

The Argument

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- Border tax adjustments (BTAs) are now part and parcel of a wholesale new Trump trade agenda the specifics of which have not been worked out yet
- Will use the Ryan-Brady proposal as example only to discuss the status of BTAs in GATT/WTO
- BTAs can be GATT-consistent if
 - Taxes can be lawfully adjusted and
 - Importers imposing taxes must ensure adherence to nondiscrimination
 - Exporters exempting from imposition respect Subsidies Agreement

Make in U.S.A.
or pay big
border tax!"

— Jan. 3 tweet



Outline

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- What is the US Ryan-Brady proposal?
- Is it GATT-consistent?
- What are the consequences of the legal qualification?

Ryan-Brady

Ryan-Brady DBCFT

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- Ryan-Brady DBCFT (destination-based cash flow tax)
 - Cash flow: relief from expenditure
 - Destination based: export market will tax what US does not tax
 - Move towards VAT (although not formal espousal)
 - Incentive to import less, use local content, and export more
- At this stage, Ryan-Brady has not been enacted into law
- There is uncertainty as to which taxes will be adjusted

Simplified Ryan-Brady

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- We assume a simplified Ryan-Brady which we use as illustration to discuss consistency of BTAs with GATT/WTO
 - A US processing industry exports its produce
 - ✦ When using US input it can deduct all costs including wage bills deviating from prior practice, which did not allow for similar deductions
 - ✦ When using inputs originating outside US cannot deduct cost of supplies deviating from prior practice, which allowed for deductions

Is Our Ryan-Brady Consistent with the WTO?

Legal Benchmark for Consistency

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- US adjusts the tax of its produce when exporting
 - Adjustment conditional on exportation hence a BTA
- GATT treatment of Border Tax Adjustments (BTAs) is key
 - No head-on regulation of BTAs
 - A Working Party (WP) established that issued a report in 1971
 - Legal value of report is anyway that of GATT acquis (if not a prior decision and thus part and parcel of GATT)
 - ✦ Subsequent panels dealing with this issue **must** take it into account

What is a Border Tax Adjustment?

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A GATT Story

GATT-Think

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- Liberalization recipe
 - Reduce ‘protection’ (elusive concept) to one instrument, tariffs
 - Ban QRs (import, export)
 - Domestic policies must observe nondiscrimination (concession erosion)
- Tough on border- less so on domestic instruments
 - QRs banned
 - Tariffs capped, now on way to extinction
 - Domestic policies, including taxation, are defined by each member
 - ✦ Whether to tax, at what level is each WTO member’s decision

Jurisdiction and Adjustments

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- GATT does not address jurisdiction as to domestic policies
 - WTO members can regulate their market and decide on level of taxes that goods produced therein would pay (territoriality)
 - If goods are exported
 - ✦ Under the **origin** principle, no adjustment takes place; tax is paid where goods have been produced
 - ✦ Under the **destination** principle, adjustment does take place; tax is paid where goods will be consumed
- Question is, if destination principle is endorsed, which domestic policies can be adjusted?

Belgium Asked the Question First

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- 1952 Belgium-Family Allowances
 - Belgium levies a charge on goods originating in countries the system of family allowances of which does not meet certain requirements
 - ✦ Belgium's family allowance system funded through payroll taxes
 - ✦ 1939 law exempts from obligation to pay a levy goods originating in countries with comparable to Belgium system of family allowances
 - ✦ Others contribute to Belgium scheme
 - Complaint by Denmark, and Norway
 - Belgian measure struck down because it was discriminatory
 - But the question remains: is this tax adjustable?
 - 1968 a Working Party is established to discuss the issue

WP on Border Tax Adjustments (BTAs)

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- GATT endorses the **OECD** definition of BTAs
 - Any fiscal measure which puts into effect the destination principle
- Three questions dominate the discussions
 - Which taxes are adjustable?
 - ✦ Ambitious approach: draw a list of taxes which could be adjusted
 - Who adjusts?
 - ✦ Importer only? Exporter only? Or both?
 - What GATT discipline should adjustable taxes observe?
 - ✦ Need to draw an inventory of relevant provisions
 - ✦ Need to avoid inconsistencies

What is Adjustable?

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Partial Agreement (Partial Disagreement)

The Distinction between Direct-Indirect Taxes

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- GATT debated the claim that it favours members that practice indirect (VAT) over those that practice direct (property) taxes
- Wrong assumption
 - Indirect taxes can be passed forward in product prices
 - Direct taxes will be absorbed
 - But market conditions and tax uniformity will determine tax incidence not a legal qualification whether a tax is direct or indirect
- Note, it is more likely that the level of taxes distorted conditions of competition
 - Hufbauer (2017): US has consistently high corporate taxes

The Outcome of the WP

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- WP members agreed that
 - Taxes directly applied on goods that are eligible for adjustment
 - ✦ Excise-; sales; cascade-; VAT
 - Taxes not eligible for adjustment (not directly levied on goods)
 - ✦ Social security charges; payroll taxes
 - Provide reasons for adjustment; methods used; compensation amount
- WP members could not agree on
 - ‘Taxes occultes’ (invisible taxes; e.g., delivery by producers)
 - Property taxes
- Legal value: GATT *acquis* (1bis GATT 1994) at least
 - Panels will take it into account

Who Adjusts?

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Importers and Exporters

Importer, Exporter

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- Importer can adjust taxes
 - US produce imported in EU is susceptible to EU VAT
- Exporter can adjust taxes
 - US exempts from consumption taxes goods exported to third markets

Legal Disciplines for Adjustable Taxes

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**Of Taxes, Subsidies, Economic Logic,
and Legal Reality**

The Relevant Legal Disciplines

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- On the import side (main provisions)
 - II: customs duties
 - ✦ BTAs not customs duties (unilaterally defined; aimed to restore equivalence)
 - III: Domestic policies
 - ✦ irrelevant if perceived at the border
 - I (MFN)
 - ✦ Important both when exporter and/or importer adjusts
 - Subsidies (SCM Agreement now, not then)
 - ✦ Firewall between III and subsidies (III.8); tax differentials are not subsidies
- On the export side
 - XVI + (SCM Agreement now, not then)
 - ✦ Relieving exported goods from the obligation to pay domestic taxes could be an export subsidy

When Importer Adjusts

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- Since they cannot be customs duties (they are nonnegotiable, unilateral impositions), BTAs are domestic taxes
- They must observe nondiscrimination
 - Item (g) Illustrative List of Export Subsidies, SCM Agreement makes this point clear
 - Irrespective of how elusive this concept is, or how often it has been misapplied by the WTO AB

When Exporter Adjusts

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- When exporter relieves exporters from obligation to pay say consumption taxes
 - XVI GATT: The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy
 - Illustrative List of SCM Agreement item (g)
 - ✦ The adjustment is not considered an export subsidy if tax is indirect
 - ✦ Illustrative List of SCM includes a list of indirect taxes
 - VI GATT/Antidumping Agreement
 - ✦ The adjustment is not considered dumping
 - ✦ It is mandated by government, it is not private practice

WP on BTAs: the Aftermath

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Litigation (and its Discontents)

Partial Agreement Led EU, US Back to the Court

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- DISC (and related disputes)
 - Both US and EU members' tax regimes found to be inconsistent (XVI.4)
 - ✦ France, Belgium, Netherlands, US: 12 years litigation
 - ✦ US: DISC part of 'Nixon shock': encourage exports in roundabout manner
 - Companies introduced DISCs, and deferred 25% of taxes on exports
 - Disagreements persisted; DISC became FSC and judged illegal again
 - ✦ Hudec (1975), (1988); Jackson (1978); Charnovitz (2005); Mavroidis (2016)
- Beyond Ryan-Brady, BTAs could find application in the realm of policies aiming to avert climate change
 - Horn and Mavroidis (2011)

Some Additional Clarifications

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- US-Taxes on Petroleum (Superfund) (1987)
 - GATT allows for adjustment of taxes imposed directly on products (and disallows adjustment of taxes indirectly levied)
 - GATT does not care about purpose of taxation
 - ✦ General revenue or rational use of environmental resources are immaterial to the question of eligibility for adjustment
 - ✦ In similar vein, what happens with proceeds is also immaterial, even if they are used to help domestic goods, US-Measures Affecting the Importation, Internal Sale and Use of Tobacco (1994)

Ryan-Brady in the WTO Ring

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One or Two Measures?

One or Two Measures?

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- Is the measure the deduction from taxes when exporting only, or is the measure that and the refusal to deduct cost of imported supplies?
- Why an issue?
 - No clear case law on what is the scope of a ‘measure’
 - Since GATT is negative integration, US has right to modify its laws as long as it respects nondiscrimination
 - ✦ Refusal to deduct is MFN (but should it observe national treatment as well?)

Inconsistent Anyway

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- If two measures, tax is direct tax on earnings, not adjustable
 - Direct taxes do not feature in the Illustrative List
 - Might look like a VAT but panels would find it hard to accept exemption of a direct tax, when illustrative list contains only indirect taxes
 - Formalism guided the outcome in US-FSC
 - The question of discrimination would not arise
 - III.8 GATT is the reason why
- If one measure, it is discriminatory
 - Value added will be treated differently depending on whether it is domestic or foreign value
 - Measure favours use of domestic value added (\neq III GATT)

Accessory

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- Complainants could argue Ryan-Brady nullifies benefits and raise a nonviolation complaint (NVC) if they can show that
 - Ryan-Brady postdates exchange of concessions
 - ✦ easy
 - Nullifies benefits
 - ✦ Equally easy
 - Was not expected at the moment when concession was exchanged
 - ✦ Equally easy since presumption in favour of complainants that Ryan-Brady could not have been anticipated precisely because it postdates exchange of concessions (Japan-Film)

Consequences of Legal Qualification

US-World Relations Could Go Pear Shaped

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Countermeasures Galore

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- Bown (2017) estimates retaliation against US could rise to
 - \$220 billion annually
 - An additional \$165 billion annually if it is treated as subsidy
 - Total of \$385 billion
 - ✦ Trade in goods EU/US (total EU imports and exports was ca. \$520 billion)
- The amount is staggering
 - Past experience suggests transatlantic partners approach retaliation with caution
 - ✦ EU did not fully utilize the \$4 billion option against US in US-FSC
 - Non transatlantic partners almost never retaliate

Tack så mycket