

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

L/3431

25 August 1970

Limited Distribution

WORKING PARTY ON BORDER TAX ADJUSTMENTS

Meeting of 6-8 July 1970

Note by the Secretariat

1. The Working Party held its eleventh meeting from 6 to 8 July 1970.
2. The Working Party dealt with (i) the provisions of the General Agreement relevant to border tax adjustments (point 1(a) of the terms of reference); (ii) the practices of contracting parties in relation to such adjustments (point 1(b) of the terms of reference); (iii) consideration of proposals and suggestions (point 2 of the terms of reference); and (iv) questions raised with regard to border taxes on products of special interest to developing countries.
 - (i) Provisions of the General Agreement relevant to border tax adjustments
(point 1(a) of the terms of reference)
3. At its second meeting from 18 to 20 June 1968 the Working Party started its examination of this question, which was conducted on the basis of a paper prepared by the secretariat (annex to L/3039). The secretariat's note on the discussions at that meeting is contained in document L/3039. A further summary of the discussion on point 1(a) of the terms of reference is contained in the Working Party's Interim Report 1969 (L/3290, paragraphs 5 to 8). Also relevant to the discussion was paragraph 21 of the Interim Report proposing the study of the interpretation of the terms "borne by" and "levied on" in relation to taxes occultes, and "like or similar products". Members of the Working Party were invited at this meeting to indicate: (a) whether they applied the provisions of the General Agreement identically to imports and exports and (b) which taxes were subject to adjustments at the border.
4. The Working Party noted that the following Articles of the General Agreement were relevant: Articles I, II, III, VI, VII and XVI. The Working Party also noted that there were differences in the terms used in these Articles, in particular with respect to the provisions regarding importation and exportation. It was established that these differences in wording had not led to any differences in interpretation of the provisions. It was agreed that GATT provisions on fiscal adjustment applied the principle of destination identically to imports and exports.
5. It was further agreed that these provisions set maxima limits for adjustment (compensation) which were not to be exceeded, but below which every contracting party was free to differentiate in the degree of compensation applied, provided that such action was in conformity with other provisions of the General Agreement.

6. One delegation stressed that the question of the degree of compensation, regardless of its consistency with GATT rules, was relevant to the issue in terms of the actual or potential effect on trade. For instance, trade distortions were likely to result from a country changing from consistent under-compensation to full compensation.
7. Some delegations did not share this view. They stated that GATT provisions on fiscal adjustments did not provide for any form of protection but rather for the possibility for governments to create equality in treatment between imported and domestically-produced goods. The various degrees of compensation practised in different countries were applied for fiscal revenue or budgetary reasons; there were no known cases of deliberate manipulation of compensation on selected products.
8. On the question of eligibility of taxes for fiscal adjustment under the present rules, the discussion took into account the term "... directly or indirectly ..." (inter alia Article III:2).
- (i) (a) The Working Party concluded that there was convergence of views to the effect that taxes directly levied on products were eligible for fiscal adjustment. Examples of such taxes comprised specific excise duties, sales taxes and cascade taxes and the tax on value added. It was agreed that the tax on value added, regardless of its technical construction (fractioned collection), was equivalent in this respect to a tax levied directly - a retail or sales tax.
- (b) The Working Party concluded that there was convergence of views to the effect that certain taxes that were not directly levied on products were not eligible for fiscal adjustment. Examples of such taxes comprised social security taxes, labour taxes and payroll taxes.
- (c) The Working Party noted that there was some divergence of views with regard to the eligibility for adjustment of certain categories of taxes, such as specific taxes on energy and transport taxes. It was noted that while a majority of countries did not compensate for these taxes, a few countries did. The Working Party further noted that this area of divergence of views and practices was marginal.
9. The Working Party noted the OECD definition of *taxe occulte* as "taxes on capital equipment auxiliary materials, and services used in the transportation and production of other taxable goods". It appeared that normally the *taxe occulte* was not rebated on export or charged on import except in countries having a cascade tax system. It was pointed out that the term *taxe occulte* was sometimes also used to cover certain indirect taxes, such as stamp duties and property taxes, which were not generally regarded as eligible for fiscal adjustment. It was generally felt that while this area of taxation was unclear, its importance - as indicated by the scarcity of complaints reported in connexion with adjustment of *taxe occulte* - was not such as to justify further detailed examination.

10. The Working Party noted that there were some taxes which, while generally considered eligible for adjustment, presented a problem because of the difficulty of calculating exactly the amount of compensation. Examples of such difficulties were encountered in cascade tax systems. For adjustment, countries operating cascade systems usually resorted to calculating average rates of rebate for categories of products rather than calculating the actual tax levied on a particular product. It was noted, however, that most cascade tax systems were to be replaced by tax on value added systems, and that therefore the area in which such problems occurred was diminishing.

11. It was generally agreed that countries adjusting taxes should, at all times, be prepared, if requested, to account for the reasons for adjustment, for the methods used, for the amount of compensation and to furnish proof thereof.

12. With regard to the interpretation of the term "... like or similar products ...", which occurs some sixteen times throughout the General Agreement, it was recalled that considerable discussion had taken place in the past, both in GATT and in other bodies, but that no further improvement of the term had been achieved. The Working Party concluded, with one exception, that problems arising from the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.

13. One delegation observed, however, that the term "... like or similar products ..." caused some uncertainty and that it would be desirable to improve on it.

(ii) Practices of contracting parties in relation to border tax adjustments
(point 1(b) of the terms of reference)

14. The representative of Denmark gave an account of the changes in tax on value added rates that had been in effect in his country since June 1970. Clarifications were sought by the representatives of the United Kingdom and the United States.

(iii) Consideration of proposals and suggestions
(point 2 of the terms of reference)

15. It was agreed that until a consolidated list of up-to-date proposals and suggestions was established, further discussion of existing proposals and suggestions would not yield any results. It was therefore agreed that countries who wished to maintain their proposals and suggestions or submit new ones for consideration should submit such proposals in writing to the secretariat before the end of September. The secretariat would circulate a consolidated list of proposals and suggestions well before the next meeting. If possible the Working Party would finalize its report to the Council at that meeting.

(iv) Questions raised with regard to border taxes on products of special interest to developing countries

Differential border tax adjustments

16. On the basis of the information supplied by developed countries on taxes levied on products of interest to developing countries, as requested in Spec(68)97 and Add.1, it was pointed out that some products were subject to unreasonable differential border tax adjustment treatment. An example was tea which in one importing country was subject to a much higher tax rate than soluble coffee. It was suggested that this form of differential tax treatment could be eliminated on a priority basis for developing countries by a downward adjustment of the tax rate on one product to the lower rate applied to another comparable product. However, the information so far available was not adequate for analyzing this issue to the fullest extent.

17. Only a few developed countries had provided information on the amount of revenue collected on products imported from developing countries. In many cases the information was difficult to extract; breakdowns of revenue data by product and by country of origin were not statistically or administratively possible for some countries. One representative from a developed country indicated that his authorities did not apply differential border tax adjustments. In this connexion, all developed countries were requested to inform the secretariat of the extent of information they could provide.

18. The representatives of some developed countries suggested that products which, according to developing countries, were subject to unreasonable differential border tax adjustment, should be indicated and subsequently examined by the interested parties on a case-by-case basis.

19. Regarding the different tax rates applied to tea and soluble coffee, the applying country said that these corresponded to the differing degrees of commercialization of the products. Moreover, excise tax rates on coffee and tea had not changed since 1953, despite price changes.

High rates of taxation

20. It was pointed out that certain products of interest to developing countries were subject to very high and sometimes excessive rates of taxation. An example was tea which in some developed countries was taxed at the same rate as wine. Such rates of taxation were excessive and should be reduced.

21. Representatives of some developed countries explained that most of these high taxes were specific or excise taxes that were not discriminatorily levied on tropical products, but also on other products such as mineral water. These taxes were mostly specific, and had remained unchanged for many years; thus, their

impact on consumption had lessened with changes in real money values. It was noted that, in general, tax rates for most of the products of interest to developing countries listed in Spec(63)97 and Add.1 were not high. Those that were high were imposed for special health or revenue reasons.

Increased tax incidence

22. It was pointed out that, as a result of changes in tax systems, (i.e. from a cascade to a tax on value added system) the tax incidence had considerably increased on some products of interest to developing countries. For instance, in one developed country, a cascade tax rate of 1.6 per cent on textiles had been replaced by a 12 per cent tax on value added tax rate. It was suggested that in these cases, tax rates should be restored to their original level. Some developed countries which had operated such changes replied that the changeover had permitted them to harmonize tax rates and to eliminate abnormal situations such as the one in textiles. Exceptions to uniform rates were difficult to maintain.

Tax exemptions for certain products

23. Recalling the proposals set out in paragraphs 26 and 27 of L/3290, it was suggested that commodities imported from developing countries but not produced by the importing developed countries be exempted from internal taxes, to ensure trade neutrality as required under GATT rules. The number of products concerned would not be large; thus developed countries could easily absorb any possible effects arising from exemption.

24. Members of developing countries stated that it should be administratively possible to exempt products from indirect taxation on a country-of-origin basis. Fiscal and trade policy were inter-related. Fiscal exemptions favouring certain imports from developing countries were therefore natural. It was replied that internal tax exemption on products of interest to developing countries would imply manipulation of the fiscal system for trade policy purposes. This would create a dangerous precedent and would be contrary to the rules and basic principles of the GATT. It should not be forgotten that these taxes were levied on consumption and not on imports. Some developed countries agreed that while the application of indirect taxation according to origin was technically feasible, the administration of such different rates of taxation would be difficult.

25. The rules laid down in Article III of the General Agreement could not be interpreted as forbidding the application of taxes to products not domestically produced. GATT rules were mainly concerned with preventing the protection of national production by means of internal taxes. Members of the Working Party were reminded of the suggestion outlined in paragraph 29 of L/3290. One member qualified the proposal as meaning that if the Working Party decided to examine further the meaning and intentions behind the drafting of Article III, his delegation would not have any objections.