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TAX ADJUSTMENTS IN INTERNATIONAL TRADE: GATT PROVISIONS AND EEC PRACTICES

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

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AT THE REQUEST OF
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SUBCOMMITTEE ON INTERNATIONAL TRADE

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I. Introduction

Some American businessmen have expressed concern that their competitive positions, both in their home market and in markets abroad, have been disadvantaged because other countries levy heavy consumption taxes on imports and grant exemptions or rebates of such taxes on their exports. They do not consider the levying of consumption taxes on imports into the United States and exemption or rebate on export of American consumption taxes as comparable because such taxes are collected at relatively low rates, are primarily collected by state and local governments rather than the Federal Government, and are not as visible as systems in other countries. Although virtually all countries have a general consumption tax system with the inevitable levy on imports and rebate or exemption on exports, the complaints by our businessmen are primarily voiced in terms of tax adjustments on goods in Europe—specifically the tax-on-value added. Many of these businessmen also believe that the direct tax burden (corporate income tax) in Europe is much lighter than it is in the United States, and since the provisions of the General Agreement on Tariffs and Trade (GATT) permit tax adjustments on imports and exports for consumption taxes but not for income taxes, American producers are disadvantaged.

This paper explores GATT provisions on tax adjustments for imports and exports, tax adjustments on traded goods in the European Economic Community, direct and indirect taxes and tax shifting assumptions, corporate profits taxes among the major trading countries, efforts to resolve the issue, and the relationship between the remission on exports of indirect taxes and countervailing duties.

II. GATT Provisions

Application of Domestic Taxes to Imports

The GATT prohibits levying on imported products any "internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products" (Article III:2) and enjoins the use of such internal taxes in such a manner as to afford protection to domestic products.[1] The GATT allows countries to impose on imported products (at the time of importation or subsequently)

[1] A similar prohibition in Article II (see Annex for text) relates only to items contained in the schedules of concessions, bound against increase in duties or other charges. Items not so bound are not covered by Article II. Articles II and III, when read together, suggest that the drafters of the GATT may have had in mind the fact that, unlike tariffs, internal taxes are generally not the subject of traditional trade negotiations and it is therefore important to ensure that protection is achieved by tariffs rather than internal taxes.

all consumption taxes up to the amount which would have been imposed on those products had they been produced and sold domestically; the GATT prohibits imposing internal taxes on imported products in excess of internal taxes on like domestic products.

Countries have traditionally imposed domestic consumption taxes on imports. Provisions similar to those in the GATT have been used in commercial treaties and agreements for over a hundred years and were contained in bilateral trade agreements between the United States and other countries from almost the beginning of the reciprocal trade agreements program in 1934. This concept was carried over into the GATT in 1947, as proposed by the United States and other countries, reflecting the practical view that governments and businessmen would not have accepted procedures which exempted competing imported goods from consumption taxes imposed on similar domestic goods.[3]

Countries apply the GATT provisions in accordance with their own domestic consumption tax system. In countries where multistage consumption taxes are levied on all transactions, whether wholesale or retail, such as under the tax-on-value added which is imposed at the same rate on imported and domestic goods (discussed in later paragraphs), the tax is levied on imports at the border and on subsequent transactions. In countries without multistage taxes, domestic consumption taxes are usually levied on imports at the import stage, if that corresponds to the stage at which the tax is imposed domestically, or at stages subsequent to the import stage. The Canadian Federal 12 percent manufacturers sales tax and provincial retail sales taxes, the United States Federal and state excise taxes and state and local retail sales taxes in 46 states and the District of Columbia, and the British purchase tax (collected at the wholesale stage) are all imposed on imports in the same manner and rate as they are imposed on domestic products. They may be less visible to the foreign exporter if they are collected subsequent to the import stage. The GATT provisions on tax treatment of imports apply to all consumption tax systems without regard to their form.

The purpose of taxing imports—whether at the time of importation or subsequently—is to ensure that foreign products do not receive more favorable tax treatment than similar domestic products. To

[3] The records of the Committee on Finance indicate the difficulties which can arise when a country deviates from this practice. As indicated in the Report of the President's Commission on International Trade and Investment Policy (GPO, July 1971, footnote at 105), the United States attempted a limited type of border tax adjustments freeze early in the trade agreements program. The United States inserted provisions in three early bilateral agreements (with Brazil, Colombia and Cuba) negotiated under the 1934 Reciprocal Trade Agreements Act freezing internal taxes on imported products with respect to which tariff concessions had been granted. Practical problems emerged almost immediately, however, and the policy was abandoned in 1935. Subsequent agreements contained a provision permitting either party to apply to imports a tax equivalent to any internal tax imposed on products produced and sold domestically. See Extending the Reciprocal Trade Agreements Act, Hearings before the Committee on Finance, United States Senate, 75th Congress, 1st Session, at 89.

exempt imported goods from such consumption taxes or to levy such taxes at a lower rate on imported goods would discriminate against domestic products in favor of imports.

Tax adjustments on imports are permitted under GATT only for taxes on products; that is, consumption taxes. The GATT prohibits levying any tax on imported products to compensate for direct taxes, including income taxes, levied on domestic producers. The provision is apparently based on the assumption that income taxes are "paid" by the legal tax payer, whereas consumption taxes are "paid" by the consumer.

Tax Treatment of Exports—"Indirect" Taxes

The GATT permits countries to exempt exported products from domestic consumption taxes and to rebate to exporters such taxes as may have been collected on the exported product. This principle was originally suggested by the United States in September 1946 in its Suggested Charter for an International Trade Organization (ITO) of the United Nations.[3]

The GATT was negotiated the following year, based on the commercial policy provisions of the draft ITO charter, as an interim multilateral trade agreement pending the establishment of the ITO. However, the United States was concerned in 1947 about the ability of some of its agricultural producers to compete in the world market without benefit of export subsidies. Under these circumstances, the GATT export subsidy provisions were limited to a notification and consultation procedure. Since the original GATT allowed export subsidization, there was at that time no reason for the GATT to specifically note that the exemption or rebate on exports of consumption taxes could not be considered to be a subsidy.

Nevertheless there was a recognition of this principle in the antidumping and countervailing duty article of the GATT (Article VI:4). This article, unchanged since 1947, provides that any consumption tax exemption or rebate on exports shall not be the basis for imposing antidumping or countervailing duties. Our own Antidumping Act, 1921, contains a similar legislated provision. The Act specifically directs the Secretary of the Treasury, in his calculations of dumping margins (usually the difference between purchase price and home market price), to add to the purchase price "the amount of any taxes imposed in the country of exportation upon the manufacturer, producer, or seller, in respect to the manufacture, production or sale of the merchandise, which have been rebated, or which have not been collected, by reason of the exportation of the merchandise to the United States." (19 U.S.C. 162.) The Congress presumably did not consider the rebate to exporters of production or sales taxes as contributing to the margin of dumping but rather considered such rebates to be a

[3] Article 25:2. Text contained in Annex.

legitimate procedure which does not contribute to unfair price discrimination.

The GATT provisions permitting rebates of domestic consumption taxes were made more explicit in 1957, following a major Review Session of the GATT Contracting Parties, in Ad Article XVI.[4] The principle was repeated in connection with new provisions which came into effect in 1962 among the major trading countries prohibiting the granting of subsidies on nonprimary products, including a prohibition of the exemption or rebate on exports of domestic charges or taxes *other than* domestic consumption taxes (see below).

It is a universally accepted concept—incorporated in our own domestic law—that since exports are not consumed in the country of production, they should not be subject to consumption taxes in the country of production.

It should be noted that, in accordance with the GATT provisions concerning consumption tax treatment of exports, the United States exempts from or rebates on exported products all state and local sales taxes (46 states and the District of Columbia), as well as Federal and state excise taxes on those exported products. Throughout most of the post-World War II period, our Federal excise taxes were imposed on a wide range of products,[5] often at relatively high rates. Only a few products are subject to Federal excise tax today.

Even in interstate trade within the United States it is customary to exempt from state consumption taxes or rebate such taxes to manufacturers of "exports" to other states.

Tax Treatment of Exports—"Direct" Taxes

As noted earlier, the major trading countries agreed in the GATT not to grant export subsidies on nonprimary products and defined subsidies to include rebates to exporters of direct (income) taxes and social security taxes.

This provision came into effect in 1962 after the major trading countries entered into a "Declaration Giving Effect to the Provisions of Article XVI:4." This Declaration was developed in a Working Party on Subsidies whose report noted that the governments prepared to accept the Declaration "agree that, for the purpose of that declaration, these practices generally are to be considered as subsidies." Among those listed were:

"(c) The remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;

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[4] "The 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."

[5] For example, alcoholic beverages, tobacco products, motor vehicles and parts, tires and tubes, business machines, household appliances, firearms, fur articles, motor fuels, coal and coke, copper, lumber, vegetable oils and seeds, jewelry, luggage, musical instruments, radios, sporting goods, cosmetics, phonographs and phonograph records, television sets, sugar, and refrigerating equipment.

"(d) The exemption, in respect of exported goods, of charges or taxes, other than charges in connection 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 connection with importation or in both forms."

Some countries accepting the Declaration had rebated on exports part or all of their employers' social security taxes (France) and part or all of their corporate income taxes (Japan). The Declaration clarified which taxes would be eligible for adjustment on export.

III. EEC Practices

The European Economic Community (EEC) Council of Ministers decided in 1964 to harmonize by 1970 its member states' consumption tax systems along the lines of the French tax-on-value added (TVA, or "taxe sur la valeur ajoutée). The TVA, in use in France since 1954, has also been adopted by Germany, Ireland, Italy, the Netherlands, Luxembourg, Belgium, Denmark and Sweden and Norway. The United Kingdom, Austria, and Finland have announced their intention to adopt the TVA system in 1973. The TVA has or will replace in all of these countries a previous national general consumption tax system. These countries have long relied on consumption taxes as important fiscal tools and have for many years made adjustments for these taxes on imports and exports.

The TVA is a consumption or sales tax collected each time a good (whether a raw material, semiprocessed or finished product) is sold, but the tax base at each stage is only the value added by the seller. While the TVA tax base can be computed in different ways, countries currently applying the TVA have chosen the simplest alternative. Under the TVA a businessman has a gross tax liability each month of the total amount of his sales times the tax rate, say 10 percent. His invoices to his customers show this 10 percent as part of the purchase price. From this gross liability he deducts TVA he paid on his purchases. His suppliers will have itemized the TVA payments on their invoices to him. His net TVA liability is the difference between the two figures. If the tax paid *by* him on his purchases (a credit) exceeds the tax paid *to* him on his sales (a debit), he may apply to the authorities for a refund or carry over the net credit to succeeding months.

For example, when a manufacturer buys $10,000 worth of materials and sells products worth $20,000 in a particular month, the difference—$10,000—is the added value for the firm's product or products in that month. At a 10 percent TVA rate, his net TVA tax liability is $1,000 whether or not the firm made a profit in that month. This process is repeated throughout the distribution chain until the product is sold at retail to the final consumer. Since the individual consumer cannot deduct the TVA, the process ends there.

The net tax base (and also the revenue) resulting from all these transactions is the equivalent of that under a retail sales tax at the same ad valorem tax rate. It differs from a retail sales tax principally in that the government gets part of the revenue ultimately paid by the consumer at the earlier stages of production and distribution and therefore it reduces the possibility of tax evasion at the retail stage. Setting aside for the moment the complex question of tax shifting, the TVA does not enter into the cost structure until the final sale to the individual consumer. Until then it is a tax item which accompanies each sale and is kept separate both in the sales invoices and in the firm's books.

Imports enter the TVA cycle at the border. The tax rate is the same as the rate on the similar domestic product, and is payable at importation, unlike retail sales taxes where most imports are not taxed until sold to an individual consumer.[6] The importer treats the TVA paid on imports as any other purchase he makes for his firm. The tax he has paid on his imports is included in his tax credits along with the tax he pays on his domestic purchases. If he sells the imported product, he collects TVA from his customer and remits to the tax authorities the difference between tax on his purchases and tax on his sales at the end of the month. If he uses the imported product, for example a machine tool, in his business, the tax process for the machine tool is completed at the end of the month when the firm treats the TVA paid at time of importation as a tax credit against the debits of the taxes it collects on its sales.

Provided the tax authorities possess adequate means of control to prevent the tax-free sale of an import to an individual consumer, it is unnecessary under the TVA to make tax adjustments at the border on imports. Collection after the import stage would have the advantage of reducing the number of tax collectors at the border but the disadvantage of facilitating tax evasion. Sweden gave serious consideration to exempting products from TVA at the time of importation, but ultimately decided for tax control reasons to make tax adjustments at the time of importation.

Exports under a TVA system are exempt from tax, as are exports under retail sales tax systems. Therefore, there is no TVA tax refund on exports. As for the tax the exporter paid to his domestic suppliers for the materials used to produce the exported product, he treats them

[6] Some have argued that the TVA collected at the time of importation should be levied on a f.o.b. basis, not, as at present, on the c.i.f. duty-paid value. In a TVA system if the tax collected at the border is lower because the valuation base is lower, the importer will simply have a smaller tax credit with which to offset his tax debit. The full c.i.f. duty-paid value of the product—plus the importer's markup—is the valuation base for the next transaction, that is, the sale by the importer to his customer. U.S. consumption taxes are also levied on imports on a c.i.f. duty-paid value.

in the same manner as all of the TVA he pays to his suppliers; that is, as a credit for his end-of-the-month accounting to the tax authorities; he omits from the total sales on which tax is due the value of his exports since he has not collected the TVA from his foreign customer. There is thus no inherent incentive in the TVA system for him to export his product rather than sell it in the domestic market. (The possibility of some backward tax shifting—and thus some possible incentive—is discussed below.) In France, most exporters have elected to operate under a system whereby they may make tax exempt purchases of goods and materials for export production up to the value of the exports in the previous year. This type of tax treatment of exports is materially similar to that of state retail sales tax systems in the United States.

IV. Direct and Indirect Taxes: Tax Shifting Assumptions and Corporate Profits Taxes

There is no record of any discussion by the drafters of the GATT of the economic assumptions underlying the differing treatment accorded to direct and indirect taxes on exports and imports. However, the GATT provisions were written as if increases in indirect taxes were fully reflected in the price of goods (i.e., fully shifted forward) while increases in direct taxes were fully absorbed by producers (or shifted back to factors of production), having no effect on price. If these assumptions are correct, the GATT provisions would equalize the amount of indirect taxes levied on competing domestic and imported goods; would avoid granting an incentive to exports by the rebate of (or credit for) taxes not reflected in prices, and would avoid distortions arising from differing direct tax systems. Under such circumstances, the GATT provisions would be trade neutral.

Few people—even European tax authorities—would argue such absolutes. It is generally recognized that the degree of tax shifting for both consumption and profits or other direct taxes depends primarily on the demand for the product, actions of the monetary authorities, the stage of the business cycle and the degree of competition among producers of the goods. Some economists also hold the view that increases in selective consumption taxes are much more easily shifted forward than increases in general consumption taxes. To the extent consumption taxes are not fully shifted forward, and direct taxes are partially shifted forward, countries may derive some trade benefit from the GATT provisions on border taxes, but it is not known how large or how lasting such benefits may be. Relative prices among countries, on which trade advantages largely depend, are subject to a mix of forces and undergo constant change. These advantages, if any, can be erased by a currency appreciation as well as differential rates of inflation, productivity changes, and even shifts in tastes. After a time, the first effects of the change may be offset to an indeterminate degree by these other factors. In short, it is impossible to measure the extent of the shifting and its effect on trade in a way which can be used for comparative country analysis. Moreover, there seems no practical way to settle the tax shifting question and quantify effects which the GATT provisions may have on a country's trading position.

It is generally recognized that trade effects can result under certain circumstances when a country changes its tax adjustments on traded goods, as follows:

1. *Equal increases in the level of domestic consumption taxes and adjustments on traded goods.*—This change can affect trade to the extent that the tax increase is not fully shifted forward to the consumer, although the treatment of traded goods assumes full forward shifting.

2. *An increase in the amount of adjustment at the border (to make up for an "insufficient" adjustment) with no change in the domestic consumption tax.*—This type of change can affect trade favorably from the point of view of the country making the change. Such changes discourage imports and promote exports.

3. *A change in the mix of taxes whereby a nonadjustable direct tax is replaced by an adjustable indirect tax.*—An example would be a reduction of a payroll tax or corporate income tax matched by an increase in a consumption tax, either in the form of a higher rate or more comprehensive coverage under a TVA or retail sales tax. This change could have an effect on trade similar to an exchange rate adjustment on trade account.[7]

4. *A change from one type of consumption tax system to another.*—Depending on the extent of undercompensation or overcompensation under the old and new systems, this type of change can also discourage imports and promote exports. A prime example of this type of change is the shift in Germany from a cascade-type gross turnover tax to the tax-on-value added in 1968. The undercompensation in tax adjustments for imports and exports was removed. According to an OECD study, the change raised the average rebate on exports 0.6 percentage points and the average compensating tax on imports 2.4 percentage points while the overall tax "burden" on German goods remained more or less unchanged. The change was similar to a small devaluation of the Deutsche Mark on trade account. This can also go in an opposite direction if the country had been overcompensating, as in the case of Italy.

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[7] Some observers have noted another possible theoretical advantage from reducing or eliminating a direct tax such as the corporate income tax and replacing it with a consumption tax such as the tax-on-value added. It has been noted that the TVA taxes the factors of production at the same rate, unlike the corporate income tax which is a tax on the return to capital only. To the extent that the TVA would encourage capital investment, productivity would be increased over time and a country's competitive position in world markets could be improved.

Corporate Income Taxes in Europe and the United States

It is sometimes said that the United States has high corporate income taxes and European countries have high consumption taxes, and that because the GATT rules permit the rebate of consumption taxes but not of corporate income taxes, the United States is disadvantaged by the GATT rules.

In fact, both have high income taxes, especially in the business sector, and in addition the European countries have higher consumption taxes and higher employers' social security taxes than the United States does.

The corporate income tax in most European countries accounts for a smaller proportion of gross national product (GNP) than it does in the United States—between 1.5 and 2.5 percent of GNP (at market prices) in 1966 in France, Germany, Italy, the Netherlands, and Sweden, compared to 4.6 percent in the United States (and 5.1 percent in the United Kingdom). The difference is largely a reflection of the fact that the corporate sector is relatively smaller in those countries. Corporate *profits* in those countries, as a percentage of GNP, also account for about half those of the United States (see table, p. 10). This is so because a larger portion of European national output arises in sectors of the economy that are largely unincorporated, and because of the differing forms of business structures in Europe. For example, only about 2.4 percent of the more than 2 million enterprises in Germany in 1967 were organized in some corporate form, compared to 18 percent in the United States.

Both statutory and effective corporate tax rates appear to be generally at similar levels for the United States and the European countries, except Belgium which had a somewhat lower statutory rate. The equivalent data for Japan suggest a corporate tax burden equal to or higher than that in the United States.

In addition, employers' contributions to social security—also not considered proper for rebate on exports (or imposition on imports) for countries accepting this GATT provision—are significantly higher in Europe than in the United States. In 1967, such taxes as a percentage of GNP (market prices) were over 10 percent in France, about 6 percent in Belgium, 5.2 percent in Germany, 2 percent in Japan, and 1.8 percent in the United States. The low figure for the United States is partly a reflection of the private pension plans to which our companies contribute.

From the above data, it is impossible to estimate what the effects on a country's trading position would be if GATT provisions were altered to permit the rebate of direct taxes. The ultimate result on a country's trading position would depend on such factors as the size of the rebate, the state of demand for the product, the stage of the business cycle at home and abroad, and the degree of competition among domestic and foreign producers of the good. In addition, competition in trade occurs not at the level of national economies but at the level of individual business firms and specific products. Therefore, the data also do not indicate whether a change in the GATT rules to permit rebate of profits tax to a specific American firm in its exports of a specific product would help or hurt that firm in competition with foreign firms receiving similar rebates. Rebates for direct taxes would necessarily be imprecise, thus affording opportunities for undetected or for competitive overcompensation.

A broader analysis of the equity of the GATT provisions requires not only an examination of relative corporate tax burdens, but a study of the nature and level of total taxation and government expenditures. A large part of tax receipts (some of which are levied on imports) finance government services which have the effect of conferring benefits on domestic producers, which may lower production costs.

CORPORATE PROFITS AND DIRECT CORPORATE TAXES AS A PERCENT OF GNP, CORPORATE TAXES AS A PERCENT OF CORPORATE PROFITS, AND STATUTORY CORPORATE INCOME TAX RATES IN THE UNITED STATES AND SELECTED EUROPEAN COUNTRIES, 1966

	Belgium	France	Germany	Italy	Netherlands	Sweden	United Kingdom	United States
Direct taxes on corporations as a percent of GNP	1.9	1.9	[1] 1.6	1.8	2.6	2.1	[1] 5.1	[1] 4.6
Corporate profits as a percent of GNP	5.5	4.6	3.6	4.6	([2])	4.8	11.4	10.5
Direct corporate taxes as a percent of corporate profits	35.2	42.5	[1] 44.2	39.1	([2])	43.6	[1] 45.2	[1] 43.4
National statutory corporate income tax rates (percent)	30.0	50.0	[3] 51.0–15.0	[4] [5] 29.9–38.8	[6] 43–46	[7] 40	[8] 40	[9] 22–48

[1] Based on corporate income taxes only.

[2] Not available.

[3] The basic rate of 51 percent is applicable to undistributed corporate profits; the rate is reduced to 15 percent on distributions. As part of the firms profits must be retained to pay the tax on the distributed portion, and is thereby subject to the 51-percent rate, the minimum effective rate is actually about 26 percent. There are also local income taxes.

[4] This represents the range of rates applicable to income from the employment of capital and labor (business activities). There are also local surcharges which range between an average of 11.93 and 13.80 percent so that the total tax on business activities ranges between 29.93 and 38.80 percent.

[5] In addition to the tax on business activities, there is a tax on corporate profits. A 15-percent rate is applicable to income in excess of 6 percent of net worth. This tax is increased by local surcharges which raise the effective to about 18 percent.

[6] On profits not exceeding f.50,000 the rate if 43 percent plus 15 percent of the excess over f.40,000. The rate on profits in excess of f.50,000 is 46 percent.

[7] In addition to the national corporate tax, there is a local tax levied in communities where the corporation has a permanent establishment. The local rate, which varies from year to year and from community to community depending on local needs, averages about 20 percent. As the local rate is deducted from income subject to the national tax the overall effective rate of national and local corporate income taxes is about 52 percent.

[8] The 1965 Finance Act which became applicable in April 1966 changed the method of taxing corporate profits and reduced the overall corporate rate from 55 to 40 percent. Part of the corporate income earned in calendar 1966 was subject to the higher rate.

[9] A normal tax of 22 percent is levied on all taxable income and a surtax of 26 percent on taxable income above $25,000.

Sources: The computed percentages were largely derived from data in Yearbook of National Accounts Statistics, 1967 Statistical Office of the United Nations, New York, 1968. The Belgium, French, German, Italian and Dutch statutory rates were obtained from: Corporate Taxation in the Common Market, Guides to European Taxation, Vol. II, International Bureau of Fiscal Documentation, Amsterdam, The Netherlands, 1968.

V. Efforts to Resolve the Issue

While there are deficiencies in the GATT provisions on border tax adjustments, neither the United States nor any other country has been able to come forward with any practical proposals for amendments. In an effort to direct attention to this issue, the United States initiated a comprehensive study in the OECD in 1968 and brought up the subject for extensive discussion in the GATT during 1968–70.

Considerable time and effort was devoted to the study of the issue within the U.S. Government in consultation with the private sector during the OECD and GATT discussions. All attempts to develop formal proposals for consideration during those discussions failed for three reasons:

1. Any limitation on border tax adjustments would affect the United States as well as others. Although the effect of any limitation on the United States would be less significant than on many other countries, implementation of any limitation would be much more difficult in the United States because most of the U.S. taxes which would be affected are levied at the state and local level and at the retail stage where no adjustment is made at the border.

2. Any effort to obtain greater latitude for the United States, for example, allowing an adjustment for corporate income taxes, could be emulated by others and any advantage gained would be offset.

3. Any proposal which would be self-serving for the United States at the expense of others would not be acceptable and hence would not have any support. The rationale of other countries in this respect has been made quite clear. They do not consider border tax adjustments unfair and state they would have no objections to the United States adopting a TVA and a border tax adjustment system similar to theirs.

The one accomplishment arising from the long consideration of this subject was the establishment within the GATT of a consultation procedure for changes in border tax adjustments.

VI. Rebates of Indirect Taxes and the Countervailing Duty Statute

Under administrative precedents dating back to 1897, the Treasury Department has generally not construed the rebate, remission or exemption on exports of ordinary indirect taxes (consumption taxes on goods) to be a "bounty or grant" within the meaning of our countervailing duty statute (Section 303, Tariff Act of 1930; 19 U.S.C.A. 1303). These precedents have been applied as a general rule with regard to all consumption taxes on goods. The precedents are based on the principle that, since exports are not consumed in the country of production, they should not be subject to consumption taxes in that country. The theory has been that the application of countervailing duties to the rebate of consumption taxes would have the effect of double taxation of the product, since the United States would not only impose its own indirect taxes, such as Federal and state excise taxes and state and local sales taxes, but would also collect, through the use of the countervailing duty, the indirect tax imposed by the exporting country on domestically consumed goods.

The Treasury Department has not applied these precedents to tax "rebates" in excess of taxes collected on the exported product. If, for example, the foreign exporter has paid $1 in excise taxes on a product he exports to the United States but receives a rebate of $1.20 on exportation, under long-established administrative precedents of the Treasury Department the imported merchandise would be subject to a countervailing duty of $0.20.

A new issue arose in 1967 in the Italian transmission tower case. Up to that time Treasury precedents were based on the assumption that indirect taxes rebated on export had been imposed on the product and that the tax burden on the Department investigation of Italian transmission tower exports revealed that this product benefited from a number of rebates (under Italian Law 639) of indirect taxes which had not been imposed on the product being exported or its components but rather were taxes on general overhead purchases, unrelated to the specific products, such as mortgage taxes, advertising and publicity taxes, and Government license fees. To the extent that such taxes were rebated, the Treasury Department found that they constituted a "bounty or grant" under the countervailing duty statute (T.D. 67-102). The Customs Court decision of September 13, 1971, (*American Express Co.* v. *United States*, *C.D. 4266*) upheld the Treasury Department finding. The Court of Customs and Patent Appeals has affirmed the Customs Court's finding. The Treasury Department has subsequently imposed countervailing duties on a range of Italian products benefiting from Law 639 rebates.

Judicial Interpretations

Considerable confusion has arisen in the countervailing duty field over the interpretation of two early Supreme Court opinions, in which there are *dicta* referring to the term "bounty or grant" as applying to *all* tax rebates, including rebates of indirect taxes. [*Downs* v. *United States*, 113 F. 144 (1902), aff'd 187 U.S. 496 (1903); *Nicholas & Co.* v. *United States*, 7 Ct. Cust. Appls. 97 (1916), aff'd 249 U.S. 34 (1919).] However, the *holdings* of the Supreme Court in these two decisions, as distinguished from the *dicta*, were that overrebates constitute a "bounty or grant" to the extent of the overrebate. As implied from the earlier discussion, the Treasury Department for more than half a century in its administrative decisions has applied the *Downs* and *Nicholas* opinions in accordance with the holdings rather than the dicta. Recent opinions of the Court of Customs and Patent Appeals in *Hammond Lead Products, Inc.* v. *United States*, 63 Cust. Ct. 316, C.D. 3915 (1969); rev'd 58 C.C.P.A. 129 C.A.D. 1017 (1971) and of the Customs Court in *American Express Co.* v. *United States*, C.D. 4266 (decided September 13, 1971), *in dicta*, have restated the *dicta* of the *Downs* and *Nicholas* opinions. It cannot be predicted how the courts will finally resolve this issue.

Conclusions

The applicability of a statute such as the countervailing duty law, basically unchanged since the early part of this century, to all consumption taxes, including the very complex tax-on-value added, requires a careful analysis. Moreover, the situation may be further complicated by the decisions which will ultimately be rendered by the courts in the countervailing duty cases presently being litigated on appeal.

The Treasury Department is examining the countervailing duty law from the standpoint of its overall impact on the present world trade situation. This study is focusing on the problems discussed earlier, in addition to an overall review of the administration of this law.

ANNEX

Extract From Suggested Charter for UN ITO 25:2

"Except as provided in paragraph 3 of this Article, no Member shall grant, directly or indirectly, any subsidy on the exportation of any product, or establish or maintain any other system which 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, due allowance being made for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability. The preceding sentence shall not be construed to prevent any Member from exempting exported products from duties or taxes imposed in respect of like products when consumed domestically or from remitting such duties or taxes which have accrued."

Extracts From the General Agreement on Tariffs and Trade

ARTICLE II 2(A)

"a charge equivalent to an internal tax 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;"

ARTICLE III

"1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

"2. 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.

"3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax."

ARTICLE VI

"4. 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."

ARTICLE XVI

Subsidies

Section A—SUBSIDIES IN GENERAL.—

"1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory. It shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

Section B—ADDITIONAL PROVISIONS ON EXPORT SUBSIDIES.—

"2. The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance to their normal commercial interests, and may hinder the achievement of the objectives of this Agreement.

"3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affected or may be affecting such trade in the product.

"4. Further, 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 products 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.

"5. The CONTRACTING PARTIES shall review the operation of the provisions of this Article from time to time with a view to examining its effectiveness, in the light of actual experience, in promoting the objectives of this Agreement and avoiding subsidization seriously prejudicial to the trade or interests of contracting parties."

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