



# BAT v VAT



**Edwin Vermulst**  
Partner VVGB Advocaten  
ECIPE 23 March 2017

# BAT

**“The border tax adjustment took on new significance and finally has emerged as a headline item and an issue of political attention.”**

**“Border tax adjustment is one of the most peculiar problems of international trade and one that has recently developed considerable prominence.”**

**“... the border tax adjustment problem has implications going considerably beyond the narrow confines of its current economic effects. It could be the bellwether for the future of international trade cooperation.”**

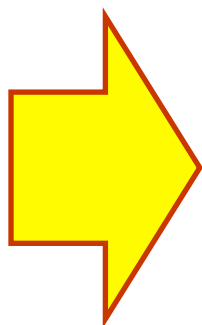
## **Ecclesiastes 1:9:**

**“What has been will be again, what has been done will be done again; there is nothing new under the sun.”**

# Ryan-Brady Tax Proposal

## According to the Blueprint

### 1. US corporations to be taxed on revenues based on place of consumption of goods and services (destination principle):



- Domestic sales revenue of domestically produced goods taxed @ 20% and deductions permitted;
- Export revenue not taxed;

### 2. Deductions on domestic sales revenue for tax base: Value of US labor and inputs BUT no deduction for imported inputs.

**NB: Precise structure and details of the tax system might affect possible WTO violations.**

# ***Prima Facie* WTO-inconsistency**

## From the perspective of imports

**No deductions for imported goods and services from tax base but deductions permitted for domestic (US) goods and services**

- 1. Implications:** (i) Penalizing imports by fully taxing them and more favorable treatment for domestic goods; (ii) impetus to use domestic over imported goods.
- 2. Violations: Article II:1(b) of the GATT 1994 -**
  - If considered equal to a tax on imports → results in tariffs exceeding those in the US' tariff schedules; or
  - Possibly violates the prohibition on the imposition of “any other duty or charge of any kind”.

**Article II:1(b)**

# Prima Facie WTO-inconsistency

## From the perspective of imports

No deductions for imported goods and services from tax base but deduction permitted for domestic (US) goods and services

### Article II:1(b)

*“The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.”*

# Prima Facie WTO-inconsistency

## From the perspective of imports

### No deductions for imported goods and services from tax base but deduction permitted for domestic (US) goods and services

#### 2. Violations (Cont.): Articles II:2(a) and III:2 of the GATT 1994

- Possibly violation of the national treatment obligation because imports will be subject to a tax not applicable to like domestic products as their import cost cannot be deducted from the revenue.

#### Article II:2 (a)

- Permits imposition on imports of a charge equivalent to an internal tax imposed consistently with the national treatment provisions of Article III:2 in respect of the like domestic product.

#### Article III:2

- *“The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.”*

# Prima Facie WTO-inconsistency

## From the perspective of imports

No deductions for imported goods and services from tax base but deduction permitted for domestic (US) goods and services

## 2. Violations (Cont.): Article 3.1(b) of the SCM Agreement

- **Possibly an import substitution subsidy which is prohibited:** Reduction of the tax base if inputs are domestic. Therefore, tax reduction contingent upon the use of domestic over imported goods.

**Prohibited import  
substitution subsidy**

- **Article 3.1(b) of the SCM Agreement:** Subsidies contingent in law or in fact upon use of domestic over imported goods.



# ***Prima Facie* WTO-inconsistency**

## From the perspective of exports

### Export revenue not taxed

- 1. Implications: Essentially an impetus for exports;**
- 2. WTO violation: Possibly a prohibited export subsidy (i) if it were to be considered a *direct* tax applicable to producers and not on products as seems to be the case; and (ii) the tax is structured as providing an exception.**



**Prohibited export subsidy**

# Prima Facie WTO-inconsistency

## From the perspective of exports

### Export revenue not taxed

#### Prohibited export subsidy

- **Article 3.1(a) of the SCM Agreement:** Subsidies contingent, in law or in fact upon export performance, including those illustrated in Annex I;
- **Annex I item (e):** *“The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises.”*
- **FN 58: Direct taxes:** *“taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property.”*

# Prima Facie WTO-inconsistency

## From the perspective of exports

### Export revenue not taxed

**2. Even if not considered a direct tax but an indirect tax on products: Likely WTO violation** because in excess of the indirect tax applicable on like products when sold for domestic consumption.

#### Item (g) of Annex I

- *“The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.”*

#### FN 58: Indirect taxes

- *“...sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges.”*

# Conceptually VAT is Trade Distortive

From the perspective of imports

Import VAT = 21% (e.g. in Belgium)

- **Domestic sales price ex works: 100**
  - **21% applied on 100 = 21**
  - **Total price including VAT for buyer = 100 + 21 = 121**
- **Imported product ex works sales price: 100**
  - **21% applied on total of CIF customs value (100 + 7 CIF costs) + import duty (10%) + AD/AS duty (20%)**
  - **Total price including VAT for buyer = 100 + 7 + 10.7 + 21.4 = 139.1 x 1.21 = 168.32**

# Conceptually VAT is Trade Distortive


## From the perspective of exports

- **Export VAT = 0**

 ***De facto* encouragement to exports;**

- **Benefit exacerbates in case of exports to countries with low or no VAT:**

- **Import VAT in Australia = 10%;**
- **Import VAT in UAE = 0**

 **Exports stand to benefit from lower VAT compared to the 21% rate applicable on sales in Belgium.**

# Conceptually VAT is Trade Distortive

- **Conceptually, VAT has trade distortive effects:**
  - **Imports v domestic sales:** On the one hand, imports are at a disadvantage due to the VAT calculation base even though the rate of imposition is the same as that applied on like domestic products (i.e. 21%); and
  - **Domestic sales v exports:** The latter are exempted from VAT.
- ***Prima facie* there is no WTO violation** because of the negotiated approach towards indirect taxes between WTO members (Article II:2 GATT and Annex I, SCM Agreement).
- **However, could the value/basis on which the VAT is applied on imports effectively result in a violation of Article III:2 of the GATT?**