

**The 5th IMF-Japan High-Level Tax Conference for Asian Countries
April 21, 2014**



“IMPLICATIONS OF WTO RULES FOR TAX POLICY”

by

Michael Daly

External Expert, Fiscal Affairs Department, IMF

TWO VIEWS OF THE WTO



'LEVEL PLAYING FIELD'



ORGANIZATION OF PRESENTATION

PART I: WTO'S UNDERLYING PRINCIPLES

PART II: TAX RULES IN WTO AGREEMENTS

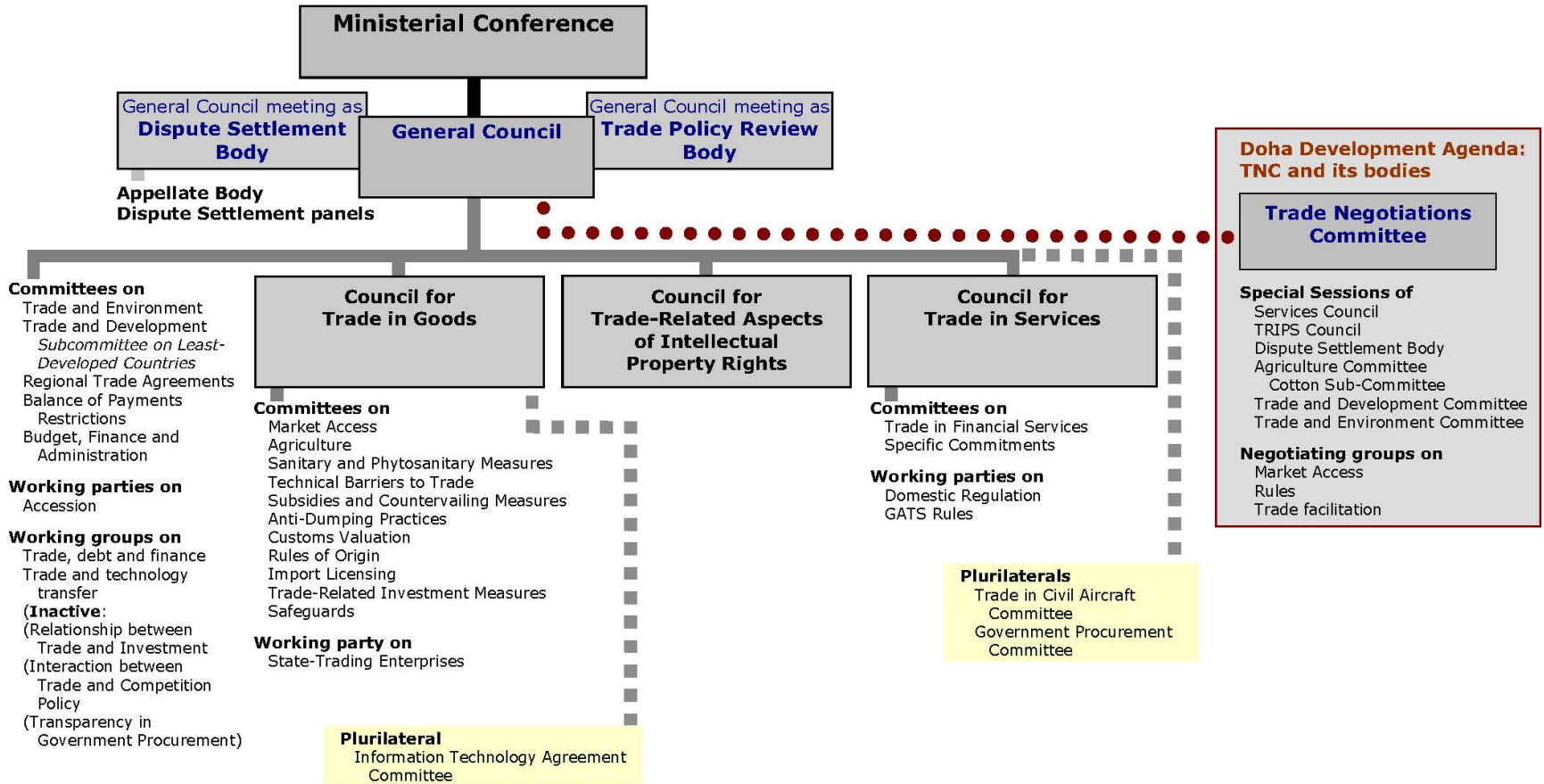
PART III: TAX DISPUTES AT THE WTO

[PART IV: TAX POLICY GUIDELINES]

PART V: CONCLUDING REMARKS

WTO structure

All WTO members may participate in all councils, committees, etc, except Appellate Body, Dispute Settlement panels, and plurilateral committees.



Key

- Reporting to General Council (or a subsidiary)
- Reporting to Dispute Settlement Body
- ■ ■ ■ ■ Plurilateral committees inform the General Council or Goods Council of their activities, although these agreements are not signed by all WTO members
- ● ● ● ● Trade Negotiations Committee reports to General Council

The General Council also meets as the Trade Policy Review Body and Dispute Settlement Body

PART I:

WTO'S UNDERLYING PRINCIPLES

2. BASIC PRINCIPLES UNDERLYING WTO RULES

- Multilateralism (GATT Art. XXIV exceptions);
- Non-discrimination (MFN and NT);
- Predictability – bindings (Dispute Settlement);
- Transparency (GATT Art. X, GATS Art. III, TPRM).

3. MFN TREATMENT

GATT, 1994, ARTICLE I

- No discrimination between trading partners' goods;
- Concessions accorded to one Member's goods should be granted to those of all countries;
- Ensures import & export neutrality.

GATS ARTICLE II

4. NATIONAL TREATMENT (NT)

GATT ARTICLE III

- Imports must be treated the same as or no less favorably than domestically-produced goods.

GATS ARTICLE XVII

5. PREDICTABILITY & STABILITY

- “Bindings” object of negotiations
- “Bound” MFN rates establish ceiling on applied MFN tariff rates
- Rules-based system

6. TRANSPARENCY

- Notifications;
- TPRM;
- Monitoring; and
- Dispute settlement -- clarification of rules.

7. DISPUTE SETTLEMENT

- GATT/WTO Agreements now ensure binding adjudication
- Rulings by DSB binding on all parties to disputes
- [Disputes over tax treaties resolved by mutual agreement between "competent authorities"]

PART II:

TAX RULES IN WTO AGREEMENTS

8. OBJECTIVES OF WTO TAX RULES

- Reduce reliance on tariffs;
- More tax neutrality with respect to trade;
- Reduce scope for taxation as policy instrument;
- Means of escape from terms-of-trade dilemma.

9. SCOPE OF WTO TAX RULES

- WTO rules reflect reality that internal taxes can have similar economic effects to border taxes (tariffs) & other trade distortions (e.g., subsidies);
- Regulator of direct & indirect taxes;
- Dubious distinction between direct & indirect taxes;
- “Carve-out” for tax treaties.

10. TAXATION IN WTO AGREEMENTS

- GATT 1994
- Agreement on Subsidies (ASCM)
- Agreement on Agriculture (AA)
- TRIMs Agreement
- GATS
- TPRM

11. GATT 1994 ARTICLES

- I (MFN);
- III (NT) – Internal taxes cannot be substitutes for tariffs;
- **[N.B. FSC panel ruled that III also applies to direct taxes.]**
- XVI (subsidies) – whereas rebates of indirect taxes on exports not subsidies, rebates of direct taxes are.

13. GATT ARTICLE III

(NATIONAL TREATMENT ON INTERNAL TAXATION)

"(T)he 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, should not be applied to imported or domestic products so as to afford protection to domestic production."

In other words, imported goods must be treated the same as, or no less favourably than, domestically-produced goods so as to ensure that discriminatory internal taxes are not used as substitutes for tariffs.

14. FSC/ETI PANEL RULING ON SCOPE OF GATT ARTICLE III

Direct as well as indirect taxes subject to Article III (NT).

"(I)n this connection, we can see no specification or limitation in the text of Article III:4 concerning the type of advantage linked to the measure under examination under Article III:4 of the GATT 1994. Thus, nothing in the plain language of the provision specifically excludes requirements conditioning access to income tax measures from the scope of application of Article III".

"Article III:4 of the GATT 1994 applies to measures conditioning access to income tax advantages in respect of certain products."

15. GATT ARTICLE XVI:4 (SUBSIDIES)

“...contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product ...”

16. 1960 DRAFT DECLARATION GIVING EFFECT TO GATT ARTICLE XVI:4 (SUBSIDIES)

Whereas the "remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises" are considered as export subsidies, tariff or consumption tax refunds on exports are not.

(Similar language is found in ASCM Annex I (e)).

"(T)he exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed a subsidy."

[Ad Article XVI]

17. SUBSIDIES AGREEMENT (ASCM)

- Definition of subsidy includes tax revenue forgone;
- Prohibited subsidies (those contingent on export performance or use of domestic products);
- “Actionable subsidies”;
- Subsidies are actionable insofar as they are “specific” and have “adverse effects”;
- Annex VII lists countries that may use export subsidies.

18. ILLUSTRATIVE EXPORT SUBSIDIES

- Item (e): measures involving "full or partial exemption, remission, or deferral specifically related to exports, of direct taxes".

Footnote 59: item (e) is not intended to prevent Members from using measures to avoid double taxation of foreign-source income.

- item (f) "special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged".
- Items (g) & (h): "exemption or remission, in respect of the ... exported products, of indirect taxes in excess of those in respect of ... like products when sold for domestic consumption."
- Item (i): "remission or drawback if import charges in excess of those levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste)".

19. AGREEMENT ON AGRICULTURE (AA)

- “Budgetary outlays” include tax revenue forgone;
- “Green box” measures (that do not increase production or depress prices) are acceptable, but “amber box” measures are not;
- Commitment to cut aggregate levels of support.

20. TRADE-RELATED INVESTMENT MEASURES (TRIMS)

- Applies GATT Article III (NT) obligation to investment;
- Includes measures “with which compliance is necessary to obtain an advantage”;
- Prohibits 4 kinds of investment measures (e.g., LCRs);
- Does not preclude attachment of export performance requirements to tax relief (which might contravene ASCM).

21. GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

- MFN treatment obligation (Article II)
- Tax measures that depart from the MFN treatment are permitted if they are the result of a bilateral tax treaties.
- Insofar as Members have made NT (Article XVII) commitments (in schedules), these apply to tax measures;
- Exception: measures to ensure "the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members";
- Hence, direct tax measures would generally be covered by Articles II & XVII;

22. GATS: MODES OF SUPPLY

- (i) Movement of services to country of consumption / importation;
- (ii) Movement of consumers to country of exportation;
- (iii) Commercial presence (FDI) in the importing country; and
- (iv) Presence of natural persons.

23. TRADE POLICY REVIEW MECHANISM

- Not intended to enforce obligations;
- Main purpose is to enhance transparency;
- Transparency entails four key elements;
- Transparency enables policy evaluation; and
- Covers measures not necessarily subject to WTO rules.

24. MAIN ASPECTS OF TRANSPARENCY

Tax policy transparency entails four key elements:

- (i) **Nature** of policies & measures (what?);
- (ii) Their **rationale** or objectives (why?);
- (iii) **Costs** – tax revenues forgone/tax expenditures (how much?);
- (iv) **Economic evaluation** of effectiveness in achieving objectives (cost-benefit analysis);

Policy implications (more cost-effective alternatives?)

25. FREE TRADE ZONES (FTZs)

- Tax measures in FTZs include relief from tariffs, indirect taxes & direct taxes (subject to conditions, such as export performance or local content rules?)
- WTO rules do not deal with FTZs *per se*.
- Nonetheless, FTZs are subject to WTO rules.
- Each of the above three forms of tax relief could be considered a “subsidy” under the ASCM.
- FTZs have not been challenged at the WTO until recently.

PART III. TAX DISPUTES AT THE WTO



26. KEY PROCEDURAL CHANGE

- Previously, adoption of rulings required consensus (so that a single objection could block a ruling).
- Now, automatic adoption of a ruling unless consensus to reject it.
- Thus, a Member losing a case can no longer block adoption of a ruling.

27. DISPUTE SETTLEMENT PROCEDURES

- Consultations, mediation, etc. (<60 days)
- Panel established (<45 days)
- Final panel report to parties (6 months)
- Final panel report to members (3 weeks)
- DSB adopts report (if no appeal) (<60 days)
- Appeals report (60-90 days)
- DSB adopts report by AB (<30 days)

28. WHAT NEXT ?

- “Prompt compliance with recommendations or rulings” of DSB
- Otherwise mutually-acceptable compensation
- Otherwise limited trade sanctions authorized by DSB (“suspend concessions or obligations”)
- In principle, sanctions should be imposed in same sector

29. PANELS

- Panelists usually chosen (from a permanent list) in consultation with the members in dispute.
- Panel consists of 3 (possibly 5) experts
- Panelists serve in their individual capacities
- Panel's report is passed to DSB
- Each appeal is heard by 3 of 7-member AB.

30. SELECTED TAX DISPUTES

- Japan – excise tax on alcoholic beverages
- Thailand – V.A.T. on cigarettes
- China – export taxes on raw materials
- U.S. – income tax exemption for “FSC”
- U.S. – reduced B&O tax rate for aircraft

31. JAPAN – EXCISE TAX

- Higher excise tax on vodka than *shochu* violated NT under GATT Art. III:2.
- *Shochu*, vodka & other liqueurs were "directly competitive or substitutable".
- Excess amount of tax must be more than *de minimis*.

32. THAILAND – V.A.T.

- VAT (*inter alia*) on imported cigarettes.
- AB upheld Panel's finding that taxing imported cigarettes more than domestic cigarettes violated NT under GATT Art. III:2, second sentence.
- Failure to justify additional administrative measures under GATT Art. XX(d).

33. CHINA – EXPORT TAXES

- Taxes (& other restraints) on China's exports of various raw materials.
- AB upheld Panel's finding that these taxes were inconsistent with the commitments made in Paragraph 11.3 of its Protocol of Accession.
- AB upheld Panel's finding that there is no basis in this Protocol to allow the application of the general exceptions in GATT Art. XX.

34. U.S. – FSC INCOME TAX EXEMPTION

- U.S. tax exemptions for Foreign Sales Corporations in respect of export-related foreign source income (applicable to all goods).
- AB upheld Panel’s finding that FSC is forgone revenue and therefore a subsidy (ASCM Art. 1.1).
- AB upheld Panel’s finding that FSC is a prohibited export subsidy under ASCM Art. 3.1(a) because FSC exemptions were (i) based on income derived from “export property” and (ii) constituted full or partial exemption of direct taxes under item (e) of Annex I. (AB & Panel rejected U.S. argument that footnote 59 to item (e) exempted the FSC.)
- AB found that FSC was inconsistent with its export subsidy commitments and therefore violated AA Art.10.1.

AIRBUS v BOEING



35. U.S. – REDUCED B&O TAX RATE

- Reduced rate (0.2904%) levied on manufacturers of commercial aircraft & components (versus 0.484% to manufacturing generally) under Washington State’s Business & Occupation tax on “gross receipts.”
- AB upheld Panel’s finding that this tax rate reduction constitutes forgone revenue (ASCM Art. 1.1).
- AB upheld Panel’s finding that this tax rate reduction is a subsidy that is specific (ASCM Art. 2.1).
- “Serious prejudice” in form of significant lost sales.

PART IV:

TAX POLICY GUIDELINES

36. TARIFFS & QUASI-TARIFFS

- Applied rates cannot exceed bound MFN tariff rates.
- Internal indirect taxes must not be more burdensome for imports than “like” domestically-produced goods.
- Withholding of tax on imports (as advance payment of income tax or VAT), in order to combat tax evasion, might contravene WTO rules.

37. EXPORT TAXES

- IF, for some reason, Members wish to restrain exports, taxes are the optimal measure.
- Although export taxes are usually not bound, they must be levied in accordance with the MFN principle and be transparent.

38. BORDER TAX ADJUSTMENT (BTA)

- BTA is allowed for tariffs & indirect internal taxes in respect of inputs used to produce exports, provided rebates do not exceed tariffs & indirect taxes paid (items (i), (g) & (h)).
- Excess rebates constitute export subsidies.
- Less than full rebates constitute export taxes.
- BTA is not allowed for tariffs & other indirect taxes levied on capital goods (as they are not consumed in the production of the exported product).
- Direct tax must not be rebated on exports (item (e)).

39. SUBSIDIES

According to the ASCM, tax incentives should:

- not be contingent upon export performance or local content (as these are prohibited)
- not be “specific” and have “adverse effects” on trading partners (as these are “actionable” and subject to countervailing measures).

40. TRIMs

Tax incentives should not be contingent upon:

- local content requirements;
- importation subject to export performance;
- foreign exchange balancing requirements; and
- domestic sales requirements (and thus restrictions on exports).

PART V:

CONCLUDING REMARKS

41. CONCLUDING REMARKS

- Increased WTO scrutiny of Members' tax policies;
- WTO rules important factor shaping Members' tax policies;
- Major DSB tax rulings following Members' complaints;
- Members' complaints to the DSB are the tip of the iceberg;
- More tax challenges at the WTO can be expected;
- WTO rules have curtailed use of tax measures as policy tools;
- Still much scope for Members to inflict damage on their trading partners and themselves.