



## South Korean Taxes on Alcoholic Beverage

Raden Ajeng Cendikia Aurelie Maharani<sup>1</sup>, Arjie Sukmawijaya Arpian Putra<sup>1</sup>,  
Angela Melani Widjaja<sup>1</sup>, Tyananda Agathalia Kumara<sup>1</sup>

Master of Notary, Faculty of Law, Airlangga University, Indonesia

Corresponding Author: Raden Ajeng Cendikia Aurelie Maharani

Email: [rcamaharani@gmail.com](mailto:rcamaharani@gmail.com)



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### Abstract

*This research aims to find out whether Korea violates the provisions of International trade Article III: 2 First sentence and second sentence of GATT in 1994. Soju is a traditional alcoholic beverage that is most famous in Korea has been produced in a diluted manner so that the beverage content of 25% alcoholic soju can be said that the beverage has a content that is below 20%. But people in European countries and the United States have complaints or opinions that they do not agree with the alcohol tax policy in South Korea, especially soju is considered unfair. So Korea is trying to offer a preference for taxes on soju drinks compared to certain imported western-style drinks. The research conclusions show that Soju and Imported Liquor Spirits are not substitutive products. Soju and Imported Liquor Spirits do not compete directly, seen from the fact that although there has been a decrease in the number of Soju sales in Korea since the ILS tax was lowered, the distance between Soju and ILS sales is still far away. So from the facts above, South Korea does not violate GATT Article III: 2 Second Sentence. From our explanation above, Like Products is a cumulative requirement to meet: Common Characteristics End Uses Channels of distribution Prices. From that data, South Korea does not violate GATT Article III: 2 First Sentence and Second Sentence although there are differences in tax imposition because the two products, Soju and ILS are not like products.*

## Introduction

The development of an increasingly modern world has spurred both developed and developing countries to cooperate in international trade. These trade relations that are more multilateral and regional in nature can include many types, from the simple form that we originally known as barter, buying and selling of goods or commodities to complex trade relations or transactions. When talking about international trade, it cannot be separated from the existence of a system. In international trade, the existence of a system is a patron that forms and directs trading activities towards certain desired goals.

In the effort to build an orderly cross-country trade relationship, it is necessary to make provisions in the form of regulatory laws which are accepted as a collective agreement aimed at ensuring the creation of a fair trade. The legal rule in question serves as a generally applicable reference that must be obeyed and supervised as well as enforced strictly to eliminate or reduce deviations that may occur in international trade relations (Jackson, 1997). In addition, what is no less important is the existence of an institution or organization that has the power of law that is able to regulate all matters related to international trade. The effort to form a world trade organization reflects a strong desire to create a fair trade system (Charnovitz, 2002).

In the early years, the General Agreement on Tariffs and Trade (GATT) trade round, GATT concentrated negotiations on tariff reduction effort which was then followed by the Kennedy Round in the mid-1960s which discussed the Anti-Dumping Agreement. Then it was followed by the Tokyo Round in 1970 and the Uruguay Round from 1986 to 1994 and led to the formation of the World Trade Organization (WTO) which included trade in services and intellectual property. By complying with the international regime, this indicates that there is a power that is more than the sovereignty of the State itself. So that in this case an international organization must be able to identify the needs of each member so that compliance can emerge. Soju is a traditional alcoholic beverage that is most famous in Korea and there are two types of soju that are distilled and diluted (Lee et al., 2005).

Unlike the Whiskey or Brandy beverage in Korea, soju has been produced in a diluted manner so that the beverage content of 25% alcoholic soju can be said that the beverage has a content that is below 20% so that it is a popular beverage in South Korea. But people in European countries and the United States have complaints or opinions that they do not agree with the alcohol tax policy in South Korea, especially soju is considered unfair. So Korea is trying to offer a preference for taxes on soju drinks compared to certain imported western-style drinks contrary to Article III: 2 First sentence and second sentence from GATT in 1994. So that in 1999 the WTO and the Dispute Settlement Body decided that the South Korean government have to make partial changes to the tax policy on a liquor but South Korea itself has become a member of the WTO so the policy cannot be avoided. What will be discussed here is whether Korea violates the provisions of International trade Article III: 2 First sentence and second sentence of GATT in 1994. The issue is whether or not South Korea breaking GATT article III:2 First and second sentence.

## Methods

The first method in this research was the statute approach or the statutory approach. The statute approach is a research that places the statutory approach as an approach in the form of legislation and regulation. The second method used was a conceptual approach. These views and doctrines were used to find out the solution. The conceptual approach connects existing concepts with economic issues.

## Results and Discussion

South Korea has maintained a tax regime on the sale of alcoholic beverages. It was based on the Liquor Tax Laws of 1949 which was amended, that South Korea had created various categories of distilled beverage and imposed a valorem tax to be different from the others. Meanwhile, the Tax Law which was regulated in 1982, stated that Korea assessed certain additional taxes on the sale as determined as a percentage of the established liquor tax. Then the liquor tax and education tax on alcoholic beverages are charged at the wholesale level. The liquor tax law has established a customs system that applies to all alcoholic beverages consumed in South Korea (Sharpe et al., 2001).

The tax is applied in disputes in the form of ad valorem tax (Corlett, 1953). If assessed as additional taxes on the sale of various items, they can be categorized as having the highest alcohol content. The alcoholic drink with the applicable tariff may refer to other tax tariff on liquor. So those who are able to assess a liquor tax rate of 80% or greater may be subjected to a 30% liquor tax by imposing an additional tax. Every consuming tax is based on an ad valorem tax system so makes it difficult to switch from an ad valorem tax system to a specific tax system (Skeath et al., 1994).

The taxation system depends on the situation and conditions of the WTO member countries which do this to them. The European Union and the United States claim that South Korea itself must increase the amount of tax on soju according to the specified tax system but not the ad valorem tax system (Chun et al., 2011). The Dispute Settlement of Body concluded that South Korea should decide to change the tax rate on soju drinks into the system. This means that the system is decided or implemented by South Korea must be changed with the amount of South Korean liquor tax, which is proof that it is in accordance with applicable regulations.

In addition, the International Regulation regarding liquor tax tariff is based on the principle of high or low amounts of liquor from high or low tax tariff on evidence of high or low drink content. European Community, in Article III: 2 of GATT 1994 there is an idea in a product that records an appeal report from Japan on an alcoholic beverage tax that differences in taste, color and other properties including differences in alcohol content do not prevent the product from qualifying for a product (Hudec et al., 2001).

However, Korea stressed the importance of a methodology that is used to compare domestic and imported products with Article III: 2 in making the main mistake that defines the comparison and grouping products together that are not physically identical. And it is used in different ways, different tastes, different benefits and raw materials so that it is marketed and sold differently at very different prices and subjected to different tax tariff. Korea argued that it was wrong to carry out the analysis on the basis of agglomeration of different characteristics.

The soju drink diluted for distillation is unacceptable. The relevance of the price difference is quite large in between soju and whiskey has been neglected. The WTO and the Dispute Settlement of Body concluded that the Korean government should raise the tax tariff on soju drinks to 100% at the same rate as whiskey. So the WTO made an appeal and confirmed that the Korean tax regime was in violation of and the obligations of the WTO under GATT Article III: 2 with non-discrimination between imports and domestic products. Korea in liquor taxes collection experienced significantly lower level of soju which is almost exclusively produced.

### ***Demands of America and European Community***

Korea is being sued by the EU and US because of two legal products in Korea, namely The Korean Liquor Tax Law 1949 and The Korean Education of Tax Law 1982. The form of the rule that is deemed to violate GATT Article III: 2 second sentence is Tax rates which means tax law in Korea is ad volarem tax on alcoholic beverages. Soju is taxed 35-50 percent while other alcoholic drinks are charged 80 to 100 percent.

Table 1. Tax on Alcoholic Drinks

<b>Item</b>	<b>Ad Valorem Tax Rate (%)</b>
Diluted soju	35
Distilled soju	50
Whisky	100
Brandy	100
General distilled liquors (vodka, gin, rum)	80
General distilled liquors containing whisky or brandy	100
Liqueur	50

Other liquors:	
- With 25% or more alcohol	80
- With less than 25% alcohol	70
- Which contain 20% or more whisky or brandy	100

Deemed to have violated GATT Article III: 2 regarding national treatment. The reasons why European Communities objected to the law were claiming that Korea had violated its obligations under GATT Article III: 2, the first sentence, by imposing different internal taxes under The Korean Liquor of Tax Law 1949 and The Korean Education of Tax Law 198, between alcoholic drinks and soju. Korea has violated its obligations under GATT Article III: 2, the second sentence, by imposing higher internal taxes in accordance with The Korean Liquor of Tax Law 1949 and The Korean Education of Tax Law 198 on imported liquor included in the category 'whiskey', 'brandy', 'general distilled liquor', 'beverages', and 'other liquor' (to the extent that they contain distilled or beverages) than soju, thus providing protection against the domestic production of Soju.

The United States claims that Korean laws are described above The Korean Liquor of Tax Law 1949 and The Korean Education of Tax Law 1982, distinguishing between the two objects on the basis of arbitrary characteristics, so that a large gap in the protection of their domestic products, namely soju. The internal tax application on vodka which exceeds the tax imposed to soju is inconsistent with the first sentence of GATT Article III: 2; and the imposition by Korea of a higher internal tax on imported alcoholic beverages classified in HS code 2208 include in the legal category of "whiskey," "brandy," "general distilled liquor," "beverages" and "other liquor" (to the extent that they contain other diluted spirits) provide protection against domestic production of Soju, inconsistent with the second sentence of Article III: 2 GATT.

The reasons the WTO won the EU and US lawsuit against Korea in Liquor Taxes are: (1) Soju, Korean traditional alcoholic beverage, and imported liquors such as tequila, whiskey, brandy, gin, vodka and other alcoholic beverages, are products that compete in the same market. The EC argument at the WTO point 3.10 session shows that the Korean Spirit Market is dominated by soju, but in the last few years sales of soju decreased from 96.37% in 1992 to 94.39% in 1996 due to increased sales of imported alcoholic beverages, according to EC indicating that these two items are directly competitive.

Although there is a gap in different sales results, their preference for consumers is in the same market. (2) Soju, Korean traditional alcoholic drinks, and imported liquors such as tequila, whiskey, brandy, gin, vodka and other alcoholic beverages are interchangeable products. (3) The two products, compete for the same market, but are taxed differently. (4) Both Soju and ISL are in the same HS code. Look at the above, Soju and other alcoholic beverages imported from outside of Korea are categorized into like products after seeing from: (1) Common Characteristics, (2) End Uses, (3) Channels of distribution, (4) Prices. So, soju and other alcoholic beverages are categorized into LIKE PRODUCTS, although they have slight differences in taste. So, the two products must be given the same tax regulation. According to our group analysis, we do not agree with the DSB WTO decision because soju and brandy are not like products in terms of:

Table 2. Alcoholic Analysis

	<b>Soju</b>	<b>Vodka</b>	<b>Gin</b>	<b>Whisky</b>	<b>Rum</b>	<b>Brandy/Cognag</b>
Common Characteristic	White, full-bodied liquor with clean aftertaste. Made from rice and wheat. The bottle is usually using plastic or glass. Contains 25 percent alcohol.	Derived from rye, wheat and barley. The alcohol content is above soju (about 40%). Used for mixing.	The taste is very different from Soju, unique and distinct. Because it is made from juniper berries.	Smooth, smoky, and warm. Golden brown color. Derived from maize, rye, and barley.	Contains at least 38 percent alcohol. There is light rum and dark rum. Derived from molasses or sugar cane. The taste is more "sweet" and has a caramel flavor. It smells smooth and appetizing.	The color is golden brown. Warm and fruity taste. Is a drink that is more concentrated and heavier. It is made from fermented grapes, put in a wooden cask for 3-12 years. Its alcohol content is at least 40%.

### **End Uses**

Soju for Korean people, soju is called a "companion for life" or an everyday drink. People believe that with soju they can share their happiness or burdens with each other. Soju is considered a drink that was cultured and hereditary from their ancestors, so soju is their daily drink for dining companions.

### **Other Alcoholic Beverages**

People consume soju and other alcoholic beverages such as whiskey for different needs. Most people drink it as a cocktail to be enjoyed at night in places such as bars, hotels. mChannel of distribution Whiskey, soju, vodka, gin, whiskey, rum, brandy/cognag are mostly sold through bars, hotels, nightclubs, karaoke, restaurants while soju that is considered cultural, mostly sold through retail stores, is bought for gifts (because part of culture) or to be enjoyed together.

### **Prices**

Table 3. Alcoholic Price

<b>IN KOREAN WON, PRE –TAX</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
Standart soju (360 ml)	289.94	305.11	322.46
Whisky (360 ml)	3401.27	3582.09	411.50

Based on the table above, it can be seen that the price between soju and other alcoholic beverages, in this case whiskey, has been different before tax, even though it is taxed the same by reducing it to the soju level or increasing it to the whiskey level. This is an indication that whiskey and soju are not direct competition or are in the same market even though the tax difference is eliminated. When compared to Rum, the price of Rum 6.2 is much more expensive than soju on the market. With Brandy/Cognac, the price of Brandy Cognac is 19.2 times more expensive than the price of soju on the market. Vodka is 5.7 times more expensive than soju. Gin is also more expensive than soju.

One example that can be observed from the inability of a country to carry out its obligations under an agreement is in the case of the United States' lawsuit case against a tax on imported alcoholic beverages which is deemed to have discriminated against and harmed the values of non-tariff free trade. Where the United States assesses the policy that classifies a beverage that is the same in form and composition, only a few components are subjected to a tariff, of course, that component is in the imported liquor brand. Actually, if we see, there is a tendency to disobey the South Korean State, but still to justify that a country is disobedience is still very difficult, because there are other factors that are difficult to find or factors that force the country to do so. The lack of clarity on a regulation can also be used as a reason for the Philippines to issue this policy, this is because in GATT Article III: 2 it does not states directly the prohibition to classify an item.

This discriminatory event has resulted in losses for the importing country in addition having to pay more expensive taxes when they arrive at the store even though the public already understands which alcoholic beverages are good and cheap. This is one way to schedule something so that something can be formed in accordance with the objectives of the State. From the case above it turns out that not only the South Korean State tends not to be able to undergo an agreement but developed countries of the caliber of the United States alone must stem the flow of free trade to save the alcoholic beverage industry in their country. So every country that joins the World Trade Organization even if there is a tendency to secure its domestic production market from the onslaught of other countries' production, so that the threat of non-compliance is very big within the WTO itself, but here the WTO's role is in making regulations are not only to request and collect compliance from its members but how a rule can maintain the integrity of its members so that an international organization can run well. Whereas, trade is one of the activities of the State in meeting its national needs, and at this time the World Trade Organization is here to mediate and make a fair game rule for all member countries. This is intended as a peaceful way for each State to fulfill its domestic needs and of course the national interests held by the State.

The non-compliance of a State in carrying out an agreed rule of the game is wrong, but this is where each State tries to maneuver to protect itself. Whether it is the ambiguity of a regulation, or differences in social and economic dimensions or even the limitations of a State to fulfill an agreement, but what needs to be underlined is that not only developing countries are likely to commit non-compliance with an agreement and regulation, but it does not preclude developed countries from committing non-compliance with an agreement. This is due to the efforts of a country to protect its domestic product market, both steps that can be taken by making a policy that discriminates against imported goods, this is done for self-protection from international trade. This suggests to us that an attitude of non-compliance from a State does not only look at the type of development of the country, but every country has a tendency to commit non-compliance itself, so that the WTO is an organization that is prone to non-compliance by a State, this is because each country will do everything possible to protect its domestic products.

One thing that is more important than the WTO is, a decision or regulation is not intended as a tool to claim compliance from the State, but a regulation and regime that is formed as an effort to stabilize organizational dynamics, because its members have sovereignty or it can be said that the State. However, the most important thing is that if a regulation is made, it must be to maintain the integrity of the members themselves to protect domestic products, law enforcement must be carried out both in a preventive manner such as socialization of regulations and review of import permits as well as repressively through the application of witnesses. Something that the government has done to secure its local industry from serious losses or the threat of serious losses. The government has a role of making policies in acting to safeguard domestic industries. The imposition of tariffs such as: increasing import obligations beyond the limit level, imposing additional fees or additional taxes, reimbursing production taxes, imposition of quota tariff, namely quotas for imports at a lower tariff and imposing higher tariff for imports that are above the quota.

## Conclusion

Soju and Imported Liquor Spirits are not substitutive products. It's very unusual for Koreans to use ILS to replace soju, as a companion for eating. With such a high price difference, they are not a substitutive product. Soju and Imported Liquor Spirits do not compete directly, seen from the fact that although there has been a decrease in the number of Soju sales in Korea since the ILS tax was lowered, the distance between Soju and ILS sales is still far away. So from the two facts above, South Korea does not violate GATT Article III: 2 Second Sentence. From our explanation above, Like Products is a cumulative requirement to meet: Common Characteristics End Uses Channels of distribution Prices. It is known from the analysis above that Soju and ILS do not meet the four conditions above, so they cannot be said to be like products. South Korea does not violate GATT Article III: 2 first sentence and second sentence although there are differences in tax imposition because the two products, Soju and ILS are not like products.

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