WORKING PARTY ON BORDER TAX ADJUSTMENTS

Meeting of 11 to 14 November 1968

Draft Note by Secretariat

1. The Working Party held its fifth meeting from 11 to 14 November 1968. This note on the meeting has been prepared by the secretariat for the convenience of delegations.

2. The Chairman requested delegations to supply the information on a short list of products of interest to developing countries asked for in the questionnaire Spec(68)97 and Add.1 as soon as possible.

3. The Working Party continued to examine the practices of contracting parties in relation to border tax adjustments. This examination was conducted on the basis of the outline adopted by the Working Party at its fourth meeting and reproduced in the Annex to the note on that meeting (L/3125). The Working Party completed a first examination of cascade taxes, single-stage taxes at the manufacturing, wholesale and retail levels, and value-added taxes.

4. Summaries of the following statements on questions in the Outline made during the meeting are attached.

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5. The Working Party agreed that the Chairman should fix the exact date of its next meeting in consultation with delegations. At that meeting the Working Party would go on to examine selective excise taxes, changes in border tax adjustments and the other miscellaneous questions in the Outline. It was agreed that there was a need to dispose of these questions as quickly as possible; short answers should be prepared; if delegations so wished, these could be submitted in writing in advance of the meeting for circulation in document form.
Cascade Taxes

AUSTRIA

The observer from Austria pointed out that no changes had been made in their tax system since the Organisation for Economic Co-operation and Development fact-finding report had been issued.

Question 1. The Austrian turnover tax was a general consumption tax of the "cascade" type. The coverage of the tax included deliveries of goods, services rendered, withdrawals and importations. In view of the fact that the tax was charged in principle at all stages of production and distribution, it was referred to in the OECD report as one of the purest forms of the cascade system.

The law provided for a number of exemptions for certain transactions, the most important of which were:

(a) the import of certain raw materials, semi-manufactured goods, foodstuffs, fodder and medicines. This exemption covered a considerable part of the total imports;

(b) the first delivery of certain raw materials, etc. after importation at the wholesale stage;

(c) the export of goods;

(d) wholesale deliveries of certain raw materials, semi-manufactured goods, foodstuffs and fodder;

(e) transactions which were subject to separate taxation, e.g. tax on transports, insurance tax, tax on the transfer of immovable property.

The tax was levied at the following rates:

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<td>Standard rate</td>
<td>5.5 per cent</td>
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<td>Non-exempt wholesale deliveries (if the goods were not processed by the taxpayer)</td>
<td>2.0 per cent</td>
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<tr>
<td>Certain foodstuffs and the sale of products of domestic agricultural and forestry enterprises</td>
<td>1.7 per cent</td>
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<td>Certain sales of small enterprises (restaurants, inns, food retailers)</td>
<td>3.75 per cent</td>
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<td>Retail sales (not falling under the 1.7 per cent rate) of large enterprises if in the previous year the retail sales had exceeded S 20 million</td>
<td>6.1 per cent</td>
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Internal transactions within an enterprise were not subject to tax except in the case of integrated textile firms where yarns passing from the spinning to the weaving section of the firm were charged at a rate of 5.2 per cent. Retail sales of products of the spinning or weaving section of a textile firm were subject to an additional tax of 5.2 per cent. This exception applied to man-made as well as cotton textile items.

The adjustments made at the border took into account the different rates and exemptions. Exemptions were not limited to domestically produced goods.

Question 2. No.

Questions 3 and 4. For imports, the adjustment was made by levying an import equalization tax, the rates ranging from 6.25 per cent to 13 per cent (2.5 per cent to 10 per cent in the case of foodstuffs subject to the reduced rate). The equalization tax was designed to compensate for the tax burden on identical or similar home-produced goods delivered to a wholesaler by the manufacturer.

For exports made by the manufacturer of a product, there were two measures to make the destination principle effective (a) the export rebate, with rates ranging from 0.85 per cent to 8.5 per cent, in order to compensate for the tax burden accumulated at earlier stages and (b) the tax exemption of the delivery to the foreign buyer of the product. These two measures together were approximately equivalent to the one measure taken on the import side.

The difference in the equalization tax rates and the export rebate rates were explained by the nature of the system. The intent was that the border adjustments should be identical to the tax burden on the same or like domestic products. The compensatory tax on imports was optically higher than the rebate on exports since on the export side the rebates only reflected the tax burden up to the factory stage while on the import side the tax on one further stage had to be added. If a product was not exported by the manufacturer himself, but by an export merchant, an export merchant's rebate was granted at a rate of 4.83 per cent or 1.564 per cent.

Question 5. All services were subject to taxation. The same was true with respect to the deliveries of goods, with the exceptions noted under question 1. These turnover tax amounts were taken into account when determining the border tax adjustments.

Question 6. If a company was dependent on another company financially, economically and organizationally, all transactions between the two companies were considered to be non-taxable internal transactions. When determining the border adjustments, the whole structure of the economic branch in question was taken into consideration.
Questions 7 and 8. Under a cascade system border adjustments were inevitably made on the basis of averages. These were calculated as exactly as possible. The calculation was made with regard to typical products; the selling price was analyzed with a view to finding out whether and to what extent the various cost elements had borne a turnover tax. Normally, a small estimated amount of taxes levied instead of the turnover tax (e.g., transport tax, insurance tax) was also taken into account. Excise duties (e.g., on hydrocarbon oil) and other taxes or contributions were not included in the border adjustments of turnover tax. In answer to a question, the Austrian representative agreed that it was not possible to calculate the averages with perfect accuracy and that these were estimates. There was, however, generally no over- or under-compensation. The rates were changed to take into account changes in the classification of goods or in the structure of the industry and the Federal Ministry always scrutinized complaints with great care. Complaints could come from abroad as well as from domestic sources.

Question 9. For the purpose of the import equalization tax the goods were valued on the basis of the c.i.f. price plus customs duties and other taxes imposed at importation, excluding the turnover tax itself.

The rates of the export rebate were applied on the selling price including the cost of transport and insurance expenses to the Austrian frontier.

Question 10. Export rebates were granted only to entrepreneurs in the sense of the law. Therefore, tourists could not benefit from the export rebate scheme. No import equalization tax was charged on limited tourist purchases and small mail shipments. The treatment followed the corresponding customs duties regulations.

Single-stage Taxes

ARGENTINA

Question 1. Imports were subject to the tax, regardless whether they were intended for personal use or consumption or to form an integral part of exempt goods. The tax was payable by the importer at the time when the goods were
cleared through customs. Goods exported might be exempted from the sales tax by the Executive when the latter considered this desirable in order to facilitate disposal. In general, goods not subject to export duties were exempt from the tax. There was a system of refund for certain products; a repayment being made to exporters in respect of taxes charged in the internal market.

**Question 2.** Not applicable; the adjustments were made at the border.

**Question 3.** Under the existing system, there was no separate taxation of raw materials or of components forming part of specific goods. No differentiation was made in the law in respect of goods used for the production or transport of other goods. Nevertheless, the Executive was empowered, in order to promote or orientate economic activity, to grant complete or partial exemption from the tax, or to raise the rate of the tax in respect of certain specified goods.

**Question 4.** The tax was applied at only one stage of marketing for each product. Retail transactions by manufacturers were subject to the tax but in this case a deduction was allowed for direct sales costs. Services in general were exempt from the tax except in certain cases specifically mentioned in the law. Capital goods were not specifically included among the exceptions, but those eligible for customs duties exemption under the special import régime were exempt from the tax.

**Question 5.** No; the law expressly provided for the same tax treatment of domestic and imported goods, with respect to both the taxes and exceptions.

**Question 6.** As already stated, there was no difference between the rates of border adjustments on imports and the rates on domestic transactions. With respect to exports, in principle there was no difference. However, if in practice some difference of relative significance existed, this was due to the practical requirements of applying the existing system of refund on exports in respect of taxes paid in the domestic market, which operated on the basis of a single conventional rate. As regards the treatment of imports of capital goods, the reply was given under question 4. Exports of such goods were not subject to the tax.

**Question 7.** No.

**Question 8.** The tax was not applied where customs duties were not applicable.
Question 1. Adjustments were made at the border where tax was payable at the time of importation of goods, and that was when goods were imported by persons for their own use, or for initial retail sale. It was calculated on a value arrived at by increasing by 20 per cent the sum of the value for duty and for duty payable.

Goods for immediate export and not for use in Australia were exempt from sales tax, provided such goods were not brought back into Australia.

Provision was made for refund of sales tax previously paid on goods subsequently exported where it was not known at the taking point that the goods would be exported.

Question 2. Qualifications for registration:

Every manufacturer and wholesale merchant in Australia, if he sold taxable goods, had to register with the Commissioner of Taxation and lodge monthly returns.

Goods, new or second-hand, imported by persons for retail sale or for their own use were subject to sales tax on importation at the customs (see calculation in answer to question 1).

If the goods were imported for wholesale sale, the importer had to quote his certificate number, i.e. endorse the import entry "I hereby certify that I am the holder of Sales Tax Certificate No.______".

The registered person was then responsible for sales tax when the goods were sold to persons not quoting a Sales Tax Certificate number.

Question 3. Manufacturers could obtain raw materials and "aids to manufacture" free of tax on the principle that as tax was payable on the finished goods, it was necessary to avoid double taxation. Use of Sales Tax Certificates and quoting of same was essential in these cases.

Question 4. Yes; at the point of final sale to the consumer or the person not registered for sales tax purposes.

Where goods were sold wholesale, the sale value upon which tax was payable was the amount for which the goods were sold, i.e. the full amount, excluding sales tax, charged to the customer in respect of the sale.
The sale value of goods sold by retail by a manufacturer who sold similar goods wholesale was the amount for which he would sell those goods if sold wholesale.

Capital goods and services normally were not subject to sales tax.

**Question 5.** No. There were no specific border taxes as such in Australia. The only adjustments made at the border were, in the case of imports, sales tax and customs duty; and in the case of exports, sales tax, customs duty where applicable, and excise duty where applicable.

**Questions 6 and 7.** Did not apply in Australia.

**Question 8.** Yes, for sales tax purposes on exports, but only to visitors (non-residents) to Australia and in no circumstances to Australian citizens.

**Other**

The reason Australia had two schedules to its Sales Tax Act, both having the same rate of tax (25 per cent), was that goods were put into the various schedules depending on their particular classification. The rates of tax applying to any schedule could be varied at budget time. It just so happened that at the moment the rate of tax on Schedule 2 goods was the same as the rate on Schedule 5 goods. This would not necessarily hold in the future.

As for the reason Australia added 20 per cent to the sum of the value for duty and duty paid in order to arrive at a base value for the imposition of sales tax on imported goods, this method of calculations only applied when the goods were imported for personal use or by a retailer. The addition of 20 per cent was to place imports by such persons on a comparable basis with imports which pass through a wholesaler in Australia. The 20 per cent represented a notional mark-up by the wholesaler when selling to a retailer. Sales tax was normally paid on the wholesale sale price.

**NEW ZEALAND**

**Question 1.** For imports, see paragraphs A.1 and 4 on pages 157/158 of Spec(68)88. For exports, see paragraph B.2 on page 161 of Spec(68)88.

**Question 2.** All persons and firms selling taxable goods by wholesale are licensed under the Sales Tax Act 1932-33. Businesses selling at both wholesale and retail levels are licensed usually only if the turnover is predominantly wholesale.
Question 3. Most raw materials and components do not incur tax. Where taxable goods are used in connexion with the production of other goods the tax is remitted or refunded to the manufacturer of the other goods. There is no provision for remission or refund in respect of taxable goods used in the transport of other goods. Ordinary trade containers do not bear tax. The situation is unaffected by whether the goods are home produced goods, exports or imports.

Question 4. See paragraphs A.1 to 4 on pages 157/158 and paragraph B.2, last sentence on page 161 of Spec(68)88. In the case of retail transactions by wholesalers, the value for tax is the normal wholesale price. There is no special provision for capital goods as such but most capital goods fall within exemptions for specific goods (e.g. industrial machinery). Services are not taxed.

Question 5. The answer to the first question is No. In reply to the second question (originally in Spec(68)98/Add.1) there are products subject to the sales tax which are not made in New Zealand e.g. watches and typewriters. This situation arises because the sales tax does not make any distinction in respect of the origins of taxable goods.

Question 6. There is no difference in rates.

Question 7. No regional differences.

Question 8. Imports: there are exemptions in respect of certain goods imported by passengers for their own use, and for gifts of a personal nature not exceeding $NZ 20 in value. Exports: purchases by tourists at duty-free shops are tax free. Tax is remitted or refunded in full except that in respect of any one shipment, claims of less than $NZ 1 are not accepted.

**NORWAY**

The Norwegian tax is a single-stage tax levied at the retail stage and applies to most movable goods.

Question 1. Imports are taxed at the time of importation only if the goods are imported for direct consumption. Goods not imported for immediate consumption will not be charged at import provided the importer is duly registered by the competent authorities. In this case the tax will be levied as for domestic goods at the time the goods are sold for consumption. For capital equipment the tax is levied at import if the importer is not distributor of the goods in question.

Question 2. The tax covers imported and domestic goods without differentiation.

Question 3. At present the rate of tax is 12 per cent of the price paid including the amount of the tax. In the case of imports the tax is imposed on the basis of the rules for evaluation of goods for customs duty purposes.

Question 4. Yes.
Question 5. Business firms pay tax on goods purchased for their own use. Capital equipment is subject to the same taxation as goods intended for immediate consumption. (See paragraph 1.) No border adjustments are made on import or export of products on the basis of the tax firms pay when purchasing capital equipment.

Question 6. See paragraph 2 above.

Question 7. The tax is general and without regional differentiation.

Question 8. Tourists may bring articles for personal use up to NKr 350 - duty and tax free. Furthermore there are some minimum exemptions for small mail gift parcels from abroad.

YUGOSLAVIA

Introduction

The representative of Yugoslavia said that they had only one form of indirect taxation, namely the turnover tax which was levied at a single stage, generally the retail stage and at the wholesale stage in the case of sales to "major consumers" (for example, public establishments), on products as well as certain services and transactions. Sales to registered traders were tax free.

Products intended for the manufacture of other goods (raw materials, equipment, energy, components) were purchased tax-free subject to a written declaration by the purchaser. The following were certain exceptions to these tax principles: sales of petroleum products (fuels and lubricants) were subject to the tax regardless of subsequent use, the only exception was the petro-chemicals industry; purchases which entered into the "overheads" in the accounts of undertakings (furniture, office machines, passenger vehicles but not lorries) were subject to the tax. In these cases no distinction was made as to whether these goods were purchased by the consumer or the producer.

The tax might be charged at the Federal, republican or communal level. These taxes were based on the same general principle, i.e. a single-stage tax, charged at the moment when the goods concerned were transferred from the trade to the consumer (or to a party required to pay the tax on certain purchases, even though it might not be a consumer in the economic sense of the term). The tax base was fixed by Federal legislation but the politico-territorial units (other than the Federation) were free to fix the rates of the tax within their jurisdiction. The Federation had the authority to set ceiling tax limits at the level of the republic and the commune if the national economic situation made it necessary. The taxes introduced by the republic and communal authorities were only chargeable on retail sales. In order to ensure that the budgetary burden was not passed on from one
region to another, the republics and communes had no authority to tax sales by producers and wholesalers. The Yugoslav system provided for certain tax exemptions which were listed in full in document Spec(63)88/Add.2. The exemptions covered products which were subject to the tax in principle but had been exempted by law. According to the overall definition set forth in the Federal law, the turnover tax could be charged in principle only at the final consumption stage (subject to the exceptions mentioned above), and in addition on the following services and transactions:

1. Gross income from exchange transactions in goods and services with other countries;
2. Gross income of wholesale trade within the country;
3. Gross income by banks from credit and other banking services.

The republics and communes were authorized to impose turnover tax on craftsmen (with exemption for services which they rendered to the enterprises), lotteries, the various forms of pari-mutual betting, admission tickets for cinemas, sports events, etc.

The tax base was the selling price of products; the tax was added to the price and not included in it. In certain cases, however, the tax was calculated according to the quantity and quality of the product (packets of twenty cigarettes of a certain specified quality, petroleum products according to the type of product and octane strength).

In principle, in the Yugoslav turnover tax system there was no need for adjustments at the border as the tax was charged only at the consumer stage (either at the retail or wholesale stage). With a few exceptions, manufacturing undertakings were exempted at all stages of production. Exports were not subject to the tax nor imported products that would not have been taxable if they had been manufactured in the country. Most imports of taxable goods were carried out by registered traders who could establish tax-free stocks. The tax was charged upon transfer from the trader to the consumer. Imported products were then normally charged with the tax as if they were domestic products.

Question 1. In theory, the system of levying the turnover tax avoided physical adjustments. As an exception to this principle, imports of products by individual persons for their own account and by enterprises which directly imported, for their own requirements, were taxed in the same way as if these products were bought in the domestic market.

Question 2. If the customs duties had been paid, there was no differentiation in sales tax liability between foreign goods and domestic goods.

Question 3. The evaluation basis for the tax was the sale price, except in cases where the imposition of the tax was based on quantity (kilogramme, unit, hectolitre, etc.). The tax was not included in the sale price, but added thereto.
Question 4. Control was carried out by a special organization called the Social Accountancy Service (SDK). This organization offered a specialized service which undertook all payments and other movements of funds for the enterprises and the banks (cash payments and transfers from one account to another). Within this organization a specialized service was authorized to check the activity of the enterprises only from the legal standpoint, not from the economic standpoint.

Question 5. Raw materials, components, capital goods and all other products which were used for the production and transport of other products were not subject to the tax. In these circumstances, no border adjustments were made. Imports of the products mentioned above were subject to the same treatment as domestic products.

Question 6. No.

Question 7. Regional taxes were collected entirely at the retail trade stage. Accordingly, they theoretically applied to local consumption and were not transmitted by the price mechanism from one region to another. There were no inter-regional differences in the tax system but the rates differed. However, the range of these differences was very small. There was no inter-regional border compensation. This was valid both for domestic and foreign products. Where differences in rates existed, these applied to groups of products and not to a particular product. Consequently, equal treatment was ensured for domestic and foreign products.

Question 8. Deliveries from abroad were exempted from the tax whenever the customs regulations provided that certain imports should not be subject to the payment of customs duties. Exemption from customs duties automatically implied tax exemption; apart from these cases, the general rules were applied. Foreign tourists could buy industrial products with a rebate of 10 per cent on the retail price. These purchases could be made only in shops which are under special control.

Other

It was noted that in July 1968, a 3 per cent tax was introduced in Yugoslavia on all imports requiring border adjustment for certain special contributions (a contribution for eliminating the consequences of natural catastrophies; a contribution for the development of power supplies; the interest on the value of the fixed capital intended for the development of the less-developed areas; a contribution for the exploitation of water power). The burden borne by the Yugoslav economy on account of these contributions was on the whole equal to this value of 3 per cent. It was obvious that differences
might exist from one year to another due to the fact that the contributions in question were calculated on a fixed basis. Accordingly, the burden might vary in accordance with the degree of progress of production.

Tax on Value Added

General

At the request of the Working Party, the representative of France agreed to outline the basic characteristics of a tax on the value added. Historically, the tax on value added seemed to be the culmination of an evolution designed to overcome the disadvantages of cascade and single-stage turnover taxes. From the economic point of view, the value added system made it possible to determine precisely what amount of tax was charged on a product or a service at the end stage of delivery to the consumer or the user, so that this charge could be uniform, whatever the conditions of production and the methods of distribution.

The tax on value added was an indirect tax on consumer expenditures. Its principal aim was to secure revenue. It was thus a consumption tax and, although it was paid by the traders, it was never a final burden on the undertaking. Because of its character - an indirect tax on consumer expenditure - it was a taxation method especially suitable for countries in which it was difficult to impose heavy income tax and in which tax rates had to be adapted to the nature of expenditure, in particular so as to lighten the tax charge on current consumer goods. This effect could not be obtained with a tax which could not be reflected in the prices and would fall even partially on the profits of the enterprise.

The tax on value added was a single ad valorem tax payable, at the consumption stage, on the prices of products and services at a uniform percentage rate. To obtain such a result, the end charge had to be the same regardless of the origin, domestic or foreign, of the products; the manufacturing process (integrated or not) and the length of the distribution channel; or the number and amount of the taxes charged on intermediate transactions.

From the technical angle of tax administration, this result was obtained by the procedure of "fragmented payments" of the tax on value added and the tax-from-tax deduction. In accordance with this procedure, the tax on value added was paid by the seller at each stage of production and distribution; he invoiced the amount and the purchaser was entitled to deduct it from the tax on value added to which he was liable in respect of his own sales.

The tax was thus settled by fragmented payments - which made settlement easier - and on a price which progressively incorporated the value added at each stage. At the end stage, the tax was levied on the price paid by the end-consumer, at the rate selected for the product or service concerned. In
principle, the same result could be obtained by a single-stage tax system which would be applied only at end sale to the consumer and, in previous stages, would comprise a system of tax suspension.

Such a system would carry serious disadvantages, however, from the aspect of tax technique. On the other hand, the system of fragmented payment made it possible; by fragmenting the payment, to lighten the tax bill of the taxpayers; to secure greater regularity in tax collection; to facilitate tax supervision and to prevent tax evasion; and, because the tax was invoiced at each stage, to enable the precise and normal incidence of the tax to be carried through the prices up to the consumption stage. The means available to the tax administration for obtaining payment of the tax made it possible to keep tax evasion to a minimum.

The essential point which emerged from this analysis was that the tax on value added was an element in the price of products and services only at the end state - delivery for consumption.

At the intermediate stages of production and distribution, the tax on the constituent elements of the price (equipment, means of production, raw materials, packaging, overhead, sales and transport costs, etc.) was cancelled by deduction of tax, the amount being shown separately on the invoices. The result was that, at these intermediate stages, only the "tax-free" prices were taken into consideration in determining the trade policy of the buyers and sellers.

As regards border tax adjustments, one might also conclude that the tax on value added did not admit of any such element. By definition, the adjustment was a tax measure, based on the principle of destination, enabling exports to be exempted from the tax levied by the exporting country and imports sold to the consumer to bear the tax levied on domestic products in the importing country.

It ultimately amounted to cancellation (at export) and restoration (at import) of the tax burden which the domestic product had borne or would have borne at stages prior to those of import or export. In the tax on value added system, the process of deductions cancelled any residue at export and the application of the tax on value added to the value of imported products eliminated any need to "restore" taxes that the like products of domestic origin would already have paid, since it exactly offset their amount. This system avoided any arbitrary single-stage calculation. There was no danger of under-compensation or over-compensation. Just as inside their countries, importers and exporters bought and sold as on the basis of "tax-free" prices.

**France**

The representative of France then supplemented the general outline of the tax on value added, by describing the particular features of the French system.
Question 1. In France, the tax on value added was levied on the major part of deliveries of goods and the whole of services bearing on business activities. In principle, other activities (liberal, agricultural, for instance) were not bound to pay the tax; but transactions in connexion with such activities might be subject to the tax at the option of the parties concerned.

However, there were exemptions which are based on:

- social, general utility or public considerations (work not for pecuniary gain, memorials, products under monopoly, transactions by State organisms on public communities, press, real estate transactions of general interest);

- the application of a special taxation which excludes the application of the tax on value added (financial activities, insurances, trade exchange transactions, shows, business concerned with antiques and collectors' pieces);

- the fact that the products are generally valueless (used operational goods) or have been recuperated for manufacture (e.g. new industrial waste).

Specific taxes (excises) applied to certain products (spirits, wines, petroleum products, for example). These taxes could not be deducted from the tax on value added and at later stages in the distribution chain tax on value added was calculated on the whole price, including excise tax. Coffee and tea had not been subject to a specific single tax since 1 January 1968.

Smaller enterprises enjoyed a diminished taxation régime, defined on the basis of the amount of tax that they would pay under the régime of common law. The tax on value added was not collected if its annual amount did not exceed F 800. When this amount was more than F 800 and less than F 4,000 (or F 10,400, in the case of craftsmen entered in the Trade Register), the tax was reduced by the application of a tax relief factor ("décote") which graduated the taxation normally levyable from 0 per cent (F 800) to 100 per cent (F 4,000 or F 10,400). This special system of tax calculation was established on the basis of the fixed sum which determined the tax theoretically payable, particularly in the light of applicable deductions. It benefited only the very small enterprises and - if it could not be taken into account at the frontier - could not have an appreciable effect on foreign trade.

It had also been necessary to make special arrangements for applying the tax on value added to agriculturists, whose taxation required transitional provisions. Normally exempt from tax on value added (as their activity was not commercial), agricultural workers might enjoy a system which simplified their tax obligations for filling in their tax returns, paying the tax and deductions.

Asked how the difference between this system and the normal tax on value added system was handled at the border, or whether it was assumed that the two systems had the same effect, the representative of France emphasized that any
differences in treatment were equalized when the goods left the agricultural sector, i.e. at the processing stage, when the normal tax on value added system was applied. This meant that there was hardly any effect on imports and exports.

Other delegations welcomed the offer of the French delegation to attempt to collect figures assessing the economic importance of the two special régimes applying to small enterprises and agriculture.

**Question 2.** Normally, the deduction at each stage of the tax invoiced by the suppliers of goods and services should avoid any accumulation of taxes within the framework of the tax on value added. There were, however, certain exceptions. The most important concerned the tax on value added levied on certain petroleum products which could not be deducted by users from the tax due under the heading of their taxable transactions. This was a historical survival retained for budgetary reasons. The resulting accumulated taxes penalized French businessmen and carriers and were a burden on the costs of exports. No import compensation was applied at the frontier.

In addition, the normal operation of the deduction might be hampered when - for a tax period - the amount of the tax that could be deducted was higher than that of the tax due under the heading of taxable transactions. The credit surplus was then carried forward to be debited to the tax due for the following months. In this case, which might arise, for example, from the acquisition of a sizeable investment or an increase in stocks, there was no tax accumulation, but a delay in these deductions which took the form of an additional financial effort. For an exporter in such a situation, the refund of the tax levied on his purchases was limited to an amount calculated from the volume of his exports in the month under consideration. In principle, his financial situation was thus aligned with that of a producer effecting the same volume of domestic trade.

Questions were asked by some delegations regarding special problems connected with purchases of capital goods; these arose from the fact that while, for sales on the domestic market, where tax credits were greater than tax liabilities these were carried forward to the next tax period, in the case of goods exported the producer might be paid the credit in cash. This would constitute a clear incentive to export and was a question to which the Working Party might wish to return. The representative of France said that no complaints of this sort had been received from traders; his delegation would be prepared to answer any further questions on this point.

**Question 3.** The basis utilized at the border was, for exports, the f.o.b. value and, for imports, the c.i.f., duty paid value. Asked why the c.i.f. value was preferred to the f.o.b. value in the basis for the tax on the import side, the representative of France said that it was logical to find in the valuation basis the whole of the cost elements of the products at the time of importation. It was also pointed out that the way in which a tax on value added operated made the precise basis of valuation of very little importance (see question 6).
Question 4. There was no border adjustment for articles purchased by foreign tourists or for small parcels; exemption is automatic, subject to justification of export. On the import side, for small parcels introduced by French tourists, the tax on value added was collected at the same time as the customs duty as a single sum. Exemption was tolerated for articles of very little value.

Question 5. It was explained in the general outline of the tax on value added that its technical application was of no effect as regards border tax adjustments, since it was possible by means of this technique to withhold "tax-free" elements both at importation and exportation.

Question 6. The effective application of the tax on value added on imports - in spite of the possibility of "catching up" at subsequent stages of marketing - was imperative for the following reasons. Fragmented payment was the general rule and importation was a lawful tax-triggering operation. It was convenient to combine collection of the tax with collection of the customs duty and this facilitated subsequent supervision of the tax. It was indispensable to apply their own appropriate rate to imported goods. If the tax were not first levied at importation but at a later stage, the importer would be favoured at the expense of the producer or the tradesman who, at home, had bought similar products on which the tax had been levied. The delay would have harmful effects on the internal economy. This question had been discussed in the European Economic Community. The decision was to apply the tax on value added at importation - except as regards goods in transit or in by-law for exports.

In answer to questions, the representative of the Commission outlined the action taken by the Community in this area. A decision to adopt a common system, the tax on value added, had been taken on 11 April 1967. Further objectives were the adoption of a common rate of tax and the elimination of tax frontiers between member States. In answer to further questions the representative of the Commission said that a directive had been drafted proposing that the collection of the tax at the frontier should be suspended for intra-Community trade in agricultural products to allow more fluidity of trade in these products. He stressed that such a suspension was possible only when certain prerequisites had been fulfilled. The problem was different for intra-Community trade and for trade with third countries since, in the case of the latter, customs control was necessary in any event, and the valuation for customs purposes was also used in the calculation of tax on value added. He stressed however that, on the other hand, the importance of the questions raised should not be exaggerated, given the recuperation effects of the added-value system.

Some delegations said that it might be useful to the Working Party if at some stage the Community could lay out in some detail the rationale for the necessity of adjustments at the frontier at all. Given the importance which was attached to this question it was inadequate to defend the making of such adjustments on the grounds of convenience. The economic advantage that would accrue to imports if the collection of the tax were postponed to the next step in the distribution channel would be very small, and, after examination these
delegations had satisfied themselves that it would be technically feasible to do away with adjustments at the border.

**Question 7.** The tax on value added was an indirect tax levied on domestic consumption of products, whatever their origin. Thus, goods not produced at home were normally taxed on importation under the same conditions as similar goods produced domestically. It was not a "tax adjustment".

**Other**

Only "business done in France" was subject to the tax. French tax legislation - and that of other countries - granted tax on value added exemption on transactions dealing with exported goods. The law treated goods and services not used in France in the same way as exports. The delivery, repair and transformation of sea-going vessels, and aircraft intended for French airline companies, the international traffic of which amounted to 80 per cent, were therefore exempted. The following services were considered to be utilized outside France; transactions carried out for the requirements of the ships and aircraft and transfers to foreign countries. This was an application of the general principle of tax territoriality.

Tax on value added was levied at four rates. This was partly a carry-over from the previous system and it might be possible in the future to reduce the number of rates. In an answer to a question, the representative of France said that newspapers, rather than newsprint as such, were exempt from tax.

**DENMARK**

The Danish tax on value added had been put into force in July 1967. It had replaced a single-stage wholesale tax with a narrower coverage. The wholesale tax had created distortions in the economy affecting prices, production and trade and arbitrary decisions had had to be made when imports were made at the retail stage and in cases where firms were both wholesalers and retailers.

A single rate, of 12½ per cent of the tax-exclusion commercial turnover, was used. It was pointed out that other countries with tax on value added systems usually had more than one rate. It was not clear that one rate was necessarily easier to administer than more than one and a single rate system might be regressive since the same rate would apply to basic foodstuffs as to other goods. The representative of Denmark said that the use of a single rate made control at the retail stage much easier and that this was an important consideration. He also said that they continued to rely on selective excise taxes on non-essential goods, which provided a progressive element in the tax structure.

**Question 1.** All new and used goods (except ships, planes and newspapers) and a wide range of services were covered. Exceptions were made for banking and insurance services, rental of rooms, health services, education, postage of letters and transportation of passengers.
Goods exported were tax free. Most of the traditional specific taxes remained. Tax on value added was levied on top of these taxes which were not deductible in the tax on value added system. The tax on value added was charged in the normal way on all sectors of the economy but if the taxable turnover was below a very small amount (DKr 5,000 a year) no tax was charged. Delegations noted with interest that although the small farmer did not normally come under the tax on value added system in France, farmers did pay tax on value added in Denmark. The representative of Denmark confirmed that there were no special regulations governing agriculture except for certain practical adjustments with regard to the tax period to take into account the seasonal cycle which dominated the farmer's economy. It was the extensive use of co-operatives, which kept adequate accounts, which made this possible. In answer to questions on certain provisions of the tax on value added law, the representative of Denmark said that, under certain circumstances, farmers were not obliged to make out invoices for goods and services exchanged between farms. This provision took into account the long tradition of exchanges between neighbours in the agricultural sector. It did not affect the final tax burden on goods leaving the sector.

Question 2. There were no such important exceptions, but in a few cases an accumulation took place, for instance in the case of passenger transportation, which was tax free. The tax on value added paid on passenger cars by firms could not be deducted by them. Such accumulation was not compensated at the border.

Question 3. The basis for border tax adjustments was f.o.b. for goods exported and c.i.f. for goods imported. This c.i.f. basis was apparently a matter of special importance for some delegations. He said that the economic effect of the tax on added value was equal to the effect of a general retail tax. Goods produced in distant countries had to bear heavier c.i.f. costs, but the retail price of these goods had, ceteris paribus, to be the same as those produced in neighbouring countries since they competed on the market. This might be a somewhat simplified model of the economic process but if this were so, the differences in costs of transportation and insurance were not included in the selling prices and were consequently not taxed.

Question 4. Goods imported by tourists were exempt from tax on value added according to the regulations allowing for duty-free importation. Tourists might, under certain conditions, buy goods free of tax.

Question 5. This important question had been dealt with at length by the French delegate, and what he had said was, of course, also valid for the Danish tax on value added. Goods exported were exempt from the tax and all - or nearly all - the tax elements paid previously during the production and distribution of these goods were automatically deducted. Taxes paid on capital goods were deductible according to the normal rule, and negative balances were offset in cash, also according to normal procedure. Goods imported by a registered firm, on the other hand, went into the tax system and were treated exactly as other goods were treated.
There was, however, a small difference in the Danish system which called for
special comment. The normal tax rate was, as previously stated, 12½ per cent on
the tax-exclusive selling price. Imported goods were taxed on importation, but
when the importer was a registered firm the rate applied was only 9 per cent.
It was important to understand that this did in no way result in a final tax
burden of less than 12½ per cent. When the importer sold the goods his tax
liability would be 12½ per cent, but the importer would have only the 9 per cent
deductible. In answer to questions, the representative of Denmark said that if
there was no rate differential the importer would be at a slight disadvantage
because he had to pay tax based on the full price of the product somewhat
earlier - a domestic producer would be able to give the wholesaler credit for the
goods plus the tax, while the importer would be able to give credit for the goods
only. If, on the other hand, the tax was not levied on importation, the importer
would be at a slight advantage. The introduction of the 9 per cent rate at
importation was a compromise between these two situations, and was a pragmatic
attempt to put imported and domestically produced goods on an equal footing.

Question 6. This question had been widely discussed and was still under
consideration. It was useful to exercise some control at the frontier and, as
had been explained, the elimination of adjustments at the border would mean some
disadvantage to the domestic producer as compared to the importer. They were,
however, inclined to believe that the importance of this question could be
exaggerated.

Question 7. Yes.

Other

The representative of Denmark made the following points in reply to
questions:

In the tax on value added system, tax paid on capital goods could be
deducted from the tax payable in the tax period in question; if the balance of
payment was negative, the firm received payment in cash corresponding to the
negative balance.

Tax became due on the delivery of the goods rather than at the time of
payment but discussions on this were still continuing.

The rate of tax on imported citrus fruit was the same as the tax on other
fruits.

The legal provisions granting discretionary authority to the Government to
make exemptions in certain cases had been used in very few cases, e.g. in
connexion with sales by the blind of their own products.

The transportation of passengers was exempt from the tax; as a result,
purchases by firms of passenger cars and fuel for use in these cars could
not be offset against liability to tax on value added.
FEDERAL REPUBLIC OF GERMANY

With regard to the general effects of the tax on value added introduced in the Federal Republic of Germany as from 1 January 1968, reference was made to the explanations by the French and the Danish delegations and to the documentation already available to the Working Party - Federal Republic's description of the Turnover Tax Law of 29 May 1962 contained in their memorandum in the OECD - (OECD Document TC(68)6 of 29 May 1968), to the Report on tax adjustments applied to exports and imports in OECD member countries, and to GATT document Spec(68)88/Add.2, pages 4 and 20-22.

The main reasons for introducing the new system were economic, legal and political.

From the economic point of view, the old cascade tax system led to distortions in competition for both home-produced goods and imported goods. The tax burden on home-produced goods depended on the number of production and distribution stages subject to the turnover tax. The tax burden was therefore higher if a product passed through many stages of independent enterprises than if a product had been produced by highly integrated firms. This system favoured highly integrated firms and was disadvantageous for non-integrated firms, i.e. most medium or smaller enterprises. At the border only an average taxation was possible. It could be that the compensation level was insufficient; it could be, on the other hand, that there was over-compensation which placed imports at a disadvantage. The degree of compensation could vary from product to product and from enterprise to enterprise. These distortions gave rise to many discussions, particularly in the EEC where a remedy for the existing weaknesses of the turnover tax system became an urgent need.

From the legal point of view, the inequality of tax treatment as between highly integrated firms and small and medium-sized firms, gave rise to trials before the Federal Constitutional Court by reason of violation of the principle of equal tax treatment. The Court decided that in the long run the existing cascade systems had to be brought into line with this principle.

From the political point of view, in order to prepare the removal of tax frontiers within the EEC, a tax harmonization was necessary. This tax harmonization could not lead to a turnover taxation with all the weaknesses of the cascade system. The Council of the Communities had therefore decided to pass to the tax on value added system, which was neutral to competition and avoided the distortions existing under the old system. The adoption of an international system of turnover taxation neutral to competition was an indispensable measure if artificial distortions of international competition were to be avoided and international trade was to be developed on an equal basis. This system was not only legally but also economically in line with the principles of GATT and OECD.
Question 1. The tax extended to all business transactions, i.e. it was imposed on:

(a) deliveries and other operations carried out by an entrepreneur for gain within the scope of his enterprise;

(b) private use, i.e. withdrawal or use of articles from an enterprise for purposes outside this enterprise;

(c) the importation of goods into the customs territory.

The law provided the following categories of exemptions:

(a) exports and transportation of goods across frontiers;

(b) turnovers in the fields of inland navigation, of financial transactions, of transactions subject to certain transfer taxes (i.e. sale of real estate), of letting and leasing of real property and similar transactions;

(c) medical services and a number of operations in the social and cultural fields, insurance services, turnovers from the activities of building and most operations involved in capital movements.

In cases (b) and (c), the exemptions were not combined with deduction of prior-stage tax, but in cases under (b) the entrepreneur might choose taxation under the normal procedure. In connexion with these transactions there might be other specific taxes which were not deductible in the tax on value added system.

There were some average rates for certain groups of entrepreneurs which should not lead to a tax liability basically different from that which arose under the normal system. There were, furthermore, average rates for agricultural and forestry enterprises. If the goods produced by such enterprises were sold to final consumers, the general tax rates, i.e. those which apply both to home-produced goods and to imports, were applicable. Therefore, the differences between the normal system and the system of average rates was not reflected in the border adjustments.

Other delegations said that a bias in favour of domestic producers might exist for certain products, e.g. animal feed, which are the subject of transactions within the agricultural sector, but which are consumed in the sector and which never enter normal commercial channels.

Question 2. Pre-tax deductions were not allowed in the following cases:

(a) an entrepreneur carrying out inland transactions that were exempt from tax;

(b) for small firms with a total turnover of not more than DM 60,000 per annum, a special taxation procedure was applied.
In these cases, which were not of great importance, a certain accumulation of taxes could arise. This accumulation was not compensated at the border. Furthermore, no prior stage tax could be deducted if goods were imported directly by private consumers. Accumulation of taxes might occur in the case of inventories on hand on 1 January 1968 where the law allowed merely the deduction of part of the old cascade tax and in the case of capital goods where the old cascade tax, which on 31 December 1967 still burdened fixed assets, could not be deducted. As from 1 January 1968, a degressive investment tax ("Steuer auf den Selbstverbrauch") was levied on new capital goods for a transitional period. That meant that German trade and industry would shoulder tax costs which would deteriorate their position in international and national markets.

Question 3. The basis for valuation was the agreed consideration with the recipient of the transaction. The turnover tax did not form part of the assessment base.

Question 4. There were certain exemptions for tourists and small shipments in line with the exemptions from customs duties granted in these cases (e.g. personal effects, clothing, goods with a value not over DM 100 - food not over DM 20 - gifts with a value not over DM 100 under certain conditions, etc.).

Question 5. The delegation of the Federal Republic supplied a written statement on this particularly important question. This is reproduced in the Annex to this note. It should be emphasized that at all stages, the incidence of tax formally corresponded to the nominal tax rate. Goods subject to the same tax rate bore the same burden of tax, irrespective of whether they were home-produced or imported and irrespective of the number of stages which each of them might have passed.

The device used to assure uniformity was the "deduction of prior-stage tax". This concept was the main feature of turnover tax legislation. It implied that any entrepreneur was allowed to deduct from his own tax liability the tax invoiced to him, including tax paid on imports. The operation of this system resulted in the fact that, all along the line of entrepreneurs, turnover tax did not become an element of cost and therefore did not need to be taken into consideration by an entrepreneur for cost accounting purposes. It was only on turnovers to private consumers that the tax became a genuine financial burden, since the latter were not entitled to deduct prior-stage tax.

Question 6. From a purely economic point of view, there was no need for border tax adjustments on imports. But this adjustment was in line with the system of fractional payments of the tax and it was necessary for sales to final consumers or entrepreneurs not subject to value added taxes. Furthermore, it facilitated the necessary tax controls. The economic effect of the value added tax was very close to that of a retail tax. All sales prior to the sale to the final consumer were practically tax-free, owing to prior-stage tax deduction. It was only for technical reasons that the tax liability had been divided into several stages, one of these being the import stage. The economic effect would be the same if the whole tax, including the tax on imports, were collected at the final stage, i.e. when sold to the consumer. Other delegations noted that the representative
of the Federal Republic had said that the economic effect of tax on value added was "very close to" that of a retail tax, that this question had been examined in detail in other fora, that the views of different delegations were not identical on the question but that it might be necessary for the Working Party to return to it when it examines the trade effects of border tax adjustments.

In answer to questions, the representative of the Federal Republic said that cars used for business purposes were subject to the same rules as apply to capital goods. Tax on value added on petroleum and diesel fuel, but not excise duties on these products, was deductible.

It was noted that newspapers pay a reduced rate of tax on value added (5 per cent) while newsprint pays a rate of 5.5 per cent. The representative of the Federal Republic pointed out that this does not act to the disadvantage of suppliers of newsprint since producers of newspapers can claim a higher deduction from liability to tax on value added.

Other

The excise taxes on tea and coffee had not been changed in connexion with the introduction of the added value tax. The rate of added value tax on coffee and tea was 5.5 per cent. If this rate was compared with the former taxes levied on all stages, the whole tax charge had not been increased.

NETHERLANDS

Question 1. The Netherlands would introduce a tax on value added on 1 January 1969. The shiftover to the tax on value added system was based upon a decision of the EEC taken in April 1967. This decision had been taken with a view to achieving two objectives: to take the first step towards complete harmonization and to abolish the well-known disadvantages of the cascade system - the distortion of competitive relations between integrated and non-integrated firms and the necessity to average the tax burden to be compensated for at importation and exportation. The Netherlands delegate further stressed that this decision of the EEC was welcomed by the Dutch Government. A lack of Government revenue could - at least in the Netherlands - hardly be covered by raising direct taxes. Indirect taxes could - politically speaking - be raised more easily. A turnover tax levied according to a cascade system could not, practically speaking, be levied at a rate much above 6 per cent because the disadvantages of the system grew worse when the general rate exceeded this level. A tax on value added system offered more possibilities in this respect.

The tax would be levied on all entrepreneurs carrying on a business or profession independently. All deliveries of all kinds of goods, all services, and all imports would be subject to the tax.

The tax was paid quarterly. the tax involved to the entrepreneur being credited against the tax due. If the amount to be credited exceeded the amount to be paid, the difference was reimbursed to the entrepreneur upon request. The general rate of the tax was 12 per cent on a tax-exclusive basis. There was a 4 per cent rate for listed goods, which were mainly essentials like foodstuffs.
There would also be nil rates and exemptions. The difference was that if a nil rate was applicable, the entrepreneur remained entitled to pre-tax deduction, whereas if an exemption was applicable, the entrepreneur lost his right to pre-tax deductions. A nil rate applied to all goods destined to be exported or to be stored in a bonded warehouse, to ships and airplanes used in international traffic and to international transport. The list of exemptions included some deliveries of immovables and further services of a social or cultural nature.

Farmers were not subject to the tax in so far as they made deliveries of goods listed in the 4 per cent rate list and in so far as deliveries of other goods did not go beyond an amount of f. 10,000 a year. Entrepreneurs who bought from these farmers were entitled to a fixed pre-tax deduction of 3 or 4 per cent. As in other countries, farmers could, however, choose to be subjected to tax in the normal way.

There was also a provision in the law for small businessmen who would not have to pay tax if the tax due by them was less than f. 1,200 a year. The tax was levied on imports in the same way and at the same rates as for domestically produced goods. As in all other countries, the Netherlands had excise taxes which were levied on the producer and which were included in the producer's selling prices and the selling prices of subsequent dealers. The tax on value added was levied on the selling price, excise tax included, so that there was, in this respect, cumulation of indirect taxes.

**Question 2.** The Netherlands delegation recalled the exemptions of tax for which pre-tax deduction was excluded. It had further been decided that, as a transitional measure, with respect to investment goods, the pre-tax deduction was reduced for investments in 1969 to 30 per cent, for investments in 1970 to 60 per cent, and for investments in 1971 to 90 per cent. Only in 1972 would a 100 per cent deduction be achieved. This meant that in those three years there would be a difference in the tax burden between the imported product and the home-produced item in favour of the imported product.

**Question 3.** On importation the tax was charged on the import value (the value for customs purposes included transportation costs plus all Netherlands taxes and customs duties with the exception of the tax on value added itself.

**Question 4.** Tourists were allowed to import tax-free goods up to a value of $25. Tourists were not allowed to buy tax free in shops, except for the tax-free shop at the airport of Amsterdam.

**Questions 5 and 6.** The Netherlands delegate referred to what had been said by his French and German colleagues.

**Question 7.** The Netherlands delegate answered that, as the tax on value added was a tax on internal consumption, the tax was also levied on imported goods which were not produced domestically.
In reply to a question, the Netherlands delegate said that practically all farm products would be subject to the 4 per cent rate.

In reply to questions he said that tax charged on private cars bought by firms for business purposes was deductible. These were treated in the same way as trucks as investment goods. The tax charged on petrol and diesel vehicles when used for business purposes was also deductible as was the tax charged on fuel oils used industrially.

**Sweden**

By way of introduction, the representative of Sweden outlined the reasons which had led his country to shift to tax on value added.

He recalled that, faced with a need to increase budgetary revenue, the Swedish Government had introduced a single-stage retail tax in 1960. A decision had also been taken at that time to look into the whole question of taxation. The Royal Commission which had been appointed had recommended a certain shift from direct to indirect taxation and had recommended the tax on value added because of its flexibility and its large revenue-raising ability. One factor that had influenced the choice was that the European Economic Community had adopted the tax on value added. Not all the recommendations of the Royal Commission had been accepted but, following extensive consultations, a bill for the introduction of a tax on value added had been laid before Parliament and accepted by it in May 1968.

Some changes of a technical nature might still be made to the system, which would be introduced on 1 January 1969.

It was noted that it had been argued that tax on value added was very similar in its end result to a single-stage tax at the retail level and asked why Sweden had felt it necessary to change from the one type of system to the other, the representative of Sweden said that it was his impression that the main reason was the budgetary limitation of the single-stage tax which is not effective if the rate is above 10 to 12 per cent.

**Question 1.** The Swedish tax on value added covered both goods and services. Imports were liable to tax and exports exempted.

In principle, all goods sold commercially were taxable, including buildings constructed and sold by building enterprises. Among exempted items were fishing ships, other ships of more than 20 tons used for commercial traffic, airplanes, electrical energy and fuels, certain military material, certain medicines, newspapers and certain other publications.
Services were also taxable, with the exemption of, inter alia, some personal services such as hair cutting and beauty treatment, and services rendered by doctors, dentists, hospitals, banks, insurance companies, certain postal services and international transport. Goods and services exempt from tax would not be subject to border tax adjustments.

Goods subject to special excise taxes would also be subject to tax on value added.

Businesses with a turnover of below SKr 10,000 per year were exempt from tax.

Question 2. No exemptions existed from the right to deductions within the tax on value added system that could result in accumulation of taxes. It was, however, to be noted that tax on value added on passenger cars was not deductible even when the purchase was made by a business enterprise. On the other hand, no tax on value added was charged on second-hand cars.

Question 3. The tax base was the sales price including tax. Tax on imported goods was based on the customs value increased by duty, if any, and tax. A reduced basis for valuation existed in certain cases, the only case of interest for foreign trade being that of prefabricated houses. In answer to a question the representative of Sweden confirmed that this related to the house as such and not to building materials.

Question 4. Tourists were allowed to take goods up to a value of SKr 275 into the country free of duty and taxes. On the export side, purchases could be made at tax-free shops. Tourists could also arrange an export transaction.

Question 5. The change from a single-stage retail tax to tax on value added was not intended to lead to changes in the level of taxation on private consumption. The tax on value added system would, however, lead to a reduction of taxation on industry and commerce, as the tax on value added on investment goods was deductible. As a practical measure to offset this, a special employers charge would be levied in the form of a payroll tax at a rate of 1 per cent of all salaries and wages. No time-limit had been fixed for this tax. To avoid transitional difficulties resulting from the shift from the previous tax on investment goods to a tax on value added, business enterprises would have the right to an extra deduction of 10 per cent from the State income tax assessment for machinery acquired during 1968. No similar arrangements had been made for existing stocks.

Question 6. A group of purely fiscal experts had proposed that tax on value added should not be levied at the import stage but all the interested parties in Sweden, including importers, had felt that it should be imposed at that stage, since the tax would apply to all transactions and a transaction lay behind importation. If tax on value added were not applied at importation a certain amount of cash, estimated at about SKr 18 to 20 million, would not be tied up, thus escaping interest payments. On the other hand, if tax on value added is
applied at the border it must be paid within fifteen days in the same way as
customs duties, while credit for domestic sales could be granted for up to two
months. The economic effects of making adjustments at the border also depended
on the length of time goods were in the hands of the importer.

It was suggested that the explanation given by Sweden and other delegations
on this point might be of critical interest to the Working Party, that countries
with a tax on value added system should evaluate the question again, including
any costs that might result from not making adjustments at the border, and that
a paper on this point might be prepared at a later stage.

**Question 7. Yes.**

**Other**

Delegations noted that tax periods varied by category of firm and enquired
why the tax period was shorter for export firms than for others. The
representative of Sweden said that, as a general rule, the tax period was two
months. For very small firms the interval was longer. A one-month period was
used if a firm's credit under the system was greater than its liabilities by
more than SKr 1,000. The credit was then paid in cash. This would apply
normally to export companies but could also apply to other companies in special
circumstances.

The representative of Sweden confirmed that there was no excise tax on tea
and that the burden of taxation on tea would not be increased by the introduction
of the tax on value added.

**Selective Excise Taxes**

**JAPAN**

The delegate of Japan referred to Spec(68)88, which explained the essential
characteristics of the Japanese indirect tax system, including the border tax
adjustments made in respect of indirect taxes.

**Question 1.** Japan's indirect tax system was, in terms of the contribution to
the national revenue, composed primarily of a series of taxes on particular
consumption of goods. These were taxes on alcoholic drinks; on tobacco
products, for which there was a State monopoly; and on hydrocarbon oils. Their
contribution to the total national revenue amounted as a whole to 11.9 per cent,
based on 1966 figures. The revenue from the taxes on the three commodity groups
which had long been traditionally subject to indirect taxes in most countries,
accounted for about 52 per cent of revenue from all indirect taxes, excluding
customs duties.

Taxes were levied on various other goods, including passenger motor
vehicles, sugar, refrigerators, cameras, cosmetics. The revenues from all taxes
on consumption accounted for 22.7 per cent of the total budgetary revenue in
fiscal year 1966. These excise taxes were, with some exceptions, generally
charged on the manufacturer's selling price.
Question 2. A tax was imposed in Japan on coffee, cocoa and chicory which Japan did not produce in significant amounts. However, this tax was imposed solely for the purpose of raising revenues, in accordance with the ability to pay, from various types of beverages, whether or not nationally produced in substantial quantities.

Question 3. In regard to the border tax adjustments at the time of exportation, the use of tax-exempt sugar was authorized for confectionery and the use of tax-exempt components of automobiles such as car coolers was authorized for buses. No border tax adjustments of the kind mentioned in the question were made at the time of importation.

Question 4. As for imports, border adjustments were based on the value for customs purposes which included insurance and freight plus customs duty on such goods. The border tax adjustments at the exportation were based on the actual selling price on the home market.

In cases where specific duties were applied to imported goods the bases and rate applicable to such goods were the same as those applicable to similar home-produced goods.

Question 5. Selective excise taxes were imposed on any purchaser, no matter whether the purchaser were a firm or not. Therefore, generally speaking, there was no way for firms to avoid payment of such taxes.

Question 6. All goods which were subject to excise taxes were exempt from such taxes at the time of exportation. In cases where any goods on which excise taxes had already been imposed were exported or where any confectionery or canned fruits for which some taxed raw sugar had been used as a raw material were exported, such taxes were repaid upon presentation by exporters of the tax payment certificate issued by the chief of the local tax office.

Question 7. In Japan, adjustments were normally made at the border. Only in the case of those goods such as jewellery, fur coats, etc. were adjustments made not at the border but at the later retail stage.

Question 8. Not applicable.

Question 9. The following were exempted at importation:

(a) souvenirs for personal use value of which was not more than $10;

(b) goods imported personally for own use or for professional purposes.
In reply to questions on the escalation of excise rates on alcohols which in practice appeared to place a higher tax burden on imported spirits such as whisky, the representative of Japan said that rates were decided on the basis of ability to pay and that higher rates were imposed on luxury products. Luxury Japanese products did not escape the higher rates. He undertook to try to obtain information on the criteria used for differentiating the rates and figures showing the quantity and value of alcohols paying each of the rates, broken down by imported and domestic products. Asked why coffee was still taxed, the representative of Japan said that coffee had not traditionally been drunk in Japan and, in that market, could be regarded as a luxury product.
STATEMENT BY THE DELEGATION OF THE FEDERAL REPUBLIC OF GERMANY ON
QUESTION IA(c)5 OF THE OUTLINE (L/3125, PAGE 27)

The German Delegation believes that in order to answer this question it
is necessary to look first on the mechanism of the added value tax and then it
will be possible to show the external aspects of this tax.

1. The mechanism of the added value tax

Explaining the functioning of the added value tax is not so much a question
of describing the methods of taxation. It is much more important to show what
economic results are achieved by the methods of added value taxation. This is
best explained by an example:

Assuming that A delivers goods worth DM 100,000 to B, A and B are
assumed to be entrepreneurs. For this delivery A has to pay - if the tax
rate amounts to 10 per cent - DM 10,000 as added value tax to the tax office.
At the same time, the bill sent by A to B will list the price of the goods
as DM 100,000 and separately the tax paid as DM 10,000. B will settle the
account totalling DM 110,000 with A. Paying DM 10,000 as added value tax
cannot present any difficulties to B since as an entrepreneur he has the
right to deduct prior-stage tax. B may immediately deduct this amount from
taxes paid on his own sales. If B is not in a position to deduct this
amount, the DM 10,000 will be refunded him by the tax office. Taxation of
the goods delivered by A is thus cancelled by the prior-stage tax deduction
effected by B. The tax burden on the goods delivered is equal to zero for B.
Neither A nor B need therefore calculate the tax.

The added value tax only becomes an actual burden to persons purchasing
the goods without having the right to deduct prior-stage tax. If B were not
an entrepreneur but a consumer, the goods would remain charged with added
value tax of DM 10,000 because in this case B cannot deduct the prior-stage
tax. In the case of such a delivery the full cost and price effect and,
thus, the problem of shifting the added value tax arises.

This example shows that prior-stage tax deduction is the essential element
of the added value tax mechanism. The right to deduct prior-stage tax - almost
automatically - has two economically important effects. On the one hand, this
right results in the fact that all sales effected by enterprises having the right
to prior-stage tax deductions are in practice tax-free sales. The tax burden on
goods sold by enterprises to enterprises is thus always equal to zero. For
entrepreneurs having the right to prior-stage tax deductions the economic problem
of shifting the added value tax will therefore not arise in the case of inter-
business sales. Competition is effected on the basis of prices before taxation
(net prices). On the other hand, the right to prior-stage tax deduction guarantees
that goods are equally charged with taxes in those cases when they enter the
consumption stage. It ensures the competitive neutrality of the added value tax system. The uniform and competitively neutral burden is obtained regardless of the number of stages that the products have gone through in the course of their production and distribution. Prior-stage tax deduction has cancelled - as has been show above - the cost and price effect in the case of all transactions in goods between enterprises.

The actual tax burden which becomes effective when the goods enter the consumption stage due to the fact that the consumer does not have the right to prior-stage deductions, always corresponds to the respective nominal tax rate. As to its economic effects, the added value tax can therefore be identified with the mechanism of a retail trade tax which is meant to apply exclusively to private consumption.

In addition, it should be noted, however, that the efficiency of the added value tax mechanism depends decisively on how the essential element of the system has been designed. If the right to prior-stage tax deduction is restricted for social, political or other reasons to the effect that certain pre-stage taxes are excluded from all deductions, the mechanism can no longer function properly. Non-deductible prior-stage taxes will turn into hidden taxes on the enterprises and possibly become cost and price effective in the form of cumulative taxes. It goes without saying that under these circumstances the added value tax, from an economic point of view, can no longer function as retail trade tax and be competitively neutral. This will result in distortions of competition which will be difficult to control. The problem arising in the development of an added value tax system consists in ensuring that the right to prior-stage tax becomes effective as far as possible without restrictions.

2. Border tax adjustment under the added value tax

It is one of the advantages of the added value tax system that no special adjustment measures have to be taken for border crossing goods if the principle of taxation according to the law of the country of destination set forth in the General Agreement on Tariffs and Trade is applied. This advantage of the added value tax can be attributed to the mechanism described above. Since as a rule only those entrepreneurs export and import who have the right to prior-stage tax deduction, almost all foreign trade is effected in a sphere in which the goods are not subject to taxation. In the case of exports and imports the economic problem of calculating and shifting added value tax does not arise.

(a) Exports

The added value tax burden on export goods is avoided by the following measures: first of all, exportation is tax exempt. Secondly, exporters have the right to prior-stage tax deduction. These two measures ensure that prior-stage taxes paid in the course of the production of export goods are deducted from taxes which are imposed on domestic sales. If there is no possibility of deducting previously paid taxes because the exporter for example has not effected any
domestic sales, prior-stage taxes are as a rule immediately refunded. Thus, it is guaranteed that export goods are not charged with added value tax as the following example will show:

Assume that the domestic producer A delivers goods worth DM 150,000 to the exporter B. For this delivery A has to pay a tax amounting to DM 15,000 to the tax office. A will make out the following bill to B:
DM 150,000 for goods delivered + DM 15,000 for added value tax paid = a total of DM 165,000. B pays this full amount. He will export these goods to the value of DM 200,000. B need not pay any taxes for this export delivery as it is tax exempt. Against the tax office B claims his right to deduct the prior-stage tax that A has placed to his account in the amount of DM 15,000. He reduces his tax liabilities for domestic sales by this prior-stage tax. If B has not effected any domestic sales, the prior-stage tax in the amount of DM 15,000 will be refunded. The tax burden on export goods therefore is equal to zero. For this reason no problems concerning the shifting of the added value tax will arise for A and B.

(b) Imports

In the case of imports (by entrepreneurs) the right to prior-stage tax deductions prevents the foreign goods - just as in the case of domestic transactions - from carrying a tax burden. Imported goods are exempt from added value tax according to the following procedure: formally a turnover tax on imports is levied upon imports unless there has been an application for postponement. This tax is, however - as is the case with taxes on domestic deliveries - merely a regularly deductible prior-stage tax. Therefore, the importer can immediately deduct the turnover tax on imports from the taxes to be paid on domestic sales. If deduction should not be possible, the turnover tax on imports as a rule is immediately refunded to the importer by the tax office. The right granted to entrepreneurs to deduct the turnover tax on imports immediately, and if need be, the refunding of these taxes, ensures that imported goods will not be liable to taxation. This is again illustrated in an example:

Assume that importer A imports goods worth DM 200,000; hence he has to pay to the customs office DM 20,000 as turnover tax on imports unless he has applied for postponement of the payment. Assuming further that importer A subsequently sells the goods to the domestic entrepreneur B at a price of DM 250,000 he owes DM 25,000 to the tax office. As A has the right to prior-stage tax deduction his tax liability amounts to (25,000 - 20,000 of taxes already paid) = DM 5,000. At the same time, however, A will make out the following bill for his customer B: DM 250,000 for goods delivered + DM 25,000 for added value tax paid = a total of DM 275,000. B pays this full amount to A, and gets a refund of the taxes paid by A amounting to DM 25,000 by way of prior-stage tax deduction (set off against domestic tax liability or refund). Thus, the actual tax burden on the imported goods for entrepreneur B is equal to zero.
As foreign products on importation by entrepreneurs are not actually charged with added value tax, equal treatment of imported and domestic products within the framework of this tax is consequently effected on a tax-free basis. As in the case of domestic products, foreign and domestic goods enter into competition on the basis of net prices.

The interpretation given at times, according to which the added value tax burdens imports and domestic production alike, is misleading. It gives the impression that the added value tax could become price and cost effective with imports and domestic transactions. This interpretation fails to reveal the facts - as explained above. The added value tax actually becomes a burden only when goods are purchased by persons who are not eligible for prior-stage tax deduction.

There is a certain interdependence between the above-mentioned misleading interpretation of the effects of added value tax on imports and its effects on the budget. In some cases the added value tax levied on imports (turnover tax on imports) is treated as actual revenue in the setting up of budgets. The tax payment of importers is regarded as actual tax revenue. Such an approach is, however, not permissible. The taxes paid by importers cannot result - as has been shown in the above example - in an actual revenue due to the prior-stage tax deduction or the refunding of taxes. These taxes - just like all taxes paid by entrepreneurs (excluding mainly the retail trade) - will not remain at the disposal of the treasury. They are withdrawn, so to speak, by the entrepreneurs by way of prior-stage tax deduction and refunds. Within the framework of the added value tax the desired fiscal effect results only when goods are delivered to final consumers who cannot deduct prior-stage taxes nor apply for refunds of taxes paid at earlier stages. With reference to imports this case is an exception which is entirely without significance. Imports are as a rule effected by entrepreneurs. Taxes paid on imports can therefore not be regarded as actual tax revenue in the budget.