

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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REPORT BY THE WORKING PARTY ON BORDER TAX ADJUSTMENTS

I. Introduction

1. The Working Party was established by the Council on 28 March 1968 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. The Working Party held twelve meetings between April 1968 and October 1970, under the chairmanship of Mr. E. Thrane (Denmark), succeeded by Mr. T. Gabrielsson (Sweden).

3. A Report of the first five meetings (L/3138) was made to the CONTRACTING PARTIES at their twenty-fifth session. A further Report on the sixth to ninth meetings (L/3290) was made to the Council in January 1970, and subsequently to the CONTRACTING PARTIES at their twenty-sixth session. In presenting the Report the Chairman stated that the Working Party would continue its discussion of the practices of tax adjustments in relation to products of interest to developing countries, and would also examine notifications made in the Committee on Trade in Industrial Products with regard to tax adjustments and report to the Committee on the results of this examination.

II. Point 1(a): The Provisions of the General Agreement
Relevant to Border Tax Adjustments

4. For the purpose of its examination the Working Party used the definition of border tax adjustments applied in the OECD. Thus, border tax adjustments were regarded "as any fiscal measures which put into effect, in whole or in part, the destination principle (i.e. which enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market and which enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products)".

5. The Working Party noted that the term "border tax adjustment" had given rise to much confusion because it implies that the adjustment necessarily takes place at the border whereas this is not the case. In fact under certain tax systems exports never become liable to tax and so no adjustment actually takes place at the border; in addition, under certain tax systems imports are usually taxed, as is home production, by the importing country at the time they are sold by registered traders to other traders or consumers, and so the adjustment takes place after the goods cross the border. For this reason it is recommended that the term "border tax adjustments" should be replaced by "tax adjustments applied to goods entering into international trade". For the sake of brevity, subsequent references in this report are to "tax adjustments".

6. The examination of the provisions of the General Agreement relevant to tax adjustments concentrated on the legislative history of the rules and their interpretation and was conducted on the basis of a paper prepared by the secretariat. (See Annex.)

7. 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.

8. There was general agreement that the main provisions of the GATT represented the codification of practices which existed at the time these provisions were drafted, re-examined and completed. Some members of the Working Party considered, however, that the main provisions of the GATT relevant to tax adjustments represent an attempt at the codification of a wide range of past practices based on assumptions which are not now universally accepted. In particular, they felt the assumption of full shifting of indirect taxes and no shifting of direct taxes is not a reflection of economic reality. They considered that the present GATT rules favour countries which rely heavily on indirect taxes and discriminate against countries which rely predominantly on direct taxes. Further, in their view, the present rules are ambiguous and lead to differing tax adjustment practices for similar types of taxes. They concluded that the current GATT provisions and tax practices are not trade neutral.

9. Most members argued that there seemed to have been a coherent approach when the relevant Articles of the GATT were drafted and that there were no inconsistencies of substance between the different provisions even if the question of tax adjustments was dealt with in different Articles. They added that the philosophy behind these provisions was the insuring of a certain trade neutrality. It was noted that the rules of the GATT had also been agreed upon by those countries predominantly relying on direct taxes. They recalled the fact that the rules of the GATT had been in force for more than twenty years and had proved fairly adequate and easy to administer. They were also of the opinion that the present rules served the purpose of trade neutrality of tax adjustment appropriately and that no motive could be found to change them. The point was made that Revenue Departments, for whom many delegates spoke, had strong reason in the interest of the revenue as well as fiscal justice, to ensure, in the treatment of imports and exports, neutrality with home-produced goods: for instance in the charging of substitutes at importation and in the ensuring for exports, that too much duty was not repaid. Some countries thought that the Working Party should not go further than a discussion on the possibilities of improvements of a technical character that could facilitate the practical handling of the GATT rules.

10. 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: for instance the terms "borne by" and "levied on". 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 tax adjustment applied the principle of destination identically to imports and exports.

11. 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.

12. 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.

13. Some delegations did not share this view. GATT provisions on tax 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.

14. On the question of eligibility of taxes for tax adjustment under the present rules, the discussion took into account the term "... directly or indirectly ..."
(inter alia Article III:2). The Working Party concluded that there was convergence

of views to the effect that taxes directly levied on products were eligible for tax 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 TVA, regardless of its technical construction (fractioned collection), was equivalent in this respect to a tax levied directly - a retail or sales tax. Furthermore, 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 tax adjustment. Examples of such taxes comprised social security charges whether on employers or employees and payroll taxes.

15. The Working Party noted that there was a divergence of views with regard to the eligibility for adjustment of certain categories of tax and that these could be sub-divided into

(a) "taxes occultes" which the OECD defined as consumption taxes on capital equipment, auxiliary materials and services used in the transportation and production of other taxable goods. Taxes on advertising, energy, machinery and transport were among the more important taxes which might be involved. It appeared that adjustment was not normally made for taxes occultes except in countries having a cascade tax.

(b) certain other taxes, such as property taxes, stamp duties and registration duties ... which are not generally considered eligible for tax adjustment. Most countries do not make adjustments for such taxes, but a few do as a few do for the payroll taxes and employers' social security charges referred to in the last sentence of paragraph 14.

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 taxes occultes - was not such as to justify further examination.

16. The Working Party noted that there were some taxes which, while generally considered eligible for adjustment, presented a problem because of the difficulty in some cases of calculating exactly the amount of compensation. Examples of such difficulties were encountered in cascade taxes. 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 TVA systems, and that therefore the area in which such problems occurred was diminishing. Other examples included composite goods which, on export, contained ingredients for which the Working Party agreed in principle it was administratively sensible and sufficiently accurate to rebate by average rates for a given class of goods.

17. 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.

18. 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 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. It was observed, however, that the term "... like or similar products ..." caused some uncertainty and that it would be desirable to improve on it; however, no improved term was arrived at.

III. Point 1(b): The Practices of Contracting Parties in Relation to Tax Adjustments

19. The Working Party devoted considerable time to a comprehensive and thorough examination of the various tax systems, and changes in those systems, of the twenty-two contracting parties, members of the Working Party and of several observer countries. The examination concerned general consumption taxes such as cascade taxes, single-stage taxes and, in particular, taxes on value added (TVA) which are or will be applied by many European countries, as well as selective excise taxes. In addition, less detailed consideration was given to certain specific problems, mainly relating to taxes on company profits and on capital. The Working Party spent much time in collecting and clarifying the extensive information received. Information on the study of practices of tax adjustments in OECD countries was made available by the OECD.

20. A consolidated document (L/3389) was drawn up by the secretariat containing information on and discussion of the existing practices of tax adjustments. The document provides a description of how adjustments in various countries are made, whether these adjustments are made either at the border or at an earlier or later stage depending on whether exports or imports are concerned, at the manufacturing, wholesale or retail level, and also supplies information on present rates and the extent to which tax systems have been changed in various countries. It was felt that this part of the work of the Working Party had been most useful.

IV. Point 1(c): The Possible Effects of Tax Adjustments on International Trade

21. In examining the possible effects of tax adjustments on international trade, a study has been made of the nature of indirect taxes and also to some extent of direct taxes, and their eligibility for adjustment. The question was raised by some members why only indirect taxes should be eligible for adjustment since the economic basis for such a clear distinction between indirect and direct taxes for

adjustment purposes has not been demonstrated. Most delegations stated, however, that in their opinion such a distinction was already justified by the fact alone that indirect taxes by their very nature bear on internal consumption and were consequently levied, according to the principle of destination, in the country of consumption, while direct taxes - even assuming that they were partly passed on into prices - were borne by entrepreneurs' profits or personal income. On the other hand, some members stated that while forward shifting of selective excise taxes could take place under most circumstances according to micro-economic approach, forward shifting in the case of general consumption taxes was according to macro-economic approach, not possible unless one assumes either a sufficient increase in money supply or in velocity of money. Some further argued that market conditions including, for example, monopoly or imperfect competition, influenced the degree to which the shifting of taxes both direct and indirect could take place. Other members expressed their doubts about this thesis. They pointed out that forward shifting of indirect taxes is the rule and that in any case the relative importance of the degree of forward shifting of these indirect taxes in the light of the economic conditions does not constitute a determining criterion for the application of tax adjustments.

22. The Working Party recognized that the problem of structural differences in taxation and the question as to what extent indirect taxes and direct taxes were shifted into commodity prices was full of difficulty and of a very complex nature. No conclusions were reached. Some members felt that this part of the Working Party's examination made it clear that present tax adjustment based on GATT provisions did not ensure trade neutrality and that it was important that solutions be found to this problem. Most other members of the Group, however, were of the opinion that the discussion rather tended to confirm that the current practices of tax adjustments were as consistent as possible with the objectives of trade neutrality. Still some others were of the opinion that the work done in the Working Party was not such as to permit definitive conclusions to be drawn regarding the objective truth in the two opposing contentions.

23. The Working Party examined whether and to what extent changes in tax systems could affect international trade. The Working Party paid special attention to changes in tax adjustments unaccompanied by changes in domestic rates of taxes and changes from cascade taxes or sales taxes to a tax on value added. In this connexion, special studies were made of Denmark, France, the Federal Republic of Germany, the Netherlands, Sweden and Norway, which had moved from a cascade or single-stage tax system, to a system of tax on value added (TVA).

24. The Working Party recognized that there were serious difficulties in the way of quantifying the possible effects of tax adjustments on international trade, it being difficult to determine what the trade figures would have been if tax adjustments had not been made.

25. It was nevertheless admitted that changes in tax adjustments could in certain conditions have a favourable effect on the trade balance. Some members shared that view only with respect to changes that put an end to under-compensation. For instance, the substitution of a TVA for a cascade tax could well be advantageous to the balance of trade, if border taxes under the cascade system did not fully reflect the turnover tax paid on similar products in the home market. However, those effects would depend on the conditions in which the changes were made. Some countries explained that as a transitional measure the effect from their changeover to full compensation would be partially offset through a limited tax deduction for investments goods and stocks during the first years after the imposition of the TVA. This meant that in those years there would be still a difference in the burden between the imported product and the home product in favour of the imported product. In addition, it appeared that, at least in one case, the expected trade advantages, which would have been of a rather small percentage anyway, had been entirely obliterated by a sharp price and cost inflation after the TVA had been imposed. It was remarked that this evolution was likely to take place under certain circumstances, when a TVA is substituted for a cascade system. Some countries said that they did not share the view that it was likely that the trade advantages of such a shift could be obliterated by this phenomenon.

26. Some members of the Working Party expressed the view that tax adjustments could have a disequilibrating impact on the world economy, if, for example, tax adjustments which would improve a particular country's trade position were in future to be made when that country was already in a sustained balance-of-payments surplus position. The members who held this view suggested that there was a need to take this aspect into account rather than simply adopting tax adjustments as a logical consequence of internal tax policy decisions. It was asked by these members of the Working Party whether it was correct for countries to change in all circumstances tax adjustments to allow for fuller compensation. Several countries pointed out that the rules of the GATT permitted tax adjustments for certain indirect taxes, which was entirely justified since in the absence of full compensation, national enterprises were at a disadvantage from the aspect of international competition.

27. The Working Party examined the problem of taxes occultes. It also discussed, to a lesser extent, incentive measures that may be taken in the context of direct taxation. Some countries stated that the problem of direct tax incentives warranted some study. Some other members expressed the view that the latter problem did not fall within the terms of reference of the Working Party. Furthermore, the adjustments in relation to selective excise taxes were discussed. It was noted that selective excise taxes could be applied on certain products but not other related products in order to affect international trade. It was recognized that this could be inconsistent with the General Agreement.

Tax adjustments on products of interest to developing countries

28. Some members pointed out that the question of imposing and hence of forward shifting of internal taxes on domestic products did not arise in the case of products which were not domestically produced by developed countries. They therefore emphasized that the principle of destination regarding tax adjustments was not relevant in the case of products of export interest to developing countries which were not produced in developed countries, and that in order to ensure trade neutrality as required under GATT rules no internal taxes should be levied by developed countries on such products.

29. Members from developing countries drew attention to the Ministerial Conclusions of 1963 and Article XXVII of the GATT, which stressed that developed contracting parties should endeavour to suppress taxes on products imported essentially from developing countries and that consequently contracting parties should give priority attention to the reduction and elimination of such taxes. These members pointed out that on the contrary, as the result of recent changes in tax systems in some countries, the tax incidence on some of the products of interest to developing countries had tended to increase.

30. Representatives of developed countries considered that a distinction should be made between internal charges of a general application and selective or specific taxes, since many of the taxes imposed such as cumulative turnover taxes and the tax on value added affected all products and were, in their view, not covered by Article XXVII:1(c), which refers to fiscal measures applied specifically to those products in raw or processed form wholly or mainly produced in the territories of developing contracting parties. Representatives of developing countries pointed out that in the process of changeover to TVA, selective excise taxes were replaced by general consumption taxes. They therefore considered that the provisions of Article XXVII:1(c) were applicable.

31. It was suggested that it was not realistic to suppose that the abolition or reduction of individual excises, on which a significant element in a country's revenue depended, could be determined by the ability of the country itself to grow or to produce the commodity in question. The representatives of developing countries stated that compared to the total revenue, revenue collected from excises on products of interest to developing countries, not domestically produced in developed countries, was very insignificant. Revenue considerations should not therefore stand in the way of removal of such taxes, particularly as these adversely affected consumption.

32. In referring to the proposal to suppress taxes on products not domestically produced in developed countries, some countries considered that it was of great importance not to introduce into fiscal policies considerations and preoccupations pertaining to trade policy. They stated that exemption of internal taxes on

products of interest to developing countries would imply manipulation of the fiscal system for commercial purposes. This would create a dangerous precedent and would be contrary to the rules and basic principles of the GATT. They added that the provisions of Article III of the General Agreement could not be interpreted as forbidding the application of taxes to products not domestically produced but that they essentially aimed at preventing protection being given to national production by means of internal taxes. These provisions, therefore, did not oblige contracting parties to favour indirectly products not domestically produced by granting them tax exemption. As regards the Ministerial Conclusions of 1963, some countries recalled that they had not subscribed to the obligations in those Conclusions, in particular those relating to taxes on products imported mainly from developing countries.

33. 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.

34. A list of products of interest to developing countries was drawn up (Spec(68)97 and Add.1) in order to examine whether and to what extent products originating in developing countries were affected by tax adjustments. Most of the information requested was provided (Spec(68)134/Add.1-12, Spec(70)40 and Spec(70)90), except that on revenue from internal taxes on products of interest to developing countries, where not all countries had the necessary breakdowns of revenue data by product and by country of origin. A useful discussion was held on the practices of contracting parties in levying taxes on commodities exported by developing countries.

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

36. 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 as these had adverse effects on consumption.

37. 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. 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(68)97 and Add.1 were not high. Those that were high were imposed for special health or revenue reasons and their elimination, while depriving States of a source of income, would not lead to any appreciable increase in the consumption of the products.

38. It was pointed out that as a result of changes in tax systems (i.e. from a cascade to a TVA 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 TVA 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. Representatives of these countries said that ... for reasons of trade policy, exceptions to the application of uniform rates could not be maintained in new generalized systems of consumption taxes.

V. Points 2 and 3: Proposals and Suggestions - Conclusions

39. The Working Party examined a proposal for the establishment of a regularized system of review of changes in tax adjustments within the GATT. The proposal comprises a notification procedure and a multilateral procedure for consultation on request.

40. The Working Party does not feel that any useful purpose would be served by pursuing the examination under its present terms of reference in the present circumstances. The Working Party recognizes the continuing interest of contracting parties in the subject and in particular in future changes in taxation systems. The Working Party recommends that a notification procedure be introduced, on a provisional basis whereby contracting parties will report changes in their tax adjustments. It is understood that such notifications need not be made prior to the changes. The contents of the notifications would aim generally at reporting any major changes in tax adjustment legislation and practices involving international trade, and in particular at bringing periodically up to date the information contained in the consolidated document on contracting parties' practices (L/3339) on tax adjustments drawn up in the course of the Working Party's work. While the notifications would cover changes in centrally-controlled taxes, countries with large locally- or regionally-controlled tax systems would be expected to make a special effort to report changes of a significance on a local or regional basis.

41. The Working Party took note of the particular interest of developing countries in the removal of tax adjustments on products not domestically produced by developed countries, and of the references which had been made in this context to Article XXXVII.
42. The Working Party agreed that the suggestions it makes concerning its own work should not affect the work under way in the Special Group on Tropical Products.
43. The Working Party recommends that a consultation procedure be established whereby, upon request by a contracting party, a multilateral consultation could take place on changes in tax adjustments, whether notified or not. Such consultations would be held within the scope of the relevant GATT provisions. Upon request, contracting parties should be prepared to justify the reasons for adjustment, the methods used, the amount of compensation and to furnish proof thereof.
44. It is suggested that this Working Party, because of its experience in the field of tax adjustments, is the appropriate forum for holding consultations.
45. The Working Party recommends that the Director-General should be asked to consider, at convenient intervals, on the basis of the notifications referred to above, and in consultation with interested parties, whether a review of notified changes is called for. He should also be asked to consider after an adequate period of operation, and in consultation with interested parties, whether the provisional notification procedure should be continued, modified or discontinued.

VI. Report on Examination of Group 5 Notifications

46. With regard to the notifications submitted to it by Working Group 5 of the Committee on Trade in Industrial Products, the Working Party referred to its Report to Group 5 (COM.IND/W/29) and considered that its task was terminated. Some members of the Working Party considered that tax adjustments that were consistent with provisions of the General Agreement could not be termed barriers to trade because they were precisely designed to ensure equal tax treatment as between foreign and domestic products.

ANNEX

THE GATT RULES ON BORDER TAX ADJUSTMENTS

Note by the Secretariat

1. At its first meeting the Working Party requested the secretariat to prepare an "analytical paper giving the relevant GATT rules, examining the legislative history of these rules and the way in which they have been interpreted during the past twenty years" (L/3009, paragraph 25).
2. The principal GATT article dealing with border tax adjustments which may be made on the import side is Article III. The principal article relating to the export side is Article XVI. Other articles relevant to this question include Articles I, II, VI and VII.
3. The discussions leading to the drafting of the Havana Charter are an important source of legislative history for the GATT. Many of the provisions of the GATT are drawn from the Havana Charter, the original text of the GATT, which was drawn up at the second session of the Preparatory Committee, having been modified to bring certain of its provisions into line with the wording of the Havana Charter. The proceedings of the Review Session of 1954-55 are, of course, also of great importance. Finally, cases which have been brought to the CONTRACTING PARTIES also provide guidance as to the interpretation of the Agreement.

Article III

4. In paragraph 1 of Article III the contracting parties recognize that "internal taxes and other internal charges ... should not be applied to imported or domestic products so as to afford protection to domestic production".
5. The more detailed provisions of paragraph 2 give effect to this recognition, providing that "the products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1." A note to the paragraph, which like other notes in Annex I is an

integral part of the General Agreement, makes it clear that a tax conforming to the requirements of the first sentence of this paragraph would be considered to be inconsistent with the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

6. Paragraph 3 of the Article deals with the special case of internal taxes which are inconsistent with the provisions of paragraph 2 but which are specifically authorized under a trade agreement in force on 10 April 1947.

7. The following paragraphs of the Article deal with matters other than internal taxes but paragraph 3(b) may be noted. This provides that "the provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article ...".

8. A note to this Article specifies that "any internal tax or other internal charge ... which applies to an imported product and to the like domestic product and is collected ... in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge ... and is accordingly subject to the provisions of Article III". A further note makes it clear that the application of this paragraph to internal taxes imposed by local governments and authorities within the territory of a contracting party is subject to the provisions of the final paragraph of Article XXIV which provides that "each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional or local governments or authorities within its territory" and gives guidance as to the interpretation of the term "reasonable measures" for the purposes of Article III.

9. Discussions leading up to the Havana Charter, on the provisions which became Article III of the GATT, centred on changes in drafting and the need for certain exceptions. The principles embodied in the GATT that taxes on products would normally be levied in the country of destination and not in the country of origin, and that adjustments would not normally be made at the border in respect of other taxes were contained in the United States' Draft Charter, on which the discussions leading to the drafting of the Havana Charter were based, and were taken into the Charter and the GATT without major modification.

10. The Article of the Draft Charter headed National Treatment on Internal Taxation and Regulation (Article 9, corresponding to Article III of the GATT) provided, inter alia, that "the products of any Member country imported into any other Member country shall be exempt from internal taxes and other internal charges higher than those imposed on like products of national origin ...".

This wording was taken over from bilateral agreements negotiated in the 1930's. The Bilateral agreement between the United States and France signed on 6 May 1936 provided, for instance, that "natural or manufactured products of the United States of America or of the French Republic shall, after their importation into the other country, be exempt from all internal taxes, fees, charges or exactions other or higher than those payable on like products of national origin or any other foreign origin".¹ Similar provisions occur in other bilateral agreements concluded by the United States. In this respect, therefore, the provisions of the Draft Charter reflected accepted practice and there was no discussion of the philosophy behind them.

11. Perhaps the main question relating to the interpretation of Article III as it stands at present has been the exact meaning of the phrase in paragraph 2 of the Article which provides that adjustments may be made at the border in respect of "internal taxes or other internal charges of any kind ... applied, directly or indirectly, to like domestic products".

12. At Havana it was recorded that "neither income taxes nor import duties fall within the scope of Article 18 (of the Havana Charter - Article III of the GATT) which is concerned solely with internal taxes on goods".²

13. The words "directly or indirectly" were added during the drafting leading up to the Havana Charter and were used in place of "in connexion with" as suggested by the United Kingdom delegate for which it had been difficult to find an exact equivalent in the French text.³

14. Further discussions on this question took place at the Review Session, at which the delegate of the Federal Republic of Germany proposed the insertion of the following interpretative note to paragraph 2 of the Article:

"the words 'internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products', as employed in the first sentence of paragraph 2, shall be construed to denote the overall charge, including the charges borne by like domestic products through being subjected to internal taxes or other internal charges at various stages of their production (charges borne by the raw materials, semi-finished products, auxiliary materials, etc. incorporated in, and by the power consumed for the production of, the finished products)."

¹League of Nations Treaty Series, Volume 199, page 260.

²Havana Reports, page 63 (Analytical Index, page 19).

³E/FC/T/C.II/W.5, page 5 (Analytical Index, page 22).

The following is the complete text of the Working Party's report of the discussions on this proposal:

"The Working Party considered the significance of the phrase 'internal taxes or other internal charges' in relation to taxes which are levied at various stages of production, and in particular whether the rule of national treatment would allow a government to tax imported products at a rate calculated to be the equivalent of the taxes levied at the various stages of production of the like domestic product or only at the rate of the tax levied at the last stage. Several representatives supported the former interpretation, while the representative of the United States, on the other hand, thought the reference to internal taxes covered only a tax levied on the final product competitive with the imported article. Against the latter view it was argued that that interpretation would establish a discrimination against countries which chose to levy taxes at various stages and in favour of those which levy a single turnover tax on finished products. Some other representatives were of the opinion that the equivalent of the taxes on the final product and on its components and ingredients would be permitted, but not taxes on power consumed in manufacture, etc. In view of these differences of opinion, the Working Party does not recommend the insertion of an interpretative note, it being understood that the principle of equality of treatment would be upheld in the event of a tax on imported products being challenged under the consultation or complaint procedure of the Agreement."¹

15. This clearly brings out the differences of opinion that existed at that time. No cases which are relevant to this point have been brought to the CONTRACTING PARTIES under the consultation procedures of the Agreement.² The uncertainty which existed at the time of the Review Session therefore still exists.

16. There appear to have been no major outstanding problems with regard to the interpretation of the other present provisions of Article III. Some points relating to the history of these provisions may, nevertheless, be of interest.

¹ BISD, 3rd Supplement, page 210.

² For cases relating to Article III see:

Brazilian Internal Taxes; BISD, Volume II, page 181,
Greek Special Import Taxes; BISD, 1st Supplement, page 48.

17. The second sentence of Article III:2 prohibits the imposition of a higher tax on an imported product which, while not being a "like product", is directly competitive with, or substitutable for, the domestic product. During the drafting of the Havana Charter, and thus the GATT, it was felt that this might occur where there was no, or negligible, domestic production of the imported product. Various examples were quoted; it was for instance suggested that a country which did not produce coffee could not impose a tax on coffee, unless it placed a similar tax on chicory, a competitive product.¹ It was agreed that the decision as to whether products were "directly competitive or substitutable" would have to be made on each case as it arose and in relation to the facts of the situation.²

18. It was, however, agreed that "a general tax, imposed for revenue purposes, uniformly applicable to a considerable number of products, which conformed to the requirements of the first sentence of paragraph 2 would not be considered to be inconsistent with the second sentence".³ At Havana it was also agreed that under the provisions of Article 18 (of the Havana Charter - Article III of the GATT) regulations and taxes would be permitted which, while perhaps having the effect of assisting the production of a particular domestic product (say, butter) are directed as much against domestic production of another product (say, domestic oleomargarine) of which there was a substantial domestic production as they are against imports (say, imported oleomargarine).⁴ At the Review Session the representative of Sweden said that his Government continued to interpret the provision in this way and this view was not challenged.⁵

19. Sub-paragraph 2(b) of Article III was redrafted at Havana "in order to make it clear that nothing in Article 18 (of the Havana Charter - Article III of GATT) could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article 18 (III) would override the provisions of Section C of Chapter IV (Article XVI)."⁶

¹First Session of Preparatory Committee, London, E/PC/T/C.II/W.2, page 6.

²Havana Conference, E/CONF.2/C.3/SR.40, page 2. (Analytical Index, page 27.)

³Havana Reports, page 62. (Analytical Index, page 21.)

⁴Havana Reports, page 64. (Analytical Index, page 24.)

⁵BISD, 3rd Supplement, page 210.

⁶Havana Reports, page 66. (Analytical Index, page 27.)

Article XVI

20. Some border tax adjustments are regarded as subsidies for the purpose of Article XVI and some are not.

21. With regard to the second of these categories, the note to Article XVI provides that "exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy".

22. The provisions of Article XVI itself do not automatically prohibit border tax adjustments which are regarded as subsidies. In this respect the GATT provisions relating to border tax adjustments on the export side are different from those on the import side, where certain border tax adjustments are prohibited. It should be noted, of course, that under Article VI subsidized products may be subjected to countervailing duties in export markets if the conditions of that Article (relating, for instance, to material injury) are met. Moreover, industrialized contracting parties have agreed, through a Declaration, not to make use of export subsidies on non-primary products.

23. The main provisions of Article XVI are given below.

24. Paragraph 1 of Article XVI provides a notification and consultation procedure relating to both production and export subsidies.

25. Section B of Article XVI, which was added at the Review Session of 1954-55, lays down additional provisions on export subsidies.

26. Paragraph 3 establishes some limitation on the use of subsidies on the export of primary products.

27. Paragraph 4 provides that "as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing subsidies." A Declaration giving effect to the provisions of paragraph 4 has entered into force for the contracting parties which have signed it. These are: Austria, Belgium, Canada, Denmark, France, Federal Republic of Germany, Italy, Japan, Luxemburg, the Kingdom of the Netherlands, New Zealand, Norway, Rhodesia, Sweden, Switzerland, the United Kingdom and the United States. A number of instruments extending the stand-still provisions of paragraph 4 have been drawn up by the CONTRACTING PARTIES. The last of these which had been accepted by only one contracting party (Finland) expired at the end of 1967.

28. Perhaps the most important question regarding the interpretation of Article XVI as this relates to border tax adjustments has been the precise meaning of "duties or taxes borne by the like product" in the note to the Article. This question appears in the past to have been dealt with separately from the question as to precisely what border-tax adjustments are permitted under Article III, although there seems to be a necessary connexion between the two.

29. It may be mentioned in passing that the language of the note to Article XVI is somewhat different from the language of the corresponding Article of the Havana Charter, referring to "duties or taxes borne by the like product" rather than "duties or taxes imposed in respect of like products". At Havana, a proposal to insert in this phrase the words "directly or indirectly" between the words "taxes" and "imposed" was withdrawn on the understanding that the text - particularly the phrase "remission of such duties or taxes ... which have accrued" - covers the case of remission of duties or taxes imposed on raw materials and semi-manufactured products subsequently used in the production of exported manufactured goods.¹

30. Discussions at the Review Session on Article VII are relevant to the interpretation of the note to Article XVI. During these discussions it was agreed by implication that this note would permit the exemption from, or remission of "only (i) internal taxes of the kind which are levied directly on the goods exported (or directly on the materials going into the manufacture of such goods), as distinct from (ii) other taxes (income tax, etc.)".²

31. This provides some guidance, but does not say whether exemptions from, or remission of "hidden taxes" (taxes imposed not on the exported product itself, nor on materials incorporated in it, but on other factors of production such as capital goods and services) is permitted under the note, since the distinction which the Working Party appears to be making is essentially one between indirect and direct taxes.

32. Discussions in the Working Party which, in 1960, drew up the Declaration giving effect to the Provisions of Article XVI:4 are more helpful in this respect. The Working Party noted that the governments prepared to accept the Declaration agreed that, for the purpose of that Declaration, a list of practices were "generally to be considered as subsidies in the sense of Article XVI:4", although the list was not considered exhaustive nor to limit in any way the generality of the provisions of the paragraph.

¹Havana Reports, page 109. It was also understood that the term "like products" was intended to mean closely similar products in the corresponding stage of production, allowing for such differences as are necessary for export purposes.

²BISD, 3rd Supplement, page 213.

33. Point (c) on this indicative list refers to "the remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises" and point (d) to "the exemption, in respect of exported goods, of charges or taxes, other than charges in connexion with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connexion with importation or in both forms".¹ The representatives of governments which were not prepared to accept the Declaration were not able to subscribe to a precise interpretation of the term "subsidies", but had no objection to the above interpretation being accepted by the parties to the Declaration for the purposes of its application.

34. The indicative list had originally been adopted in the Organization for European Economic Co-operation² but was brought to the GATT following the establishment of the Organization for Economic Co-operation and Development with its modified structure and competence. As originally drafted in the OEEC, point (d) read: "The remission or repayment, in respect of exported goods, of indirect taxes, whether levied at one or several stages, or of charges in connexion with importation, to an amount exceeding the amount paid on the same product if sold for internal consumption." The wording of this point was changed to ensure that a country could not "consider itself entitled to pay exporters amounts corresponding to the import charges and indirect taxes levied at one or several stages on products - identical to those exported - sold on the domestic market, even when not all these charges and taxes were in fact levied on the exported products during their manufacture. In such cases, these products would, in fact, be benefitting from more aid than the sum total of the indirect fiscal charges effectively levied on them, i.e. from a State subsidy".

35. This explanation and the wording of point (d) of the indicative list seem to indicate that contracting parties which have accepted the Declaration giving effect to Article XVI:4 agree that the exemption from, or repayment of "hidden taxes" would constitute a form of export subsidy.

¹ BISD, 9th Supplement, page 186.

² OEEC Council Decision C(59)202, as amended by Decision C(60)130.

³ OEEC document C(60)105, noted in Council Decision C(60)130.

36. During the above discussions in the OEEC reference was also made to the use of average or standard rates for reimbursement of taxation on exported products. It was agreed that "these rates must be calculated very carefully for each product in respect of which a repayment is applied, so as to prevent individual export operations from benefiting from a State subsidy".¹

Other articles of the Agreement

37. Paragraph 1 of Article I prescribes unconditional most-favoured-nation treatment with respect to all matters referred to in paragraph 2 of Article III by reference to that paragraph. A note to Article I provides that this obligation shall be considered as falling within Part II of the Agreement for the purposes of the Protocol of Provisional Application. Contracting parties have therefore undertaken to apply this provision "to the fullest extent not inconsistent with existing legislation".

38. In an amendment of Article I provided for in the Protocol Amending Part I and Articles XXIX and XXX of 10 March 1955, (now abandoned), the words "and with respect to the application of internal taxes to exported goods" would have been added to paragraph 1 of the Article. The Working Party at the Review Session proposed this "because the words 'with respect to all matters referred to in paragraphs 2 and 4 of Article III' might be construed as relating only to taxes on imported goods".² This modification was intended to confirm the ruling given by the Chairman of the CONTRACTING PARTIES at the Second Session³, and to remove any uncertainty on this point.

39. Paragraph 2(a) of Article II also contains a cross-reference to paragraph 2 of Article III, providing that the inclusion of a concession in its GATT schedule shall not prevent any contracting party "from imposing at any time on the importation of any product ... a charge equivalent to an internal charge imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part".

40. At the Second Session of the Preparatory Committee at Geneva in 1947 the Legal Drafting Committee agreed on the following interpretation of the word "equivalent" in paragraph 2(a) of what is now Article II of the GATT; "the word 'equivalent' means here that if a charge is imposed on an article because a charge is imposed on part of the content of this article, then the charge should only be imposed regarding the particular content of this article; for example, if a charge is imposed on perfume because it contains alcohol, the charge to be imposed must take into consideration the value of the alcohol and

¹OEEC document C(60)105.

²BISD, 3rd Supplement, page 206.

³BISD, Volume II, page 12.

not the value of the whole".¹ Little other guidance can be found on the basis for the imposition of border tax adjustments. The interpretative note to Article VII which was added at the Review Session concerning the words "or other charges" was intended by the Working Party to "make it clearly understood that the wording does not require internal taxes (or their equivalents) which are charged on imported goods to be assessed on the same basis as that established for the purpose of charging customs duties. While some countries assess internal taxes on imported goods on the customs value or the customs value inclusive of duty, certain countries establish the value on which such internal taxes are charged on a different basis, being the same basis as is adopted for the charge of such internal taxes on domestically produced goods."²

41. Paragraph 4 of Article VI provides that "no product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes".

42. Article VII dealing with valuation for customs purposes is also indirectly connected with the question of border tax adjustments on the import side since a note to the Article makes it clear that the Article does not apply to valuation for the purpose of levying border tax adjustments.

43. Article VII also contains an indirect reference to the question of the border tax adjustments made with respect to exported products. Paragraph 3 of the Article provides that "the value for customs purposes of any imported product should not include the amount of any internal tax, applicable within the country of origin or export, from which the imported product has been exempted or has been or will be relieved by means of refund". Reference to discussion of this provision at the Review Session has been made in the section of this paper dealing with Article XVI.

¹EPCT/TAC/PV/26, page 21. (Analytical Index, page 13.)

²BISD, 3rd Supplement, page 212.