Border Tax Equalization

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The assigned topic of "border tax equalization" does not exactly match the treaty terms of the WTO Agreement (Goode 2007, p. 61). But that phrase "border tax equalization" often serves as a codeword for a public policy that seeks, among other purposes, to impose (or relieve) fiscal measures at the border in order to match or counteract a domestic policy on imports or exports. The economic rationale for a border tax adjustment was recognized by economists at least as far back as the early 19th century when David Ricardo argued that when a domestic tax raised the price of corn, "a duty should be imposed on its importation" (Ricardo 1822, p. 15).[1]

This paper explores the many facets of border tax equalization as one of the challenges facing the world trading system. In particular, the paper will address the following questions: First, under what circumstances does the law of the World Trade Organization (WTO) permit border tax equalization?[2] Second, what are the implications of those disciplines for current multilateral challenges such as climate change? Relatedly, should WTO law on border tax equalization be revised in order to better achieve the goals of the trading system or other multilateral goals?

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[1]The domestic tax at issue in Ricardo's analysis was not a pure tax on a product. Rather, Ricardo referred to "peculiar taxes" on corn, "such as tithes, a portion of the poors' rate, and perhaps, one or two other taxes, all of which tend to raise the price of corn…."

[2]The paper addresses only general WTO law, not the individual laws of accession applying to countries, such as China, that entered the WTO under sui generis rules.

I. Overview of WTO Law on Border Tax Equalization

Governments apply a variety of measures at the border and also apply policies to imports and exports within the domestic market. Although perhaps of diminishing significance, the most important border measure is the common tariff. In WTO law, such a tariff is known as an "*ordinary customs duty*" (OCD). Besides OCDs, governments have been known to utilize many other border measures that go by names such as a transitional surcharge, foreign exchange fee, or exceptional duties. Such fees, charges, and duties fall within the GATT nomenclature of "*other duties and charges*" (ODC). Another type of border measure is the antidumping duty or countervailing duty applied to an imported products. When taxes or charges apply (equally or unequally) to both domestic and imported products, such measures are often referred to as "*internal taxes*" or "*internal charges*." Such taxes or charges can be imposed or exempted. The economic instrument of an internal regulation is often substitutable with an tax. Such *internal regulations* can be applied solely to imports (for example, a sanitary regulation) or to both imports and domestic production in a symmetric fashion. Although this is not typically done, a *subsidy* applied to domestic production could also be applied to a like imported product. Much more common is the subsidy applied to the exportation of a good, known in the WTO as a (prohibited) export subsidy. The rebating of taxes upon exportation can also be an export subsidy depending on the type and amount of tax rebated. Of course, many *tax rebates* at time of exportation are not considered export subsidies.

The rationale for the use of this panoply of governmental instruments can reflect either domestic or foreign policy interests, or both. The instruments of ODC, OCD, antidumping and countervailing duties, internal taxes and charges, internal regulations, subsidies, and tax rebates are employed by governments principally to achieve a domestic policy purpose (but could also have secondary foreign policy purposes). By contrast, other instruments, including quantitative restrictions, import bans, and export bans, are commonly used directly not only for domestic policy purposes, but also for foreign policy purposes. Such quantitative restrictions and import/export bans lie outside of the scope of this paper.

ODCs, OCDs, trade remedies, taxes, charges, regulations and subsidies have a variety of motivations including raising revenues, shielding domestic producers from competition, protecting consumers, leveling the playing field, and avoiding double taxation. All of these purposes can be legitimate under WTO law in certain circumstances. For example, purely protective OCDs are permitted provided that they at levels below or equal to any tariff binding and imposed on a most-favored-nation basis (or consistently with a preferential trade agreement).[3] Taxes on imports solely to raise revenues are permitted provided that the imported product is not being treated less favorably than the like domestic product. The remission at the border of indirect taxes accrued on exported products is permitted.[4] Certain direct taxes related to exports can be remitted in order to avoid the double taxation of foreign source income.[5] Consumer regulations applying to domestic products can generally be applied to imported products provided that the like imported product is not being treated less favorably and the regulation is not more trade restrictive than necessary to fulfill a legitimate objective.[6]

Although the WTO Agreement does not detail permitted objectives of measures that are legally allowed, within WTO policy discourse several of the above measures are justified for the purpose of leveling the playing field with a competing economy. For example, antidumping duties imposed on imports are calibrated to equilibrate with the "full margin of dumping or less" of the foreign

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[3]The WTO Appellate Body has quoted approvingly the statement of the *Turkey - Textiles* panel that "A basic principle in the GATT system is that tariffs are the preferred and acceptable form of protection." Appellate Body Report, *India - Additional Import Duties*, adopted Nov. 17, 2008, para. 159 footnote 316 (citing Panel Report, *Turkey - Textiles,* para. 9.63).

[4]Agreement on Subsidies and Countervailing Measures (SCM Agreement), Art. 1.1(a)(1)(ii) and footnote 1, and Annex I, paras. (g), (h).

[5]SCM Agreement, Annex I, para. (e), footnote 59, 2nd paragraph.

[6]GATT Art. III:4, Agreement on Technical Barriers to Trade, Arts. 2.1, 2.2.

production.[7] The highest permitted countervailing duty is equalized to the amount of the foreign subsidy found to exist, "calculated in terms of subsidization per unit of the subsidized and exported product."[8] Although the SCM Agreement prohibits employing a subsidy as a "specific action against a subsidy of another Member," governments do regularly take into account the domestic subsidies offered by their trading partners in determining whether to provide parallel domestic subsidies.

Like the other measures, taxes and charges can be imposed or remitted for all of the same reasons noted above. An excise tax on a domestically made product is imposed on the like imported product to level the playing field and perhaps to raise revenue. A value-added tax imposed on domestic products is remitted on export to level the playing field and avoid double taxation despite the reduction in revenue for the government. Although GATT Article II:1(b) second sentence prohibits the imposition of ODCs,[9] GATT Article II:2(a) carves out of that discipline "a charge equivalent to an internal tax" imposed consistently with GATT Article III:2 in respect of the like domestic product or in respect of an article from which the imported product has been manufactured. Specifically, Article II:2(a) provides:

> Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product: (*a*) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III* in respect of

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[7]Antidumping Agreement, Art. 9.1.

[8]SCM Agreement, Art. 19.4.

[9]GATT Article II:1(b) states:

> 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.

This means that no new ODCs can be imposed (on at least bound items) following a government's entry into the GATT or the WTO. See WTO Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994. Frieder Roessler goes further in saying that "The second sentence obliges Members to reduce the number and diversity of import duties or charges by prohibiting, in principle, all duties and charges on bound items other than ordinary customs charges." Roessler 2010, pp. 266, 269 (Table 1). Yet as Roessler also notes, there is suggestion in the caselaw that an ODC validly recorded in the GATT Schedule of Concessions would be permitted. Id. p. 267.

> the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part....[10]

In other words, as Frieder Roessler has explained, this provision clarifies that governments have a right to burden imports with the collection of the charges specified in Article II:2(a) (Roessler 2010, p. 267).[11] Roessler also notes that the purpose of the border adjustment is "To equalize conditions of competition..." (Roessler 2010, p. 268).

This GATT Article II provision came into play in the GATT *Superfund* case, where Canada and the EEC challenged a U.S. tax on certain imported substances.[12] As described by the panel, under this U.S. tax, "the amount of tax on any of the imported substances equals in principle the amount of the tax which would have been imposed under the Superfund Act on the chemicals used as materials in the manufacture or production of the imported substance if the taxable chemicals had been sold in the United States for use in the manufacture or production of the imported substance."[13] In defending itself against a claim of a GATT violation, the United States pointed to GATT Article II:2(a) and argued that the Superfund Act "imposed the same fiscal burden on imported and like domestic substances."[14] The panel agreed with the United States that its excise tax adjustment was consistent with GATT Articles II:2(a) and III.[15]

Superfund was a highly precedential case in explicating the contours of the GATT Article II:2(a) exemption for border tax adjustments for environmental purposes. The EEC argued that the

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[10]The asterisk refers to the Ad Note which referenced the original date to go into force.

[11]The remainder of Article II clarifies that governments have a right to burden imports with antidumping and countervailing duties and with fees commensurate with the costs of services rendered.

[12]GATT Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, adopted June 17, 1987. Another issue in the case a U.S. tax on petroleum. This dispute is known as the *Superfund* case.

[13]Id. para. 2.5.

[14]Id. para. 3.2.5.

[15]Id. paras. 5.2.7, 5.2.8, 5.2.10.

U.S. tax was not "eligible for border tax adjustment" because "It was a tax on pollution…", not a sales or excise tax imposed for general revenue purpose.[16] In addition, the EEC and Canada argued that the pollution created in the production of the imported substances did not occur in the United States" and "it was therefore inappropriate to tax these substances upon entry in the United States."[17] In addition, the EEC argued that "it was incorrect to assume that the border tax adjustments were necessary to avoid giving foreign producers an unfair advantage."[18] Rather, the EEC suggested that the foreign competitors of the United States "could be assumed to have paid for the pollution caused by the production of the chemicals and substances either directly -- by paying a tax for the removal of pollution -- or indirectly -- by meeting regulatory requirements designed to prevent pollution."[19] Based on that assumption, the EEC then argued that the U.S. border tax adjustments gave U.S. producers an unfair advantage because a chemical exported from the EEC to the United States "would have to bear the costs of environmental protection twice: once in the exporting country in accordance with the Polluter-Pays Principle and upon importation into the United States under the Superfund Act."[20] The EEC further argued that it was inappropriate for the United States to exempt export sales of the involved chemical from the excise tax "because the pollution caused by the production of those chemicals occurred in the United States whether the chemicals were sold in the domestic market or abroad."[21]

The panel rejected the line of objections put forward by Canada and the EEC. According to the panel, the purpose of a tax is irrelevant: "Whether a sales tax is levied on a product for general revenue

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[16]Id. para. 3.2.7.

[17]Id.

[18]Id. para. 3.2.8.

[19]Id.

[20]Id.

[21]Id. para. 3.2.7.

purposes or to encourage the rational use of environmental resources, is therefore not relevant for the determination of the eligibility of a tax for border tax adjustment."[22] The panel went on to explain that although the GATT's rule on tax adjustment set maxima limits for adjustment, governments were free to impose a lower tax or no tax at all on like imported products.[23]

The *Superfund* case played an important role in 1987 in teeing up several difficult issues that were discussed extensively in the trade and environment debate of the 1990s and that continue to perplex the trading system today. These issues include: (1) what kind of taxes or charges are eligible for border adjustment, (2) when are rebates on environmental or energy taxes a prohibited export subsidy, (3) how does a defendant government show that a border tax equalization qualifies for the carveout in GATT Article II:2(a), and (4) are environmental purposes still irrelevant under GATT Articles II:2(a) and III:2, and (5) how would recourse to Article XX (General Exceptions) by the defendant make a difference in cases challenging policy-motivated border tax adjustments.

Only one dispute has occurred during the WTO era regarding GATT Article II:2(a) – *India - Additional Import Duties*. Thus, this case and *Superfund* constitute the only significant jurisprudence on border adjustments under Article II:2(a). In the India case, the complainant United States challenged certain additional and extra-additional duties levied on imports into India that were designed to "counterbalance" domestic sales taxes, value-added taxes, and various other local taxes. Ultimately, neither the panel nor the Appellate Body found any violations, but the Appellate Body in dicta suggested that many of the Indian border charges challenged did not meet the conditions of GATT Article II:2(a).

These holdings by the Appellate Body in 2008 provide important guidance on the application of GATT Article II:2(a) to an ODC with respect to its alleged "corresponding" domestic

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[22]Id. para. 5.2.4.

[23]Id. para. 5.2.5.

"counterparts."[24] First, ODCs cover only duties and charges on imports that are not OCDs.[25] Second, Article II:2(a) "exempts" a charge from the coverage of Article II:1(b) only when the Article II:2(a) conditions are met.[26] Third, whether a measures is a "charge" under Article II:2(a) or an "internal tax or other internal charge" under the Ad Note to GATT Article III "has to be decided in the light of the characteristics of the measure and the circumstances of the case."[27] Fourth, an ODC is not necessarily of a nature that it discriminates against imports.[28] Fifth, the term "equivalent" in Article II:2(a) needs to be interpreted "harmoniously" with the requirement of consistency with Article III:2.[29] Sixth, the requirement for consistency with Article III:2 applies both to an internal tax as well as a charge.[30] Seventh, the requirement for equivalence between a charge and an internal tax requires a comparative assessment that is both qualitative and quantitative in nature; such an assessment needs to include elements of effect, amount, and value.[31] Eighth, consistency with Article III:2 is a necessary condition to qualification under Article II:2(a).[32] Ninth, that a plaintiff in making a prima facie claim under Article II:1(b) may be required not only to present arguments regarding that provision, but also to present arguments that the challenged measure is *not* justified under Article II:2(a).[33]

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[24]Appellate Body Report, *India - Additional Import Duties*, paras. 208, 211.

[25]Id. para. 151.

[26]Id. para. 153.

[27]Id. para. 153, footnote 304.

[28]Id. para. 158.

[29]Id. para. 170.

[30]Id. para. 170.

[31] Id. paras. 170–175.

[32]Id. para. 181.

[33]Id, para. 190.

The WTO law on border adjustments is also informed by the talismanic 1970 Report of the Working Party on Border Tax Adjustments (GATT 1970) which has been cited by five Appellate Body reports. The Working Party begins its Report by defining "border tax adjustments" (based on an OECD definition) as measures that "enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market and which enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products" (GATT 1970, para. 4). In addition, the Working Party made several important points relevant to this paper. First, there was a suggestion that the term "border tax adjustments" be replaced with "tax adjustments applied to goods entering into international trade" (GATT 1970, para. 5). Second, "GATT provisions on tax adjustment applied the principle of destination identically to imports and exports" (GATT 1970, para. 10). While that characterization of the trade law may have remained valid from 1970 to 1994, it would appear to have been overturned by the adoption of the SCM Agreement which trumps the GATT in the event of an inconsistency. Third, the GATT provisions on border tax adjustment "set maxima limits for adjustment (compensation)…" (GATT 1970, para. 11). This point was picked up in the *Superfund* case and remains a good interpretation today. Fourth, the Report noted the disagreement among governments as to whether border adjustments could cause trade distortions, and noted that other governments believe that border adjustments "create equality between imported and domestically-produced goods" (GATT 1970, paras. 12–13). Fifth, taxes "directly levied on products were eligible for tax adjustment," such as excise duties, sales taxes, and value-added taxes (GATT 1970, paras. 14). This remains good law. Sixth, "certain taxes that were not directly levied on products were not eligible for tax adjustment," such as payroll taxes (GATT 1970, paras. 14).[34] This remains good law and was

[34]Note that the Report does not say that all taxes not levied on products are not eligible for border adjustment.

broadened and enacted with respect to exports in the SCM Agreement.[35] Seventh, the Working Party noted that there was a divergence of views as to the eligibility for adjustment of "taxes occultes" which are certain consumption taxes on capital equipment, and taxes on advertising, energy, machinery and transport (GATT 1970, para. 15(a)). This lacunae in law remains a legal gap today and was not clarified in the SCM Agreement.[36] Eighth, the Working Party discussed how to interpret the term "like product" (GATT 1970, para. 18) and this is the part of the Report that has been regularly alluded to in the WTO jurisprudence. The WTO caselaw on "like product" continues to mature and is more nuanced than is suggested by a rereading of the 1970 Working Party Report.

Putting all this together, one can begin to restate the WTO law on border tax equalization. With regard to imports, a government may impose a border charge on an imported product when such charge is equivalent to (and not in excess of) an internal product tax on a like domestic product. A government may also impose a border charge on an imported product when such charge is equivalent to an internal tax in respect of an article from which the imported product has been manufactured or produced in whole or in part. With regard to exports, a government may remit (or relieve) from an exported product an indirect tax, but may not remit in excess of those taxes levied in respect of the production or distribution of like products when sold for domestic consumption.

The law on border tax equalization also clarifies what adjustments are prohibited. With regard to imports, a charge mirroring an internal payroll or social security tax would not be eligible to impose on imports. And of course, charges in excess of the corresponding domestic internal tax would be illegal adjustments. Moreover, because Article II:2(a) incorporates Article III:2, a charge imposed on an import cannot be in excess of a tax or charge applied directly or indirectly to a like domestic

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[35]SCM Agreement, Annex I, para. E.

[36]See SCM Agreement, Annex I, para. (e), footnote 58 defining direct taxes to be taxes on wages, profits, interest, rent, and all other forms of income including the ownership or real property. This provision does not address consumption taxes or excise taxes on energy, transportation, etc.

product. This rule would seem to preclude border tax adjustments based on direct taxes. With regard to exports, the SCM Agreement prohibits adjustments for direct taxes and social welfare charges and adjustments for indirect taxes in excess of the domestic tax (with one possible exception).

Under the existing caselaw, several issues remain unresolved: First, would a tax occultes (or to use David Ricardo's term, a peculiar tax) be border adjustable on imports or exports, particularly when such a tax, for example, a pollution tax or an energy tax, is styled as a tax on a product? Second, how narrowly could the accordion of "like product" contract in comparing an imported and domestic product that have different environmental or social externalities? Third, does GATT Article II:2(a) permit the imposition of a charge equivalent to the economic effects of an internal regulation? Fourth, does the SCM Agreement permit border adjustments on exports of prior stage cumulative indirect taxes on energy or pollution?

This first issue can be concretized by considering a carbon tax on domestic products calculated with respect to the consumption of fossil fuels used in producing such a product. Could a border carbon charge on imports be instituted equivalent to this internal tax? One of the leading WTO law experts has clearly said no; Frieder Roessler writes that GATT Articles II and III "do not permit Members to offset the competitive impact of internal taxes borne by producers (such as energy taxes raising the costs of transportation) and regulations affecting exclusively production (such as emission regulations increasing the cost of production)" (Roessler 2010, p. 271). In my view, however, leaving aside problems under the Article I most-favored-nation rule (to be discussed below), one could argue that such an adjustment could be doable under GATT Articles II and III (Hufbauer, Charnovitz & Kim 2009, pp. 67–69) And at least in principle, even if there is a violation of GATT Articles I or II/III, there could still be a policy defense under the environmental exceptions in GATT Article XX.

The second issue is whether a WTO court would ever treat matched products as *not* like based on the processes and production methods (PPMs) used in producing the product. For many decades, trade law doctrine has denied this possibility, but the caselaw has evolved on how to apply the factor of "consumers tastes and habits" identified in the Border Tax Adjustment Working Party Report as one of the relevant factors in determining product likeness. Although it did not specifically consider product likeness, the recent decision of the Appellate Body in *Canada – Renewable Energy/FITs* shows an important development in the caselaw. In that dispute, the central issue was whether the Ontario renewable energy subvention was a subsidy as defined in the SCM Agreement. A contested question was whether the feed-in-tariff provided a "benefit" to the recipient and for that, the Appellate Body held that the relevant market for analysis was not the wholesale electricity market, but rather electricity produced from renewable energy.[37] The Appellate Body did not specifically state that electricity made from renewable energy was not a like product to electricity made from carbon energy, but based on past jurisprudence, if two products do not compete in the same market, then one would consider that not only are they not "like" under GATT Article III:2 first sentence, but they are also not "directly competitive" under GATT Article III:2 second sentence.

The third issue is whether a regulation can be border adjusted with a fiscal charge or tax on the import. Traditionally, commentators have denied that such cross-adjustment was a possibility pursuant to GATT Article II:2(a)). For example, Hufbauer, Charnovitz & Kim wrote in 2009 that "when there is no domestic tax, then the application of the supposedly corresponding tax or charge on imports is not a BTA [border tax adjustment]…." (Hufbauer, Charnovitz & Kim 2009, p. 66). Paola Conconi and Jan Wouters wrote in 2010 that "the exception under Article II:2(a) seems to require that there exist a domestic *charge* (e.g. not product standard) that is counterbalanced by a border charge…" (Conconi & Wouters 2010, p. 258). Roessler (quoted above) wrote in 2010 that GATT border adjustment rules

[37]Canada – *Certain Measures Affecting the Renewable Energy Generation Sector/* Canada – *Measures Relating to the Feed-In Tariff Program,* WT/DS412, WT/DS426, adopted May 24, 2013, paras. 5.177–178.

"do not permit Members to offset the competitive impact of … regulations affecting exclusively production (such as emission regulations increasing the cost of production)" (Roessler 2010, p. 271). Most WTO law commentators (including me) would continue to deny the possibility of cross regulation/tax adjustment, but a comprehensive analysis would have to take into account defenses under GATT Article XX. Moreover, as Don Regan has noted, whether a measure for border adjustment purposes is a tax or a regulation may not be clear (Regan 2009, p. 122), an ambiguity we have also seen in the U.S. Obamacare debate.

Adjusting border tax adjustments based on the country of origin also raises legal problems under the most-favoured nation disciplines in GATT Article I.[38] The norm of a border adjustment is to apply a charge to imports equivalent to a domestic tax. But should this norm be origin blind? In other words, what if the exporting country already has an equivalent domestic tax? Should the importing country be able to refrain from taxing the imported product so as to avoid double taxation?

This general question arose early in the GATT in the *Belgian Family Allowances* case in 1952.[39] To complement the domestic tax revenue it was using to pay for family allowances, Belgium had imposed a parallel domestic tax on imported goods purchased by public bodies.[40] In an exercise of comity, Belgian had exempted from taxation imports from countries whose system of family allowances met similar requirement to Belgium's system. (Belgium was not using its provision to

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[38]GATT Article I:1 states:

> With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III,* any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

[39]Belgian Family Allowances, BISD 1S/59, adopted Nov. 7, 1952.

[40]Belgium's tax was an internal tax reviewed solely under Article III; Belgium did not raise a defense under Article II:2(a).

encourage other countries to adopt a similar social policy, but rather was presumably seeking to avoid double taxation.) Norway and Denmark had been denied the exemption and brought a case to the GATT seeking to show that they were as qualified for the exemption as France and other countries, and alleging discrimination. The complainants won the case but on much broader grounds because the panel ruled that the system of exemptions violated GATT Article I:1. *Belgian Family Allowances* established an important precedent in the trading system that remains good law today although one should note that Article XX would be available as a defense for a policy motivated system of exemptions if that policy is covered within Article XX (Charnovitz 2005). In addition, one should note that WTO jurisprudence has left open the issue of whether certain origin-neutral distinctions (e.g., based on corporate characteristics) could be consistent with GATT Article I. The most recent Appellate Body holding came in the 2014 European Communities – *Seal Products* case where the appellators stated that "Article I:1 permits regulatory distinctions to be drawn between like imported products, provided that such distinctions do not result in a detrimental impact on the competitive opportunities for like imported products from any Member."[41]

The issue of whether to exempt the imported product from a border adjustment for policy reasons was at the forefront of the 1970 *Superfund* case and has reappeared in discussions of trade and the environment since then. As noted above, the EEC argued that the United States should have assumed that foreign producers had already paid a tax on pollution and therefore its exports should have been exempted from the border adjustment so that its producers would not have to bear the costs of environmental protection twice.[42] The panel rejected this line of reasoning, holding that the United States was entitled to a tax adjustment to match its tax on like domestic products.

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[41]EC – Seal Products, WT/DS400,401/AB/R, adopted June 18, 2014, para. 5.88.

[42]GATT Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, para. 3.2.8.

The *Superfund* and *Belgian Family Allowances* holdings together create a conundrum. On the one hand, the adjustment on imports is allowed to equilibrate competition. Yet on the other hand, applying the adjustment to imports from certain countries could dis-equilibrate competition because the exported product would already be bearing the burden of the tax at home. But *Belgian Family Allowances* rules out distinguishing imports based on their origin.

One traditional answer to this conundrum going back to the early OECD studies is that if all countries remitted such a domestic tax on exports, then in principle there would be no double taxation. But the problem is that relevant government instruments are broader than just taxes on products. Taxes on processes and producers are likely not be rebatable on exports under the SCM Agreement and the cost of regulations certainly cannot be remitted to exporters. Furthermore, a government may for budget (or other policy) reasons not want to remit taxes on exports.

The fourth issue is quite complex and beyond the scope of this paper. Although the Tokyo Round Subsidy Code can be read as to have prohibited the rebates of tax occultes, the SCM Agreement allows the rebate of prior-stage cumulative indirect taxes levied on "inputs" that are consumed in the production of the exported product.[43] The SCM Agreement also allows the rebate of indirect taxes on the production or distribution of like product destined for domestic consumption.[44] These provisions has been the subject of scholarly debate, but have not been interpreted in WTO dispute settlement. One scholar has recently opined that rebates of energy and carbon taxes are justified under the SCM Agreement (Coppens 2014, p. 518).

The above overview of WTO law on border equalization is summarized below. Although the discussion above identified some potential flexibilities and escape hatches in WTO law, Table 1 below adopts a hardnosed position in viewing WTO law restrictively:

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[43]SCM Agreement, Annex I, para (h) and Annex II.

[44]SCM Agreement, Annex I, para (g).

Table 1.

When Do WTO Rules Prohibit Border Equalization of Social and Environmental Taxes?

	Measure	**WTO Law Status**
On Imports		
	Application of charge equivalent to a domestic tax on like products	Permitted under GATT Art. II:2(a)
	Application of a charge equivalent to a domestic tax on the production process	Prohibited by GATT Art. III:2 and II:2(a)
	Differential application of a charge on imports depending on the exporting country	Prohibited by GATT Art. I
	Application of a charge equivalent to the economic effect of a domestic regulation on like products	Prohibited by Article III:2
On Exports		
	Exemption of a tax or charge borne by the domestic product	Permitted by SCM Agreement and GATT Ad Art. XVI
	Exemption of a tax on inputs consumed in the product process	Status under SCM Agreement unclear
	Differential application of the export exemption depending on the importing country	Prohibited by GATT Art. I

As noted above, measures inconsistent with GATT Articles I, II, or III could potentially be justifiable under the GATT Article XX environmental exceptions in paragraphs (b) and (g). This exception would be applicable to border adjustments on imports, but not on exports, because the latter are governed by the SCM Agreement which today lacks an environmental exception. Detailing the law and caselaw of Article XX is beyond the scope of this paper, but two key points can be noted.

First, a measure could be justified under Article XX if it has a purpose of protecting human, animal or plant life or health or conserving exhaustible natural resources. Tax measures designed to collect more government revenue or make a domestic regime politically feasible would be viewed by a WTO panel as falling outside of those acceptable environmental purposes. Second, to qualify under Article XX, a measure must pass scrutiny under the chapeau of Article XX which requires "that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade…." This provision has been interpreted to require transparency, due process, and flexibilities for individual exporting countries.

II. Implications for Multilateral Challenges

One of the key issues in climate change policy is the interface of climate and international trade (World Economic Forum 2010). The UN Framework Convention on Climate Change (UNFCCC) states the general principle that "Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade" (Art. 3.5). Neither the UNFCCC nor any subsidiary acts discuss border tax equalization.

Several governments considering climate legislation have floated proposals to incorporate border adjustments to address so-called carbon leakage or to avoid competitiveness impact. Such proposals have been a particularly salient feature in the U.S. legislative process (Durán Medina & Polanco Lazo 2011, p. 31).

The latest such proposal is the Healthy Climate and Family Security Act of 2014 (H.R. 5271), introduced by Congressman Chris Van Hollen and colleagues in July 2014. This bill caps carbon emissions, auctions carbon pollution permits, and returns these auction receipts to American residents. In addition, the Van Hollen bill includes a chapter on "Border Adjustments" that would impose a "carbon equivalency fee" on imports of carbon-intensive goods. The amount of the carbon equivalency fee would be set equal to the cost that domestic producers of a comparable carbon-intensive good incur as a result of-- (1) prices paid in the acquisition of carbon permits by covered entities; and (2) carbon equivalency fees paid by importers of carbon-intensive goods used in the production of the comparable carbon-intensive good. The bill also provides for a payment to exporters of carbon-intensive goods produced in the United States. The amount of the payment would be equal to the cost that domestic producers of the carbon-intensive good incur as a result of-- (1) prices paid in the acquisition of carbon permits by covered entities; and (2) carbon equivalency fees paid by importers of carbon-intensive goods used in the production of the comparable carbon-intensive good. The bill also contains a sunset provision for the import and export provisions which states that these programs shall cease to have effect at such time as and to the extent that-- (1) an international agreement requiring countries that emit greenhouse gases and produce carbon-intensive goods for export markets to adopt equivalent measures comes into effect; or (2) the country of export has implemented equivalent measures. The bill defines an "equivalent measure" as a tax, or other regulatory requirement that imposes a cost, on manufacturers of carbon-intensive goods located outside the United States, by reason of greenhouse gas emissions in the production of such goods by such manufacturers, approximately equal to the cost imposed by this legislation on manufacturers of comparable carbon-intensive goods located in the United States. The bill does not discuss its relationship to WTO law, and no statement by Congressman Van Hollen has come to my attention analyzing the WTO implications of this bill. Moreover, unlike some other U.S. legislation over the years, the bill does not contain a provision for suspending a challenged measure should it be found to be a trade law violation.

In August 2014, the Van Hollen bill was praised by the Washington Post in an editorial "An answer to global warming," (Washington Post 2014, p. A16.) The editorial opines that the border charge

> will be hard to pull off efficiently. Officials will have to calculate the carbon footprint of various goods from various points or origin, and other countries will accuse the United States of protectionism. Yet any carbon pricing plan will have to include some trade adjustment. Otherwise U.S. industry will be disadvantaged.

The *Post* editorial makes no mention of the trade law problems with the proposal.

The question of whether the Van Hollen bill would be consistent with WTO border adjustment rules is straightforward. It would not. The carbon equivalency fee would not qualify under GATT Article II:2(a) because there would be no equivalent internal tax or charge to mirror. Rather, there would be a domestic regulation that would require producers to purchase carbon permits. The payment to exporters would likely a prohibited export subsidy because there is no domestic indirect tax to be rebated at the border. The exemption for imports of particular goods from countries with taxes or regulations that impose a cost on local manufacturers approximately equal to the cost imposed by U.S. law would violate GATT Article I and be very questionable on due process and transparency grounds under the chapeau of GATT Article XX. Even if it is true that for domestic U.S. political reasons, any carbon plan will have to include some trade adjustment, as the *Post* avers, that domestic political constraint is not likely to buttress the case for WTO legality before a WTO panel.

Does WTO law need to be changed to accommodate climate measures? One answer could be current WTO law is adequate because governments should not attempt to shift the costs of their domestic policies onto their trading partners. But that is not a satisfactory answer given the justification for at least some adjustments in Ricardian economics and the longtime accommodation in trade rules for border equivalency measures. The fact that climate change is a global challenge also makes it hard to rule out in principle all unilateral measures seeking to induce multilateral solutions. While it may be true that if all governments agreed to identical climate measures there would not be need for border measures, that condition of consensual climate policymaking does not exist.

Perhaps the most radical proposal on this topic came 30 years ago in a landmark study by Gary Clyde Hufbauer and Joanna Shelton Erb. They recommended that in order to “restore fiscal sovereignty" to GATT parties, "the international community should embrace the full destination principle as a *permissible* (not *mandatory*) method of border tax adjustment, for both direct and indirect taxes" (Hufbauer & Erb 1984, p. 55). In other words, a country that wants to shelter its industries from the consequences of high taxation could provide destination principle border adjustments, and a country that did not wish to shelter could refrain from them. How such a flexible tax adjustment scheme might have worked out in practice would be an interesting gaming exercise.

Five years go, a major study on trade and climate (Hufbauer, Charnovitz & Kim 2009, p. 106) called for the negotiation of an international Trade and Climate Code that would include permission for the imposition of carbon equivalent taxes at the border based on domestic costs. This proposal also called for a credit for imports from countries that imposed equivalent carbon taxes on their production and exports. No progress toward such a Code has occurred over the past half-decade.

Looking ahead, one path forward might be for multilateral stakeholders in the trade and climate regimes to devise a model carbon adjustment scheme that could copied by governments into their domestic climate legislation and considered by climate negotiators for inclusion within climate law norms.

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