

KOREA – TAXES ON ALCOHOLIC BEVERAGES

*Arbitration
under Article 21.3(c) of the
Understanding on Rules and Procedures
Governing the Settlement of Disputes*

Award of the Arbitrator
Claus-Dieter Ehlermann

I. Introduction

1. On 17 February 1999, the Dispute Settlement Body (the "DSB") adopted the Appellate Body Report¹ and the Panel Report,² as upheld by the Appellate Body Report, in *Korea – Taxes on Alcoholic Beverages*. The measures in dispute in the underlying proceedings are contained in Korea's Liquor Tax Act and Education Tax Act.³ The Panel concluded that "soju (diluted and distilled), whiskies, brandies, cognac, rum, gin, vodka, tequila, liqueurs and ad-mixtures are directly competitive or substitutable products" and the measures in dispute result in "dissimilar taxation ... applied in a manner so as to afford protection to domestic production," and, therefore, the measures are inconsistent with Article III:2, second sentence, of the GATT 1994.⁴ This conclusion was upheld by the Appellate Body.⁵ The Appellate Body and the Panel recommended that the DSB request Korea to bring the Liquor Tax Act and the Education Tax Act into conformity with its obligations under the GATT 1994.⁶

2. On 19 March 1999, Korea informed the DSB, pursuant to Article 21.3 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), that it would implement the recommendations and rulings of the DSB in this dispute. Korea indicated that it was impracticable to comply with the recommendations and rulings immediately, and that it would therefore require a reasonable period of time to complete the implementation process.

3. Following the meeting of the DSB on 19 March 1999, the European Communities and Korea held consultations to determine a mutually agreeable period of time for implementation. The United States and Korea also held consultations on this matter.

4. By communication of 9 April 1999, the European Communities and the United States requested that the reasonable period of time be determined by binding arbitration, pursuant to Article 21.3(c) of the DSU. In a joint letter dated 23 April 1999, Korea, the European Communities and the United States informed the Chairman of the DSB that they had agreed that I should act as Arbitrator. In this letter, the parties noted that a period of 90 days is set forth in Article 21.3(c) of the

¹Appellate Body Report, *Korea – Taxes on Alcoholic Beverages* ("Korea – Alcoholic Beverages"), WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999.

²Panel Report, *Korea – Taxes on Alcoholic Beverages* ("Korea – Alcoholic Beverages"), WT/DS75/R, WT/DS84/R, adopted 17 February 1999.

³*Ibid.*, paras. 2.1-2.23.

⁴*Ibid.*, para. 11.1.

⁵Appellate Body Report, *Korea – Alcoholic Beverages*, *supra*, footnote 1, para. 169.

⁶Panel Report, *Korea – Alcoholic Beverages*, *supra*, footnote 2, para. 11.2; Appellate Body Report, *Korea – Alcoholic Beverages*, *supra*, footnote 1, para. 170.

DSU for completion of arbitration proceedings and the issuance of an arbitration award. For this arbitration, however, the parties requested that this period be extended for a period of twenty additional days, that is, until 7 June 1999. The parties were informed, by letter of 26 April 1999, that I had accepted the appointment.

5. Korea, the European Communities and the United States filed written submissions on 4 May 1999. In response to my request, Korea provided English-language translations of provisions of certain Korean laws on 11 May 1999. An oral hearing was held on 12 May 1999. On 18 May 1999, Korea provided a revised translation of certain of its laws.

II. Arguments of the Parties

A. *Korea*

6. Korea requests that the arbitrator declare 15 months as the reasonable period of time for implementation. Korea states that it intends to implement the DSB rulings and recommendations through an increase in tax rates applicable to soju, which requires an amendment of its Liquor Tax Act. Korea states that this legislative amendment will take at least 15 months because it involves actions of the executive branch and the National Assembly, as well as additional administrative actions for its full implementation.

7. According to Korea, any acts related to budgetary changes are reviewed and passed at the regular session of the National Assembly. The Korean Government intends to submit a bill to amend the Liquor Tax Act to the National Assembly's regular session this year, which commences on 10 September 1999. Since its enactment in 1949, the Liquor Tax Act has been amended 23 times, 22 of which were during a regular session of the National Assembly. The one instance where an amendment was passed during an extraordinary session was exceptional, involving a bill that did not entail changes in the budget.

8. Korea argues that the initial executive procedure will take seven months. Korea explains that when the executive branch submits a bill to the National Assembly, the procedural rules set out in the Regulation on the Procedures of Legislative Activities (the "Regulation") must be observed. Under the Regulation, sufficient time must be secured for consultations between relevant agencies, including the Office of Government Legislation. According to Korea, this means that it takes at least four months for the relevant Ministry, in this case the Ministry of Finance and Economy, to prepare the draft amendment. During this period, the Ministry is required to consult with local governments and

private interest groups, including the relevant domestic industries and consumer groups. Barring serious opposition, a first draft of the amendment could be ready by June of this year.

9. Korea explains that the draft amendment will then be submitted to the relevant ministries for comments. This comment period normally takes one month. In addition, if the amendment involves issues that require economic policy coordination, an inter-agency meeting will be convened for this purpose. At the end of this process, the draft amendment will be made public in the Official Gazette and, if necessary, through other means. Korea calculates that this process will be completed by the end of August, at the earliest. At this stage, the draft amendment must be submitted to the Office of Government Legislation for review, a process that takes approximately one to one and a half months. After these procedures, the bill could be sent to the National Assembly by the end of September this year at the earliest. In addition to the requirements described above, the relevant ministry must hold a party-government consultation, to generate political support in the National Assembly.

10. Since the change in the liquor tax rates will have an impact on tax revenues, Korea states that the draft bill should be attached to the global budget bill for the upcoming fiscal year, which is to be passed at the regular session of the National Assembly. Korea explains that the executive branch will formulate the budget bill and submit it to the National Assembly ninety days before the beginning of the fiscal year, i.e., by October 2. Because the early part of the regular session will be allocated to an inspection of state affairs, the review of the budget bill will not take place until mid-October. Following approval by certain committees, the bill will be submitted to the plenary for deliberation. The formal legislative process, including the promulgation by the President, will be completed by the end of December, provided there is no political or social opposition.

11. Korea claims that after the bill is passed by the National Assembly, an additional five months is necessary to complete "follow-up measures", including related changes in Presidential and Ministerial Decrees, enforcement regulations and administrative procedures. This period also includes an adjustment period of at least 30 days before its actual implementation, pursuant to Article 13-2 of the Act on the Promulgation of Acts and Decrees, etc.

12. In addition, Korea argues that, independent of its arguments relating to the time needed for implementation under Korea's domestic legal system, Article 21.3(c) of the DSU provides 15 months as a guideline for the implementation period, only to be adjusted depending upon "particular circumstances". Korea submits that unless such "particular circumstances" are presented and successfully argued by the complaining parties, the 15-month period should be granted to the implementing Member. In support of this argument, Korea cites the statement of the arbitrator in

EC Measures Concerning Meat and Meat Products (Hormones) ("European Communities – Hormones") that "[i]n my view, the party seeking to prove that there are 'particular circumstances' justifying a shorter or longer time has the burden of proof under Article 21.3(c)."⁷ Korea also refers to the Awards of the Arbitrators in *European Communities – Regime for the Importation, Sale and Distribution of Bananas* ("European Communities – Bananas")⁸ and *Japan – Taxes on Alcoholic Beverages* ("Japan – Alcoholic Beverages")⁹ in support of its position.

13. Korea also maintains that each implementing Member should be accorded a measure of discretion in choosing the modalities of implementation, as long as these are consistent with the recommendations and rulings of the DSB and with the covered agreements. Thus, the decision by a Member concerning the precise means of implementation should be honoured even if it may seem unsatisfactory to the complaining parties, as long as the implementation period does not exceed 15 months.

14. Finally, Korea argues that there is no reason it should be accorded treatment different than that given to Japan in *Japan – Alcoholic Beverages*. The European Communities and United States argued before the Panel that Korea's liquor tax system was very similar to the Japanese system challenged in the *Japan – Alcoholic Beverages* case, and Korea sees no reason why it should be given less than the 15 months Japan was given to implement changes to its liquor tax law.

B. *European Communities*

15. The European Communities argues that the "reasonable period of time" for implementation of the recommendations and rulings of the DSB in this dispute should be no more than six months from 17 February 1999, the date of adoption of the Appellate Body Report and the Panel Report, i.e., by 17 August 1999.

16. In the view of the European Communities, Members are not automatically entitled to the 15-month period noted in Article 21.3(c) of the DSU. This period is merely a guideline for the arbitrator. The European Communities refers to the statement of the arbitrator in *European Communities – Hormones* that the reasonable period of time "should be the shortest possible within the legal system of the Member to implement the recommendations and rulings of the DSB."¹⁰ The European Communities cites statements by the arbitrators in *Indonesia – Certain Measures Affecting the*

⁷Award of the Arbitrator, WT/DS26/15, WT/DS48/13, 29 May 1998, para. 27.

⁸Award of the Arbitrator, WT/DS27/15, 7 January 1998, para. 19.

⁹Award of the Arbitrator, WT/DS8/15, WT/DS10/15, WT/DS11/13, 14 February 1997, para. 27.

¹⁰*Supra*, footnote 7, para. 26.

*Automobile Industry ("Indonesia – Automobiles")*¹¹ and *Australia – Measures Affecting Importation of Salmon ("Australia – Salmon")*¹² for the same proposition.

17. The European Communities argues that, in determining what period of time is "reasonably practicable" for implementation, the arbitrator should consider exclusively: 1) the degree of complexity of the measures to be adopted (e.g., drafting a sanitary standard may require more time than a simple change of a tariff or tax rate); 2) the legal nature of the required implementing act (e.g., whether legislative or administrative measures are needed); and 3) the procedures which must be followed in order to adopt that type of act under the domestic law of the Member concerned.

18. In referring to the Award of the Arbitrator in *Indonesia – Automobiles*,¹³ the European Communities notes that the political, economic or social consequences of the required measures are not pertinent considerations for the arbitrator. If those consequences were to be taken into account, it could have the paradoxical result that the greater the degree of inconsistency with the WTO obligations, the longer the period of time a Member may be granted for implementation.

19. In the view of the European Communities, the legislative procedure for amending the Liquor Tax Act and the Education Tax Act can be completed much earlier than December 1999. Korea is not required to wait until the opening of the regular session of the National Assembly in September 1999. The Korean Constitution provides that an extraordinary session of the National Assembly may be convened at any time, a procedure that is frequently invoked.

20. The European Communities argues that the necessary legislative amendments are fairly simple. All that would be needed is to change the tax rates applicable to soju and/or imported distilled spirits. Thus, the Ministry of Finance and Economy should be able to prepare the draft bill within a relatively short period of time. The legislative procedure (including the promulgation of the amendments) could be completed within 5 to 7 months from the adoption of the Appellate Body and Panel Reports, i.e., between 17 July and 17 September 1999.

21. The European Communities further argues that even if it were not possible to convene an extraordinary session of the National Assembly, nothing prevents Korea from completing all the requisite preparatory steps preceding the introduction of the bill into the National Assembly well

¹¹Award of the Arbitrator, WT/DS54/15, WT/DS55/14, WT/DS59/13, WT/DS64/12, 7 December 1998, para. 22.

¹²Award of the Arbitrator, WT/DS18/9, 23 February 1999, para. 38.

¹³*Supra*, footnote 11, para. 23.

before the opening of the regular session in September 1999. Accordingly, even if the bill were submitted during the regular session, the amendments could still be promulgated by the end of October 1999.

22. The European Communities notes a claim made by Korea during consultations that the proposed amendments were to be part of a larger effort to "streamline and enhance the transparency of the existing tax system." In response, the European Communities states that any plans to "streamline" the Korean tax system are not a relevant circumstance for this arbitration.

23. In response to a claim by Korea during consultations that the revenue from the tax measures at issue finances local governments and local education, the European Communities responds that even if some of the tax revenue is ear-marked for local authorities, there is no requirement to consult those authorities before amending the measures, let alone to obtain their consent. Moreover, Korea may implement the recommendations and rulings of the DSB without altering the current level of tax revenue and without modifying the destination of the tax proceeds.

24. The European Communities fails to understand why a change in tax rates would require the adoption of any implementing administrative measures at all, given that tax rates are not regulated in the Presidential Decrees or in the Notices. In any event, such measures would only be purely technical adaptations not involving the exercise of administrative discretion. Furthermore, there is nothing that prevents the Korean authorities from preparing those amendments in advance, in parallel with the legislative changes. Past practice demonstrates that changes in tax rates have often taken effect within a few days of their promulgation.

25. Finally, the European Communities asserts that Korea simply wants to avoid the adoption of an unpopular measure before elections to the National Assembly that are due to take place in April 2000. The European Communities reiterates that the electoral needs of the ruling party are not a relevant circumstance in determining the duration of the "reasonable period of time."

C. *United States*

26. The United States argues that Korea's legal system, as evidenced by past practice, is such that Korea could have complied with the rulings and recommendations of the DSB within six months of their adoption. The United States contends that it is possible for Korea to comply by the end of October 1999, and in any event, no later than 1 January 2000.

27. The United States argues that compliance by Korea in this case involves only a change in the relative tax rates applied to soju and Western distilled spirits under the Liquor Tax Act and the

Education Tax Act. The United States therefore does not accept the schedule for implementation envisaged by Korea - waiting seven months to submit legislation and spending five months in regulatory activity all for a very simple change in the law. In the view of the United States, the real purpose of the Korean schedule is to delay meeting its WTO obligations because of pending general elections scheduled for April 2000.

28. The United States notes that the 15-month period provided for by Article 21.3(c) of the DSU is a guideline, not a rule,¹⁴ and that the text "does not mean ... that the arbitrator is obliged to grant 15 months in all cases."¹⁵ According to the United States, it is clear from the context of Article 21.3(c) that prompt compliance is the overriding objective. This principle is also emphasized in Article 3.3 of the DSU. These considerations have led previous arbitrators to rule that the "reasonable period of time" for implementation be the "shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB."¹⁶

29. The United States argues that, to determine which "particular circumstances" warrant a period of time less than 15 months, arbitrators have focused on the requirements of the particular legal system at issue.¹⁷ By contrast, the reasonable period of time must not encompass time for structural adjustments to be made by the protected domestic industry.¹⁸

30. In the view of the United States, under Korea's legal system, there is no regulatory reason for the effective date of the new tax measure to be later than 1 January 2000. The United States notes that it is far from rare that tax legislation is amended during extraordinary sessions of the National Assembly. According to the United States, once a bill has been submitted to the National Assembly, the legislative process should be completed within a month, the prescribed time for an extraordinary session. In any event, Korea has acknowledged that the process can be finished in two and a half months. Prior drafting, inter-ministerial consultations and the public comment period for a law prior to its submission to the National Assembly should not take more than two months. Thus, Korea still has ample time to call an extraordinary session of the National Assembly and adopt tax rate changes by no later than November 1999.

¹⁴*European Communities – Hormones, supra*, footnote 7, para. 25.

¹⁵*Australia – Salmon, supra*, footnote 12, para. 30.

¹⁶*European Communities – Hormones, supra*, footnote 7, para. 26; *Australia – Salmon, supra*, footnote 12, para. 38; *Indonesia – Automobiles, supra*, footnote 11, para. 22.

¹⁷*Australia – Salmon, supra*, footnote 12, para. 38.

¹⁸*Indonesia – Automobiles, supra*, footnote 11, para. 23.

31. The United States notes that Korea wants to submit the tax amendments in the overall budget package because it intends to include them in a package of additional reforms. The United States maintains that the amendments do not have to be part of a broader tax rationalization plan.

32. The United States further argues that Korea can, in any event, implement the tax rate changes by 1 January 2000. The United States notes that Korea has not explained precisely what aspects of its administrative regulations need to be changed, and that the two most recent amendments to tax rates in the Liquor Tax Act took effect only a few days after their promulgation.

33. According to the United States, even if changes to the Presidential Decrees or ministerial ordinances were required, such changes would only be technical, not substantive, corrections. Thus, they can hardly require five additional months of regulatory activity. Moreover, Korea's assumption that the regulatory process has to be sequential to the legislative process is belied by past practice.

III. The Reasonable Period of Time

34. My mandate in this arbitration is governed by Article 21.3(c) of the DSU. It provides that when the reasonable period of time is determined through arbitration:

... a guideline for the arbitrator should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.

35. The precise meaning of this provision becomes clear when it is read in its context. Paragraph 1 of Article 21 provides:

Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.

36. Under Article 21.3 of the DSU, if it is impracticable to comply immediately with the recommendations and rulings of the DSB, the Member concerned shall have a reasonable period of time for implementation. When the reasonable period of time is determined through arbitration, the guideline for the arbitrator is that it should not exceed 15 months from the date of adoption of the panel and/or Appellate Body reports. This does not mean, however, that the arbitrator is obliged to

grant 15 months in all cases. The reasonable period of time may be shorter or longer, depending upon the particular circumstances.¹⁹

37. The most important factor in establishing the length of the reasonable period of time is set out in the Award of the Arbitrator in *European Communities – Hormones*, where it is stated:

... it is clear that the reasonable period of time, as determined under Article 21.3(c), should be the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB.²⁰

38. In the present case, the parties agree on the necessity to amend Korea's tax legislation in order to properly implement the recommendations and rulings of the DSB. In fact, Korea has indicated that it intends to increase the tax rates applicable to soju, which requires an amendment of its current Liquor Tax Act.²¹

39. According to Korea, its tax legislation cannot be amended, in this case, before the end of December 1999.²² Korea asserts that the initial executive procedure, preceding the submission of the tax bill to the National Assembly, will take seven months. Therefore, the bill can be sent to the National Assembly by the end of September at the earliest.²³ Korea maintains that the change in the liquor tax rates will have an impact on tax revenues, and that, therefore, this bill should be attached to the global budget bill for the upcoming fiscal year, which is to be passed at the regular session of the National Assembly, commencing on 10 September 1999.²⁴

40. According to the United States, the preparatory steps prior to the submission of the bill to the National Assembly should not take more than two months.²⁵ The European Communities submits that these steps require, as a general rule, from two to four months, but may be completed within a much shorter period of time in cases of urgency.²⁶ Both the United States and the European Communities argue that the tax bill could, and should, be adopted in the course of an extraordinary session of the National Assembly which, according to Korea's Constitution, can be convened upon the request of the President or of one fourth or more of the members of the National Assembly. An extraordinary session

¹⁹Article 21.3(c) of the DSU.

²⁰*Supra*, footnote 7, para. 26; quoted with approval in *Indonesia – Automobiles*, *supra*, footnote 11, para. 22; and *Australia – Salmon*, *supra*, footnote 12, para. 38.

²¹Written Submission of Korea, para. 3.

²²*Ibid.*, para. 24.

²³*Ibid.*, paras. 4-14.

²⁴*Ibid.*, para. 16.

²⁵Written Submission of the United States, para. 15.

²⁶Written Submission of the European Communities, para. 27.

shall not exceed 30 days.²⁷ According to the United States and the European Communities, the discussion and adoption of the bill by the National Assembly could be completed within one month, whether submitted during a regular or an extraordinary session.²⁸ Both of these parties cite a number of amendments of tax laws which have been adopted in extraordinary sessions of the National Assembly.²⁹

41. The parties agree that a tax bill with budgetary implications should normally be submitted to the National Assembly at a regular session, together with the draft budget for the following fiscal year. They disagree on whether the proposed amendments to Korea's tax legislation in this case could be passed in an extraordinary session of the National Assembly.

42. Although the reasonable period of time should be the shortest period possible within the legal system of the Member to implement the recommendations and rulings of the DSB, this does not require a Member, in my view, to utilize an *extraordinary* legislative procedure, rather than the *normal* legislative procedure, in every case. Taking into account all of the circumstances of the present case, I believe that it is reasonable to allow Korea to follow its *normal* legislative procedure for the consideration and adoption of a tax bill with budgetary implications, that is, to submit the proposed amendments to the next regular session of the National Assembly. For the same reasons, I consider it reasonable that the new tax legislation should be enacted by the National Assembly in the course of the next regular session, and promulgated by the President before the end of this year.

43. According to Korea, an additional period of five months is necessary to complete certain "follow-up measures", including related changes to Presidential and Ministerial Decrees, enforcement regulations and administrative procedures.³⁰ This period of five months includes an adjustment period of at least thirty days, Korea argues, as required by Article 13-2 of the Act on the Promulgation of Acts and Decrees, etc.³¹

44. The United States and the European Communities contest the need for amendments to these regulatory instruments. They consider that even if amendments to these regulatory instruments were required, such amendments would only be technical corrections.³² They argue that these amendments

²⁷Written Submission of the European Communities, para. 44; Written Submission of the United States, paras. 14-15.

²⁸Written Submission of the European Communities, para. 28; Written Submission of the United States, para. 15.

²⁹Written Submission of the European Communities, para. 24; Written Submission of the United States, para. 14.

³⁰Written Submission of Korea, para. 25.

³¹*Ibid.*, para. 26.

³²Written Submission of the European Communities, paras. 54-55; Written Submission of the United States, paras. 18-20.

could be prepared in advance, in parallel with the legislative amendments. Past practice, they maintain, shows that the regulatory instruments implementing new tax legislation have been amended within days, and the new tax legislation has entered into force a few days after promulgation.³³

45. My mandate in this arbitration relates exclusively to determining the reasonable period of time for implementation under Article 21.3(c) of the DSU. It is not within my mandate to suggest ways and means to implement the recommendations and rulings of the DSB. Choosing the means of implementation is, and should be, the prerogative of the implementing Member, as long as the means chosen are consistent with the recommendations and rulings of the DSB and the provisions of the covered agreements.³⁴ I consider it, therefore, inappropriate to determine whether, and to what extent, amendments to various regulatory instruments are required before the new tax legislation comes into effect.

46. However, assuming that amendments to these regulatory instruments are necessary, I am not convinced that they can only be prepared *after* the promulgation of the amendments to the tax legislation. On the contrary, in the light of past experience, I consider that it is possible to prepare such measures during the course of the legislative process. The amendments to the tax legislation could, in my view, be promulgated together with any required amendments to the regulatory instruments by 1 January 2000.

47. Bearing in mind Article 13-2 of the Act on the Promulgation of Acts and Decrees, etc., which provides for a thirty-day grace period for enforcement of certain acts, Presidential Decrees, and other instruments, I consider that it is reasonable to allow Korea an additional thirty days, after the promulgation of the amendments to the tax legislation and the amendments to the regulatory instruments, as part of the reasonable period of time.³⁵

³³Written Submission of the European Communities, para. 56; Written Submission of the United States, para. 21.

³⁴*European Communities – Hormones*, *supra*, footnote 7, para. 38; quoted with approval in *Australia – Salmon*, *supra*, footnote 12, para. 35.

³⁵I recognize that this period of time is shorter than the 15 month period granted by the Arbitrator in *Japan – Alcoholic Beverages*. I would note, however, that the arbitration proceedings in these two cases took place at different times in the respective legislative and budgetary processes of Korea and Japan.

IV. The Award

48. In light of the above considerations, I determine that the reasonable period of time for Korea to implement the recommendations and rulings of the DSB in this case is 11 months and two weeks, that is, from 17 February 1999 to 31 January 2000.

Signed in the original at Geneva this 31st day of May 1999 by:

Claus-Dieter Ehlermann