Background

The COVID-19 pandemic has ushered us in an era of increased protectionism. A recent report of the World Trade Organization suggests that at least 80 countries have put in place some sort of export prohibitions or restrictions on account of COVID-19. India has been no exception. Beginning March this year, India also placed export restrictions on face mask, personal protection equipment and certain pharmaceutical drugs. The Prime Minister has also appealed to citizens to use local goods as opposed to imported goods. An Economic Times report suggested that the government was mulling a proposal to levy 15% COVID-19 tax (**COVID-19 tax**) on all chemical and petrochemical imports from May 1, 2020 to March 31, 2021 to protect domestic manufacturers. The report suggested that the COVID-19 tax would apply to all imports of chemical and petrochemical products including preferential imports under India's various free trade agreements (**FTA**) in addition to the applied tariff. It is not clear whether the proposed tax would be applied on the landed value of products in addition to the basic customs duty or it would be in the form of a surcharge/ cess applied on the basic customs duty. Certain industry associations such as Aluminum Association of India (AAI) and the All India Plastic Manufacturers' Association have appealed to the government to refrain from applying such a duty. The proposed tax has not yet been levied.

While the economic prudence of the proposed move is debatable, we assess the treatment of the levy of a special COVID-19 tax in addition to basic customs duty under the relevant WTO rules and some of India's FTAs, should such a tax be levied in future.

GATT 1994 and the schedule of concessions: What taxes are permitted?

The General Agreement on Tariffs and Trade 1994 (**GATT 1994**) sets out disciplines with respect to border taxes that are applied to imported products. Article II:1(b) of the GATT 1994 prohibits a Member from applying:

- ordinary customs duties (**OCDs**) *in excess of* those specified in its schedule of concessions; and
- all other duties or charges of any kind (**ODCs**) in connection with importation of a product *in excess of* those recorded in the schedule of concessions as on the date of the agreement (i.e. April 15, 1994)[1].

However, this does not prevent a Member from imposing on the importation of a product:

- a charge equivalent to an internal tax imposed consistently with Article III:2 in respect of a like domestic product;
- an anti-dumping or countervailing duty applied consistently with Article VI; or
- fees or other charges commensurate with the cost of services rendered.[2]

Chapters 28 to 38 of the HS Code broadly pertain to chemical and petrochemical products. India's schedule of concessions records varying OCDs for products falling within these chapters with lowest being 5%, highest being "unbound" (i.e. can maintain any duty) and the median applicable duty being approximately 40%. India is permitted to impose OCDs up to the ceiling specified in its schedule of concessions. Notably, India has not scheduled any ODCs with respect to these products (i.e. India, therefore, cannot apply any ODCs unless such ODCs are in the nature of charges equivalent to an internal tax applied to a like domestic product).

In order to assess consistency of the proposed COVID-19 tax with WTO law, it is critical to determine the nature of the tax i.e. whether it is in the form of: (i) an OCD; or (ii) ODC; or (iii) a charge equivalent to an internal tax applied to a like domestic product; or (iv) and anti-dumping or countervailing duty; or (v) fees or other charges commensurate to cost of services rendered. We can undertake an elimination approach to determine the nature of the proposed COVID-19 tax. The proposed tax is unlikely to be applied to like domestic products given the purpose of the proposal i.e. protection of domestic industry and therefore, it cannot be charge equivalent to an internal tax applied to a like domestic product. It is also not a trade-remedial duty. Further, given the proposed tax is in the form of ad-valorem duty (i.e. 15% of the landed value of the product), it is not in the nature of fees or other charges.[3] Therefore, we are left with two categories i.e. OCD and ODC.

COVID-19 tax: An OCD or an ODC?

The GATT 1994 does not define an ordinary customs duty. Previous Dispute Settlement Body panels have noted that expression **ordinary customs duties** in Article II:1(b) of the GATT 1994 refers to duties collected at the border which constitute **customs duties** in the strict sense of the term (***stricto sensu***) and that this expression does not cover possible extraordinary or exceptional duties collected in customs.[4] In particular, when assessing whether a certain fiscal measure like the proposed

[1] *Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994*, paras. 1 and 2.
[2] GATT 1994, Art. II:2; see also, Appellate Body Report, *India – Additional Import Duties*, para. 153.
[3] Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 7.25.
[4] Panel Report, *Dominican Republic – Safeguard Measures*, para. 7.85.

COVID-tax constitutes an OCD, it is relevant to analyze the **design, structure and operation** of the measure.[5] Accordingly, if the design, structure and operation of the proposed COVID-19 tax is in the nature of a customs duty, then it would constitute an OCD. For instance, if the proposed 15% duty is to be applied on landed value of the products and implemented through a simple modification of basic customs duty pursuant to Section 12 of the (Indian) Customs Act, 1962 read with Section 2 of the (Indian) Customs Tariff Act, 1975, it is likely to qualify as an OCD. To the extent such revised basic customs duty is not in excess of specified ceiling with respect to any product under India's schedule of concessions, such revision of basic customs duty would be permissible.

However, if the proposed COVID-19 tax is applied as a **special tax** distinct from the applicable basic customs duty (whether on landed value or as a surcharge/cess) pursuant to a special legal provision other than Section 12 of the Customs Act, 1962, one could argue that it is in the nature of an ODC.[6] Based on the ET report, it is appears that the proposed tax is in the nature of an **exceptional** duty, aimed to protect domestic industry and would be applicable for a limited period of time. Therefore, the possibility that the proposed COVID-19 tax is viewed as an ODC cannot be ruled out. As stated earlier, India has not scheduled any ODCs and in the event the proposed COVID-19 tax is considered as an ODC, it will be inconsistent with India's obligations under Article II:1(b) of the GATT 1994.

Nevertheless, the GATT 1994 provides for certain general and security exceptions under Article XX and XXI respectively, that allow Members to derogate from their obligations. These exceptions are narrowly construed and in order to avail benefit of any of these exceptions, India would need to demonstrate that the proposed COVID-19 tax meets the requirements under the relevant exceptions.

COVID-19 tax and FTAs

India has also entered into several FTAs including with Japan, South Korea and Singapore which are major exporters of chemical products to India. Unlike the GATT, certain FTAs have specifically defined **customs duties**. For instance, the term **customs duty**, under the India - Korea Comprehensive Economic Partnership Agreement (**India-Korea CEPA**), includes any duty or charge of any kind imposed in connection with the importation of a good with certain exceptions similar to Article II:2 of the GATT 1994 (i.e. duties like trade remedial duties, charges equivalent internal tax applied in accordance with Article II:2 and III:2 of the GATT 1994 and fees or other charges).[7] Similarly, under the India - Japan Comprehensive Economic Partnership Agreement (**India-Japan CEPA**), the term **customs duties** means any customs duty, import duty or a charge of any kind imposed in connection with the importation of a good with similar exceptions.[8] Therefore, in terms of FTA commitments for India, the characterization of the proposed COVID-19 tax as an OCD or an ODC is immaterial. The proposed COVID-19 tax is likely to be viewed as **customs duty** as it is in the nature of import duty to be imposed in connection with the importation of a product and such duty is not proposed to be imposed on like domestic product. Consequently, any imposition of the proposed COVID-19 tax must conform to India's commitment to reduce or eliminate customs duty over a defined period under the respective CEPAs[9] subject to exceptions built in these CEPAs which rely on Articles XX and XXI of GATT 1994.

Both the CEPAs provide for commitments to reduce tariffs gradually between the parties in the manner set out in specific schedule. For example, under the India-Japan CEPA, the duties applicable to most of the products falling under Chapters 28 to 38 of the HS Code (broadly pertaining to chemical and petrochemical products) must be reduced to zero in 11 equal annual instalments from the base rate from the date of entry of force of the agreement.[10] The India – Japan FTA entered into force on August 2011.[11] Based on the provisions of the FTA, assuming a base rate of 10%, India's applied customs duty for the current year appear to be as low as 1% or less given this is tenth year of the agreement. Similarly, under the India-Korea CEPA, India is required to, *inter alia*, eliminate duties for products by fourth year or seventh year ore reduce the duty by 50% by ninth year from the date of entry of force of the agreement.[12] The India-Korea CEPA was came into effect on 1 January 2010. Therefore, several products falling chapters 28 to 38 either enjoy nil duty or 50% of the base duty. Therefore, the proposed COVID-19 tax

[5] Panel Report, *India — Iron and Steel Products*, para. 7.40

[6] For example, the Panel in *India — Iron and Steel Products* while assessing the nature of a safeguard duty took into account the legislative provisions through which the duty was imposed, the purpose of the duty and tenure of the duty and found that it was "an "extraordinary" or "exceptional" instrument and not an "ordinary" one." (para. 7.42).

[7] India-Korea CEPA, Art. 2.1. It may be noted that footnote 1 to the CEPA provides that "Customs duties for India refer to basic customs duties as specified in the First Schedule to the Customs Tariff Act, 1975 of India. This is without prejudice to Korea's position either on the definition of customs duties or on the consistency of India's internal tax or charge equivalent to an internal tax with Article 2.3 of this Chapter or Article III of GATT 1994."

[8] India-Japan CEPA, Art. 16(b)

[9] India-Japan CEPA, Art. 19; India-Korea CEPA, Art. 2.4.

[10] India-Japan CEPA, Annex I, Part I, General Notes, paragraph 1 (d), p. 103 read with Part II, Schedule of India.

[11] India-Japan CEPA, Article 146, Entry into Force.

[12] Year one means the subsequent year after the Agreement enters into force.

at 15% (whether on landed value of the products or as a surcharge) would amount to reneging on the bargain unless India is able to successfully take benefit of in-built exceptions under these CEPAs. which is less than the proposed COVID-19 tax.

While the economic disruptions caused by the pandemic calls for greater governmental intervention in the economy, India must balance its response to the current challenges taking into account its multilateral and bilateral obligations and interests of industries that are dependent on imports of chemical and petrochemical products.

Authors:

Sanjay Notani, Partner

Parthasarathi Jha, Associate Partner

Ronjini Ray, Associate