27 June 1949

BRAZILIAN INTERNAL TAXES

First Report adopted by the CONTRACTING PARTIES on 30 June 1949

(GATT/CP.3/42 - II/181)

1. The working party examined the question of internal taxes imposed by the Government of Brazil, in order to determine whether these were consistent with Brazil's obligations under the General Agreement.

2. Details of the taxes in question were furnished by the Brazilian delegation.

3. With the agreement of the Brazilian representative, the working party decided to adopt, as the basis for its examination, the text of Article III of the General Agreement as modified by the protocol amending Part II and Article XXVI. At the time of examination, Brazil was bound by the provisions of the original and not of the amended text, but it was understood that the government of Brazil intended to accept the protocol in the near future.

4. The working party agreed that a contracting party was bound by the provisions of Article III whether or not the contracting party in question had undertaken tariff commitments in respect of the goods concerned. The delegates of Brazil and India qualified their agreement by the statement that the obligations of Article III applied only in respect of goods exported by other contracting parties.

5. The working party then considered the Brazilian Law 7404 of 1945. The Brazilian delegate agreed that the law imposed taxes which discriminated between products of national origin and like products supplied by other contracting parties, but pointed out that, during the period of provisional application, the application of the provisions of Article III of the Agreement was limited by the Protocol of Provisional Application in the sense that contracting parties were obliged to apply the provisions of Part II of the Agreement only "to the fullest extent not inconsistent with existing legislation". The Brazilian delegate informed the working party that any change in the rates of tax established by this law could not have been effected by administrative action, but would have required amending legislation to be enacted by the Brazilian Congress. The working party therefore concluded that in view of the mandatory nature of Law 7404 the taxes imposed by it, although discriminatory and hence contrary to the provision of Article III, were permitted by the terms of the Protocol of Provisional Application and need not be altered so long as the General Agreement was being applied only provisionally by the Government of Brazil.

6. The working party then examined Law No. 494 of 1948, and first considered two particular taxes established by it, relating to *conhaque* and clocks and watches respectively.

7. With reference to amendment No. 7 made to Brazilian internal taxes by Article I of Law No. 494 of 1948, the Brazilian delegate explained that this amendment concerned beverages containing aromatic or medicinal substances and known as tar, honey or ginger *conhaque*, which were quite different from French cognac. He gave an assurance that the authorities responsible for administering the taxes were able to distinguish between those products (which were of strictly local origin and subject to a tax of 3.60 cruzeiros per litre) and cognac imported from abroad. He made it clear that home-produced beverages similar to the cognac produced abroad were subject to the tax of 18 cruzeiros per litre. The members of the working party accepted this explanation, since the Brazilian delegate gave an assurance that careful instructions would be sent to the authorities administering the taxes, concerning the distinction to be drawn between these various products.

8. As regards alarm, table and wall or hanging clocks, the Brazilian delegate agreed that the law of 1948 had imposed a new discrimination which was not permitted by the terms of the Agreement even during the period of provisional application and agreed to recommend that the law should be modified in this respect. The delegate of Brazil pointed out that there was no domestic production of watches and that those imported into Brazil were supplied mostly by countries which were not contracting parties. He agreed, however, that watches would in future have a separate classification in the law and that the same rate of tax would be applied to the imported and to the (theoretical) domestic product.

9. The working party then considered as a whole the other taxes imposed by Law No. 494 of 1948.

10. As regards cigarettes, the working party found that under the Law No. 8538 of 1946 (which modified Law 7404 of 1945 in respect of cigarettes) the difference between the highest tax charged on cigarettes of national origin and the tax charged on imported cigarettes was 2.70 cruzeiros per 20, whereas under the law of 1948 the tax on imported cigarettes was at the same level as the highest tax on cigarettes of national origin, and in both cases, the tax had been raised to 8 cruzeiros per 20. The delegate of Brazil explained that the retail price on which the tax was based included the rate of tax itself.

11. In all remaining cases the rates of tax on the domestic product had been increased, and the differential of 100 per cent on the rate imposed on imported products had been retained, with the result that the absolute difference between the two rates had been increased although the proportionate relationship had been retained. The Brazilian delegate, supported by one other member of the working party, took the view that, since this proportionate relationship had already been established by the law of 1945, any increase in the absolute difference in the rates was permitted during the period of provisional application, so long as this proportion was retained.

12. The other members of the working party, however, took the view that the Protocol of Provisional Application limited the operation of Article III only in the sense that it permitted the retention of an absolute difference in the level of taxes applied to domestic and imported products, required by existing legislation, and that no subsequent change in legislation should have the effect of increasing the absolute margin of difference. To take a case in point, the Brazilian law of 1945 required the tax on domestic liqueurs to be 3 cruzeiros and the tax on imported liqueurs 6 cruzeiros. The law of 1948 had raised the tax on domestic liqueurs to 18 cruzeiros and the tax on imported liqueurs to 36 cruzeiros. These members of the working party felt that while the Brazilian Government was entitled to raise the tax on the domestic product to 18 cruzeiros, the new tax on imported liqueurs could not in these circumstances exceed 21 cruzeiros if the increase were to be compatible with the requirements of Article III and the Protocol; it was evident to them that the structure of the law of 1945 (which imposed a margin of 100 per cent on imported products) could have been modified when the rates had been altered.

13. The Brazilian delegate adduced the further argument that the object of Article III was to prevent the protection of domestic products by the use of discriminatory taxes, and that therefore unless it could be shown that the effect of the law of 1948 had been to increase the protection of the national product, the law could not be held to be incompatible with the provisions of Article III. In support of this argument the Brazilian delegate said that Article III, paragraph 2, should be read in the light of paragraph 1 and for the interpretative note to paragraph 2.

14. Several members of the working party, on the other hand, took the view that the interpretative note to Article III, paragraph 2, modified the second sentence only of that paragraph, that taxes on imported products in excess of those on like domestic products were inherently protective and therefore in all cases contrary to Article III, and that the second sentence, as explained by the interpretative note,

merely referred to certain other types of taxes which were proscribed by Article III because of the protective results which might occur.

15. The Brazilian delegate supported by two other delegates, advanced the view that unless damage to other contracting parties could be demonstrated, a breach of Article III could not be alleged. Three other members of the working party took the view that, whether or not damage was shown, taxes on imported products in excess of those on like domestic products were prohibited by Article III, and that the provisions of Article III were intended to prevent damage and not merely to provide a means of rectifying such damage. The Cuban delegate supported the interpretation of the Brazilian delegate in cases where there was no domestic production of the like imported product.

16. The delegate for Brazil had stated at the meeting of the CONTRACTING PARTIES that in respect of some of the products on which internal taxes were imposed there were hardly any imports from other contracting parties. He laid particular emphasis on the interpretative note to Article III, paragraph 2, and stated that none of the contracting parties was either greatly interested or affected by the levy of these internal taxes. He did not feel that in such a situation contracting parties were materially affected and could lodge a complaint. In this connection, the delegate of Brazil submitted the argument that if an internal tax, even though discriminatory, does not operate in a protective manner the provisions of Article III would not be applicable. He drew attention to the first paragraph of Article III, which prescribes that such taxes should not be applied "so as to afford protection to domestic production". His view of the obligations under Article III was, he said, borne out by the interpretative note to paragraph 2. The delegate for Brazil, supported by one delegate, suggested that where there were no imports of a given commodity or where imports were small in volume, the provisions of Article III did not apply. Another delegate took the view that the provisions of Article III applied in cases where there were small imports, but not in cases where there were no imports. The other members of the working party argued that the absence of imports from contracting parties during any period of time that might be selected for examination would not necessarily be an indication that they had no interest in exports of the product affected by the tax, since their potentialities as exporters, given national treatment, should be taken into account. These members of the working party therefore took the view that the provisions of the first sentence of Article III, paragraph 2, were equally applicable whether imports from other contracting parties were substantial, small or non-existent.

17. In conclusion the working party noted that the Brazilian Government had already called the attention of the Brazilian Congress to all existing laws providing for different levels of taxation with respect to domestic and imported products, in order to bring those laws into conformity with Article III of the General Agreement. The working party also accepted the statement by the Brazilian delegation that the Government was willing to send a further message to the congress asking it to proceed as soon as possible with the amendment of all such laws and in particular the law of 1948.

18. It was understood that in view of the constitutional procedure of Brazil such action by the Brazilian Congress, even in respect of the law of 1948, could not have an effective result before 1 January 1950.

19. In view of these statements the working party recommends to the CONTRACTING PARTIES that no further action in this matter be undertaken at the present session, but that at the next session the question should be reviewed in the light of action taken by the Brazilian Government by that date.