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.

The terms of reference and the list of members of the Working Party are reproduced in L/3002/Rev.1.

2. At the twenty-fifth session of the CONTRACTING PARTIES, the Chairman of the Working Party made an interim report (L/3138), on the first five meetings, during which the Working Party conducted a preliminary examination of the provisions of the General Agreement relevant to border tax adjustments and started its study on the practices of contracting parties in relation to such adjustments.

3. In taking note of the report the CONTRACTING PARTIES underlined the importance of the task of the Working Party and recognized that the problems under its examination deserved high priority.
4. Since the twenty-fifth session the Working Party has held four constructive meetings under the chairmanship of Mr. I. Gabrielsson (Sweden). Finland and Norway have become members of the Working Party and several contracting parties are now taking active part in the work as observers. Comprehensive notes by the secretariat on these meetings have been circulated in documents L/3183 and L/3272.

Point 1(a): The provisions of the General Agreement relevant to border tax adjustments

5. The examination of the provisions of the General Agreement relevant to border 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. This paper, and a summary of the main points discussed are contained in a note by the secretariat (L/3039). The Working Party agreed that the main articles it should consider were, on the import side, Articles II and III and, on the export side, Article XVI. Other relevant articles included Articles I, VI and VII.

6. During the discussion, it was pointed out that the main provisions of the GATT represented only a codification of existing practices. Some countries thought the present GATT rules favoured countries with indirect tax structures and discriminated against countries which rely predominantly on direct taxes which are not adjustable at the border. They said that the present rules were ambiguous and that they had created conditions under which the practices of countries differed from each other. Furthermore, they doubted whether the current GATT rules and border tax practices secured trade neutrality.

7. Other 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 border tax adjustments was dealt with in different articles. They added that the philosophy behind these provisions was the assurance 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 border tax adjustment appropriately and that no motive could be found to change them. 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.

8. It was agreed that it was essential to continue the discussion on the relevant provisions of the General Agreement in conjunction with the examination of the practices of border tax adjustments and the possible effects of such adjustments on international trade before final conclusions could be made.

Point 1(b): The practices of contracting parties in relation to border tax adjustments

9. The Working Party has 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. Members and observers explained their tax systems individually and replied to many detailed questions which were raised. The Working Party spent much time in collecting and classifying the extensive information received.

10. The Working Party agreed that a consolidated document be drawn up by the secretariat listing all information on and discussion of the existing practices of border tax adjustments. The consolidated document consisting approximately of 200 pages, inter alia provides a precise description of how adjustments at the border in various countries are made, whether these adjustments are made at the border or at a later stage, at the manufacturing, wholesale or retail level, and also supplies information on the extent to which tax systems have been changed in various countries.
11. It was felt that this part of the work of the Working Party had been most useful and constituted the fundamental basis for its further examination of the relevant rules of the GATT and the possible effects of border tax adjustments on international trade. It was therefore agreed that the Working Party should return to this part of its terms of reference any time it should be considered necessary. It was suggested that GATT should provide a forum of a more permanent character for the exchange of information on changes in, or the introduction of, new indirect tax systems.

Point 1(c): The possible effects of border tax adjustments on international trade

12. In examining the possible effects of border tax adjustments on international trade, a profound study has been made of the nature of indirect and direct taxes and their eligibility for adjustment at the border. The question was raised why only indirect taxes should be eligible for adjustment at the border, since it had not been proved that a clear distinction between indirect and direct could be made.

13. During this discussion the Working Party was highly concerned with the problem of structural differences in taxation and the question as to what extent indirect taxes and direct taxes were shifted forward into commodity prices. The Working Party recognized that this discussion was full of difficulty and of a very complex nature. It seemed that definitive conclusions could not be reached. Some members felt that this part of the Working Party's examination made it clear that here further discussion was needed and solutions should be found. Others, however, were of the opinion that the discussion rather tended to confirm that the current practices of border tax adjustments were fully consistent with the objectives of trade neutrality.

14. 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 border 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 and Sweden, which had moved from a wholesale, cascade or single-stage tax system, to a system of tax on value added (TVA). Other
countries, Belgium, Finland, Italy and Norway, said they intended to prepare similar changes in their tax systems. The special measures, taken in November 1968 by the Federal Republic of Germany and France owing to certain economic circumstances were also discussed.

15. It was felt that there were serious difficulties in the way of any attempt to quantify the possible effects of border tax adjustments on international trade, it being impossible to determine what the trade figures would have been if border tax adjustments had not been made.

16. It was nevertheless recognized that at least in theory certain changes in border tax adjustments could have a favourable effect on trade and on the balance-of-payments position of the country concerned. For instance, the substitution of a TVA for a cascade tax would 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.

17. It was asked by some members of the Working Party whether it was correct for countries to change in all circumstances to a tax system allowing for fuller compensation at the border. Several countries pointed out that the rules of the GATT permitted full compensation of indirect taxes. Some of them explained that as a transitional measure the effect from their change-over to full compensation would be partially offset through a limited tax deduction for investments goods 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, at least in one case, that the expected trade advantages, which would have been of a rather small percentage any way, 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 be inherent in the substitution of a TVA for another tax system.

18. The Working Party also examined the problem of "taxes occultes" and direct tax incentives. There was some support for the view that further study here was needed. Furthermore, the adjustments at the border 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 so as to affect international trade. It was recognized that this would be inconsistent with the General Agreement.
19. A list of products of interest to developing countries was drawn up in order to examine whether and to what extent products originating in developing countries were affected by border tax adjustments. All members of the Working Party had provided in full the information requested. A profound and useful discussion was held on the practices of contracting parties in levying taxes on commodities exported by developing countries.

20. Developing countries suggested that their export products which were not domestically produced in developed countries should be exempt from internal taxes. Some countries remarked that the rules of both Article III and those of Part IV of the General Agreement were relevant in this connexion and worthwhile to be considered.

21. Others 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.

Point 2: Proposals and suggestions

22. The Working Party has embarked upon the second point of its terms of reference regarding proposals and suggestions to be made in the light of its preceding examination.

23. One member recalled in this connexion the great importance he attached to the subject of border tax adjustments in terms of their effects on trade and in terms of the concern expressed by business circles. High priority should therefore be given to the resolution of the border tax issue. A solution was to be found within the entire framework of the international adjustment process. The Working Party should first begin consideration of solutions of the question of the interpretation of the present GATT rules and the practices relating to these rules, such as the calculation of adjustments at the border and "taxes occultes". It should also consider the establishment of a machinery within the GATT for the surveillance of changes in border taxes. Further proposals would be put forward at a later stage.
24. Another member supported the proposal of a thorough examination of the adjustments of "taxes occultes" and of the ambiguities of the rules of the General Agreement. In order to resolve differences of views, this member was of the opinion that it would be desirable to devise a complaints procedure, based by analogy on the spirit of Article XXIII of the GATT.

25. In regard to this point in the terms of reference of the Working Party, a group of countries referred to their statement made at the beginning of the examination of the effects of the border tax adjustments on international trade. Another group of countries also presented their view on the problem of border tax adjustments in a written form.

26. The Working Party noted that its discussions had so far been useful and clarifying and that the atmosphere of active co-operation in which its important work is carried out would facilitate the need to find mutually acceptable solutions to any problems that might be found.