ICC

Are value-added taxes a barrier to trade?

Policy brief

On 13 February 2025, the United States administration announced the "Fair and Reciprocal Plan", directing the development of a comprehensive strategy to address non-reciprocal trade practices, including value-added taxes (VAT), which the administration considers discriminatory towards US businesses. This ICC policy brief provides an overview of the main features of VAT, operational mechanics, and neutrality in international trade. It clarifies that VAT is a consumption tax – not an import tariff – and highlights how VAT, by design, treats domestic and foreign businesses equally. This brief concludes with key takeaways on the importance of understanding the differences between VAT and tariffs for purposes of international trade policy.

A. What is VAT?

VAT is a consumption tax levied on the supply of goods and services – similar to sales tax in the United States – but with some key differences. While businesses collect and pay VAT throughout the supply chain, the tax is ultimately borne by the final consumer. It is generally considered neutral for businesses, ensuring a level playing field for both foreign and domestic companies.

B. How does it work in practice?

The VAT system operates through a multi-stage payment mechanism: when a business buys a good or service from its supplier (inputs), it pays VAT. When that same business then sells its own goods or services (outputs), it collects VAT from its customers. The business then calculates the amount of tax owed to the tax authorities by taking the input VAT it collected from customers and offsetting it against the VAT it paid to suppliers, resulting in a net tax liability. This mechanism ensures that VAT "flows through" the business and ultimately rests on the final consumer.

At each stage of the supply chain, businesses are entitled to fully deduct the input VAT they have incurred. This ensures that the tax burden ultimately falls on the final consumer and does not unduly burden businesses within the supply chain.

Because VAT can be an effective way to raise government revenue without creating barriers to international trade, VAT has been adopted by over 170 countries globally. Some countries call it Goods and Services Tax (GST) instead of VAT, but the concept is the same.

The United States is a notable exception, being the only major economy that does not apply a national VAT. Instead, it relies on a system of sub-national sales and use taxes at the state level.

C. What does it mean that VAT is neutral?

VAT systems are designed to treat all businesses equally, regardless of their location or origin. This principle of neutrality ensures that no business has an unfair competitive advantage or suffers disadvantage solely because of where they are based, which may otherwise distort international trade and limit consumer choice.

The cornerstone of VAT neutrality is the destination principle, which stipulates that goods are taxed in the country where they are consumed, not where they are produced.

Under the destination principle, exports are exempt from VAT in the country of origin, while imports are subject to the same VAT as equivalent domestic goods in the destination country. This ensures that all products competing in the same market face identical tax treatment, regardless of their origin.

Neutrality for business is ensured at each stage of the supply chain through input VAT deduction (the right for a business to deduct VAT incurred on its purchases as input VAT)**, which makes it a tax borne and paid by the final consumer.**

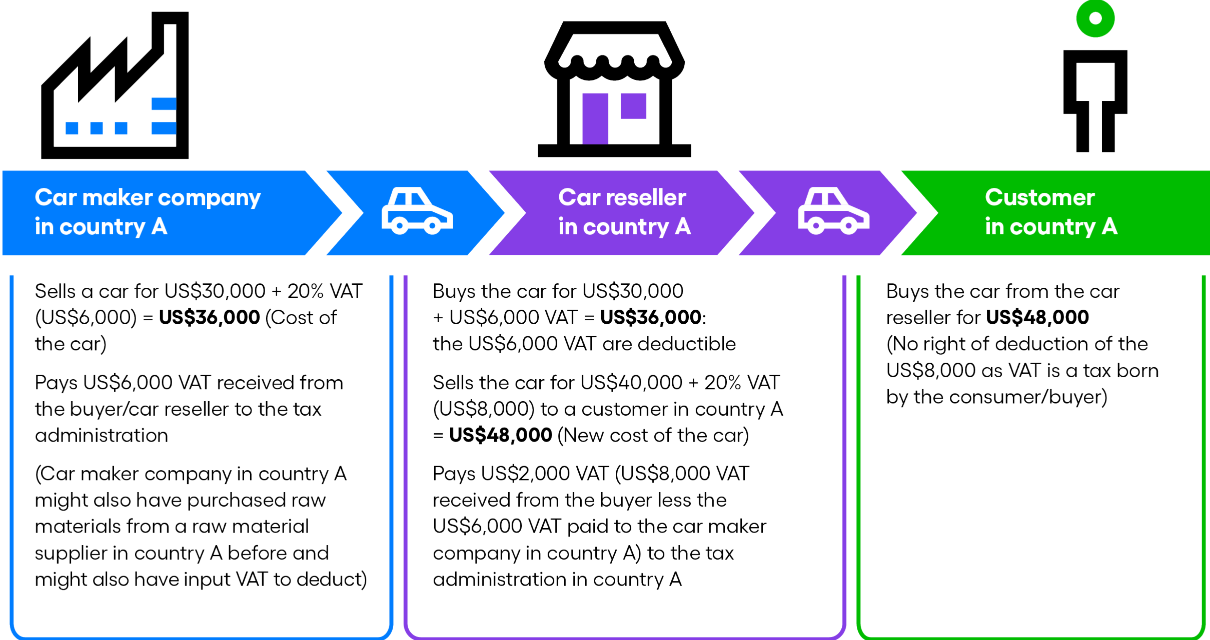
D. Is VAT discriminatory towards foreign business?

No. Due to its design, VAT ensures a level playing field for businesses whether locally established or established abroad.

In concrete terms, this means:

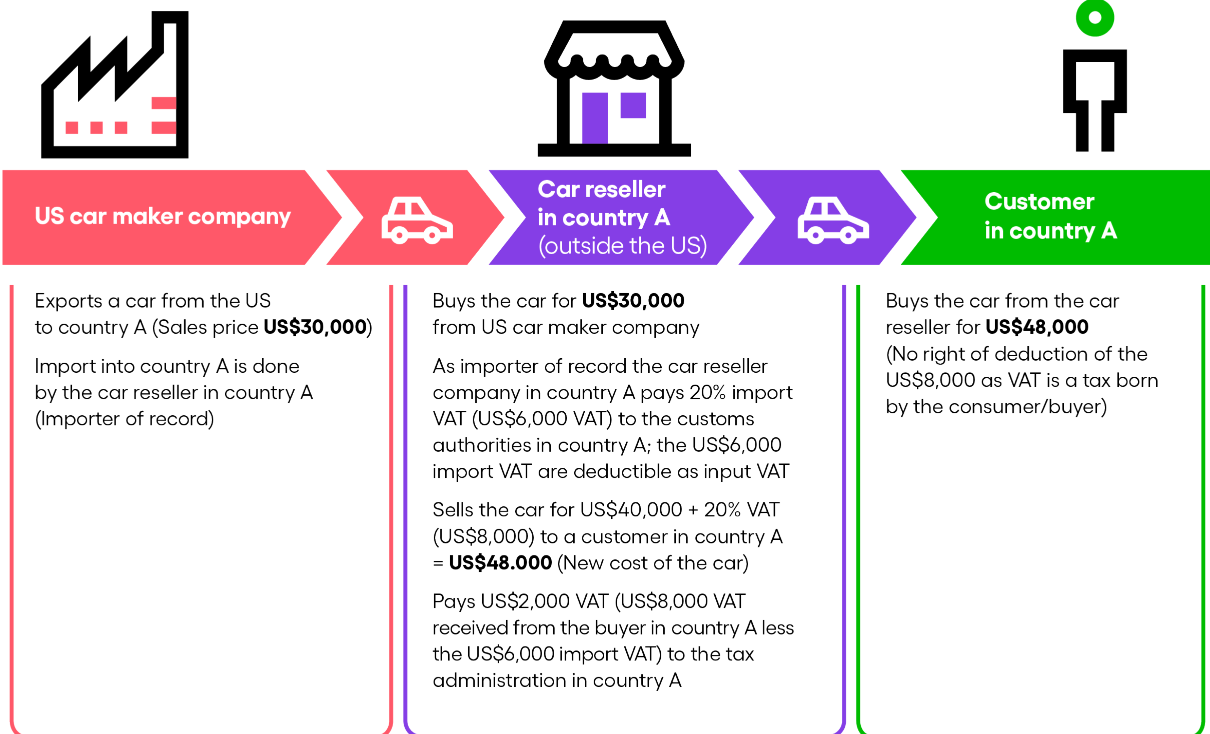
- If a business makes purchases from a local supplier for its operations (for example, manufacturing goods), it pays domestic VAT to that supplier, which the business then deducts as input VAT.
- If the same business makes purchases from a foreign supplier (for example, imported raw materials), it pays import VAT, which is likewise deductible as input VAT, thereby ensuring VAT neutrality.
- Whether the business is established locally or abroad, it is treated on equal footing – provided that appropriate business structures are in place. While VAT is collected at various stages in the supply chain, its design ensures neutrality for business both for local and foreign business who are only the collectors.

Figure 1. VAT in a domestic situation



Source: ICC (2025), Policy brief: Are value-added taxes a barrier to trade?

Figure 2: VAT in an import situation[1]



Source: ICC (2025), Policy brief: Are value-added taxes a barrier to trade?

[1] For simplicity, this example focuses only on VAT and does not include customs duties or Incoterms® -related aspects, which could affect the final retail price of imported goods.

E. So, is VAT comparable to a tariff?

No. VAT is not the same as a tariff. Here's why:

Definition and mechanism:

- VAT is a consumption tax applied to the value added at each stage of production and distribution of goods and services. It is typically collected at the point of sale to the final consumer. Even when VAT is due on an import, it is deductible, meaning that the tax burden ultimately will be borne by the consumer and will be the same for domestic and imported goods.
- Tariffs, on the other hand, are taxes levied specifically on imported goods. While they generally do not have a deduction mechanism similar to VAT, certain schemes such as duty drawbacks, free trade zones, and inward processing may allow for tariff relief in specific cases.
- **Scope of application**: VAT is a broad-based tax applied to most goods and services consumed withina country regardless of origin, whereas tariffs are limited solely to imported goods.
- **Impact on prices:** While both VAT and tariffs can impact prices, they do so through different mechanisms. Tariffs directly increase the cost of imported goods, while VAT is generally passed on to consumers as part of the product price and applied equally to both domestic and imported goods.

F. Conclusion

VAT and tariffs are substantially different not only in scope but also in terms of the impact they have on trade and the overall economy. VAT is neutral by design. Viewing it as a reciprocal tariff could lead VAT-imposing countries to adopt retaliatory measures, potentially escalating trade conflicts unnecessarily.

Figure 3. Differences between VAT and tariffs

Feature	Tariffs	VAT
Purpose	Trade policy instrument: to protect domestic industries by increasing the cost of imported goods	Revenue instrument: to generate government revenue from domestic consumption
Scope	Applied only to imported goods	Applied equally to both domestic and imported goods and services
Cost	Increases cost only for imported goods; can be absorbed by businesses or passed on to consumers	Final consumer bears the cost for all goods and services, whether imported or domestic, with businesses able to recover the tax
Collection point	Collected at the border when goods enter the country	Collected throughout the supply chain, from production to final sale
Treatments of imports vs. domestic products	Discriminatory by design to make imports more expensive than domestic products	Neutral by design – same treatment for domestic and imported goods
International trade impact	Directly affects trade flows by making imports more expensive	Neutral impact on trade under destination principle

Source: ICC (2025), Policy brief: Are value-added taxes a barrier to trade?

Finally, some additional considerations to note:

- Targeting the use of VAT regimes could encourage the adoption of other harmful tax or non-tax policies (such as imposing customs duties on electronic transmissions).
- While VAT is neutral from a tax perspective, its practical implementation creates significant burdens for businesses, particularly micro-, small- and medium-sized enterprises (MSMEs). Simplifying VAT compliance and refund processes would benefit both businesses and tax authorities – reducing compliance costs and improving compliance for companies while lowering administrative costs and improving tax collection efficiency for governments.

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