

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

L/3138

25 November 1968

Limited Distribution

CONTRACTING PARTIES
Twenty-Fifth Session

WORKING PARTY ON BORDER TAX ADJUSTMENTS

Interim Report by Chairman of Working Party

1. Following a request by the Government of the United States, the Working Party was established by the Council on 28 March with the following terms of reference:

Acting under paragraph 1 of Article XXV and with a view to furthering the objectives of the General Agreement, and taking into account the discussions in the Council:

1. To examine:

- (a) the provisions of the General Agreement relevant to border tax adjustments;
- (b) the practices of contracting parties in relation to such adjustments;
- (c) the possible effects of such adjustments on international trade.

2. In the light of this examination, to consider any proposals and suggestions that may be put forward; and

3. To report its findings and conclusions on these matters to the Council or to the CONTRACTING PARTIES.

2. Since that time the Working Party has held five meetings. The first was devoted to general statements; these have been summarized in the secretariat's note on the meeting (L/3009). In the opinion of the United States delegation there were three main types of problem which should be examined, and dealt with, by the Working Party. First, these rules did not neutralize the effects of taxes on trade but were instead export promoting and import restricting for indirect tax countries; second, increases in border tax adjustments - either on the argument that the move was from under-compensation to full compensation or as a result of a changeover from one form of taxation to another - placed other countries at a trade disadvantage; third, the present GATT rules were ambiguous or silent on certain points. In the view of the United States' delegation, the trade effects of border tax adjustments exacerbated the existing multilateral trade and payments adjustment problem. The United States Government requested all countries to refrain from increasing the level of their border tax adjustments pending completion of the work of the Working Party. This was particularly urgent because of the

proliferation of additional border tax adjustments without any special limit to their scope and magnitude. They expressed the hope that the conclusions which the Working Party would reach would take the form of recommendations to change certain aspects of the GATT rules and new interpretations of existing rules, although their ideas on appropriate recommendations were not fixed.

3. Other members of the Working Party expressed their willingness to co-operate actively in the work provided for under the terms of reference and in examining the questions raised by the United States. They considered that the questions before the Working Party involved the fundamental rules and practices of GATT, they also involved a re-examination of universally accepted rules dating back to the inception of indirect taxes. They emphasized the complexity of fiscal questions and their effects, which touched on all aspects of the economy and influenced countless factors involved in economic activity and price formation both internally and in international trade. The complexity of these matters was confirmed by studies made in other multilateral fora. It was considered that it would be appropriate, in particular to examine whether the countries relying predominantly on direct taxes were at a disadvantage compared with those for which those taxes were less important. In addition, it was recalled that tax matters were traditionally the responsibility of parliaments, which jealously guarded those prerogatives and generally refused to allow them to be the subject of international negotiations.

4. It was the general feeling that it was essential to examine the GATT rules on border tax adjustments and the practices of contracting parties with relation to such adjustments as called for by items 1(a) and 1(b) of its terms of reference before drawing conclusions on possible trade effects and recommendations to deal with them.

5. At its second meeting the Working Party conducted a preliminary examination of the provisions of the General Agreement relevant to border tax adjustments as called for in point 1(a) of its terms of reference. This examination concentrated on the legislative history of the rules and their interpretation and was conducted on the basis of a paper prepared by the secretariat. This paper, and a summary of the main points raised at the meeting, are contained in the note on the meeting (L/3039). The Working Party agreed that the main articles it should consider were, on the import side, Articles II and III and, on the export side, Article XVI. Other relevant articles included Articles I, VI and VII. During the discussion on the legislative history there was general agreement that the main provisions of the GATT represented the codification of existing practices. However it was also argued by some members that there seemed to have been a coherent approach and that there were no inconsistencies of substance between the different provisions, even if the question of border tax adjustments was dealt with in different articles, and that the philosophy behind these provisions was the ensurance of a certain trade neutrality. The Working Party noted some points on which the interpretation of the rules was uncertain or on which the rules were silent. Members of the Working Party also suggested that certain of the existing provisions should be re-examined. The Working Party agreed to return to point 1(a) at a later stage, it being pointed out, inter alia, that an examination of the border tax practices of contracting parties would throw light on the way in which countries interpreted the GATT rules.

6. The third meeting was largely spent in preparing the procedures for this examination and the documentation which would be required. A note on this meeting has been circulated in L/3048. Contracting parties have been requested to supply factual information in writing. For contracting parties which are also members of the OECD this supplements information contained in the documentation of that organization, since that documentation has been made available to the Working Party. Other contracting parties have been asked to complete a questionnaire based on that used by the OECD. Many contracting parties have already supplied the information requested of them; the Working Party would be grateful if other contracting parties could also provide this information. A special questionnaire has also been circulated to members of the Working Party asking for information on a short list of products of export interest to developing countries.
7. At the fourth meeting the Working Party started its examination of border tax practices. Members of the Working Party and some observers explained their tax systems and border tax practices, using as a basis a list of questions drawn up by the Working Party - these questions and a summary of the discussions have been circulated as L/3125. This process was continued at the fifth meeting, held during the present session. The Working Party has examined cascade turnover taxes, general single-stage taxes at the manufacturing, wholesale and retail levels and added-value taxes. At its next meeting it will go on to examine selective excise taxes, changes in border tax adjustments and some other miscellaneous questions.
8. The Working Party observed that its work to date had been carried out in an atmosphere of active co-operation and that it had already covered much ground in its intensive work. In this regard the Working Party recognized that the problems under its examination were of major importance and that its activities deserved high priority. The Working Party had so far carried out an examination of the legal provisions of GATT and of border tax practices which had brought out the fact that tax adjustments were applied in practically every country and that their magnitude, which of course varied in relation with the incidence of indirect taxation in the various countries, was such that it was important to ensure that such adjustments were properly applied and were not exploited for reasons of protection. The work done so far had brought out the extreme complexity of this question, and that fact accounted for differences of views that might sometimes prove to have been based on misunderstandings; it was desirable to clarify these by means of a sincere and frank effort of mutual comprehension. The Working Party in particular recognized the need to find mutually acceptable solutions if problems were found to exist in the course of the Working Party's examination.