to Gerdau have been allocated using an uncreditworthy discount rate.

The petitioners also alleged that Usiba was uncreditworthy in 1986, 1987, and 1989. At the time of the initiation, as well as in the Preliminary Determination, we did not examine Usiba's creditworthiness in those years because there were no programs allegedly bestowing benefits on Usiba in those years. However, because we now are investigating alleged subsidies to Usiba in 1986 and 1987, we are examining Usiba's creditworthiness in those years.² Because the respondents did not specifically address the creditworthiness of Usiba in 1986 and 1987 in their responses, and did not decline to challenge Usiba's creditworthiness as was the case in 1988, we are, for 1986 and 1987, analyzing the creditworthiness of Usiba as specified in 19 CFR 351.505(a)(4)(i).

Because Usiba was government-owned during this period, the Department does not consider the receipt of comparable commercial loans to be dispositive of the firm's likely ability to obtain long-term commercial credit. Moreover, we have no information on record that would have been available in these two years with respect to Usiba's future financial position. Thus, in this situation, the Department must focus its analysis on items two and three, above. This entails an examination of relevant financial ratios. Because there is no information on the record that could be used to derive financial ratios for 1985, we instead examined financial ratios and data from 1983, 1984, 1986, and 1987.³

Data from these four years show a generally poor financial performance on the part of Usiba. The current and quick ratios evidence an overall decline in Usiba's ability to cover its short-term liabilities. Additionally, Usiba's net results in all four years were negative. Moreover, Usiba's

²We note that, in the Initiation Notice, we found that the petitioners established a reasonable basis to believe or suspect that Usiba was uncreditworthy in 1988. The petitioners' information also provided a reasonable basis to believe or suspect that Usiba was uncreditworthy in 1986 and 1987. Because we determined, as noted below and in the Preliminary Determination, that any benefits in 1989 would have been expensed in the year in which they were received, we are not addressing the creditworthiness of Usiba in 1989.

³We note that, in past cases, we have excluded from our analysis financial data which itself could be considerably impacted by the very programs for which the creditworthiness analysis is necessary in the first place. See, e.g., Final Affirmative Countervailing Duty Determination: Stainless Steel Plate in Coils From Italy, 64 FR 15508, 15524 (March 31, 1999). However, in this instance, even if data from 1986 and 1987 is included in the analysis, the analysis still concludes that Usiba was uncreditworthy in those two years.

times interest earned ratio was low in the first three years and even negative in 1987. This ratio is monitored carefully by a company's creditors because it gauges the degree to which the creditors/bondholders are protected from the possibility of default. Finally, the rate of return on equity and on assets was negative. Based on this data, as well as news reports from the petition which discussed Usiba's poor financial performance in the years prior to its privatization, we have determined that Usiba was also uncreditworthy in 1986 and 1987. Thus, any non-recurring benefits received by Usiba in 1986 and 1987 that are also attributable to Gerdau have been allocated using an uncreditworthy discount rate.

Analysis of Programs

I. Programs Determined To Be Countervailable

A. Financing for the Acquisition or Lease of Machinery and Equipment through the Special Agency for Industrial Financing

The FINAME program, which is administered through BNDES and agent banks throughout Brazil, was established in 1966 by Decree No. 59.170 of September 2, 1966 and Decree/Law No. 45 of November 18, 1966. FINAME loans provide capital financing to companies located in Brazil for the acquisition or leasing of new machinery and equipment. Although financing is available for both machinery manufactured in Brazil and non-domestic machinery, almost all FINAME financing is provided for new machinery and equipment manufactured in Brazil. FINAME financing is available for non-Brazilian machinery only when domestically-manufactured machinery is unavailable. FINAME financing for leasing of equipment or machinery is only available for domestic equipment. Under the terms of this program, FINAME loans may be used to finance no more than 80 percent of the purchase price of the machinery.

Both Belgo Mineira and Gerdau received loans through this program that had interest and principal outstanding during the POI. Specifically, Belgo Mineira has reported that it had FINAME loans outstanding during the POI that originated in each year from 1995 through 2000, and Gerdau has reported that it had FINAME loans outstanding during the POI from 1990 and in each year from 1993 through 2000.

We determine that FINAME loans are specific because they constitute an import substitution subsidy within the meaning of 771(5A)(C) of the Act. Although these loans are available in limited circumstances for machinery and equipment manufactured outside of Brazil, in practice, almost all FINAME loans for the acquisition of merchandise are made for Brazilian-produced merchandise. Additionally, loans to lease equipment are limited only to Brazilian-produced machinery. As discussed below in Comment 4, we also determine that these FINAME loans provide a financial contribution in the form of a direct transfer of funds as described in section 771(5)(D)(i) of the Act.

Finally, we determine that a benefit exists for loans originating in certain years for both Belgo Mineira and Gerdau pursuant to section 771(5)(E)(ii) of the Act. According to 19 CFR 351.505(a)(5), in order to determine whether long-term variable interest rate loans confer a benefit, the Department first compares the variable benchmark interest rate to the rate on the government-provided loan for the year in which the government loan terms were established. For instance, for a FINAME loan originating in 1993, we compare the FINAME interest rate in 1993 to the rate in that same year on the comparable commercial loans also originating in 1993. According to 19 CFR 351.505(a)(5)(i), if the comparison shows that the interest rate on the government-provided loan was equal to or higher than the interest rate on the comparable commercial loan, the Department will determine that the government-provided loan did not confer a benefit. However, if the interest rate in the year of origination of the government-provided loan was lower than the origination-year interest rate on the comparable commercial loan, the Department will examine that loan in the POI to measure the benefit.

In this investigation, only Gerdau reported the FINAME loan rates for some of the years in which its loans originated. Specifically, Gerdau has reported FINAME loan interest rates for loans originating in 1995 through 2000. Based on a comparison of the origination year interest rates of the FINAME and the benchmark loans, we found that the government loan rates were lower than the benchmark rates in 1997 through 2000. However, the government loan rates were higher than the benchmark rates in 1995 and 1996. Thus, we determine that no benefit exists according to 19 CFR 351.505(a)(5) for the 1995 and 1996 FINAME loans to Gerdau. With respect to the 1997 through 2000 loans, because the government loan rates were preferential when compared with the benchmark rates in those years, we determine that a benefit was conferred through these loans as described in 19 CFR 351.505(a)(5), and that the FINAME loans to Gerdau that originated in 1997 through 2000 constitute countervailable subsidies pursuant to section 771(5) of the Act. Thus, as is further discussed below, we calculated a benefit during the POI in accordance with 19 CFR 351.505(c)(4).

Belgo Mineira did not provide FINAME loan interest rates by year of origination for the loans it received from 1995 through 2000. Additionally, Gerdau did not provide origination year FINAME loan rates for its loans from 1990, 1993, and 1994. Therefore, we were unable to make the comparison described in 19 CFR 351.505(a)(5)(i), noted above. Instead, we determined whether a benefit existed, as well as the amount of the benefit, by calculating the difference between the amount actually paid on the outstanding loans during the POI and the amount the firms would have paid on a comparable commercial loan during the POI, consistent with 19 CFR 351.505(a)(5)(ii) and 19 CFR 351.505(c)(4). Based on this comparison, we determine that Belgo Mineira received a benefit on all FINAME loans outstanding during the POI. For Gerdau, we determine that Gerdau received a benefit on all FINAME loans taken out in 1993, 1994, and 1997 through 2000.

To calculate the POI subsidy amount, we divided the total POI benefit from these loans for each company by each company's total sales during the POI. Accordingly, we determine that a

countervailable benefit of 0.15 percent ad valorem exists for Gerdau and a countervailable benefit of 0.06 percent ad valorem exists for Belgo Mineira.

B. Programa de Financiamento as Exportacoes

The PROEX program is administered by the Banco do Brasil. PROEX funding is available to Brazilian companies involved in exporting only. PROEX funds are available in two forms: (1) PROEX Financing, which involves the direct financing of a company's exports and (2) PROEX Equalization, which reimburses certain interest costs to Brazilian exporters.

Under the PROEX Equalization program, exporters discount their receivables with a private lender. After payment is collected by the private bank from the customer, the GOB remits to the bank the difference between the financing costs collected from the exporter and the financing costs that would have been collected based on international interest rates at the time. The private bank then forwards this differential to the Brazilian company. Thus, the Banco do Brasil, in effect, reimburses the exporter for a part of the financing costs actually incurred so that the net financial costs to the Brazilian company are consistent with financial expenses incurred in the international market.

During the POI, neither Gerdau nor Belgo Mineira utilized the PROEX Financing program; Gerdau also did not use the PROEX Equalization program. However, Belgo Mineira did use the PROEX Equalization program during the POI.

As further discussed in Comment 10, below, we determine that the PROEX Equalization program constitutes an export subsidy pursuant to 771(5A)(B) of the Act because equalization funds are contingent on export performance. We furthermore determine that PROEX equalization funds provided by the GOB through this program constitute a financial contribution as described in section 771(5)(D)(i) of the Act and a corresponding benefit in the amount of equalization funds received.

Because the interest reimbursement reasonably can be anticipated by the exporter at the time the loan is taken out, we are treating these equalization payments as reduced-rate loans in accordance with 19 CFR 351.508(c)(2). Thus, to calculate the subsidy rate for Belgo Mineira, we divided the total equalization payments received by Belgo Mineira during the POI by Belgo Mineira's export sales during the POI. On this basis, we determine that a countervailable benefit of 0.00 percent ad valorem exists for Belgo Mineira.

C. Tax Incentives Provided by the Amazon Region Development Authority ("SUDAM") and the Northeast Region Development Authority ("SUDENE")

The SUDENE program was created under Law No. 3692 to promote the development of the Northeast Region of Brazil. The SUDAM program is a similar program that promotes the development of the Amazonia Region of Brazil. Both programs are administered by the

Brazilian federal government, and are linked to the Ministry of National Integration. Under these programs, companies can receive either a partial or complete tax exemption from the Brazilian corporate income tax, which is assessed at a rate of 25 percent. The tax exemption applies only to income from facilities operating in the designated regions. Both programs allow companies a 100 percent exemption if the company (1) makes an initial investment in the region involved, (2) increases capacity in the applicable region, or (3) modernizes its facilities in the specific region. If a company does not meet these three criteria, it is permitted to exempt 37.5 percent of its income from facilities operating in that region from taxation.

During the POI, only Gerdau used the SUDENE program. Neither Gerdau nor Belgo Mineira used the SUDAM program.

A tax benefit is a financial contribution as described in section 771(5)(D)(ii) of the Act which provides a benefit to the recipient in the amount of the tax savings pursuant to section 771(5)(E) of the Act and 19 CFR 351.509(a)(1). Moreover, we determine that SUDENE tax benefits are de jure specific pursuant to section 771(5A)(D)(iv) of the Act because SUDENE tax benefits are limited to operations in the Northeast Region. Therefore, we find these benefits to constitute a countervailable subsidy.

In calculating the benefit, consistent with 19 CFR 351.524(c)(1), we treated the tax savings as a recurring benefit and divided the tax savings received by Gerdau during the POI by Gerdau's total sales during the POI. On this basis, we determine that a countervailable benefit of 0.16 percent ad valorem exists for Gerdau.

D. Gerdau

Debt Forgiveness/Equity Infusions Provided to Usina Siderurgica da Bahia S.A. (previously 1988 Equity Infusions/Debt Forgiveness Provided to Usina Siderurgica da Bahia S.A.)

Prior to 1989, Usiba was owned by Siderurgica Brasileira S.A.- SIDERBRAS ("SIDERBRAS"), the GOB entity responsible for all state-owned steel companies. As part of the first phase of Brazilian privatizations carried out under the auspices of Decree 95.886, SIDERBRAS, through BNDES Participacoes S.A.- BNDESPAR ("BNDESPAR"), sold Usiba to Gerdau in a privatization auction in October 1989.

In order to restructure Usiba and to restore its operational viability, as well as to prepare Usiba for privatization, SIDERBRAS made several investments in the company. First, in 1988, SIDERBRAS restructured some Usiba debt in a debt-for-equity swap. As part of this arrangement, according to Usiba's 1988 Financial Statement, SIDERBRAS "cleans{ed}" past due debt of 58,888,558,000 Cruzados in exchange for increased equity in Usiba. In addition to this debt restructuring, SIDERBRAS also made equity infusions into Usiba of 101,243,000 Cruzados in 1986; 13,182,699,000 Cruzados in 1987; and 8,204,000 Cruzados in 1989.

The respondents are not contesting the petitioners' allegation that Usiba was unequityworthy at the time of the 1986, 1987, and 1989 infusions, and the 1988 debt-to-equity conversion. Based on an analysis of record information, we determine that the 1986 through 1989 equity infusions and the debt-to-equity conversion into Usiba conferred a benefit according to section 771(5)(E)(i) of the Act and 19 CFR 351.507(a) because they were not consistent with the usual investment practices of private investors. Furthermore, these infusions constitute a financial contribution within the meaning of section 771(5)(D)(i) of the Act. Finally, these infusions are specific within the meaning of section 771(5A)(D)(i) of the Act because they were limited to Usiba. Accordingly, we find that these equity infusions confer a countervailable subsidy within the meaning of section 771(5) of the Act.

Because we have determined that these subsidies are properly assigned to Gerdau (see Comment 1, below), we have treated these infusions in Usiba as a benefit to Gerdau in the amount of the equity infusions pursuant to 19 CFR 351.507(a)(6). With respect to the 1989 equity infusion into Usiba, we note that, under 19 CFR 351.524(b)(2), if the total amount of a non-recurring subsidy is less than 0.5 percent of the recipient's sales during the year in which the subsidy was approved, then the benefit under the program will be allocated to the year of receipt. In the case of the 1989 infusion, any benefit received thereunder would be completely allocated to the year of receipt pursuant to 19 CFR 351.524(b)(2) with no benefit remaining in the POI. As for the 1986 and 1987 equity infusions and the 1988 debt-for-equity swap, because Usiba was uncreditworthy in those years, we used the uncreditworthy discount rates as described above in the "Subsidies Valuation Information" section to allocate the benefits. We divided the amount allocated to the POI by Gerdau's sales during the POI. We determined that the net subsidy for Gerdau is 0.45 percent ad valorem.

E. Belgo Mineira

1. National Bank for Economic and Social Development Financing for the Acquisition of Dedini Siderurgica de Piracicaba

Until 1997, Belgo Mineira was involved in a partnership with the Dedini Group, a consortium of companies with operations in numerous sectors, through Belgo Mineira's 49 percent ownership of the Dedini Group's steel operations. Due to economic problems, the Dedini Group decided to restructure its operations and sell some of its assets, including its steel operations.

After several rounds of negotiations between Belgo Mineira and Dedini, Belgo Mineira agreed to take over certain of Dedini's debts as recorded in Dedini's books, including debt owed to BNDES and another government creditor, in exchange for the remaining 51 percent of the Dedini Group's steel operations and three Dedini properties. Once Belgo Mineira and Dedini reached an agreement on this issue, the two companies approached the creditors involved, including BNDES, to receive approval in order to complete the transactions. In giving its approval in late 1997, BNDES agreed that Belgo Mineira would assume the amount of the Dedini debt agreed upon by Belgo Mineira and Dedini, and that BNDES would write off any remaining debt in its

books as a loss. Separate negotiations took place between Belgo Mineira and the other government creditor to which Dedini was indebted.

In the Preliminary Determination, we determined, based upon the respondents' questionnaire responses, that BNDES was not involved with Belgo Mineira's acquisition of Dedini. However, at verification, we discovered, as noted above, that BNDES and another Brazilian government creditor were, in fact, involved in the transaction, and that BNDES had forgiven a portion of debt that was owed to it by Dedini. With respect to the BNDES debt forgiveness, we have determined that this debt forgiveness constitutes a countervailable subsidy within the meaning of section 771(5) of the Act because it is a direct transfer of funds pursuant to Section 771(5)(D)(i) of the Act, with the benefit being the amount of the debt forgiveness pursuant to 771(5)(E). This transaction is also specific within the meaning of Section 771(5A)(D)(iii)(I) of the Act because it is limited to a single company.

Additionally, as noted above, during verification, we discovered that a portion of the original Dedini debt that was taken over by Belgo Mineira as part of this transaction was owed to a separate government creditor (whose identity is business proprietary). This requested information was not reported in the respondents' questionnaire responses. Moreover, after learning about this creditor at verification, we questioned officials from this institution seeking information concerning its involvement in Belgo Mineira's acquisition of Dedini and whether there was any debt forgiveness as there was in the BNDES transaction. The requested information was not supplied, and we were unable to pursue the matter further because we were not aware of this agency's involvement in this transaction prior to the verification due to deficiencies in the respondents' questionnaire responses.

As discussed below in Comment 7, as adverse facts available, pursuant to sections 776(a)(2)(A) and (D) and 776(B) of the Act, we determine that this separate creditor also forgave outstanding debt of Dedini. This debt forgiveness constitutes a financial contribution in the form of a direct transfer of funds, pursuant to section 771(5)(D)(i) of the Act. We further determine, as adverse facts available, that the amount of forgiveness was proportionate to the amount forgiven by BNDES, and that the benefit equals the amount forgiven, pursuant to section 771(5)(E) of the Act. Finally, this transaction is also specific within the meaning of section 771(5A)(D)(iii)(I) of the Act because it is limited to a single company.

To calculate the POI subsidy amount from the debt forgiveness from the two GOB entities, we divided the total POI benefit from the debt forgiveness by Belgo Mineira's total sales during the POI. Accordingly, we determine that a countervailable benefit of 0.06 percent ad valorem exists for Belgo Mineira.

2. National Bank for Economic and Social Development Financing for the Acquisition of Mendes Junior Siderurgica S.A.

MJS operated a steel mill in the state of Minas Gerais. In 1995, because MJS could no longer service its existing debt obligations, it entered into negotiations with Belgo Mineira. MJS and Belgo Mineira reached an agreement in which Belgo Mineira would lease MJS' facility in the state of Minas Gerais. In 1998, Belgo Mineira negotiated an agreement with BNDES in which BNDES transferred MJS' outstanding debt, exclusive of any late fees and penalties, to Belgo Mineira in exchange for R\$98 million in debentures and certain other rights, the details of which are proprietary. At the time of the BNDES negotiation, MJS' debt was categorized by BNDES as a non-performing loan and any outstanding late fees and penalties in excess of the original debt amount were written off by BNDES.

The debentures issued by Belgo Mineira to BNDES in this transaction are for a term of 12 years and pay the Brazilian Long Term Interest Rate ("TJLP") plus three percent.⁴ Furthermore, the agreement between BNDES and Belgo Mineira was structured such that, if Belgo Mineira had reached agreement with other creditors of MJS on terms more favorable than those in the BNDES-Belgo Mineira agreement, then Belgo Mineira would compensate BNDES in the amount of the difference.

We find that the amount paid by Belgo Mineira to BNDES for the acquisition of MJS' debt is not less than the amount Belgo Mineira paid to the other MJS creditors. Thus, BNDES sold the debt on commercial terms. Furthermore, we compared the interest rates being paid to other MJS creditors for their restructured debt to the interest rate paid by Belgo Mineira on its debentures to BNDES. We found that the terms were similar and, hence, that the terms on the debentures to BNDES were commercial terms. Therefore, we determine that no benefit exists with respect to these parts of the transaction under section 771(5)(E)(ii) of the Act.

However, with respect to BNDES' forgiveness of MJS' late fees and penalties, as discussed in Comment 11, below, we find that this debt forgiveness constitutes a countervailable subsidy within the meaning of section 771(5) of the Act. Specifically, this debt forgiveness is a direct transfer of funds pursuant to section 771(5)(D)(i) of the Act with the benefit being the amount of debt forgiven pursuant to section 771(5)(E) of the Act. This transaction is specific pursuant to section 771(5A)(D)(iii)(I) of the Act because it was limited to one company.

To calculate the POI subsidy amount from this debt forgiveness, we divided the total POI benefit from the debt forgiveness by Belgo Mineira's total sales during the POI. Accordingly, we determine that a countervailable benefit of 5.16 percent ad valorem exists with respect to this debt forgiveness for Belgo Mineira.

⁴The TJLP is the Brazilian long-term interest rate, a rate set periodically by the Brazilian Central Bank.

F. “Presumed” Tax Credit for the Program of Social Integration and the Social Contributions of Billings on Inputs Used in Exports

Subsequent to the Preliminary Determination, the Department initiated an investigation of this program based on section 775 of the Act and on a concurrent countervailing duty investigation of this program. See Notice of Preliminary Determination and Alignment with Final Antidumping Duty Determinations: Certain Cold-Rolled Carbon Steel Flat Products from Brazil, 67 FR 9652 (March 4, 2002) (“CVD Preliminary Brazil Cold-Rolled Steel II”). See, also, “Second Supplemental Questionnaire for the Government of Brazil” dated February 19, 2002, which is on file in the Department’s Central Records Unit (“CRU”) in Room B-099 of the main Department building.

In 1970, through Supplementary Law No. 7, the GOB established PIS which is “intended to bring about integration of employees in the life and growth of their companies.” Essentially, companies make PIS contributions to a fund which is “a means of creating wealth for. . .employees.” In 1991, through Supplementary Law No. 70, the GOB established COFINS as a contribution for the financing of social insurance “intended solely to defray the cost of health care and social security and assistance work.” PIS and COFINS taxes are assessed on all products purchased domestically but do not apply to the sale of products that are exported. During the POI, the PIS and COFINS rates were 0.65 percent and 3.0 percent, respectively. Each company is responsible for making monthly payments of PIS and COFINS based on the total sales value of its domestic sales of goods and services.

In 1996, through Law 9363, the GOB established the PIS and COFINS tax credit program to provide a rebate of PIS and COFINS contributions assessed on the purchase of raw materials, intermediate products, and packing materials used in the production of exports. The PIS and COFINS “presumed” tax credit was established to prevent the cascading effect of these taxes which accrue at each point in the chain of production. A company calculates its own PIS and COFINS credit, on a monthly basis, using a standard formula established by Law 9363, and claims the credit by making deductions from the Industrial Products Tax (“IPI”) due.

The “presumed” tax credit rate for PIS and COFINS is 5.37 percent and applies to all industries. According to the GOB, this percentage was calculated based on the PIS and COFINS rate in effect at the inception of Law 9363, 2.65 percent. In establishing this credit rate, the GOB assumed two stages of processing prior to exportation and, thus, two prior stages of PIS and COFINS taxes. The tax credit is applied quarterly against IPI tax payments. To calculate the tax credit, a company divides its export revenues, accumulated through the prior month, by its total gross sales revenues for the same period. This export revenue ratio is then multiplied by the company’s production costs on total domestically-purchased inputs accumulated over the same period in order to determine the percentage of domestically-purchased inputs used in the production of the export products. This figure is multiplied by the tax credit rate of 5.37 percent to yield the year-to-date accumulated tax credit. In order to calculate the credit for the current month, the credit used through the prior month is deducted from this accumulated tax credit.

In order to claim the credit, a company files the “Declaration of Debt and Credit,” which is calculated monthly, with the Secretariat of Federal Revenue. This document shows the total cost of primary material, intermediate products and packaging used in production, and the amount of these items which is excluded from the credit calculation. These filings are subject to audit by the GOB. During the audit process, the Secretariat of Federal Revenue reviews a company’s records which include the inputs used to calculate the credit and the costs of such inputs.

Section 351.102(b) of the Department’s regulations defines an indirect tax as a “sales, excise, turnover, value added, franchise, stamp, transfer, inventory, or equipment tax, border tax, or any other tax other than a direct tax or an import charge.” As noted in the PIS and COFINS legislation, these taxes are derived from the “monthly invoicing” or “invoicing” originating from the sale of goods and services. Therefore, we find that the manner in which these taxes are assessed is characteristic of an indirect tax, and we are treating PIS and COFINS taxes as prior-stage cumulative indirect taxes. (For further discussion, see Comments 8 and 9, infra).

Based on our determination that PIS and COFINS are prior-stage cumulative indirect taxes, we examined whether the GOB has a system or procedure in place within the meaning of 19 CFR 351.518(a)(4)(i). Because we found that the GOB has not met this requirement, we have determined that the entire amount of the PIS and COFINS remission confers a benefit to respondent companies. According to section 771(5)(D)(ii) of the Act, granting tax credits constitutes a financial contribution. Furthermore, because PIS and COFINS rebates are calculated based on a company’s export revenue, we find that this program is specific according to section 771(5A)(B) of the Act. (For further discussion, see Comment 9, infra).

In calculating the benefit, consistent with 19 CFR 351.524(c)(1), we treated the tax rebate as a recurring benefit and divided the total tax credit claimed by each Gerdau and Belgo Mineira during the POI by each company’s export sales, respectively, during the POI. On this basis, we determine that a countervailable benefit of 3.68 percent ad valorem exists for Gerdau and a countervailable benefit of 1.46 percent ad valorem exists for Belgo Mineira.

II. Programs Determined to Be Not Countervailable

A. National Bank for Economic and Social Development Export Financing

BNDES provides three types of export loans: (1) Pre-shipment loans, (2) Special Pre-shipment loans, and (3) Post-shipment loans. Pre-shipment loans are linked to specific export shipments. Special Pre-shipment loans are not linked to specific export shipments but rather are granted to exporters who pledge to increase exports. BNDES only grants special pre-shipment loans to a company that has previously exported and is in a likely position to increase exports. Post-shipment loans finance the export sales of goods or services abroad by financing an exporter’s accounts receivable. A company may apply directly to BNDES or through agent banks to receive BNDES export loans. However, regardless of a company’s application method, BNDES export loans are disbursed through agent banks rather than directly to the recipient company.

The terms of these loans are determined by the agent bank after evaluating a company's creditworthiness and the proposed use of the loan. The interest rate for BNDES export loans is determined by either the London Interbank Offered Rate or the TJLP, plus a basic spread of one or two percent, which is paid to BNDES. If an agent bank provides a guarantee to BNDES, then the basic spread is one percent. If no such guarantee is provided, then the basic spread is two percent. Additionally, the agent bank charges an additional spread which is negotiated with the borrowing company. This spread covers, *inter alia*, any cost associated with administering the loan.

Belgo Mineira had certain long-term Brazilian Real and short-term U.S. dollar denominated loans outstanding from BNDES during the POI. As further discussed below in Comment 5, because all of the long-term Brazilian Real loans were initially received during 2000, no payments were due during the POI. Therefore, we determine that no benefit pursuant to section 771(5)(E)(ii) of the Act exists for the long-term Brazilian Real loans during the POI.

Regarding Belgo Mineira's U.S. dollar-denominated loan, as further discussed below in Comment 5, the interest rate on the BNDES loan exceeds the benchmark. Therefore, we determine that BNDES U.S. dollar-denominated short-term export financing does not confer a benefit during the POI under section 771(5)(E)(ii) of the Act.

B. National Bank for Economic and Social Development Financing for Gerdau's Acquisition of Aco Minas Gerais S.A.

In 1999, Acominas, Gerdau, and BNDES agreed on a modernization program in which Acominas issued a total of 165,501,872,821 shares of common stock to the public for R\$339 million. At the same time, Gerdau agreed to purchase 79,769,148,475 shares of Acominas common stock for R\$164 million. Acominas agreed to use this investment for the purchase of new machinery to modernize and improve the Acominas production facilities.

Based on Acominas' pledge to use the funding in the above manner, BNDES agreed to provide Gerdau with a FINEM loan, typically intended to finance capacity expansions or modernizations, to provide Gerdau with the necessary funds for the Gerdau investment in Acominas. Normally, BNDES makes these loans available at variable interest rates dependent on the credit rating of the borrower and the size of the project. The Acominas FINEM loan to Gerdau covered a period of over six years and consisted of four sub-credits all with different conditions for repayment and financing.

We determine that FINEM loans, including the loan Gerdau received to invest in Acominas, are widely available to all producers in Brazil. Moreover, the steel industry received only 10.99 percent of the funds distributed under this program. In light of the shares received by other industries (e.g., 33.7 percent by the mail/telecommunications sector and 13.9 percent by the electricity/gas/water sector), the steel sector is not a predominant or disproportionate user of the

program. Therefore, we determine that FINEM loans, including the loan Gerdau received to invest in Acominas, are not specific within the meaning of section 771(5A) of the Act.

C. Gerdau

Debt Forgiveness/Equity Infusions Provided to Cia Siderurgica do Nordeste (previously 1991 Debt-to-Equity Conversion Provided to Cia Siderurgica do Nordeste)

Prior to 1991, Cosinor was owned by SIDERBRAS. In 1991, SIDERBRAS sold Cosinor to Gerdau in a privatization auction that was conducted under the auspices of the National Privatization Program (“PND”), which was overseen by the GOB through BNDESPAR.

In order to restructure Cosinor and to restore its operational viability, as well as to prepare Cosinor for privatization, the GOB made several investments into Cosinor in 1986 through 1989 and 1991. In 1986 through 1989, the GOB made the following equity infusions into Cosinor: 175,643,000 Cruzados in 1986; 4,958,611,000 Cruzados in 1987; 22,026,471,000 Cruzados in 1988; and 1,241,333,000 Cruzados in 1989. Additionally, in 1991, the GOB, through BNDES and BNDESPAR, converted as much as US\$12.8 million of Cosinor’s debt into equity.

As discussed below in Comment 1 of the “Analysis of Comments” section, because any subsidies provided to Cosinor by the GOB prior to its privatization were extinguished, we determine that no financial contribution or benefit under sections 771(5)(D) and 771(5)(E), respectively, was provided to Gerdau during the POI.

III. *Programs Determined Not To Have Been Used*

- A. Amazonia Investment Fund and Northeast Investment Fund Tax Subsidies
- B. Constitutional Funds for Financing Productive Sectors in the Northeast, North, and Midwest Regions (Fundos Constitucionais de Financiamento do Nordeste, do Norte, e do Centro-Oeste)
- C. Fiscal Incentives for Regional Development (Provisional Measure No. 1532 of Dec. 18, 1996)
- D. Accelerated Depreciation

IV. *Program Determined to Have Been Terminated*

Exemption of Import Duties, the Industrial Products Tax, the Merchandise Circulation Tax, and the Merchant Marine Renewal Tax on the Imports of Spare Parts and Machinery

V. *Program Determined to Not Exist*

BNDES Programa de Modernizacao de Siderurgica Brasileira - Fund for the Modernization of the Steel Industry

VI. *Programs for Which No Determination Was Made*

A. Reduction of the Urban Building and Land Tax

The IPTU tax is administered by each municipality in Brazil. Thus, the collection of the IPTU tax is the responsibility of each municipality, and any individual tax exemption results from direct negotiations between the municipality and the recipient of the exemption. Gerdau did not receive an IPTU tax exemption during the POI. However, one municipality in Minas Gerais offered an IPTU tax concession to Belgo Mineira during the POI. Specifically, the city of Sabara provided a 50 percent reduction of IPTU taxes beginning in 1996 through 2003 to Belgo Mineira's facility in the city of Sabara. This tax abatement was given to Belgo Mineira as payment for a parcel of land Belgo Mineira transferred to Sabara.

It is the Department's practice in situations where any benefit to the subject merchandise would be so small that there would be no impact on the overall subsidy rate, regardless of a determination of countervailability, to not determine whether benefits conferred under these programs to the subject merchandise are countervailable. (See, e.g., Live Cattle From Canada: Final Negative Countervailing Duty Determination, 64 FR 57040, 57055 (October 22, 1999).) In this instance, any benefit to the subject merchandise resulting from these transactions would be so small that there would be no impact on the overall subsidy rate, regardless of a determination of countervailability. Thus, consistent with our past practice, we do not consider it necessary to determine whether benefits conferred thereunder to the subject merchandise are countervailable.

B. Gerdau

National Bank for Economic and Social Development Financing for Gerdau's Purchase of Usiba

In October 1989, Gerdau purchased Usiba from SIDERBRAS as part of a privatization auction run by BNDESPAR. Under the Brazilian privatization system that was in place prior to the creation of the PND in 1990, any person interested in purchasing a company that was being privatized could opt to finance the transaction through SIDERBRAS. Under this system, the purchaser could pay 30 percent down at the time of purchase, and the remaining 70 percent would be financed by SIDERBRAS on an installment basis for up to ten years at an interest rate of 12 percent.

Gerdau opted to utilize this funding in its purchase of Usiba. Thus, upon being selected as the winning bidder in the privatization auction, Gerdau paid 30 percent up front and the remaining

amount was financed at 12 percent, with the first interest payment being made in November 1989. Prior to the POI, however, these original terms were revised based on negotiations between the GOB and Gerdau, the details of which are proprietary and cannot be discussed in this memorandum.

As discussed below in Comment 2, because the original loan provided as part of the privatization was restructured and terminated prior to the POI, the appropriate loan to examine is the “new” loan that was in existence during the POI. With respect to the loan terms that were in existence during the POI, because this program was not discovered until just prior to the Preliminary Determination and the Department was not able to issue a full questionnaire to Gerdau with respect to this program until just prior to verification, there was insufficient time remaining in the proceeding to issue subsequent questionnaires and to gather further information with respect to the loan terms that were in place during the POI. Thus, we do not have sufficient information on the record in order to determine the countervailability of this transaction. However, as discussed in Comment 2, below, if this investigation results in a countervailing duty order for Gerdau, we will seek further information regarding this transaction in a future administrative review, in accordance with 19 CFR 351.311(c)(2).

Analysis of Comments

Comment 1: Usiba and Cosinor Privatizations

Respondents’ Argument: The respondents argue that the Department should revise its privatization analysis and find that pre-privatization equity infusions provided to Usiba and Cosinor by the GOB did not provide a countervailable benefit to Gerdau.

The respondents first argue that, in conducting the privatization analyses for Usiba and Cosinor for the final determination, the Department should not use its “same person” methodology because that methodology is currently being challenged in the courts and in the World Trade Organization (“WTO”). The respondents argue that, due to this fact, the Department’s same person analysis is not permissible as a legal matter and, therefore, is irrelevant. Instead, the respondents argue that the Department should analyze whether Gerdau paid full fair market value for Usiba and Cosinor when it acquired those companies. According to the respondents, Gerdau acquired both companies as part of competitive and open bidding processes in which Gerdau prevailed due solely to its willingness to pay more for the companies than other bidders. The respondents argue that there has been no allegation or suggestion by the petitioners that either Usiba or Cosinor was sold and purchased for anything less than fair market value. Thus, the Department should conclude that Gerdau did not receive any countervailable benefits by virtue of its purchases of Usiba and Cosinor at privatization auctions.

The respondents next argue that, if the Department does use its same person methodology in conducting its privatization analyses, the Department should find that no countervailable benefits

are passed through to Gerdau from the pre-privatization infusions into Usiba and Cosinor. With respect to Usiba, according to the respondents, due to changes to Usiba after privatization related to the modernization of Usiba by Gerdau and internal restructuring in Usiba following the privatization, the Department should find that post-privatization Usiba is no longer the same person as the pre-privatization Usiba that received equity infusions from the GOB. The respondents argue that the Department should, if it uses its “same person” methodology, compare pre-privatization Usiba to Usiba during the POI in order to determine whether the two are the same person. The respondents argue that, given the numerous changes to Usiba between the time of the infusions and the POI, and the fact that Usiba no longer exists as a corporate entity, the Department cannot find that Usiba and Gerdau are the same person.

With respect to Cosinor, the respondents argue that, because Gerdau disposed of or permanently idled the assets of Cosinor and dissolved the company shortly after it was purchased, it is inconceivable that the Department would find that Cosinor and Gerdau are the same person following privatization. According to the respondents, the same person criteria cannot even be meaningfully applied in this case because there was no post-privatization entity to compare to the pre-privatization Cosinor. Thus, the respondents state that the Department must find that pre- and post-privatization Cosinor are not the same person, and that the pre-privatization infusions received by Cosinor from the GOB did not benefit Gerdau. The respondents note that, because a small amount of Cosinor’s assets were transferred to other Gerdau facilities when Cosinor was shut down, if the Department somehow determines that these few assets can be construed as being the same person as the pre-privatization Cosinor or that the infusions provided by the GOB to Cosinor are somehow embedded in these Cosinor assets, the Department should discount the face value of any infusion by the percentage of assets that were transferred to the other facilities. According to the respondents, this discounting would render the infusions provided by the GOB to Cosinor that are applicable to the POI insignificant with no meaningful impact on the overall subsidy rate.

Petitioners’ Argument: The petitioners argue that information on the record confirms that Gerdau is the same person as Usiba pursuant to the Department’s change-in-ownership methodology. Specifically, the petitioners state that the general business operations of Usiba did not change substantially due to Usiba’s sale to Gerdau. The petitioners note that the same line of products was produced before and after the sale; moreover, the customers and suppliers remained essentially the same. The petitioners also contend that, according to information presented at verification, the production facilities did not substantially change immediately subsequent to the sale, and the liabilities and assets generally remained intact until later increases in assets were made due to normal investments and modernizations by the new owner. Finally, according to the petitioners, there is no information that any changes in personnel occurred immediately following the privatization, and that any streamlining that was done occurred over time. The petitioners state that the respondents’ contentions that Usiba did change substantially following the change in ownership ignore the findings in the verification report and the fact that these changes happened over a period of many years and not immediately prior and subsequent to the change in ownership event.

The petitioners did not make a specific argument with respect to the same person analysis for Cosinor. However, the petitioners note in their case brief that application of the same person factors to pre-sale Cosinor and post-sale Cosinor indicates that Cosinor did not continue to operate as the same person following its privatization.

The petitioners disagree with the respondents' argument that the Department should not utilize its same person methodology in the final determination. According to the petitioners, none of the sources cited in the respondents' case brief supports the conclusion that the Department should reject the "same person" test. The petitioners point out that the court cases in question are ongoing and not final, and that certain cases sustained the use of the "same person" test (see, e.g., AST - GOES). Moreover, the petitioners note that, although in some cases the Department has examined fair market value in remand redeterminations (see, e.g., Results of Redetermination Pursuant to Court Remand, Acciai Speciali Terni S.p.A. v. United States, Court No. 99-06-00364 (June 3, 2002)), these decisions are not final, and the Department noted that it carried out this examination only at the direction of the CIT and it did not agree with the CIT's decision to require such an analysis. Additionally, the petitioners argue that the recent court decisions and WTO actions do not specify that, if the "same person" test is not utilized, fair market value alone should be used to determine whether a subsidy continues to be countervailable following a change in ownership. The petitioners note that, in fact, certain court rulings have indicated that fair market value could not, in and of itself, eliminate past subsidies. See, e.g., Acciai Speciali Terni S.p.A. and Acciai Speciali Terni USA v. United States, Slip Op. 2002-10 (CIT 2002) ("AST -Stainless Steel Plate"). Thus, the petitioners argue that a review of the law supports the conclusion that the Department's "same person" test is sound and should be maintained, and that a fair market value in and of itself cannot eliminate subsidies.

Department's Position: We agree, in part, with both the petitioners and the respondents. With respect to the respondents' first argument that the Department should not utilize its "same person" methodology for the final determination, we disagree with the respondents that the Department's "same person" change-in-ownership methodology is not in accordance with law or in conformance with the CAFC's decision in Delverde III. In several recent cases, various judges of the CIT have ruled on the Department's "same person" test. Some found that this methodology was not in accordance with law and the cases were remanded to the Department for further proceedings: see Allegheny Ludlum 182 F. Supp. 2d 1357 (CIT 2002); GTS Industries S.A. v. United States, 182 F.Supp. 2d 1369 (CIT 2002); AST - Stainless Steel Plate; ILVA Lamiera E Tubi S.R.L. and ILVA S.p.A v. United States, Slip Op. 2002-32 (CIT 2002). In another case, AST - GOES, the CIT affirmed the Department's "same person" methodology.

All of these cases, however, are subject to further appeal. Therefore, notwithstanding the respondents' arguments regarding the inappropriateness of our "same person" methodology, until there is a final and conclusive decision regarding the legality of the Department's change-in-ownership methodology, we have continued to apply it for purposes of this final determination. Thus, we need not address the respondents' arguments with respect to the use of a fair market value analysis in place of the Department's "same person" analysis.

We also disagree with the respondents that Usiba was not the same person as Gerdau following the change in ownership. As noted above, the first step under our change-in-ownership methodology is to determine whether the legal person, or, more specifically, the business entity to which the subsidies were given, is distinct from the business entity that produced the subject merchandise exported to the United States.

The first of the four criteria examined by the Department is the continuity of general business operations, including whether the successor holds itself out as the continuation of the previous enterprise. This may be indicated, for example, by use of the same name. At verification, we found that Usiba continued its production process without interruption following the sale, producing the same line of products under the same name until 1996, seven years after the change in ownership. We also found that Usiba's customers and suppliers remained the same before and after the sale. Thus, the overall business operations of Usiba pre- and post- change in ownership were essentially the same.

As for the second and third criteria, continuity of production facilities and assets and liabilities, at verification, Gerdau reported that Usiba's liabilities were passed along to Gerdau when the sale took place, but that Usiba's assets increased because of improvements made by Gerdau to the Usiba production facilities following the sale. However, we found that these improvements were not started until 1991, two years after the sale, and that the improvements that added to Usiba's assets and that improved the production facilities were made over an extended period of time lasting until 1996. Thus, Usiba's assets, liabilities, and production facilities were essentially the same prior to and following the sale until major improvements were made several years after the change in ownership. Finally, with respect to the fourth criterion, retention of personnel, although changes to overall staffing levels and directors were made following the change in ownership, at the time of the acquisition, Gerdau assumed all of Usiba's individual collective and individual labor contracts, and only later did Gerdau initiate an informal plan for voluntary resignations.

Based on the totality of the factors considered, we determine that pre- and post-sale Usiba is a continuous business entity because it was operated in substantially the same manner before and after the change in ownership. Although it is evident that long-term changes were being carried out by Gerdau, a comparison of Usiba immediately prior to and subsequent to the sale indicates that the two entities were the same person. Thus, we are attributing subsidies received by Usiba that continue to be allocable during the POI to Gerdau's sales during the POI.

Finally, based on an examination of record information for Cosinor, we agree with both the petitioners and the respondents that the legal person (entity) to which the subsidies were given, Cosinor, is, in fact, distinct from the legal person that produced the subject merchandise exported to the United States, Gerdau. Thus, we find that, because Gerdau and Cosinor are not the same person, any subsidy that was received by Cosinor would have been extinguished. Therefore, no financial contribution or benefit under sections 771(5)(D) and 771(5)(E), respectively, was provided to Gerdau as a result of the equity infusions and debt-to-equity conversion provided by the

GOB to Cosinor. Furthermore, there is no information on the record that would indicate, and petitioners made no allegation to the effect, that a new subsidy was provided in the course of the sale or the dismantling of Cosinor. We have, therefore, not examined whether the sale of Cosinor occurred at arm's length for fair market value.

Comment 2: GOB Financing for the Purchase of Usiba

Petitioners' Argument: The petitioners contend that Gerdau received preferential financing from the GOB for its purchase of Usiba. According to the petitioners, at the time of Usiba's privatization, the GOB offered financing to the purchasers of government companies. Specifically, the petitioners stated that the GOB allowed purchasers to pay 30 percent of the cost of acquisition at the time of purchase, with the remaining 70 percent financed over a period of 10 years at an interest rate of 12 percent. The petitioners state that Gerdau took advantage of this opportunity in purchasing Usiba. The petitioners acknowledge that these terms were later revised. According to the petitioners, this transaction constitutes a financial contribution pursuant to section 771(5)(D)(i) of the Act. Moreover, this transaction was specific according to the petitioners because this type of financing was limited only to purchasers of SIDERBRAS steel companies under the "old" Brazilian privatization system. Finally, the petitioners contend that a benefit was provided because the interest rate that Gerdau was paying on the financing was less than comparable commercial loans.

Respondents' Argument: The respondents contend that the financing terms for the Usiba privatization did not confer a countervailable benefit to Gerdau. First, the respondents argue that these financing terms were standard and applied to all other privatizations under the old privatization system. Thus, the respondents argue that these financing terms were not provided on a preferential or specific basis to Gerdau. Moreover, the respondents argue that, because these financing terms were known to all potential bidders prior to the auction, the bidders would have incorporated the economic value of the financing terms into their bid for Usiba. Specifically, the respondents argue that the bidders would have adjusted their maximum bids knowing that they could finance up to 70 percent of the purchase price and that the financed portion would be at a 12 percent interest rate. Thus, the respondents argue that Gerdau's winning bid "paid for" the value of the financing terms, and that Gerdau did not receive any financial contribution or benefit from the GOB due to the financing terms included in the Usiba privatization.

The respondents argue that the petitioners, in their case brief, never clarify whether they are addressing the original deferred payment terms or the terms that were valid during the POI. Moreover, the respondents state that the petitioners' analysis of the three elements of a subsidy in this instance are unsupported and misinterpret the facts in this proceeding. With respect to a financial contribution, the respondents argue that no funds or "financing" were provided by the GOB to Gerdau. The respondents argue that there was no direct transfer of funds, only an agreement to provide deferred payment terms, and that the GOB never forfeited the right to collect any funds. Moreover, the respondents contend that, in Gray Portland Cement and Cement Clinker from Venezuela: Suspension of Investigation, 57 FR 9242 (March 17, 1992), the

Department recognized that a loan agreement reached in settling litigation between the government and the respondent did not provide a countervailable benefit, and that a settlement to resolve a protracted litigation, unless on terms inconsistent with commercial considerations, does not confer a subsidy.

The respondents also state that the transaction was not specific, as argued by the petitioners, because the deferred payment terms were available to anyone purchasing a company under the GOB's old privatization system and were available to anyone wanting to purchase Usiba. Moreover, the petitioners did not allege that the revised payment terms with the GOB that were in place during the POI were specific. Finally, the respondents state that, with respect to the original payment terms, the petitioners did not provide any evidence that the payment terms were less than those of comparable commercial loans at the time. Moreover, as noted above, the respondents contend that the bidders in the Usiba auction would have adjusted their bids knowing in advance about the deferred financing and the applicable interest rate. Thus, any reference to other interest rates at the time would only be relevant had there been no competitive bidding for Usiba. As for the revised payment terms with the GOB that were in place during the POI, the respondents state that the petitioners offered no analysis of how the new terms benefitted Gerdau. According to the respondents, the facts surrounding the establishment of these terms (which are business proprietary and cannot be discussed in this memorandum) do not show that there was a benefit to Gerdau.

Finally, the respondents state that the petitioners fail to note that, if the "same person" methodology is applied to Usiba, and Usiba and Gerdau are found to be the same person, the Department is, according to the respondents, precluded from finding that a subsidy was conferred as part of the change in ownership transaction.

Department's Position: As the respondents have pointed out, the original terms of the agreement were revised prior to the POI through negotiations between Gerdau and the GOB, and new loan terms were in place by the time of the POI. In this situation, it is the Department's practice to analyze the terms of the "new" loan that was in existence during the POI, not the original loan that was restructured and terminated prior to the POI. See, e.g., Final Affirmative Countervailing Duty Determinations: Certain Steel Products from France, 58 FR 37304, 37311 (July 3, 1993).

As discussed above in the "Analysis of Programs" section, because this program was not discovered until just prior to the Preliminary Determination and the Department was not able to issue a full questionnaire to Gerdau with respect to this program until just prior to verification, there was insufficient time remaining in the proceeding to issue subsequent questionnaires and to gather further information with respect to the loan terms that were in place during the POI. Thus, we do not have sufficient information on the record in order to determine the countervailability of this transaction. In situations like this, section 775(2) of the Act permits the Department to defer a determination of whether this loan confers a subsidy until the administrative review (should an order be issued). Therefore, in accordance with section 775(2) of the Act and 19 CFR

351.311(c)(2), if this investigation results in a countervailing duty order, we will seek further information regarding this transaction in a future administrative review.

Comment 3: Benchmarks for Long-Term, Brazilian Currency Denominated Loans and Discount Rates

Petitioners' Argument: The petitioners argue that, for the final determination, the Department should utilize a different benchmark for long-term, variable rate, Brazilian currency loans than was used in the Preliminary Determination. The petitioners first argue that the Department's reliance on the past cases noted in the Preliminary Determination⁵ was misplaced in this situation. The petitioners argue that in three of the four cases (Brazil Cold-Rolled Steel, Brazil Hot-Rolled Steel, and Venezuela Wire Rod), the U.S. dollar interest rate was used only as a discount rate to allocate non-recurring grants where the value of the grants was also converted to U.S. dollars (which was reasonable, according to the petitioners) and not as a benchmark rate. The petitioners argue that the fourth case, Brazil Certain Steel, was conducted prior to the issuance of the Department's current countervailing duty ("CVD") regulations, which codified currency as one of the criteria for defining a "comparable" commercial loan.

The petitioners note that, according to 19 CFR 351.505(a)(2)(i) (the Department's current CVD regulations), the Department defines a comparable loan as one that is similar to the loan being examined in terms of structure (e.g., fixed versus variable interest rate), maturity (e.g., short-term versus long-term), and the currency in which the loans are denominated. The petitioners note, however, that, as the Department found in the Preliminary Determination and subsequently verified, there are no long-term, variable-rate loans denominated in Brazilian currency in Brazil other than the FINAME loans being investigated. The petitioners contend that, based on information discovered by the Department at verification, the Department should utilize as a benchmark for the long-term Brazilian currency loans short to medium-term Brazilian loans that are also denominated in Brazilian currency.

According to the petitioners, although the two types of loans differ in terms of maturity, it is important in this situation that the loans being compared be denominated in the same currency. The petitioners argue that currency is particularly important in comparing loans made in commercial markets with widely divergent traits. The petitioners point out that the Department learned at verification that the market in Brazil has historically been volatile, with high inflation, high interest rates, and instability. The petitioners argue that the different market conditions in the United States and Brazil directly affect the relative interest rates, and that, in markets with high inflation or instability, the interest rate will necessarily be higher to take into account credit risks and currency volatility. Thus, the petitioners argue that the U.S. dollar-based rates will on their face be lower than the Brazilian-currency based interest rates. The petitioners note,

⁵Brazil Cold-Rolled Steel, Brazil Hot-Rolled Steel, Brazil Certain Steel, and Final Affirmative Countervailing Duty Determination: Steel Wire Rod from Venezuela, 62 FR 55014, 55019, 55023 (October 21, 1997) ("Venezuela Wire Rod").

moreover, that the private banker with whom Department officials met while on verification confirmed that this was the case when comparing Brazilian currency denominated loans to U.S. dollar-denominated loans.

Thus, although it is the Department's preference to utilize loans with the same maturity as the loans in question as a benchmark, in this case, the petitioners argue that, because of the volatility of Brazilian interest rates and the fact that there are no other long-term Brazilian currency denominated loans in Brazil than the ones under investigation, the Department should use as a long-term Brazilian currency loan benchmark the Brazilian "lending rate" as reported by the International Monetary Fund ("IMF"). The petitioners argue that, although this rate is a short- to medium-term rate, it is a better comparison than the U.S. dollar denominated long-term rate used in the Preliminary Determination because it is a Brazilian currency rate that better reflects the market situation in the Brazilian market.

Respondents' Argument: The respondents disagree with the petitioners and argue that, for the final determination, the Department should continue to utilize the U.S. dollar-denominated, company-specific commercial loans used as benchmarks in the Preliminary Determination for long-term Brazilian currency loans.

The respondents first argue that, with respect to the four cases cited by the Department in its Preliminary Determination to support the use of a dollar-denominated benchmark, the petitioners are wrong in stating that these cases are inapposite. According to the respondents, with respect to the three cases in which U.S. dollar-denominated loans were used as discount rates for the allocation of grants (Brazil Cold-Rolled Steel, Brazil Hot-Rolled Steel, and Venezuela Wire Rod), the petitioners provide no explanation as to what distinction between discount rates and benchmark rates would preclude the application of the analysis used in those three cases in the instant situation. According to the respondents, the regulations and goals for choosing a benchmark interest rate are similar to those for choosing a discount rate, and both focus on the cost of financing to the firm in the year of the grant or loan in question. The respondents further argue that, because the purposes and goals behind selecting discount and benchmark rates are similar, there is no justification for using U.S. dollar loans to determine discount rates but not benchmarks. As for the fourth case (Brazil Certain Steel) in which the Department did use a U.S. dollar benchmark for Brazilian currency denominated loans, the respondents argue that the Department's new CVD regulations with respect to benchmarks were intended to be more, not less, flexible. Moreover, the respondents argue that the Department has continued to make cross-currency comparisons since the promulgation of the new CVD regulations. *See, e.g., Stainless Steel Sheet and Strip in Coils from the Republic of Korea, 64 FR 30636 (June 8, 1999) ("Korean Sheet and Strip")*.

According to the respondents, the petitioners have lost sight of the overall objective in the Department's benchmark selection. The respondents argue that the essence of the Department's benchmark comparisons is to determine what financing costs "would have been" if the company had opted for non-government funding. The respondents state that, if the only other long-term

financing was U.S. dollar-denominated loans, then this should be the benchmark. The respondents contend that it is important to select an alternative that most closely approximates the company's realistic choices at the time that the government loan was secured regardless of the currency of the loan.

Moreover, the respondents argue that the petitioners mischaracterize the statements of the private banker and offer them out of context. According to the respondents, the banker, who was speaking from the perspective of an investor and not a borrower, did not state that U.S. dollar-denominated loans were inappropriate for use as a benchmark for Brazilian currency borrowing. Instead, the respondents contend that the banker stated that these loans would not provide a "perfect comparison," which, the respondents state, is correct. However, the respondents point out that there is nothing that would provide a "perfect comparison" in this instance, and, thus, the Department must select the next best option which, according to the respondents, is the commercial U.S. dollar loans. The respondents state that the banker's testimony also proves another of the respondents' contentions, that U.S. dollar commercial loans provide the best comparison option in terms of a benchmark because both the long-term Brazilian currency and U.S. dollar loans include a currency variation component, where a nominal rate would not. Thus, both are long-term, variable-interest loans. Finally, the respondents argue that the petitioners' contention that U.S. dollar interest rates will be lower than Brazilian interest rates has no basis in the law or in fact and is patently outcome-driven.

If the Department does decide to disregard the company-specific benchmark rates, the respondents argue that the Department should use the World Bank national average debt tables for Brazil that were submitted by the respondents. The respondents state that these are the only source of national average interest rates that are on the record of the proceeding, and that the IMF rates recommended by the petitioners should not be used because they constitute new information and are not on the record of the proceeding. Moreover, the respondents argue that there is no evidence that short-term interest rates in Brazil should always be lower than long-term interest rates as cited by the petitioners. Additionally, the respondents argue that short-term rates are fixed-interest rates, unlike the FINAME loans in question which are long-term variable-rate loans. The respondents argue that these short-term rates would not reflect any adjustment for inflation or for credit risk as are accounted for in the FINAME loans. Thus, using the short-term loans as a benchmark would be inappropriate according to the respondents.

Department's Position: We agree with the respondents. According to section 771(5)(E)(ii) of the Act, in determining whether a loan confers a benefit, the Department examines the difference between the amount the recipient of the loan pays on the loan and the amount the recipient would pay on a comparable commercial loan that the recipient could actually obtain on the market. In selecting a comparable commercial loan, 19 CFR 351.505(a)(2)(i) states that the Department will place primary emphasis on similarities in the structure of the loan (e.g., fixed interest rate v. variable interest rate), the maturity of the loan (e.g., short-term v. long-term), and the currency in which the loan is denominated. Section 351.505(a)(3)(i) of the Department's regulations further states that, in selecting a comparable commercial loan that the recipient "could actually obtain on

the market,” the Department will normally rely on the actual experience of the firm in question. Finally, 19 CFR 351.505(a)(3)(ii) states that, in instances where the firm in question did not take out any comparable commercial loans, the Department may use a national average interest rate for comparable commercial loans.

Thus, the Department’s regulations show a clear preference for the use of comparable commercial loans obtained by a company rather than a national average interest rate. In this instance, both Belgo Mineira and Gerdau have reported that they have commercial loans that can be used as benchmarks for their long-term, variable rate, Brazilian currency-denominated FINAME loans. Thus, these loans represent commercial loans that “could actually be obtained on the market” by Belgo Mineira and Gerdau, consistent with 19 CFR 351.505(a)(3)(i). The commercial loans reported by Belgo Mineira and Gerdau also meet two of the three criteria noted by the Department in 19 CFR 351.505(a)(2)(i): like the FINAME loans, they are long-term loans, and they have variable interest rates.

With respect to currency, the third criterion listed in 19 CFR 351.505(a)(2)(i), while FINAME loans are denominated in Brazilian currency, the commercial loans reported by Belgo Mineira and Gerdau are denominated in U.S. dollars. We found in this case, as we have in past Brazilian cases (see, e.g., Brazil Cold-Rolled Steel, Brazil Hot-Rolled Steel, and Brazil Certain Steel) that there are no long-term loans that can be obtained in Brazil that are denominated in Brazilian currency other than the loans that are being investigated. Thus, there are no loans that meet all of the criteria set out in 19 CFR 351.505(a)(2)(i). However, both Gerdau and Belgo Mineira’s original U.S. dollar-denominated loans were converted and indexed in these company’s accounting systems to take into account monetary variations. While the currency in which a loan is denominated is an important factor in selecting a benchmark, the indexing of these dollar-denominated loans, in our view, addresses the petitioners’ concerns about the effects of the variability of Brazilian interest rates and the value of U.S. currency. Finally, as noted by the respondents, the Department has used commercial loans denominated in a different currency as benchmarks in other cases (see, e.g., Brazil Certain Steel and Korean Sheet and Strip).

Although the petitioners argue that the Department should use the short- to medium-term Brazilian “lending rate” as reported by the IMF as our benchmark, we note that this rate does not meet two of the three criteria established in 19 CFR 351.505(a)(2)(i) because this interest rate is based on fixed-rate loans and is also for short- to medium-term loans. Moreover, this rate is a national average rate, not a company-specific commercial rate as preferred by the Department under 19 CFR 351.505(a). In light of these differences, and because of the indexing of the dollar-denominated loans, discussed above, the dollar-denominated loans taken out by Gerdau and Belgo Mineira provide the best benchmark to determine whether FINAME loans are preferential.

Comment 4: FINAME Loans

Petitioners' Argument: According to the petitioners, the Department should affirm its Preliminary Determination findings with respect to the financial contribution and specificity of FINAME loans. The petitioners further argue that the Department should compare the actual payments made by Gerdau and Belgo Mineira to BNDES during the POI instead of using the “accrued charges” reported by these companies to calculate the POI benefit.

Respondents' Argument: The respondents disagree with the petitioners. First, the respondents contend that, contrary to the petitioners' arguments, no financial contribution exists with respect to FINAME loans. Specifically, the respondents contend that there was no “direct transfer of funds” as required by section 771(5)(D)(i) of the Act. Instead, the respondents argue that FINAME loans are negotiated between an accredited financial institution, which is generally a non-governmental entity, and the borrower, and that the funds are disbursed directly by this accredited institution directly to the borrower. Moreover, the respondents argue that a significant part of the financial cost to the borrower of a FINAME loan, the agent spread, is determined by the third-party institution through negotiations with the borrower. The respondents state that the CVD law contemplates the provision of goods and services by the government to a company without any involvement of a third party that influences the ultimate costs of the loan. Here, the respondents argue that there is a disconnect between the actions of the government and the benefit or costs to the recipient. Thus, there is no “direct” transaction between the government and the Brazilian company as required under the statute.

The respondents further argue that, if the Department finds that a financial contribution does exist with respect to FINAME loans, the Department should use provisioned and not actual payments in calculating the benefit amount. The respondents contend that the provisioned amounts provide the best measure of the actual financial cost of the loan over the life of the loan. Moreover, the respondents state that the use of the provisioned figures would not result in any distortions because a company is not permitted under Brazilian accounting law to provision any more than it ultimately actually incurs. The respondents argue that, if the Department does use actual costs, the Department should continue to utilize provisioned costs in instances where no actual payment information is available.

Department's Position: We disagree with the respondents' that FINAME loans do not provide a financial contribution because there was no “direct transfer of funds.” The funds being loaned through the FINAME program are GOB funds. Moreover, the largest portion of the financing charges paid by the borrower are paid to the GOB. The GOB established the “financial cost” and the “basic spread” which make up as much as 14.5 percent, whereas the agent banks' spread was generally less than 2.5 percent according to the respondents. While it is true that FINAME loans are processed through agent banks, these banks must be approved by BNDES and they act as agents on behalf of the GOB.

Regarding the use of provisioned versus actual payments to calculate the benefit from FINAME loans, we agree with the petitioners that the actual amounts paid during the POI, and not provisioned costs, should be used. Section 771(5)(E)(ii) states that, in the case of a loan, the benefit is the difference between the amount the loan recipient pays (not provisions) on the loan and the amount the recipient would actually pay (not provision) on a comparable commercial loan. Moreover, 19 CFR 351.505(c)(4) stipulates that, in the case of a long-term variable interest rate loan, the benefit will be determined by calculating the difference in payments, not amounts provisioned, in a particular year for the government loan and a comparable commercial loan. Thus, we are revising the respondents' FINAME calculations to base them on the respondents' reported actual instead of accrued expenses.

Comment 5: BNDES Export Financing

Petitioners' Argument: The petitioners argue that the Department should revise its Preliminary Determination findings with respect to Belgo Mineira's outstanding POI BNDES Export loans for the final determination. The petitioners first contest the Department's preliminary finding that Belgo Mineira's outstanding long-term, Brazilian-currency based BNDES Export loans were non-countervailable because Belgo Mineira made no payments on them during the POI. According to the petitioners, payments on these loans would have been due had it not been for grace periods extended on these loans. The petitioners point to 19 CFR 351.505(b) which states that the benefit from preferential loans is considered to be received in the year in which the firm otherwise would have had to make a payment on a comparable commercial loan. According to the petitioners, the respondents have provided no information that comparable commercial loans would have had similar grace periods. Therefore, the petitioners argue that the Department should consider the grace period part of the benefit from these loans and calculate the benefit accordingly.

Secondly, the petitioners argue that, based on clarifications received at verification with respect to the interest rate for Belgo Mineira's outstanding "Special Preshipment" U.S. dollar-denominated loan, the Department should now find that this loan provides a benefit to Belgo Mineira.

Respondents' Argument: The respondents argue that the Department should reaffirm its preliminary conclusion that the outstanding "Special Preshipment" BNDES Export U.S. dollar-denominated loan to Belgo Mineira did not confer a benefit on Belgo Mineira because the rate paid by Belgo Mineira exceeded the benchmark. According to the respondents, the petitioners are applying the incorrect benchmark in making their comparison.

With respect to Belgo Mineira's outstanding long-term, Brazilian currency-based BNDES Export loans, the respondents disagree with the petitioners' claim that these loans were preferential. Specifically, the respondents argue that the petitioners' allegation with respect to the grace periods is both untimely and unsubstantiated. The respondents argue that this is the first time the petitioners have advanced this allegation, well after the time limit set by the Department's

regulations for new allegations. Moreover, the respondents state that the petitioners' allegation is unsubstantiated because there is no evidence on the record that the grace period of these BNDES Export loans was preferential or exceeded the grace periods provided in connection with the benchmark loans.

Department's Position: We disagree with the petitioners, and agree with the respondents, on both arguments made with respect to this program. First, with respect to Belgo Mineira's outstanding "Special Preshipment" U.S. dollar-denominated loan, the revisions made to the interest rate for this loan at verification do not change our preliminary conclusion. We continue to find that the interest rate on the "Special Preshipment" loan exceeds the benchmark interest rate and that no benefit is conferred by this loan during the POI pursuant section 771 (5) (E) (ii) of the Act.

As for Belgo Mineira's outstanding long-term, Brazilian currency-based BNDES Export loans, we disagree with the petitioners' argument that the Department should consider the grace period on these loans as part of the benefit from these loans. The petitioners have provided no evidence to support their contention that comparable commercial loans would not have had a similar grace period. Moreover, based on an examination of record evidence gathered during verification, it appears that comparable commercial loans that would be used as benchmarks for these loans could, indeed, have comparable grace periods. Thus, we determine that no payments would have been made on the benchmark loans during the POI and, consequently, that no benefit was conferred on Belgo Mineira from its long-term, Brazilian currency-based BNDES Export loans that were outstanding during the POI.

Comment 6: Reduction of the IPTU Tax

Petitioners' Argument: The petitioners first argue that the revised tax reductions provided at verification indicate a statistically significant benefit from the IPTU reduction. The petitioners contend that the IPTU tax reduction constitutes a special agreement, specific to Belgo Mineira, that benefitted Belgo Mineira by lowering its taxes and ridding the company of a "troublesome property." Additionally, the petitioners argue that the respondents failed to provide any documentation relative to the establishment of the value of the land which was transferred to the Government of Sabara ("GOS").

Respondents' Argument: The respondents maintain that the total amount of the POI tax reduction is statistically insignificant when divided over the value of Belgo Mineira's POI sales of subject merchandise. They also argue that the land transferred to the city of Sabara in exchange for the tax treatment had monetary value and, therefore, no benefit was realized.

Department's Position: As noted above in the "Analysis of Programs" section, we continue to find that any benefit to Belgo Mineira from the IPTU tax reduction would be so small that there would be no impact on Belgo Mineira's overall subsidy rate. Therefore, it is not necessary to determine whether benefits conferred under this program to the subject merchandise are countervailable.

Comment 7: BNDES Financing for Belgo Mineira's Acquisition of Dedini

Petitioners' Argument: The petitioners maintain that because neither the GOB nor Belgo Mineira disclosed BNDES' involvement in Belgo Mineira's acquisition of Dedini until verification, the Department should rely on facts available in measuring the benefit which they claim was conferred upon Belgo Mineira by that program.

According to the petitioners, the Department should treat the write-off by BNDES of certain penalties and late fees made in connection with Belgo Mineira's acquisition of Dedini stock as debt forgiveness. The petitioners further argue that the Department should assume that Dedini's debts to a separate government entity were written down by a similar amount and should also be treated as debt forgiveness.

The petitioners state that although the respondents in their case brief attempt to minimize their failure to report BNDES' involvement in the transaction and try to argue that there was no benefit to Belgo Mineira, these arguments come far too late in the proceeding. The petitioners contend that the respondents fail to address the debt forgiveness issue and attempt to diminish its significance. Thus, the petitioners state that the Department should, as facts available, find this debt forgiveness to be countervailable.

Respondents' Argument: The respondents argue that, with respect to the Dedini transaction, the Department must examine whether the GOB provided some form of financial contribution to Belgo Mineira, and whether a benefit was conferred because of such financial contribution. The respondents maintain that Belgo Mineira's execution of loan agreements with Dedini's creditors, which occurred subsequent to the acquisition of Dedini assets, was not part of a GOB program designed to confer subsidies to Brazilian companies, and that the loan agreements did not confer a subsidy to Belgo Mineira.

According to the respondents, the terms of the first part of the Belgo Mineira-Dedini transaction were negotiated directly between Belgo Mineira and Dedini without the GOB's participation. Because the GOB was not involved in this transaction, the respondents argue that there was no benefit or financial contribution provided by the GOB to Belgo Mineira.

The respondents maintain that there is no evidence that the terms of the loan restructuring conferred a financial benefit on Belgo Mineira. According to the respondents, the interest rate paid by Dedini for its underlying debt obligations (which were assumed by Belgo Mineira) was not preferential when compared with other Belgo Mineira financing rates in 1998. The respondents argue that the GOB's involvement in this transaction was purely ancillary, and was required only to carry out the terms of the already agreed-upon agreement between Belgo Mineira and Dedini. The respondents state that the new loan agreement did not provide an actual subsidy.

The respondents submit that BNDES' records reflect a higher Dedini gross debt than the figures which formed the basis of negotiations between Belgo Mineira and the Dedini stock owners. The respondents proffer that the discrepancy is likely related to late payment penalties which were not recognized by Dedini. The respondents argue that during the negotiations with Dedini's owners, the value of the debt was based on Dedini's records, and that Belgo Mineira "had every reason" to believe that Dedini's records were accurate and complete. They argue that Belgo Mineira's decision to assume Dedini's debt in exchange for stock was based on the presumption that the value of the outstanding debt was as it was represented by Dedini. Therefore, according to the respondents, the fact that BNDES maintained a different value for the underlying debt in its accounts was not relevant. According to the respondents, from Belgo Mineira's perspective of the value of the debt it was willing to assume, no debt was in fact forgiven by the GOB. Additionally, according to the respondents, Belgo Mineira never agreed to assume the differential.

In this case, the respondents maintain that BNDES presumably agreed to the value that Belgo Mineira negotiated with Dedini and did not contest the differential between Dedini's calculation of outstanding late payment fees to ensure that loan payments would resume without delay. According to the respondents, this decision was consistent with the principal objectives of BNDES in its debt recovery operations. Based on this analysis, according to the respondents, there can be no countervailing benefit conferred to Belgo Mineira as a result of BNDES' decision not to contest the underlying debt amount negotiated between Belgo Mineira and Dedini. The respondents state that this same analysis would also apply to the debt owed by Dedini to the other government entity in question.

Finally, the respondents submit that their description of the Dedini transaction in their questionnaire response was "incomplete" and "imperfect," and incorrectly stated that the GOB was not involved at all in the events resulting in the transfer of Dedini's debt to Belgo Mineira. The respondents argue that the fact that there was a difference in valuation between Dedini's records and BNDES' records was brought to the attention of Belgo Mineira for the first time during verification. The respondents argue that despite the questionnaire responses, the ultimate issue to be considered by the Department relates to the above discussion and the fact that, from Belgo Mineira's perspective, no debt was forgiven by the GOB and no benefit was provided through the new loan agreements.

Department's Position: During verification, we asked the respondents to substantiate their claims that BNDES was not involved in the Belgo Mineira-Dedini transaction as reported in their questionnaire responses. The respondents thereafter disclosed the scope and nature of BNDES' involvement in Belgo Mineira's acquisition of Dedini, and also revealed that BNDES wrote off debt as part of the transaction. We obtained sufficient information at verification to serve as the basis for our determination regarding the BNDES write-off and, therefore, have not had to rely on facts available.

Regarding the actions of the second government creditor, the respondents did not disclose this creditor's involvement in the transaction prior to verification in their questionnaire responses. However, unlike the BNDES situation, no further information was produced at verification regarding this creditor. When we questioned officials from this institution at verification concerning its involvement in Belgo Mineira's acquisition of Dedini, and any debt forgiveness associated therewith, we were told that the officials could not provide further information during verification.

Section 776(a)(2) of the Act provides that "if an interested party or any other person (A) withholds information that has been requested by the {Department} under this title, (B) fails to provide such information by the deadlines for submission of the information or in the form and manner requested, subject to subsections (c)(1) and (e) of section 782, (C) significantly impedes a proceeding under this title, or (D) provides such information but the information cannot be verified as provided in section 782(i), the {Department} shall, subject to section 782(d), use the facts otherwise available in reaching the applicable determination under this title." Section 776(b) of the Act further provides that adverse inferences may be used when an interested party has failed to cooperate by not acting to the best of its ability to comply with a request for information.

As discussed above, the respondents withheld information that was requested by the Department. Moreover, once the Department learned of the second creditor's involvement in this transaction, details related to this creditor's involvement could not be further verified. Therefore, the use of facts available in this instance is justified pursuant to section 776(a)(2)(A) and (D) of the Act.

Moreover, because the information provided by the respondents concerning this government creditor was deficient, and because the Department could not otherwise obtain the information required to complete an adequate factual record, we conclude that the respondents have failed to cooperate by not acting to the best of their abilities in this investigation. Thus, an adverse inference is warranted pursuant to section 776(b) of the Act. Therefore, we have based our determination with respect to debt forgiveness by the second GOB creditor on adverse facts available, as discussed above in the "Analysis of Programs" section.

Comment 8: PIS and COFINS - Direct Taxes vs. Indirect Taxes

Petitioners' Argument: The petitioners argue that PIS and COFINS taxes are direct taxes and, as such, exempting export revenue from these taxes and remitting these taxes on inputs used in the production of exports constitute countervailable export subsidies. Specifically, the petitioners argue that the record developed during the course of the instant investigation establish that PIS and COFINS taxes are direct taxes "in the form of social welfare charges."

In support of their assertion that PIS and COFINS taxes are direct taxes, the petitioners point to 19 CFR 351.102(b) as defining a direct tax as "a tax on wages, profits, interests, rent, royalties, and all other forms of income, a tax on the ownership of real property or a social welfare charge"

(emphasis added by the petitioners). The petitioners maintain that the Department's findings at verification support the conclusion that PIS and COFINS are social welfare charges because GOB, Belgo Mineira, and Gerdau officials acknowledged that these taxes are used for social welfare programs which, among other things, provide universal health care in public hospitals and professional training for workers. The petitioners also point to PIS Supplementary Law No. 7 and COFINS Supplementary Law No. 70 to support their assertion. The petitioners maintain that the COFINS law indicates that its purpose is to "defray the cost of social security, health care, and worker assistance" and that the PIS law is "intended to bring about integration of employees on the life and growth of their companies."

In response to the respondents' argument that PIS and COFINS taxes are not social welfare charges because of how these taxes are levied, the petitioners maintain that the use of the resulting tax revenues should be determinative of whether PIS and COFINS are social welfare charges. Specifically, the petitioners argue that the Department's regulations are consistent with the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") because to determine whether a tax relates to social welfare, both consider its use. Moreover, the petitioners maintain that the Department's regulations recognize the remission or rebate of both social welfare charges (defined as taxes used for social welfare purposes) and other direct taxes (defined as taxes paid by the company rather than the consumer) as countervailable subsidies. The petitioners cite to the SCM Agreement as distinguishing between direct taxes and social welfare charges while finding the remission of either countervailable if related to exports.

Furthermore, the petitioners maintain that, although the SCM Agreement defines direct and indirect taxes on the basis of who ultimately pays the tax, social welfare charges are specifically distinguished from either direct or indirect taxes; according to the petitioners, it is implicit in the SCM Agreement that the tax revenue's use determines whether a tax is a social welfare charge. Additionally, the petitioners argue that the Department's regulations expand the definition of direct taxes provided in the SCM Agreement by defining direct taxes as including social welfare charges, but this expansion does not change the unique nature of social welfare charges or the fact that social welfare charges are properly defined by their use. The petitioners argue that the respondents' assertion that social welfare charges should be defined according to the definition of a direct tax included in the SCM Agreement controverts the SCM Agreement which clearly considers social welfare charges distinct from direct taxes. The petitioners reiterate that substantial evidence on the record demonstrates that PIS and COFINS are used for social security, medical care and healthcare, worker support, job generation and similar social welfare purposes, and argue that in other cases involving similar taxes, the Department has found similar payments to be social welfare charges. (See Preliminary Results and Partial Rescission of Countervailing Duty Administrative Review: Certain Pasta from Italy, 67 FR 16722 (April 8, 2002) ("Pasta from Italy").

The petitioners also argue that the manner in which the PIS and COFINS rebate is calculated suggests that these taxes are distinct from indirect taxes because the rebate is applied as a deduction from the IPI tax amounts due rather than from the PIS and COFINS taxes due. The

petitioners maintain that “normal indirect taxes” are not rebated in such a way as to reduce the liability on other taxes.

The petitioners further argue that PIS and COFINS are direct taxes because they are imposed upon a company and paid by the company rather than being imposed on a product and paid by consumers. The petitioners essentially argue that direct taxes are distinguished from indirect taxes by which entity bears the tax burden. The petitioners cite to the Final Affirmative Countervailing Duty Determination of Prestressed Concrete Steel Wire Strand from Brazil, 48 FR 4516, 4520 (February 1, 1983) (“Steel Wire Strand from Brazil”) which states that “{t}he IPI tax is an indirect tax and as such is passed forward to the consumer. A steel company collects this tax on sales as the agent for the government; the steel company does not, itself, pay the tax.” Thus, the petitioners argue that “while direct taxes are levied on the firm and are paid directly to the government, indirect taxes are levied on products and are paid to the government via an intermediary” (emphasis added by the petitioners). Furthermore, the petitioners maintain that the respondents’ reliance on AD and CVD Preliminary Brazil Cold-Rolled Steel II⁶ to support their argument that PIS and COFINS are indirect taxes is unwarranted given the preliminary nature of these findings. Moreover, the petitioners argue, contrary to the respondents’ claims, that international definitions of direct and indirect taxes demonstrate that PIS and COFINS are direct taxes because they are paid by the company rather than by the consumer.

The petitioners argue that Steel Wire Strand from Brazil is consistent with the Department’s analysis in antidumping cases which have examined PIS and COFINS taxes and found them to be direct taxes. Citing to the Notice of Final Determination of Sales at Less Than Fair Value: Certain Hot-Rolled Flat-Rolled Carbon Quality Steel Products from Brazil, 64 FR 38765 (July 19, 1999) (“Brazil AD Hot-Rolled Steel”) and Notice of Final Determination of Sales at Less Than Fair Value: Certain Cold-Rolled Flat-Rolled Carbon-Quality Steel Products from Brazil, 65 FR 5554 (February 4, 2000) (“Brazil AD Cold-Rolled Steel I”), the petitioners state PIS and COFINS taxes were found to be direct taxes “as they ‘do not appear to be imposed on the subject merchandise or components thereof’.” The petitioners reiterate that, although the Department preliminarily found PIS and COFINS taxes to be indirect taxes in AD and CVD Preliminary Brazil Cold-Rolled Steel II, the Department “stated that it would continue to examine whether the taxes should be construed as direct taxes in the form of social welfare charges.”

The petitioners argue that the record of the instant proceeding supports the Department’s prior findings that PIS and COFINS taxes are direct taxes. Specifically, the petitioners point to the method with which these taxes are assessed as being indicative of a direct tax because “(1) the tax is not assessed on the good at the point of consumption, (2) the consumer does not pay the tax to the wire rod producer when purchasing the good, and (3) the producer does not collect the tax

⁶See Notice of Preliminary Determination and Alignment with Final Antidumping Duty Determinations: Certain Cold-Rolled Carbon Steel Flat Products from Brazil, 67 FR 9652 (March 4, 2002) and CVD Preliminary Brazil Cold-Rolled Steel II (collectively, “AD and CVD Preliminary Brazil Cold-Rolled Steel II”).

from consumers as an agent for the government.” Furthermore, the petitioners argue that, because the producer has the burden of paying the taxes and the discretion to shift the taxes to the consumer, these are direct taxes, and the fact that “no particular amount” of these taxes is shifted to consumers further distinguishes PIS and COFINS from indirect taxes such as value-added taxes.

Additionally, the petitioners argue that the respondents’ claim that these taxes are assessed on gross revenue instead of payroll is not dispositive of whether these taxes are social welfare taxes. Rather, the petitioners argue that the General Agreement on Trade and Tariffs (“GATT”) Working Party Report on Border Tax Adjustments supports the petitioners’ assertion that social welfare taxes may be assessed on various tax bases, including both employers and employees. Finally, the petitioners cite to the GOB Verification Report, Exhibit 13 at section A.2.1 (which is on file in the Department’s CRU), to support their contention that the GOB has “recognized that PIS and COFINS taxes are distinct from indirect taxes.”

Respondents’ Argument: The respondents argue that PIS and COFINS are indirect taxes. In determining that PIS and COFINS are indirect taxes, the respondents argue the Department should examine how these taxes are levied rather than how they are spent. The respondents argue that, because the Department confirmed at verification that PIS and COFINS taxes are “levied as a percentage of sales of finished products, raw materials and other inputs at all stages in the production chain,” they fall within both the Department’s definition and international definitions of indirect taxes. Furthermore, the respondents assert that the Department’s practice is to find taxes on total sales, such as PIS and COFINS, to be indirect taxes. The respondents cite to AD and CVD Preliminary Brazil Cold-Rolled Steel II, where the Department preliminarily determined PIS and COFINS to be indirect taxes, to support their proposition that the manner in which these taxes are assessed is essential to the Department’s analysis. The respondents claim that the Department reached its preliminary decisions in AD and CVD Preliminary Brazil Cold-Rolled Steel II after analyzing the salient legislation for each tax and finding that COFINS is “charged against monthly billings, that is, gross revenue” and that PIS is calculated “on the basis of invoicing” which is “the gross revenue ‘originating from the sale of goods.’”

The respondents further argue that the Department’s definition of an indirect tax as a tax on gross revenues or the sale of goods is consistent with both the international definition and the U.S. Internal Revenue Service’s definition of an indirect tax. Specifically, the respondents claim that a key distinction between an indirect and direct tax is that “the cost of paying an indirect tax such as PIS and COFINS can be shifted from the producer to the consumer of a good.” Unlike indirect taxes, the respondents argue that direct taxes are levied on wages and other forms of income and cannot be shifted to others. The respondents also argue that indirect taxes are directly correlated to sales, thus permitting a seller to pass such a tax to its customers whereas direct taxes are charged with no relationship to the volume of production or the value of sales.

The respondents note that the most common type of direct tax is a social welfare contribution, however, they assert that PIS and COFINS taxes are not direct social welfare taxes under the

Department's regulations. The respondents argue that, where a tax is assessed on gross sales rather than on wages or profits, the Department's regulations define such a tax without regard to the manner in which the resulting tax revenue is spent.

The respondents maintain that the Department's practice is to find social welfare taxes direct "only when they are assessed as such (e.g., as a tax on profits, wages, or other income)." In support of this assertion, the respondents cite to the Department's decisions in three cases. First, the respondents claim that, in Pasta from Italy, the Department found exemptions of payroll contributions that employers normally make for health care benefits and pensions under the Italian social security system to be countervailable under 19 CFR 351.524(c). Second, the respondents claim that, in Stainless Steel Plate in Coils from Belgium: Final Results of Countervailing Duty Administrative Review, 66 FR 45007 (August 27, 2001), the Department found certain exemptions from payroll taxes countervailable. Third, the respondents cite to the Notice of Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Countervailing Duty Determination With Final Antidumping Duty Determination: Certain Hot-Rolled Carbon Steel Flat Products From Argentina, 66 FR 10990, 10996 (February 21, 2001), where "the government assumed a company's labor and social security obligations during the company's privatization."

Finally, the respondents assert that the Department has never identified an indirect tax such as PIS/COFINS as a countervailable social welfare tax on the basis of the uses of the revenue generated. Rather, the respondents argue that the reference in the Department's regulations to social welfare taxes "is made in the context of illustrative examples of the *means* by which taxes are collected. . ." (emphasis added by respondents).

The respondents argue that the petitioners' definitions of direct and indirect taxes are inconsistent with the Department's regulations and prior practice. In responding to petitioners' proposed definitions, the respondents make six arguments:

First, the respondents argue that the petitioners' definition of direct taxes is without legal basis and inconsistent with the Department's past practice. In defining direct taxes as any taxes which are levied on a firm and paid directly to the government, the petitioners base their distinction on the entity responsible for paying the tax and whether the producer of the product serves as an agent of the government by collecting the tax from consumers and forwarding it to the government. The respondents argue that this definition would transform de jure indirect taxes such as turnover, transfer, and inventory taxes, to direct taxes because they are levied on a firm, rather than consumers, and forwarded to the government. Furthermore, the respondents state that the Department's regulations illustrate that direct taxes, unlike indirect taxes, are applied to non-sales items, such as income or wages and that the petitioners have not alleged that PIS and COFINS are income or payroll taxes.

Second, the respondents argue that the petitioners' assertion that the inability to determine the exact amount of PIS and COFINS taxes borne by the customer indicates that these taxes are

direct is erroneous. The respondents maintain that not all forms of indirect taxes are transparently passed to the customer and that the nature of cumulative multistage or cascading indirect taxes makes it difficult to ascertain the degree to which these taxes are passed forward at each prior stage of sale. The respondents argue that the complexity of disaggregating the levels of cumulative taxes is not determinative of whether such taxes are direct or indirect. (See The Commerce Department Speaks on Import Administration and Export Administration, 455 PLI/Corp. 301, 338-9 (September, 1984) (“The Commerce Department Speaks”); Final Determination of Sales at Less Than Fair Value: Certain Carbon Steel Butt-Weld Pipe Fittings From Thailand: Certain Butt-Weld Pipe Fittings from Thailand, 57 FR 21065, 21070 (May 18, 1992); and Ball Bearings and Parts Thereof From Thailand; Preliminary Results of a Countervailing Duty Administrative Review, 60 FR 42532 (August 16, 1995)). Rather than focus on the complexities of disaggregation, the respondents maintain that the Department applies a “physical incorporation” standard to determine which prior stage cumulative taxes may be legitimately rebated upon export.

Citing to The Commerce Department Speaks, the respondents state that “[t]he physical incorporation test states that if an indirect tax is paid on an input physically incorporated in the final product, then an exemption from, or a non-excessive rebate of, that tax upon exportation does not confer a subsidy.” Furthermore, the respondents maintain that a government’s preference to assess such taxes on a turnover basis rather than on an invoice-by-invoice basis has no effect on the taxes calculated and to distinguish direct from indirect taxes on this basis would place form over substance. Finally, the respondents argue that the petitioners misconstrued the Working Party Report on Border Tax Adjustments and that this report expressly defines “cascade taxes” like PIS and COFINS as indirect taxes. The respondents’ claim that the Working Party Report on Border Tax Adjustments identifies cascading taxes, like PIS and COFINS, as indirect taxes for which border adjustments were permissible, and contrasts these taxes with “social security charges whether on employers or employees and payroll taxes” for which no such adjustments were permissible.

Third, the respondents argue that the fact that tax revenues may be applied to social welfare programs is irrelevant to the Department’s analysis. Rather, the respondents argue the Department’s regulations define an indirect tax, without reference to the use of the tax revenue, as all “sales, excise, turnover, value added, franchise, stamp, transfer, inventory, or equipment tax, border tax, or any other tax other than a direct tax or an import charge.” The respondents state that the petitioners attempted to conflate indirect taxes, the revenue from which is used for social welfare spending, with direct taxes levied on payrolls in support of social insurance systems.

Fourth, the respondents argue that the petitioners’ assertion that the Department must consider the use of tax revenue in distinguishing between direct taxes and indirect taxes, is unworkable and leads to absurd results. The respondents claim that the petitioners’ definition of a direct tax would lead to results which would, for example, make the exemption of U.S. sales taxes upon

export countervailable if the collected revenues are used for “social welfare spending” such as schools, public hospitals or roads.

Fifth, the respondents argue that, because “the form of the tax credit is not necessarily connected to the nature of the underlying tax,” the Department should dismiss the petitioners’ argument that PIS and COFINS are direct taxes because the tax credit is granted against IPI taxes. The respondents maintain that neither the Department’s regulations nor the Act identify the nature of the rebate or credit as a determinative criterion in distinguishing between a direct or indirect tax. The respondents argue that, from the perspective of the Brazilian Ministry of Finance, PIS and COFINS and IPI are indistinguishable for purposes of offsetting tax credits because all are sales-related taxes.

Sixth, the respondents note that the petitioners have attempted to persuade the Department that the preliminary decisions in AD and CVD Preliminary Brazil Cold-Rolled Steel II are rogue determinations in that they found PIS and COFINS to be indirect taxes. However, the respondents claim that the Department only began classify PIS and COFINS as a direct tax in late 1990s. Prior to the late 1990s, the respondents state that the Department classified these taxes as indirect. Thus, the respondents claim that the Department’s decisions in AD and CVD Preliminary Brazil Cold-Rolled Steel II are consistent with its historical analysis.

Department’s Position: We disagree with the petitioners’ argument that PIS and COFINS are direct taxes “in the form of social welfare charges.” The petitioners essentially argue that the Department should examine the manner in which tax revenue collected under PIS Supplementary Law No. 7 and COFINS Supplementary Law No. 70 is spent in order to determine whether PIS and COFINS constitute “social welfare charges.” Although this method of analysis may seem understandable on first impression, we find that it is problematic for a number of reasons.

First, 19 CFR 351.102(b) defines “direct tax” to include “social welfare charge” because of the manner in which both are levied. To the extent there is a definition of “social welfare charges,” it may be found in the manner in which social welfare charges are “paid or payable by industrial or commercial enterprises” not in the manner in which the resulting tax revenue is spent. Although there may be a distinction, as petitioners argue, between the definition of “social welfare charge” and that of “direct taxes,” the Department’s regulations do not draw a distinction between the manner in which they are levied.

Second, 19 CFR 351.503(a) directs that “{i}n the case of a government program for which a specific rule for the measurement of a benefit is contained in this subpart E, the Secretary will measure the extent to which a financial contribution. . .confers a benefit as provided in that rule.” Therefore, rather than explore the undefined meaning of “social welfare charge,” we must apply specific rules as they exist in the Department’s regulations. The Department’s regulations at section 351.102(b) provide several specific definitions which are applicable to PIS and COFINS. According to 19 CFR 351.102(b), “{i}ndirect tax’ means a sales, excise, turnover, value added, franchise, stamp, transfer, inventory, or equipment tax, a border tax, or any other tax other than a

direct tax or an import charge.” We note that PIS and COFINS taxes are calculated upon the gross revenue of a company and that the World Bank Report No. 22523-BR, Brazil Issues in Fiscal Federalism (May 31, 2002) (“World Bank Report”) categorized both as turnover taxes. Thus, PIS and COFINS fall within the explicit definition of an indirect tax. The Department’s regulations further define both “cumulative indirect tax” and “prior-stage indirect tax.” (See 19 CFR 351.102(b) (2002)). A “cumulative indirect tax” is “a multi-staged tax levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production.” Therefore, because PIS and COFINS are charged on inputs used to make wire rod, they are charged on goods at one stage of production that are used in a succeeding stage of production, thus falling within the definition of “cumulative indirect tax.” A “prior-stage indirect tax” is defined as “an indirect tax levied on goods or services used directly or indirectly in making a product.”

Therefore, because PIS and COFINS are charged on inputs used directly in making wire rod, they are also prior-stage indirect taxes. Combining these definitions, we find that PIS and COFINS are not simply indirect taxes, but rather they are “prior-stage cumulative indirect taxes” within the context of 19 CFR 351.518. Because 19 CFR 351.518 contains a specific rule for the measurement of the benefit from prior-stage cumulative indirect taxes exists, we are required to apply it to PIS and COFINS.

Third, as respondents argue, there is a valid distinction between indirect taxes, the revenue from which are used for social welfare spending, and direct taxes or social welfare charges which are levied on payrolls in support of social insurance systems. The Department’s regulations do not contemplate defining taxes by the use of the resulting tax revenue. According to the World Bank Report, Brazil clearly has a direct tax levied on payrolls in support of its social insurance system in place, the National Social Security Institute (“INSS”) tax. However, the INSS tax is not subject to the instant investigation. Defining a tax by its use, rather than by the explicit definitions contained within the Department’s regulations, would violate the clear mandate of 19 CFR 351.503(a).

Fourth, although the petitioners argue that, because the PIS and COFINS rebate is credited against the IPI tax, PIS and COFINS cannot be “normal indirect taxes,” we do not find that the Department’s regulations define indirect taxes through their methods of exemption or rebate. Rather, the Department’s regulations explicitly state that turnover taxes and “all other taxes other than direct taxes and import charges” are indirect taxes without mandating a particular form of rebate. (See 19 CFR 351.102(b)).

Fifth, although the petitioners cite to Pasta from Italy to support the proposition that the Department has previously determined that taxes similar to PIS and COFINS are social welfare charges, we find that the exemptions to which they refer are granted on “the payroll contributions that employers make to the Italian social security system. . .” (See Pasta from Italy, 67 FR at 16725). We note that payroll contributions to a social security system is considered a “tax on wages” as defined under 19 CFR 351.102(b) and, therefore, is a direct tax. Moreover, we did not

determine that the payroll contributions that employers make to the Italian social security system are social welfare charges. Unlike the payroll contributions in Pasta from Italy, PIS and COFINS are not taxes on wages, but rather turnover taxes. Therefore, the petitioners' misreading of the Department's treatment of "Social Security Reductions and Exemptions" in Pasta from Italy is not instructive on our treatment of PIS and COFINS in the instant investigation.

Sixth, although the petitioners cite to Steel Wire Strand from Brazil to support their argument that PIS and COFINS are direct taxes, we determined that the IPI is an indirect tax which is passed forward to the consumer. Like the IPI tax treated in Steel Wire Strand from Brazil, PIS and COFINS are indirect taxes. Additionally, we note that PIS and COFINS are cascading indirect taxes which are charged on the gross revenue at each point in the chain of production. Therefore, a "cascading" effect occurs which increases the tax load incorporated in the price of the product. This cost must be passed forward, to some extent, to the customer.

Finally, the petitioners argue that, because two antidumping determinations, Brazil AD Hot-Rolled Steel and Brazil AD Cold-Rolled Steel I treated PIS and COFINS as direct taxes, we should treat PIS and COFINS as direct taxes in the instant investigation. However, we note that more recent determinations have determined that PIS and COFINS are in fact indirect taxes. (See, e.g., Frozen Concentrated Orange Juice from Brazil: Preliminary Results and Partial Rescission of Antidumping Duty Administrative Review, 67 FR 18859 (April 17, 2002)).

Comment 9: PIS and COFINS - Excessive Remission

Petitioners' Argument: The petitioners state that, if the Department finds that PIS and COFINS taxes constitute indirect taxes, it should countervail the full amount of the "presumed tax credit" on inputs used in exports in its final determination. The petitioners maintain that the record of the instant proceeding is consistent with the finding under 19 CFR 351.518(a)(4) in AD and CVD Preliminary Brazil Cold-Rolled Steel II that there is no evidence that the presumed tax credit is based on any system or examination of the actual inputs consumed in the production of wire rod. The petitioners argue that the Department must determine that the entire amount of the tax rebate confers a countervailable benefit unless the respondents demonstrate that the requirements of 19 CFR 351.518(a)(4)(i) or (ii) are met. The petitioners argue that the GOB did not have an effective system in place and did not carry out an examination to confirm the nature or amount of inputs consumed in the production of wire rod.

The petitioners disagree with the respondents' claim that the facts of the instant proceeding are similar to those in the Notice of Final Affirmative Countervailing Duty Determination: Polyethylene Terephthalate Film, Sheet, and Strip from India 67 FR 34905 (May 16, 2002) ("PET Film from India") and require the Department to find that the tax remission monitoring system of PIS and COFINS satisfies the requirements of 19 CFR 351.518(a)(4). First, the petitioners distinguish PET Film from India from the instant proceeding by noting that, in PET Film from India, the Department examined the exemption of sales taxes on purchased inputs that required the use of a government form at the time of purchase. In contrast, PIS and COFINS are

assessed on a company's total invoiced value of all sales, including services. Unlike PET Film from India, the petitioners claim that neither the purchaser nor the government can know how much PIS and COFINS is charged on each purchase. (See Issues and Decisions Memorandum: PET Film from India, Comment 10). Second, the required use of the government form in PET Film from India limits the tax exemption to inputs actually consumed in producing the exported good. However, the presumed PIS and COFINS tax credit is based on a standard formula applied by all companies which assumes two prior stages of PIS and COFINS and includes inputs not consumed in production.

In support of the assertion that the GOB does not examine the actual inputs consumed in the production of wire rod, the petitioners cite to the GOB Verification Report which confirms that a standard formula is applied by all companies which assumes two prior production stages and therefore, two prior stages of PIS and COFINS taxes. Because of this, the petitioners claim that the 5.37 percent PIS and COFINS tax credit is not reflective of the actual tax incurred by wire rod producers on purchases of inputs. Moreover, the petitioners claim that the GOB does not confirm which of the domestic purchases of inputs are actually consumed in production of exports because "a 'company's domestic purchases of raw material, intermediary products, and packing materials' are used to determine the total tax." The petitioners note, for example, that Gerdau's Verification Report (which is on file in the Department's CRU) confirms that Gerdau's tax rebate is "based on items not consumed in the production of the exported product" and that Belgo Mineira "stated that the PIS and COFINS taxes are assessed on the total invoiced value of all sales. . ."

Furthermore, the petitioners claim that the GOB does not meet the requirements of 19 CFR 351(a)(4)(ii) by examining the actual inputs consumed in the production of wire rod. In lieu of performing this examination, the petitioners argue that the respondents provided two studies of these taxes which are non-specific to subject merchandise and are flawed. The petitioners assert that these studies do not provide the basis for confirming the actual inputs consumed as intended by 19 CFR 351(a)(4)(ii) for the following reasons. First, the petitioners note that these studies were completed subsequent to the POI. Second, the petitioners claim that the studies examine the tax incidence throughout the entire Brazilian economy rather than examining the actual inputs consumed in producing wire rod. Third, the petitioners claim that the use of improper data distorts these studies.

The petitioners note three distortive points of these studies. First, the studies include the CPMF tax along with the PIS and COFINS taxes which, the petitioners argue, results in the assumed tax incidence on inputs being inflated. Second, the studies include taxes that are assessed on all domestic input purchases rather than the inputs consumed in the production of wire rod. Third, the petitioners claim that the studies "contain numerous internal inconsistencies" such as the IPEA study's estimate of PIS and COFINS at 3.15 percent rather than the actual 3.65 percent rate.

Finally, the petitioners refute the respondents' assertion that inputs included in calculating the tax credit were subject to at least one application of PIS and COFINS tax at the time the inputs were sold to Gerdau and Belgo Mineira by their suppliers. The petitioners claim that the respondents have submitted no evidence that input suppliers charged these taxes or that respondent companies have passed these taxes on to their customers.

Respondents' Argument: The respondents argue that the GOB maintains a comprehensive system to track the use of PIS and COFINS tax credits which comports with the requirements of 19 CFR 351.518(4)(i). The respondents maintain that the Department "will find the non-excessive exemption of indirect taxes upon export not to be countervailable" when a government has and applies a system to confirm which inputs, and the amounts thereof, are consumed in the production of the exported product, and to confirm which indirect taxes are imposed on these inputs, and when such system is reasonable and effective.

The respondents cite to the Issues and Decisions Memoranda incorporated in PET Film from India as instructive on the "nature on an acceptable tax remission monitoring system." The respondents maintain that the facts of PET Film from India are similar to the instant case in that the Government of India ("GOI") tracked claims for indirect tax exemptions through quarterly forms filed by the exporter which reported claimed exemptions. At the time when the taxes would normally be assessed, the GOI confirmed the accuracy of the exporter's report through forms provided to the tax authority by the producer. Thus, the GOI confirmed the claimed exemptions through both the exporter and producer. Similarly, in the instant case, the GOB confirms the PIS and COFINS credits through monthly tax forms submitted by both the consumer of the input for which the credit is claimed and the producer of the input. Moreover, the respondents maintain that the Department verified that the GOB periodically audits companies "to insure that all taxes are being properly claimed." (See GOB Verification Report at 20). Additionally, the respondents note that respondent companies demonstrated at verification the accuracy of their tax credit calculations. The respondents argue that the required quarterly filings, routine audits, and verified tax credit calculations constitute substantial evidence that the GOB maintains a reliable monitoring system that identifies and confirms the inputs used in the tax credit calculations and exceeds the standards the Department found acceptable in PET Film from India.

The respondents argue that there is substantial evidence on the instant record to prove that credits for PIS and COFINS granted to respondent companies during the POI were not excessive, and that the GOB allows companies to apply for tax credits "related only to those inputs actually subjected to PIS/COFINS taxes and used in the production of merchandise for export." The respondents maintain that rather than being excessive, the actual credits provided to respondent companies were partial credits and, therefore, did not confer a countervailable benefit. The respondents argue that the Brazilian studies confirm that "the cumulated incidence of PIS/COFINS on inputs consumed by the Brazilian steel industry is 10 percent," which respondents claim, "far exceeds the limited 5.37 percent PIS/COFINS credit granted to steel exporters." The respondents argue as indisputable fact that the respondent companies pay at least

a 3.65 percent PIS and COFINS tax (which represents one stage of input usage) on their purchases of raw materials. The respondents argue that if an exporter were to include inputs in its rebate calculations that were not subject to PIS and COFINS taxes, such an exporter would be in violation of the GOB's regulations. Thus, the respondents argue that inputs included in the calculation were incontrovertibly subject to at least one application of PIS and COFINS taxes when sold to respondent companies. Therefore, the respondents argue that the relevant question which the Department must consider is whether the 1.72 percent difference between the 5.37 percent variable used in the rebate calculation and 3.65 percent (based on one stage of input usage) is excessive.

The respondents maintain that the Department not only confirmed that the presumed tax credit based on two stages of PIS and COFINS taxes was less than the total incidence of these taxes on inputs actually purchased by respondent companies, but also examined specific inputs and confirmed that (1) the amount of PIS and COFINS paid exceeded 5.37 percent and (2) these inputs must go through three processing stages before reaching a wire rod producer. The respondents further argue that because Brazilian law limits a producer's credit to two processing stages, the actual incidence of the tax is understated in the credit calculation.

The respondents argue that the petitioners do not properly analyze the requirements of 19 CFR 351.518. The respondents argue that the regulations require the Department to first make a determination under 19 CFR 351.518(a)(4)(i) as to the reasonableness of the GOB's system of monitoring PIS and COFINS remission before determining whether such remission is excessive.

The respondents argue that 19 CFR 351.518(a)(4)(i) requires a prior-stage cumulative indirect tax system to meet three conditions: (1) the system must confirm which inputs are consumed in the production of exported products; (2) the system must confirm the amounts of inputs used for export production; and (3) the system must confirm which indirect taxes are imposed on the inputs used for export production. Moreover, the respondents argue that these three conditions must be judged by a reasonableness standard in which the Department determines whether the system is "effective for the purposes intended" and "based on generally accepted commercial practices." In analyzing the system's efficacy, the respondents argue that the Department should examine whether the system prevents excessive rebate or credit. Furthermore, the respondents argue that although the petitioners maintain that the GOB's system fails to measure the "actual PIS/COFINS incidences," 19 CFR 351.518(a)(4)(i) does not require the measurement of actual PIS and COFINS taxes charged on inputs. Rather, the respondents argue that the Department's regulations only require the identification and measurement of the inputs and the confirmation of which indirect taxes are imposed on those inputs. The respondents argue that PIS and COFINS' actual incidence is only relevant to whether remission is excessive.

In responding to the petitioners' argument that the GOB's system fails to confirm which inputs are consumed in the production of wire rod, the respondents argue that petitioners ignore the reasonableness standard of 19 CFR 351.518(a)(4)(i). The respondents argue that in light of the reasonableness standard, the GOB's system of monitoring, audits, and examinations is effective

for the purposes intended. Moreover, the audit process allows the GOB to examine an exporter's monthly PIS and COFINS calculations. The respondents note that if the GOB were to determine that an exporter included inputs not actually used in the production of exports, that exporter would be subject to "findings of tax fraud."

Additionally, the respondents maintain that the petitioners do not allege that the GOB's system fails to meet the second and third conditions of the Department's system regulation. The respondents argue that the GOB's system meets the second requirement by confirming the amounts of inputs used for export production. Specifically, the respondents argue that the GOB allows exporters to attribute a portion of total raw material purchases to exports using a ratio of exports to total sales. The respondents argue that this method of deriving the volume of raw material used in the production process is "effective for the purposes intended" given the fact the rebate of 5.37 percent is "significantly less" than the actual PIS and COFINS incidence of approximately 10 percent. As to the third condition of the Department's system regulation, the respondents argue this criterion is met because exporters may only include domestic purchases of input materials which are subjected to PIS and COFINS in the credit calculation.

Furthermore, the respondents maintain that the petitioners focus only on the "system requirement" without analyzing whether or not the PIS and COFINS credit provides an excessive rebate or credit. The respondents argue that of the 5.37 percent credited under the rebate system, 3.65 percent is uncontroversial because all inputs purchased domestically by Gerdau and Belgo were subject to at least one incidence of PIS and COFINS. Therefore, the respondents argue that the only questionable portion of the credit is the resultant 1.72 percent differential. The respondents argue that the petitioners inadequately and indirectly address this differential by attacking the two Brazilian PIS and COFINS studies as "fatally flawed." However, respondents maintain that the petitioners' argument is made in the context of 19 CFR 351.518(a)(4)(i) rather than in context of 19 CFR 351.518(a)(2). The respondents argue that these studies were offered to demonstrate that the credits were not excessive under 19 CFR 351.518(a)(2) rather than being offered as confirmation that the GOB used the studies to calculate the actual level of PIS and COFINS tax incidences. The respondents claim that these studies do effectively demonstrate that the 1.72 percent differential is not excessive.

Finally, the respondents argue that the Department should dismiss the petitioners' attacks on the credibility of the studies for the following reasons: (1) the studies are historical in nature and contain data from 2000, 1999, and earlier, therefore, they relate to the POI; (2) both studies specifically examined the incidences of PIS and COFINS on steel producers; (3) both studies reach the conclusion that the incidence of PIS and COFINS cascading taxation on the Brazilian steel industry is approximately 10 percent; and (4) the CPMF tax that the petitioners claim distorts the studies is only 0.38 percent and is, thus, irrelevant.

Department's Position: As discussed in Comment 8, supra, we have determined that PIS and COFINS are prior-stage cumulative indirect taxes that should be analyzed within the mandates of 19 CFR 351.518. Under 19 CFR 351.518(a)(4), we must find the entire amount of PIS and

COFINS remission countervailable unless we find that the GOB “has in place and applies a system or procedure to confirm which inputs are consumed in the production of the exported products and in what amounts, and to confirm which indirect taxes are imposed on these inputs, and the system is reasonable, effective for the purposes intended, and is based on generally accepted commercial practices in the country of export” (See 19 CFR 351.518(a)(4)(i)). These provisions under the Department’s regulations establish specific criteria and standards, all of which must be met to find the remission of prior-stage cumulative indirect taxes not to be a subsidy. Record evidence establishes that the GOB has not demonstrated in this investigation that its system for rebating PIS and COFINS taxes meets all of these criteria, or that the study submitted to show that actual tax incidence is lower than the rebated amount effectively does so for the producers of the subject merchandise.

The GOB has claimed that the system it applies to rebate PIS/COFINS taxes to Brazilian exporters meets the system requirements identified in the Department’s regulations. To determine the monthly PIS/COFINS tax rebate under this program, Brazilian companies first establish their total monthly purchases of eligible inputs used to produce all products produced by the firm. “Eligible” inputs for which rebates may be claimed are defined by the PIS/COFINS law as packing materials, intermediate products and raw materials. The value of these total input purchases is multiplied by the company’s ratio of export revenue to total revenue. The resulting amount is then multiplied by 5.37 percent, the “presumed” PIS/COFINS tax incidence, to determine the actual rebate amount that can be claimed. Brazil has also claimed that it has the ability to audit individual companies’ rebate claims, to confirm which inputs are consumed in the production or exports.

We disagree that the system requirements in the Department’s regulations are in fact being met by the GOB in this case. First, this system was established as a simplified and streamlined methodology to determine the amount of the tax rebate for all companies in Brazil. The only limitation imposed on companies making rebate claims is that the claims be limited to those inputs defined under the PIS and COFINS rebate law, which is broader than the consumed in production process standard. Companies report their purchases of inputs based on the assumption that they are consumed equally in exported and domestically sold goods. Further confirmation is not conducted by the government. As such, we find that this system does not permit the GOB to confirm which inputs are being consumed in the consumption of exported goods.

Moreover, record evidence also establishes that companies in Brazil can and are making claims for tax rebates that are not consumed in the production of exported goods. First, while the monthly calculations of the PIS and COFINS rebate made by the respondent companies on the Finance Ministry’s “Declaration of Debits and Credits” contain the amount of primary materials, intermediate products, and packaging “used in production,” these include items that do not meet the definition of “consumed in production.” (See Respondents’ March 8, 2002 Supplemental Questionnaire Response at Exhibit 8). Further, at verification of Gerdau, we found that “raw materials such as ingot molds, refractories, electrodes, and gasses are examples of raw materials

that were included in the PIS and COFINS rebate calculation based on the sum of their purchases that are not incorporated into the final product.” (See Gerdaud Verification Report at 19). Section 351.102(b) states that inputs “‘consumed in the production process’ are inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the product.” Therefore, because Gerdaud explicitly stated that ingot molds, refractories, electrodes, and gasses are “not incorporated into the final product,” we find that the GOB system does not confirm which inputs are consumed in the production of the exported products, but it permits rebate claims to be made for input purchases not consumed in the production of exports.

We also have several additional concerns that this system does not operate in accordance with the requirements under the regulations. The system does not account for the fact that domestic and export sales may include imported inputs. These imports may be included by varying degrees in either export or domestic sales, thus distorting the ratio. Either way, the GOB does not account for, and does not require Brazilian companies to account for, any such potential distortions. Further, in determining the actual amount of inputs consumed in final products, the government does not make due allowance for waste, thereby raising the concern that the claim amount is overstated. This is an important element that the Department has found to be grounds for countervailing a similar type of rebate program in the past. See e.g., Certain Hot-Rolled Carbon Steel Flat Products from Thailand, 66 FR 50410 (October 3, 2001).

Respondents have argued that the facts of PET Film from India are similar to the instant case, and that the monitoring system which identifies and confirms the inputs used in the tax credit calculations exceeds the standards found acceptable in that case. We disagree. The system examined in Pet Film from India is distinguishable from the GOB’s system. The system applied by the Government of the State of Uttar Pradesh (“SUP”) establishes a more rigorous standard for tracking both the inputs consumed in the production of exported products and the indirect taxes from which those inputs are exempted. First, unlike the PIS/COFINS program which rebates taxes levied on inputs, Indian exporters are exempt from paying taxes at the time they purchase their inputs. Exporters are required to track, on a specific form, all of their raw material purchases that are destined for consumption in exported products, and for which they have not paid sales taxes. Further, exporters file monthly state tax returns with the state tax authorities detailing the amount of taxes a company collects on its sales of subject merchandise and the amounts it pays on purchases of inputs. These product-specific tax returns are then audited by the tax authorities. Finally, the SUP conducts on-site inspections, during which exporters must demonstrate that the inputs exempted from taxes were used in the exported products. See, e.g., Memorandum to the File from Mark Manning, Verification Report for Ester Industries Ltd., dated February 8, 2002; and Memorandum to the File from Alexander Amdur, Garware Polyester Limited and Garware Chemicals Limited: Report on the Verification of Information, dated January 31, 2002 (which are on file in the Department’s CRU). This rigor of detail and audit is not applied by the GOB in its remission of PIS/COFINS taxes to Brazilian exporters.

We note that the respondents have submitted two studies on the actual incidence of PIS and COFINS within various Brazilian industries, including “steelmaking.” Respondents have explicitly stated that these studies were submitted for the purpose of confirming that the remission of PIS and COFINS does not exceed the amount of PIS and COFINS paid on inputs that are consumed in the production of the exported product, making normal allowance for waste under 19 CFR 351.518(a)(2). These studies do not alter our conclusion that the PIS/COFINS rebates are countervailable. First, because we have found that the system requirement of 19 CFR 351.518(a)(4)(i) is not met, we do not reach as a legal matter the question of whether the remission of PIS and COFINS is excessive. Second, even if we were to consider the studies at issue, they raise the same fundamental concerns that are found in our analyses of the system requirement and the actual examination requirement. These concerns are the over-inclusion of inputs, *i.e.*, inputs not consumed in the production of exported products, and whether a normal allowance for waste exists. In establishing the non-excessive remission or prior-stage cumulative indirect taxes, both of these elements must be accounted for. The GOB has not demonstrated in this investigation that these requirements are in fact sufficiently accounted for in the two studies.

Comment 10: PROEX Equalization Program

Respondents’ Argument: The respondents argue that the Department should reverse its decision from the Preliminary Determination that the PROEX Equalization Program provided countervailable subsidies to Belgo Mineira during the POI. The respondents argue that the PROEX Equalization program places Brazilian exporters on an “equal footing” with, rather than at an unfair competitive advantage to, foreign exporters with regard to the cost of financing export activities. The respondents point to the input pricing mechanism in 19 CFR 351.516(a)(1) as an example that shows that the countervailing duty law does not generally prohibit such equalization measures. The respondents also cite to the Illustrative List of Export Subsidies in Annex I of the SCM Agreement as another example that such equalization measures are not prohibited. The respondents argue that the fact that the list does not include such equalization measures stands as the WTO’s tacit approval of programs that serve to equalize, rather than distort, the cost to Brazilian exporters vis-a-vis foreign exporters of financing exports.

Petitioners’ Argument: The petitioners argue that the Department accurately determined at the Preliminary Determination that the PROEX Equalization Program constituted a countervailable subsidy in this case. The petitioners contend that the respondents’ case brief attempts to cloud the Department’s clear analysis of this program by citing to regulations and a statutory provision that are not applicable. The petitioners note that the Department, in its Preliminary Determination, already indicated that 19 CFR 351.516(a)(1) is not applicable in this instance because it addresses a product and not export financing. Moreover, the petitioners contend that Annex 1 of the SCM Agreement clarifies at paragraph “d” that only equalization programs related to products, not services, are allowable in certain instances. Finally, the petitioners state that the Department found a similar equalization program to be countervailable in the Final Affirmative Countervailing Duty Determination Certain Stainless Steel Wire Rod from Italy, 63 FR 40474, 40479 (July 29, 1998).

Department's Position: We disagree with the respondents and are continuing to find this program to be countervailable in the final determination. We agree with the respondents that an exception does exist in the Department's regulations at 19 CFR 351.516(a)(1) for programs that "equalize" the cost of input "products." However, the Department does not find that this exception applies to this program. The Department's regulations allow for government provision of input "products" used in the production of exported products as long as the terms of this provision are not more favorable than those available on the commercial market. However, the "protection" granted by 19 CFR 351.516(a)(1) applies only to a specifically and narrowly defined case of input goods used in the production of exported products. We see no basis for extending this "protection" beyond this narrow case.

Comment 11: BNDES Financing of Belgo Mineira's Acquisition of MJS

Petitioners' Argument: The petitioners argue that BNDES' renegotiation of MJS' debt constitutes countervailable debt forgiveness. The petitioners argue that BNDES provided no evidence at verification that it performed a financial evaluation of MJS' assets prior to the negotiations that led to Belgo Mineira's assumption of the debt. The petitioners claim that such an evaluation would have determined if liquidation of MJS' assets would better meet the outstanding debt obligation rather than transfer of ownership of the debt to Belgo Mineira. The petitioners also claim that information with respect to the repayment of MJS' loans was contradictory and not supported by documented evidence.

According to the petitioners, the Department should determine that BNDES did not act as a commercial actor in forgiving a portion of MJS debt. The petitioners claim that BNDES has not demonstrated that the R\$98 million in debentures and certain other rights are more than would have been recovered at liquidation. Moreover, the petitioners argue that BNDES cannot be compared to other MJS creditors because it holds a different status than those creditors. Thus, the petitioners state that this debt forgiveness should be countervailed for the final determination.

Respondents' Argument: The respondents disagree with the petitioners and argue that the Department accurately determined at the Preliminary Determination that the transaction by which Belgo Mineira acquired BNDES' claims against MJS did not provide a countervailable subsidy. The respondents argue that the Department confirmed at verification that the terms of this transaction were not distinguishable from comparable transactions conducted by Belgo Mineira with other MJS creditors. The respondents argue that the petitioners misunderstand the concept of verification as a "spot-check" rather than a comprehensive verification of every statement made in the responses. As such, the respondents argue that the Department collected sufficient information to verify the information provided in the responses.

The respondents find fault with the petitioners' focus on whether BNDES provided a financial contribution to Belgo Mineira as part of this transaction. The respondents argue that, at the Preliminary Determination, the Department determined the program to be not countervailable because Belgo Mineira did not receive a benefit. Therefore, according to the respondents, the

issue of whether or not the program constituted a financial contribution or is specific is irrelevant. However, the respondents argue that, even if the Department were to examine the transaction in terms of a financial contribution, the appropriate examination in this instance would be whether BNDES provided a financial contribution by forgoing or not collecting revenue that is otherwise due. According to the respondents, the liquidation value that was extensively discussed and examined at verification was far less than what BNDES eventually recovered. Moreover, the respondents state that the petitioners' arguments with respect to this program were unsupported and irrelevant. Thus, the respondents argue that no revenue was forgone by BNDES and no financial contribution under section 771(5)(D)(ii) of the Act exists.

With respect to benefit, the respondents argue that the Department verified the accuracy of its findings in the Preliminary Determination that the discount rate negotiated between Belgo Mineira and BNDES was generally less favorable to Belgo Mineira than those rates negotiated by other MJS creditors. Based on these findings, the respondents argue that the Department should reaffirm its Preliminary Determination finding that this program conferred no benefit on Belgo Mineira and is, thus, not countervailable.

Department's Position: With respect to the issue of whether this transaction conferred a benefit upon Belgo Mineira in terms of BNDES selling its debt on commercial terms, we agree with the respondents and are not revising our Preliminary Determination finding with respect to this issue. At verification, we examined numerous documents relating to this program and confirmed that the amount paid by Belgo Mineira to BNDES for the acquisition of MJS' debt is not less than the amount Belgo Mineira paid to the other significant MJS creditors, other creditors in general, or the amount BNDES would have recovered had MJS been liquidated. Thus, BNDES acted as a rational commercial actor.

However, with respect to the issue of debt forgiveness, we agree with the petitioners. We have examined all relevant data in this case and determined that BNDES' forgiveness of late penalties and fees owed by MJS constitutes a countervailable subsidy because it was a direct transfer of funds pursuant to section 771(5)(D)(i) with a benefit in the amount of the debt forgiveness as defined in section 771(5)(E) of the Act. The transaction was also specific within the meaning of section 771(5A)(D)(iii)(I) of the Act because it was limited to one company. Therefore, we find that this transaction constitutes countervailable debt forgiveness.

Recommendation

Based on our analysis of the comments received, we recommend adopting all of the above positions and adjusting all related margin calculations accordingly. If these recommendations are accepted, we will publish the final determination in the Federal Register.

AGREE _____ DISAGREE _____

Faryar Shirzad
Assistant Secretary for
Import Administration

(Date)