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A Comparison between EU and South Korean VAT from a Legal Transplants Perspective[1]

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Abstract: South Korea introduced VAT in 1977 and the Sixth VAT Directive was enacted in the same year. In this article, the EU and Korean VAT systems are compared and analysed from a legal transplants perspective. The first research question pertains to whether there was any European influence on the Korean VAT Act at the time of its introduction, and, if so, how this influence was exerted. The second research question concerns the identification and explanation of similarities and differences between the two systems, both at the time of the introduction of Korean VAT and today. This leads to the third research question, whether the two VAT systems have moved towards or away from each other. The analysis has been carried out from a legal transplants' perspective, which analyses whether, how and why such laws spread across the globe. The article ends with a final analysis and conclusions. Our conclusions are that there was a European influence on the Korean VAT Act by the time of its introduction, that many similarities are so close that they can hardly have occurred spontaneously, and that the two systems have drifted apart from each other.

Keywords: tax; VAT; Value Added Tax; South Korea; EU; Legal transplants

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1 Introduction

South Korea introduced value added tax, VAT, in 1977, and the Sixth VAT Directive[2] was enacted in the same year. In this article, the European Union (EU) and Korean VAT systems are compared and analyzed from a legal transplants perspective. The first research question pertains to whether there was any European influence on the Korean VAT Act at its introduction and, if so, how this influence was exerted. The reason for this research question is that there are many similarities between the two systems. Thus, whether the similarities occurred spontaneously or not needs to be examined. The second research question concerns identifying and explaining similarities and differences between the two systems, both at the time of the introduction of the Korean VAT and today. This leads to the third research question: whether the two VAT systems have moved toward or away from each other. The legal transplants perspective analyzes whether, how, and why laws spread across the globe.

The article is structured as follows: It begins with a historical overview that examines the introduction of VAT in both Europe and South Korea, as the perspective of legal transplants necessitates a historical approach to comparative law. Following this, a comprehensive comparison is made between the VAT systems of the EU and Korea. The comparison includes both the Second and the Sixth VAT Directives and the original version of the Korean VAT Act 1977 on the one hand and the current VAT Directive and the current Korean VAT Act on the other. This multidimensional comparison encompasses various substantive areas, including taxable transactions, taxable persons, tax rates, exemptions, place of supply, and deduction of input VAT. Subsequently, an analysis is conducted to ascertain whether the two systems have converged or

2 Sixth Council Directive 77/388/EEC of May 1977 on the Harmonization of the Laws of the Member States Relating to Turnover Taxes – Common System of Value Added Tax: Uniform Basis of Assessment.

diverged over time. The article ends with the authors' concluding remarks.

2 Historical Background

2.1 The Introduction of VAT in Europe

In Europe, VAT can be traced back to the late 1910s and the German engineer Wilhelm von Siemens. Wilhelm von Siemens was the son of Werner von Siemens, the founder of the German multinational conglomerate now known as Siemens AG.[3] Wilhelm von Siemens died in 1919, and even though many of his writings were saved in the Family Archives of Siemens and the Siemens Historical Institute, his texts about VAT are not to be found.[4] After Wilhelm von Siemens' death, his younger brother from Werner von Siemens' second marriage, Carl-Friedrich von Siemens, published the second edition of the monograph *Veredelte Umsatzsteuer*.[5] In this book, he refers to Wilhelm von Siemens as the inventor of VAT.[6] The proposed VAT was based on the subtractive direct method, meaning that the value-added was calculated by subtracting the input transactions from the output transactions for a certain period of time and levying VAT on the result.[7] The idea of introducing VAT in Germany was discussed in the legal doctrine and in politics, but in the 1920s and 1930s, it was not well received and therefore not introduced.[8] France was the first European country to introduce VAT. The French VAT Act was enacted on April 10, 1954,[9] with the aim not only to raise revenue but also to develop the economy of the country.[10] The next European country to introduce VAT was Denmark in 1967.[11]

A common VAT system was introduced in what was then the European Community (EC) and what is now the EU in 1967 through the First and Second VAT Directives.[12] The first countries that implemented the First and Second VAT Directives were France and Germany, both in 1968.[13] Thereafter came Luxembourg and the Netherlands in 1969, whereas Belgium and Italy waited until 1970.[14]

The objective of the First VAT Directive was that all Member States should replace their various turnover taxes with VAT.[15] The concept of a common VAT system was described in Article 2 of the First VAT Directive. Accordingly, the common system of VAT involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions that take place in the production and distribution process before the stage at which tax is charged. The calculation of VAT is regulated in Article 2 Section 2. Consequently, VAT shall be chargeable on each transaction, calculated on the price of the goods and services at the rate applicable to such goods or services, after a deduction of the amount of VAT borne directly by the various cost components. The VAT calculated under the First VAT Directive was thus, as opposed to the VAT proposed by the von Siemens brothers, based on the subtractive indirect method, under which the tax on the input transactions is subtracted from the tax on the output transactions for a certain period.[16] VAT should be applied up to and including the retail stage, but initially, there were particular possibilities for the Member States for a

3 Bertrand Monfort. 2021. "100 Jahre 'Veredelte Umsatzsteuer: 'die Gebrüder von Siemens und die Erfindung der Mehrwertbesteuerung." *Umsatzsteuer-Rundschau* 70 (1): 1.

4 Monfort, 2.

5 Carl Friedrich von Siemens. [1921.] *Veredelte Umsatzsteuer*. 2nd ed. (Berlin: Siemenstadt).

6 See Monfort, 70 (1): 3.

7 Monfort.

8 Monfort, 70 (1): 6.

9 Loi n °54-404 du 10 avril 1954 portant réforme fiscale. It should, however, be mentioned that Richard Fellinger claims in Handelsbeilage der *Berliner Börsen-Zeitung*. 1932. 164, that Turkey had introduced VAT already in 1927; see Monfort, 70 (1): 6.

10 See Charlène Adline Herbain. 2015. *VAT Neutrality* (Larcier, Luxembourg: Promoculture), 50.

11 Lov nr. 102 af 31. marts 1967 om merværdiafgift (momsloven).

12 First Council Directive of 11 April 1967 on the Harmonisation of Legislation of Member States concerning Turnover Taxes (67/227/EC) and Second Council Directive of 11 April 1967 on the Harmonisation of Legislation of Member States concerning Turnover Taxes. Structure and Procedures for Application of the Common System of Value Added Tax (67/228/EC).

13 See Hans Fehr, Christoph Rosenberg, and Wolfgang Wiegard. 1995. *Welfare Effects of Value Added Tax Harmonization in Europe: A Computable General Equilibrium Analysis* (Berlin: Springer Verlag), 13.

14 Fehr, Rosenberg, and Wiegard.

15 Article 1 of the first VAT Directive.

16 See Alain A. Tait. 1988. *Value Added Tax: International Practice and Problems* (Washington, DC: International Monetary Fund), 16.

transition period to combine other retail taxes with VAT up to and including the wholesale trade stage.[17]

The Second VAT Directive lays down the structure and the procedures for applying VAT.[18] It states that the supply of goods and the provision of services within the territory of the country by a taxable person against payment as well as the importation of goods shall be subject to VAT.[19] Consequently, it defines "the territory of the country,"[20] "taxable person,"[21] "supply of goods," "provision of services,"[22] and "importation of goods."[23] Furthermore, the second VAT Directive contains rules regarding the basis of assessment,[24] tax rates,[25] exemptions,[26] deductions,[27] and requirements of records of account.[28] The Second VAT Directive contains an Annex A with explanations of the articles in the directive.

A decision from April 21, 1970 provided that the budget of the EC should be financed entirely from the EC's own resources.[29] These resources include those accrued from VAT.[30] This decision created a need for greater harmonization of the common VAT system to achieve a fair and legitimate system where all Member States contributed on equal conditions. This was one of the reasons for the Sixth VAT Directive from May 17, 1977.[31] Other reasons were to achieve further progress concerning the removal of restrictions on the movement of persons, goods, and capital, and the integration of the national economies and to ensure that the common system of turnover taxes was nondiscriminatory as regards the origin of goods and services so that a common market permitting fair competition and resembling a genuine internal market could ultimately be achieved.[32] Before the Sixth VAT Directive, the treatment of agriculture, the deduction of import taxes, the exemptions and the supply of services across borders were far from harmonized.[33] Many of the explanations in Annex A of the Second VAT Directive are incorporated in the different articles of the Sixth VAT Directive. Compared to the Second VAT Directive, the Sixth VAT Directive contains much more detailed rules, creating the basis of today's EU VAT system.[34]

2.2 The Introduction of the Korean VAT Act

Before the introduction of VAT, Korea's indirect tax system consisted of the business turnover tax and the commodity tax, as well as excise duties on textiles, petroleum, gas and electricity, travel, admissions, and nightlife foods. The business turnover tax was primarily a tax on business profits. Therefore, the business turnover tax had no indirect tax characteristics of modern VAT.[35] In addition, the commodity tax did not have the characteristics of a "general consumption tax" because only certain goods were subject to taxation.[36] In other words, it was difficult to regard Korea's indirect tax as a VAT at the time.

The process of introducing VAT adopted by the Korean government is in chronological order as follows. First, in August 1971,[37] the Tax Review Council's "An Outline of Value-Added Tax" set the introduction of VAT as a long-term task.[38] To analyze whether VAT

17 Article 2, Sections 3 and 4 of the First VAT Directive.
18 Article 1 of the Second VAT Directive.
19 Article 2 of the Second VAT Directive.
20 Article 3 of the Second VAT Directive.
21 Article 4 of the Second VAT Directive.
22 Articles 5 and 6 of the Second VAT Directive.
23 Article 7 of the Second VAT Directive.
24 Article 8 of the Second VAT Directive.
25 Article 9 of the Second VAT Directive.
26 Article 10 of the Second VAT Directive.
27 Article 11 of the Second VAT Directive.
28 Article 12 of the Second VAT Directive.
29 OJ No L 94, 28. 4. 1970, 19.
30 See Marie Lamensch. 2015. *European Value Added Tax in the Digital Era: A Critical Analysis and Proposals for Reform*, IBFD Doctoral Series 36 (Amsterdam: IBFD), 11.
31 Sixth Council Directive 77/388/EEC of 17 May 1977 on the Harmonization of the Laws of the Member States Relating to Turnover Taxes – Common System of Value Added Tax: Uniform Basis of Assessment.
32 The preamble of the Sixth VAT Directive.
33 Fehr, Rosenberg, and Wiegard, 13.
34 European Commission. 1973. Explanatory Memorandum to the Proposal for a Sixth Council Directive on the Harmonization of Member States Concerning Turnover Taxes. Common System of Value Added Tax: Uniform Basis of Assessment, COM (73) 950, 20 June 1973. *Bulletin of the European Communities* 11/73, 7.
35 Korea Institute of Public Finance. 2012. *Korean Taxation History. Part 2. History and Evaluation by Subject. Volume 2. Consumption Taxation and Customs* (Seoul: Korea Institute of Public Finance), 34.
36 Korea Institute of Public Finance, *Korean Taxation History. Part 2*, 35.
37 The current name is the "Committee on the Development of the Tax System," which is a committee under the Ministry of Economy and Finance.
38 Korea Institute of Public Finance. 2004. *Tax Policy and Tax System in Korea* (Seoul: Korea Institute of Public Finance), 233.

was feasible for Korea, a member of the International Monetary Fund (IMF) fiscal panel, James C. Duignan, was invited to Korea in 1972.[39] In 1973, Professor Carl S. Shoup, who had previously drafted a VAT system for Japan,[40] was invited as an expert for the same purpose.[41] Another international expert from the IMF who was invited to Korea both in 1975 and 1976 was Alan A. Tait.[42] His studies were focused on calculating the effects of abolishing certain previous indirect taxes and replacing them with VAT. Duignan made a very comprehensive follow-up study in 1976. This report consists of three parts: Part I is a provisional report on the proposed scheme of VAT for Korea, Part II comprises a study of the administration system, and Part III raises various issues, such as special schemes for small businesses, cash registers, and the question about establishing VAT appeal tribunals.[43] In his more than 800-page report, he parallels the state of affairs in many European countries, such as Denmark, Sweden, Belgium, the United Kingdom (UK), and West Germany, and the draft Sixth VAT Directive.[44]

In July 1974, the Ministry of Finance dispatched a working group to Europe and other countries.[45] The group visited the UK, West Germany, Belgium, and the Commission of the EC, before going on to Japan and Taiwan.[46] The expedition aimed to inspect the introduction process, each country's system, and performance.[47] Furthermore, in 1975, the Director-General of Taxation made a comprehensive inspection of the British system again.[48]

In January 1976, the government officially announced the introduction of VAT, and after collecting opinions from various fields, the government announced the final bill in August 1976.[49] The VAT and a special consumption tax, which was more or less an excise duty, replaced the eight indirect taxes, namely, the business turnover tax, the commodity tax, and taxes on textiles, petroleum, gas and electricity, travel, admissions, and nightlife foods.[50]

The VAT system came into effect on July 1, 1977, with the primary objective of meeting the financial requirements for economic development. Another aim was to enhance the quality of the tax system by restructuring the intricate and outdated indirect tax framework. These dual purposes are intertwined, as the introduction of VAT was not merely intended to boost tax revenue by raising the overall tax rate but also to significantly curtail tax evasion through the modernization of the indirect tax system while naturally increasing tax revenue by broadening the tax base.[51]

Tait has later described the Korean VAT as "a brave initiative."[52] He concludes, "It was particularly courageous in that it involved the abolition of eight taxes, putting a large proportion of revenue and, though the entire tax transformation was designed to be revenue neutral, there had to be numerous changes in relative prices."[53]

VAT continued to be subject to repeated criticisms, such as the Bu-Ma Democratic Protests and strong tax resistance. Therefore, the Korean government made every effort to implement the VAT Act successfully. In the beginning, it was engulfed in an abolition controversy. Still, after overcoming that, the VAT Act subsequently

39 See Soo Han Seung. 1987. "The Value Added Tax in Korea," Discussion Paper, Report No. DRD221, Development Research Department Economics and Research Staff, World Bank, 4. https://documents1.worldbank.org/curated/en/293101468752372160/pdf/multi-page.pdf. The paper was also published in *Value Added Tax in Developing Countries*, ed. Malcolm Gillis, , Carl S. Shoup, and Gerardo P. Sicat, A World Bank Symposium (Washington, DC: The World Bank, 1990), 129–42, https://documents1.worldbank.org/curated/en/107821468764724876/pdf/multi-page.pdf.

40 See R. Khadka. 1999. "Preparation and Implementation of VAT in Nepal." *International VAT Monitor* 2: 60; and R. Khadka. 1991. "Focus on Japan." *International VAT Monitor* 12.

41 See Seung, 4.

42 Alan A. Tait. 1975. *A Report on the Possible Korean Value-Added Tax* (Washington, DC: International Monetary Fund, Fiscal Affairs Department); and Alan A. Tait. 1976. *A Report on the Proposed Value-Added Tax, with Special Reference to the Effects on the Retail Price Index and Household Expenditures (Washington, DC: International Monetary Fund, Fiscal Affairs Department).*

43 James C. Duignan. 1976. *Part I. Provisional Report on Proposed Scheme of VAT for the Republic of Korea; Part II. Study on Administration System; Part III. For Discussion and Information*, as Requested. Report addressed to Mr. Choi, Chin Bae, Director General, Tax System Bureau, Ministry of Finance.

44 Duignan, *Provisional Report.*

45 Seung, 4.

46 Seung, 4.

47 Jin-Bae Choi. 1984. *The Value Added Tax in Korea* (Seoul: Sam-Mun), 53.

48 Jin-Bae Choi.

49 Myeong-Geun Choi and Sung-Gil Na. 2007. *The Theory of VAT Act* (Seoul: Sekyungsa).

50 Tait, *Value Added Tax*, 23.

51 Korea Institute of Public Finance. 2004. *Tax Policy and Tax System in Korea* (Seoul: Korea Institute of Public Finance), 233.

52 Tait, *Value Added Tax*, 231.

53 Tait, *Value Added Tax.*

went through major and minor revisions every year until it took on the shape that it has today.[54]

The Korean Tax Act undergoes annual revisions; in certain circumstances, it may be amended more than twice within a year. These revisions serve the purpose of incorporating changes in the prevailing economic conditions. Additionally, legislative modifications are often made to align with the rulings of the Supreme Court. Consequently, gaining a comprehensive understanding of Korea's VAT system necessitates an examination of relevant legal precedents.

3 A Comparison between EU VAT and Korean VAT

3.1 Background and Methodological Issues

Historical data demonstrates that before Korea introduced VAT in 1977, experiences from European VAT systems were studied. The theory of legal transplants, launched by Watson in the early 1970s, assumes that legal borrowing has been the main driver behind legal development and legal change.[55] Watson states:

> [L]aw develops by transplanting, not because some such rule was the inevitable consequence of the social structure and would have emerged even without a model to copy, but because the foreign rule was known to those with control over law making and they observed the (apparent) benefits which could be derived from it. What is borrowed, that is to say, is very often the idea. If this conclusion is accurate then it also follows that the accessibility—for whatever reason—of the foreign rule will play a considerable role in its influence, and that legal development by transplanting derives from the expertise of the lawyers who know the foreign rule rather than from the common consciousness of society.[56]

Since we know that Korean lawmakers were familiar with the European VAT and also studied it thoroughly before introducing VAT, it is of scientific interest to study the Korean VAT Act from a legal transplants perspective to find out the similarities between the two systems.

By the time of the introduction of Korean VAT, VAT was not widely spread outside Europe. Korea was the first country in Asia to introduce VAT.[57] If you were to try to identify "VAT families" or different branches of VAT, you would find two branches in the 1950s: The above-mentioned French VAT and a U.S. branch invented by the economist Thomas S. Adams.[58] The U.S. State of Michigan implemented a kind of VAT in 1953 called Business Activities Tax, or BAT.[59] The Michigan BAT was, however, abolished in 1967 with a temporary come-back in 1975.[60] Thereafter, there was only one branch, the European one, which had a profound influence over the VAT systems that spread over the world.[61]

Before carrying out the comparative study, it was essential to decide which European legal act to use to make a comparison with the Korean system. Our first assumption was that it would be the Sixth VAT Directive, since it was enacted the same year as the Korean VAT Act. However, our research has shown that the experts studied VAT acts that were already in force. The European VAT acts studied by the Korean experts already in force were based on the First and Second VAT Directives. Thus, these directives are the most relevant as a basis for comparison, and these are relevant for a comparison with the original version of the Korean VAT Act. However, Duignan also discussed the draft Sixth VAT Directive in his report. For that reason, it can be assumed that the draft Sixth VAT Directive may have influenced the Korean VAT Act. To avoid too many repetitions, the Sixth VAT Directive is mentioned when it contains novelties in relation to the Second Directive, which seem interesting in relation to the Korean VAT Act. No comparison is made with the First Directive when we compare the different components of VAT, such as taxable persons and taxable transactions. This is because the First Directive does not regulate these topics specifically but stipulates that the Member States

54 Jong-Seok Nam and Dong-Phil Won. 2019. "The Economic Background of The Pusan-Masan Democratic Resistance Movement in 1979: Focusing on Pusan." *Social Ideology and Culture* 22, no. 1: 18.

55 Alan Watson. 1978. "Comparative Law and Legal Change." *The Cambridge Law Journal* 37, no. 2: 313, 314.

56 Watson, 315.

57 See Tait, *Value Added Tax*, 232.

58 Thomas S. Adams. 1921. "Fundamental Problems of Federal Income Taxation." *The Quarterly Journal of Economics* 35, no. 4: 527–56.

59 Michigan Office of Revenue and Tax Analysis. 2002. *The Michigan Single Business Tax.* (Lansing, MI: Michigan Office of Revenue and Tax Analysis).

60 Michigan Office of Revenue and Tax Analysis, *The Michigan Single Business Tax.*

61 Tait, *Value Added Tax*, 436.

should replace their turnover taxes with VAT.[62] In this study, we also examine whether the Korean VAT system has drifted apart from the EU VAT system or whether it has followed the development of the EU VAT system. Thus, we also compare the current VAT Directive with the current version of the Korean VAT Act. Such a comparison has the potential to be very extensive, especially if it includes all relevant case law. We have therefore focused on providing the bigger picture and not going into too much detail. Even though the Court of Justice of the European Union (CJEU) plays a fundamental role in the development of EU VAT Law,[63] the scope of the study has made us focus on legislation and not on case law. References to case law have been made when needed to make relevant concepts more understandable. There is also an extensive literature on VAT, both in Korea and in Europe, which it has not been necessary, feasible, or possible to take into consideration for carrying out this study.

When comparing EU VAT and Korean VAT, it is crucial to acknowledge that the comparison is conducted at different levels. EU Directives carry binding force, specifying the desired outcome that each addressed Member State must achieve while allowing national authorities the discretion to determine the appropriate forms and methods.[64] Consequently, these directives are incorporated into national legislation, resulting in each EU Member State possessing its own national VAT Act. Additionally, Member States have their own national courts to enforce the law. The role of the CJEU is solely to interpret the directives. If the Korean VAT had been based on EU law, the VAT Directive would have been implemented in the Korean VAT Act, and the Korean Supreme Court would have asked the CJEU for a preliminary ruling. When comparing an EU country with a non-EU country, a comprehensive comparison can only be made by considering national legislation and national case law. Nonetheless, the purpose of this study is not to conduct an exhaustive comparison between Korean VAT and VAT laws across all EU Member States but rather to ascertain the influence of European VAT on the Korean VAT system. Considering this objective, comparing the EU VAT directives with the Korean VAT Act is pertinent.

The divergent levels of the EU VAT directives and the Korean VAT Act, along with the specific objective of the study, impact the treatment of preparatory works and legislative intent. Given our examination of the influence of European VAT on the Korean VAT system, the intentions of Korean lawmakers hold significant relevance. To maintain a fully balanced approach, equal attention should have been given to the intentions of European lawmakers, specifically the EU Commission, as to the Korean lawmakers. However, achieving such a balance would be illusory, considering the involvement of 27 national lawmakers in the Member States who would not have been listened to. Furthermore, the study's aim is not to analyze EU VAT's historical background. Therefore, the divergent treatment of case law from the CJEU and the Korean Supreme Court and the different approaches to EU and Korean preparatory works can be attributed to these underlying factors.

The Korean legislation system consists of *acts*, *enforcement decrees,* and *enforcement rules*. The subordinated system includes specific contents in implementing the upper-level system. For example, the enforcement decree is created to enforce the act. The enforcement decree on the tax act is made by the responsible administrative department, the Ministry of Economy and Finance. The enforcement decree made by the responsible administrative department should be promulgated as a presidential decree to be effective and enforced. Therefore, the enforcement decree is legally binding. However, if the enforcement decree, a subsystem, contains content that exceeds the scope stipulated by the act, the upper system, it is not legally binding and is invalid.

In this article, scrutiny is directed towards the analysis of the *enforcement decree* only in instances where the Korean Value-Added Tax (VAT) Act fails to afford a precise comprehension. In some cases, the enforcement decree is either unclear or even nonexistent. In such circumstances, elucidation is sought in the precedents established by the Korean Supreme Court. *Enforcement rules* are characterized by their specificity and frequent engagement with ancillary matters and remain thus outside the scope of this article.

62 See Ad van Doesum, Herman van Kesteren, Simon Cornielje, and Frank Nellen, eds. 2020. *Fundamentals of EU VAT Law* 2nd ed. (Alphen aan den Rijn, The Netherlands: Wolters Kluwer), 14.

63 See Joachim Englisch. 2014. "Development of The EU VAT System," 23–28 in ed. Michael Lang, *ECJ — Recent Developments in Value Added Tax: The Evolution of European VAT Jurisprudence and Its Role in the EU Common VAT Systems* (Vienna: Linde Verlag). 23–28.; Rita del la Feria. 2006. *The EU VAT System and the Internal Market*, IBFD Doctoral Series 16 (Amsterdam: IBFD), 179.

64 Article 288 of the Treaty of the Functioning of the European Union (TFEU).

The substantive areas selected to compare are taxable transactions, taxable persons, place of supply, tax rates, exemptions, and deductions for input VAT. These are the basic elements of every VAT system, even though the names may vary from jurisdiction to jurisdiction. The text structure follows the Second VAT Directive, where taxable transactions are found in Article 2, taxable persons in Article 4, place of supply in Articles 5 and 6, tax rates in Article 9, exemptions in Article 10, and deductions in Article 11.

There are other areas of VAT which have been left out, for instance, the chargeable event and chargeability of VAT, the taxable amount, the VAT administration, and special schemes. There is also much more to explore within the areas we have chosen to include in the comparison. There are several reasons for not comparing the VAT systems in every detail. This delimitation is mainly because the analysis is carried out on a system level. To fulfill the aim of the study and answer the research questions, it was not necessary to go into detail. Comparing both systems, both how they were in 1977 and how they are now, without delimitations would not have fit into the format of an article, even if only the result and not the study as such would have been reported. Consequently, extensive delineations were necessary. The reason why chargeable event and chargeability of VAT, as well as the taxable amount, have not been considered as important as the areas included in the study is that the former areas are of a more technical nature than the latter. They have more to do with the timing for the VAT collection and the calculation of VAT than the other, more fundamental issues. The VAT administration was not included because the EU rules in that field were, by the time of the introduction of VAT, not harmonized and are even now not harmonized to a greater extent. Thus, there is no full set of EU rules to compare with. Finally, the special schemes were initially not very developed in the early EU VAT system. For example, in Article 14 of the Second VAT Directive, the special scheme for small companies was formulated as follows: "Each Member State may, subject to consultations mentioned in Article 16, apply to small undertakings whose subjection to the normal system of value added tax would meet difficulties the special system best suited to national requirements and possibilities." Since the special schemes were found in the national VAT acts of the Member States and not in the directive, a proper comparison with early Korean law would not have been possible within the framework of the scope of this article.

3.2 Taxable Transactions

3.2.1 General Remarks

The field of application for VAT is taxable transactions. Taxable transactions in VAT form crucial components of any comprehensive understanding of VAT systems. This section delves into the transactions subject to VAT, shedding light on the key principles, criteria, and considerations governing VAT's imposition on various goods and services.

3.2.2 The Second and Sixth VAT Directives

According to Article 2 of the Second VAT Directive, the supply of goods and the provision of services within the territory of a country by a taxable person against payment and the importation of goods shall be subject to VAT. At the time the Second Directive came into effect, the EC had not yet realized its Single Market, which is now known as the Internal Market. It had thus not introduced intra-Community acquisitions as the third feature subject to VAT today. The Internal Market was established in 1993. Consequently, the supply of goods and provision of services within the territory of a country and the importation of goods were the only taxable transactions.

The supply of goods and the provision of services were subject to VAT if they were within the country, carried out by a taxable person and against payment, insofar as they were not VAT-exempt under Article 10 of the Second VAT Directive. The Second VAT Directive defines the supply of goods as "the transfer of the right to dispose of tangible property as owner."[65] The provision of a service is defined as "any transaction which does not constitute a supply of goods."[66] The word "provision" regarding services was replaced with "supply" in the Sixth VAT Directive.[67]

Article 5 (2) of the Second VAT Directive further elaborates on what shall be considered as a supply of goods. This applies to the transfer of goods pursuant to a contract under which a commission is payable on a purchase or sale. In the Second VAT Directive, there is no corresponding provision regarding services. However, Article 6 (4) of the Sixth VAT Directive states that when

65 Article 5 (1) of the Second VAT Directive.
66 Article 6 (1) of the Second VAT Directive.
67 Article 6 (1) of the Sixth VAT Directive.

a taxable person acting in his/her own name but on behalf of another takes part in a supply of services, he or she shall be considered to have received and supplied those services him/herself.

Transactions without payment could also be subject to VAT under the Second VAT Directive. These constituted the appropriation by a taxable person, from his undertaking, of goods which he or she applies to his/her own private use or transfers free of charge, as well as the use for the needs of his/her undertaking, by a taxable person, of goods produced or extracted by him/her or by another person on his/her behalf.[68] In the Second VAT Directive, there were no corresponding provisions regarding the supply of services free of charge. Such rules occurred for the first time in the Sixth VAT Directive. According to Article 6 (2) of the Sixth VAT Directive, the use of goods forming part of the assets of a business for the private use of the taxable person or of his/her staff or more generally for purposes other than those of the business should be treated as supplies of services for consideration. This only applies where the input VAT on such goods is wholly or partly deductible. Equally, supplies of services carried out free of charge by the taxable person for his/her own private use or that of his/her staff or more generally for purposes other than those of his business, should be treated as supplies of services for consideration. Additionally, the Member States were allowed, but not obliged, to treat as a supply of services for consideration the supply by a taxable person of a service for the purposes of his/her undertaking where the VAT was levied on such a service, had it been supplied by another taxable person, would not be wholly deductible.[69]

Annex A of the Second VAT Directive deals with the situation when a whole or part of a company's assets is given as a contribution to another company. In that case, the Member States were allowed but not obliged to regard the benefiting company as the successor in the title of the contributor. Under Article 5 (8) of the Sixth VAT Directive, the transfer, whether for consideration or not or as a contribution to a company, of a totality of assets or part thereof, can be considered by the Member States as not to constitute a supply of goods. In that event, the recipient shall be treated as the successor to the transferor. The Member States may take the necessary measures to prevent distortion of competition in cases where the recipient is not wholly liable to tax. Article 5 (8) applies similarly to the supply of services.[70] The Member States were not obliged to exclude the transfer of business from the scope of the supply of goods or services, since this was an optional rule for the Member States to implement. From the wording of Article 5 (8), it is not obvious that it is specifically aimed at the transfer of a business. That this was the fact became clear in 2003 in the CJEU case *Zita Modes Sàrl*, where Article 5 (8) of the Sixth VAT Directive was confirmed to apply to "any transfer of a business or an independent part of an undertaking, including tangible elements and, as the case may be, intangible elements which, together, constitute an undertaking or a part of an undertaking capable of carrying on an independent economic activity."[71]

Importation is defined in Article 7 of the Second VAT Directive. Importation of goods means the entry of goods into the territory of the country. The wording is identical to the Sixth VAT Directive.[72]

3.2.3 The Korean VAT Act of 1977

The Korean VAT Act of 1977 lists taxable transactions in Article 1.[73] According to this article, VAT shall be levied on the following transactions:

1. the supply of goods or services; and
2. the importation of goods.

Under Article 1 Paragraph 2 of the Korean VAT Act of 1977, *goods* refers to all tangible and intangible objects with property value. *Services* refers to other activities with property value other than goods.[74] The Korean VAT Act's original version deals with composite goods and services supplies in Article 1, Paragraph 4. According to this provision, a supply of goods or services essential to the supply of goods should be considered included in the main supply.

68 Article 5 (3) of the Second VAT Directive.

69 Article 6 (3) of the Sixth VAT Directive.

70 Article 6 (5) of the Sixth VAT Directive.

71 Case C-497/01, Zita Modes Sàrl v. Administration de l'enregistrement et des domaines, ECLI:EU:C:2003:644, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62001CJ0497.

72 Article 7 of the Sixth VAT Directive.

73 Korean VAT Act of 1977. There is no English version of the Korean VAT Act of 1977. The first English version provided seems to be from 1995.

74 Article 1, para. 3 of the Korean VAT Act of 1977. Article 1 of the VAT Act of 1977 and Article 1 of the VAT Act of 1995 remain the same in content and description.

The supply of goods is defined in Article 6 of the Korean VAT Act of 1977 as "the delivery or transfer of goods due to any contractual or legal cause." "Delivery" is generally applied to movable property among goods, and "transfer" is generally applied to immovable real estate or intangible objects among goods.

Article 6 of the Korean VAT Act of 1977 also covers a deemed supply of goods to maintain taxation equity and tax neutrality. The deemed supply of goods occurs when an entrepreneur directly uses and consumes the goods produced or acquired in connection with his own business, where the entrepreneur uses and consumes the goods produced or acquired in connection with his/her own business for his/her employee's personal purposes or for any other purposes, as well as where he/she donates the goods to customers or to many and unspecified persons.[75] Also, goods remaining by the entrepreneur when he closes down his/her business is a taxable supply of goods.[76] Furthermore, in the case of consignment trading or trading by an agent, the consignor or the principal shall be deemed to have directly supplied or received the goods.[77] However, this is not the case if the consignor or the person in question is unknown.[78]

The provision of goods as collateral and the transfer of business shall not be regarded as the supply of goods.[79] The reason why VAT is not levied on the transfer of business is as follows. Since the transaction amount is large, the VAT amount is also significant in the case of the transfer of business. The transferee can normally be expected to deduct the input tax amount on the transfer of business. However, for such a transaction, having the transferor collect the output tax amount[80] would impose an unnecessary financial burden on the transferee of the business. The rationale for this provision is thus to avoid an unnecessary financial burden. In addition, the transfer of business, which sets the overall price of a business entity and pays for it, does not conform to the essential nature of VAT, which targets the supply of individual goods.[81] However, not all transfer of business is excluded from the supply of goods. The acquirer must comprehensively inherit all or substantially all rights and obligations related to the business; the value-added production organization must be maintained and kept as it is; only the management entity may be changed.

The supply of services is defined in Article 7 of the Korean VAT Act of 1977. Accordingly, the supply of services means either the supply of services or making goods, facilities, or rights available pursuant to all contractual and legal titles.[82] There is a deemed supply of services, namely, where an entrepreneur supplies services directly to his own business.[83] In such cases, these services shall be considered to have been supplied to him/herself.[84] The supply of services to others without consideration or the supply of labor under an employment relationship shall not be considered a supply of services.[85]

The import of goods is defined in Article 8 of the Korean VAT Act of 1977. It has two requirements: (1) goods arriving in the Republic of Korea from a foreign country (including marine products caught and collected in high seas by a foreign vessel); and (2) goods licensed for export. In addition, the specific meaning of

75 Article 6, para. 2 and 3 of the Korean VAT Act of 1977. Article 6 Paragraphs 2 and 3 of the VAT Act of 1977 and Article 6, para. 2 and 3 of the VAT Act of 1995 are slightly different. The contents described above are commonly described by the Value-Added Tax Act of 1977 and the Value-Added Tax Act of 1995. After all, the difference between Article 6, para. 3 of the VAT Act 1977 and Article 6, para. 3 of the VAT Act 1995 is as follows. The VAT Act of 1977 treats all transactions as gifts to own customers or to an unspecified person, without exception, as a supply of goods. However, under the Value-Added Tax Act of 1995, only gifts prescribed by Presidential Decree are considered as a supply of goods.

76 Article 6, para. 4 of the Korean VAT Act of 1977. Article 6, para. 4 of the VAT Act of 1977 and Article 6, para. 4 of the VAT Act of 1995 remain the same in content and description.

77 Article 6, para. 5 of the Korean VAT Act of 1977. Article 6, para. 5 of the VAT Act of 1977 and Article 6, para. 5 of the VAT Act of 1995 remain the same in content and description.

78 Article 6, para. 5 of the Korean VAT Act of 1977.

79 Article 6, para. 6 of the Korean VAT Act of 1977. Article 6, para. 6 of the VAT Act of 1977 and Article 6, para. 6 of the VAT Act of 1995 remain the same in content and description.

80 The Korean VAT Act calls "Charging in Transaction" for the supplier (transfer) to receive consideration including the amount of VAT. However, it is written as above because the meaning of the word is inaccurate when only looking at this official English translation.

81 Supreme Court Decision 82Nu86, decided on June 28, 1983.

82 Article 7, para. 1 of the Korean VAT Act of 1977. Article 7 of the VAT Act of 1977 and Article 7 of the VAT Act of 1995 remain the same in content and description.

83 Article 7, para. 2 of the Korean VAT Act of 1977. Article 7 of the VAT Act of 1977 and Article 7 of the VAT Act of 1995 remain the same in content and description.

84 Article 7, para. 2 of the Korean VAT Act.

85 Article 7, para. 3 of the Korean VAT Act of 1977. Article 7 of the VAT Act of 1977 and Article 7 of the VAT Act of 1995 remain the same in content and description.

import is omitted because it is dealt with in the Customs Act.

3.2.4 The VAT Directive

In the EU VAT law of today, it is not only the supply of goods and services for consideration and the deemed supplies but also the import of goods subject to VAT. In addition, there is also a third category, the intra-Community acquisition of goods. Due to the establishment of the Internal Market in 1993[86] , intra-Community acquisitions also require that a transfer by a taxable person of goods forming part of his/her business assets to another Member State shall be treated as the supply of goods for consideration.[87]

The basic concepts of the supply of goods and services and imports have not changed substantially.[88] Over the years, EU VAT law has become increasingly complex, with special rules, which is also reflected in the definitions of the supply of goods and services. For instance, distance sales of goods were introduced as a particular category of supply of goods in 2017 and has been in effect in the Member States from 2021.[89] The introduction of call-off stocks necessitated that a transfer by a taxable person of goods forming part of his/her business assets to another Member State under call-off stock arrangements shall not be treated as a supply of goods for consideration, which they would otherwise have done.[90] The concepts of supply of services and of imports have been more stable since its introduction and have not changed substantially.[91]

3.2.5 The Current Korean VAT Act

The wording and the structure of the current Korean VAT Act have become more precise.[92] The concepts of goods and services are stipulated in Article 2 of the VAT Act. In addition, the concepts of the supply of goods (Article 9) and the supply of services (Article 11) are also described separately in separate articles. Special cases concerning the supply of goods (Article 10) and special cases concerning the supply of services (Article 12) have been separated into distinct articles. The special cases concerning the supply of goods are almost the same, except that the order has been changed slightly, and a provision concerning trust property has been added.

The supply of services still does not include those provided free of charge, so it is not subject to VAT. The reason for this is of a practical nature, namely, that the value of services is difficult to measure, and it is thus difficult for tax administrations to decide the value.[93]

Article 13 of the VAT Act concerns the import of goods. Although the expression is slightly different, the requirements for the import of goods are almost the same as in the original Korean VAT Act.

Article 14 regulates the incidental supply of goods and services that, in EU VAT law, would be called composite supplies. An incidental supply shares the VAT faith of the main supply when goods and services are supplied for which the price is ordinarily included in the supply price of the main goods and services. This also applies to goods or services deemed to be ordinarily incidental to the supply of the main goods or services considering trade practices. Article 14 also defines when an independent supply is deemed as a separate supply. This is the case in two situations:

1. Goods or services which are supplied accidentally or temporarily in connection with the main business;
2. Goods which are indispensably produced in the process of manufacturing the main goods or in the process of offering services, in connection with the main business.[94]

86 See Article 2 (b) of the VAT Directive.

87 Article 17.1 of the VAT Directive.

88 See Articles 14.1, 15.1, and 30.1 of the VAT Directive.

89 Council Directive (EU) 2017/2455 of 5 December 2017 Amending Directive 2006/112/EC and Directive 2009/132/EC as Regards Certain Value Added Tax obligations for Supplies of Services and Distance Sales of Goods. The different distance sales of goods are defined in Article 14.4 of the VAT Directive.

90 Article 17a.1 of the VAT Directive.

91 Articles 24–30 of the VAT Directive.

92 However, there is no English version of the Korean VAT Act 2021. The English version provided seems to be from 2020. https://elaw.klri.re.kr/eng_service/lawView.do?lang=ENG&hseq=531

10. https://www.law.go.kr/LSW/lsInfoP.do?lsiSeq=213009&viewCls=engLsInfoR#0000. The Enforcement Decree of the Value-Added Tax Act of 2021: https://www.law.go.kr/LSW/eng/engLsSc.do?menuId=2&section=lawNm&query=value+add+tax&x=7&y=39#liBgcolor0. However, there is a Korean version of the Korean VAT Act 2022. https://www.law.go.kr/법령/부가가치세법.

93 Supreme Court Decision 95Nu4018 decided on July 14, 1995; Sung-Gil Na, Min-Ho Shin, and JI-Sun Jeong. 2019. *The Theory of VAT Act* (Seoul: Samil InfoMain), 146–47.

94 Article 14, para. 2 of the Korean VAT Act of 2021.

Wheat bran is a typical example of goods which are indispensably produced. Entrepreneurs that make and supply wheat flour can supply wheat bran, produced in the process of producing wheat flour, as goods. However, due to the exemption applied to wheat flour, the exemption also extends to wheat bran.[95]

The challenge lies in the ambiguous determination of an "incidental" supply, as the Korean VAT Act lacks sufficient clarification. To ensure predictability for taxpayers, it is customary to address such ambiguities through specific provisions in the enforcement ordinance when legislative clarity is lacking. Regrettably, the Enforcement Decree of the Value-Added Tax Act fails to include provisions regarding the incidental supply of goods and services.

Consequently, it becomes imperative to meticulously examine the precedents set by the Supreme Court to discern the precise meaning of "incidental." The Supreme Court's interpretation holds significance, as it helps bridge the gaps within the legislation.

The Korean Supreme Court has ruled in a case where a school corporation, as a sideline activity, leased and operated a hospital funeral hall.[96] The dispute concerned food services that were supplied in connection with funerals. The corporation had declared the supply of food services exempt from VAT, assuming that this service was an incidental service that shared the same VAT faith as the main funeral service, which was exempt from VAT. The tax authority, however, imposed VAT. The lower court justified that, in practice, the supply of food services to a hospital funeral hall is normally incidental to the supply of funeral services subject to VAT exemption.[97] [98] In Korean funeral culture, it is a natural practice to have a meal at a funeral, so the necessary relationship between the main supply and the incident supply was recognized. Interesting in this case is that the ratio of the sales of the incidental service to the total sales is not a critical factor.

In this regard, the Supreme Court ruled that when determining whether the supply of goods or services is subject to tax exemption under the provisions of the VAT Act, a decision must be made based on various circumstances. Therefore, the incidence of the supply of certain goods or services (food services) is not necessarily denied only because it does not correspond to the original meaning of the main goods or services (funeral service) subject to tax exemption. In other words, it is not simply the numbers concerning the scale, size, frequency, etc. Still, it is a decision stipulating that certain circumstances should be considered when judging whether supply is incidental.

3.2.6 A Comparison

There are many similarities between the original Korean VAT Act of 1977 and the Second and Sixth VAT Directives. For example, VAT is levied on the supply of goods and services and on the import of goods. The supply of goods to others, but not the supply of services to others free of charge is subject to VAT both under the Korean VAT Act of 1977 and the Second VAT Directive. With regard to the supply of services free of charge, the Korean and EU systems have drifted apart, since already in the Sixth VAT Directive, services supplied free of charge were subject to VAT.

Under the Korean VAT Act, goods as collateral are not subject to VAT. This is not specifically regulated in EU VAT law, but the supply of goods requires the right to dispose of the goods as the owner to be transferred. This is not the case when goods are used as collateral, such as a lien or mortgage. Even though this seems like a difference at first sight, it is a similarity.

Under the Korean VAT Act of 1977, in the case of consignment trading or trading by an agent, the consignor or the principal shall be deemed to have directly supplied or received the goods. This provision seems to have a similar objective as the rule on commission agents in the Second Directive, which is to enable the intermediate to act in his/her own name, also for VAT purposes.

The transfer of business is not subject to VAT under the Korean VAT Act of 1977. Interestingly, there was no such provision in the Second VAT Directive, only the provision in Annex A dealing with an instance when the assets are given as a contribution to another company. It is possible that the Korean legislation has drawn inspiration from the draft Sixth VAT Directive in this regard, since we know that Duignan also examined the draft Sixth VAT Directive. Furthermore, the method of making the transfer of business free of VAT is the same in Korea as in the EU, which implies that there might be a link between the two systems. Instead of making the

95 Supreme Court Decision 2000Du7131, decided on March 15, 2001.

96 Supreme Court Decision 2013Du932, decided on June 28, 2013.

97 See Seoul Administrative Court Decision 2010GuHab47527, decided on June 16, 2011.

98 See Seoul High Court Decision 2012Nu24820, decided on December 7, 2012.

transfer of business VAT-exempt, which could have been an alternative, the transfer of business is not a supply of goods—it plays no role from a VAT perspective.

The concepts of goods and services differ in the Korean VAT Act of 1977 and the Second VAT Directive. Korean VAT includes intangibles in goods, whereas intangibles are services under EU VAT Law.

Besides the fact that services within the EU, but not under the Korean VAT Law, include intangibles, there are no significant differences between the Second VAT Directive and the Korean VAT Act of 1977 regarding the supply of services. Also, imports are regulated similarly in the two legal acts.

Another difference between the Korean and the EU VAT systems is that composite supplies are regulated in legislation in the Korean but not the EU VAT system. In Korean VAT law, the main rule is that each supply is separate. The original Korean VAT Act stipulated that the supply of goods or services essential to the supply of goods should be considered as being included in the main supply. In the current Korean VAT Act, goods or services should be considered as being included in the main supply if they are supplied accidentally or temporarily in connection with the main business and when they are indispensably produced in the process of manufacturing the main goods or in the process of offering services in connection with the main business. In EU VAT law, the principles on how to deal with composite supplies have been developed in the case law of the CJEU. A milestone case in the development of the doctrine of composite supplies is the CCP case.[99] To put it very simply, the doctrine of composite supplies could be described as follows. Splitting is the main rule.[100] From this main rule, there are two exceptions. The first exception occurs when there is a single supply from an economic point of view.[101] This is the case where the elements of the composite supply are indispensable for carrying out the composite supply.[102] The second exception occurs when a main supply absorbs a subordinated supply.[103] A supply is considered as ancillary to a main supply when it does not constitute an aim in itself for custumers, but a means to better enjoy the main supply.[104] An ancillary service shares the fate of the main supply.[105] Comparing the two VAT systems, you can see that the Korean system took notice of composite supplies earlier than the EU system, since it was stipulated already in 1977. Today, both systems have a primary rule that each transaction is taxed separately and have two exceptions. The exceptions are not the same, but both have one that takes an economic reality approach and a second where one part, which could have been a supply if it had been provided separately, is subordinated to another supply. Regarding VAT treatment of composite supplies, the two systems have moved toward each other.

Looking at the Korean VAT Act of today and the current VAT Directive, significant concepts such as the definition of the supply of goods and the supply of services and imports have remained much the same. The EU system has increased in complexity and has introduced intra-Community acquisitions following the realization of the Internal Market. In Korea, not as many special VAT regimes have been introduced, which is why it has not been necessary to redefine the supply of goods in a similar way to the EU.

3.3 Taxable Persons

3.3.1 General Remarks

A taxable person is, according to the main rule in Article 9 (1) of the VAT Directive, any person who independently carries out in any place an economic activity, regardless of the purpose or result of the activity. Taxable persons are closely connected to taxable transactions since "taxable person" is one of the requirements for many taxable transactions. For instance, the supply of goods for consideration within the territory of a Member State by a *taxable person* acting as such is a taxable transaction.[106] Taxpaying obligations are, in EU law, separated from being a taxable person. Only because a person is a taxable person, that person is not necessarily liable to pay the VAT. In the English

99 van Doesum et al., 160; Case C-349/96, Card Protection Plan Ltd (CPP) v Commissioners of Customs & Excise, ECLI:EU:C:1999:93, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61996CJ0349.

100 See van Doesum et al., 160.

101 van Doesum et al.

102 van Doesum et al.; Case C-44/11, Finanzamt Frankfurt am Main V-Höchst v Deutsche Bank AG, ECLI:EU:C:2012:484, para. 27.

103 van Doesum et al., 161.

104 Case C-349/96, *para. 30.; see also Giacomo Lindgren Zucchini. 2020. "Composite Supplies in the Common System of VAT,"* (PhD diss., Örebro University), 81, https://oru.diva-portal.org/smash/record.jsf?pid=diva2%3A1443226&dswid=4317.

105 Case C-349/96, para. 32.

106 Article 2.1 (a) of the VAT Directive.

official translation of the Korean VAT Act, the taxable person is called "entrepreneur". In the Korean VAT Act of today, taxpaying obligations are, just as in EU law, separated from being an entrepreneur. Consequently, both entrepreneurs and persons who import goods are liable to pay the VAT.[107] This section focuses on the concept of taxable person/entrepreneur, and not on all the special rules for tax payment, such as special tax-payment rules for trusts in the Korean VAT Act.[108]

3.3.2 The Second and Sixth Directives

In Article 4 of the Second VAT Directive, a taxable person is defined as any person who independently and habitually engages in transactions pertaining to the activities of producers, traders or persons providing services, whether or not for gain. In Annex A of the Second VAT Directive it is explained that it is possible for Member States not to consider as separate taxable persons, but as one single taxable person, persons who, although independent from the legal point of view, are organically linked to one another by economic, financial or organizational relationships.[109] Furthermore, in Annex A, it is explained that the expression independently is intended in particular to exclude from taxation wage-earners who are bound to their employer by a contract of service.[110]

In Article 4 of the Sixth VAT Directive, the general definition of a taxable person was given its current wording. Accordingly, a taxable person means any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity. The requirements of being a taxable person are:[111]

1. any person
2. in any place
3. economic activity
4. independently

The activities specified in paragraph 2 are all activities of producers, traders and persons supplying services, including mining and agricultural activities and activities of the professions. Also, the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall be considered an economic activity. Furthermore, the Sixth VAT Directive allows the Member States to treat anyone who on an occasional basis carries out the activities specified in paragraph 2 as a taxable person. This applies in particular to the supply before the first occupation of buildings or parts of buildings and the land on which they stand and the supply of building land.[112]

VAT registration as such does not constitute an economic activity. In fact, the VAT Identification Number and the VAT registration were not EU harmonized until 1991.[113]

Article 4.4 of the Sixth VAT Directive comprises two novelties in relation to article 4 of the Second Directive: first, a clarification of what is meant by "independently" in the first paragraph and second, a group treatment regime. The word "independently" means that employed and other persons should not be regarded as taxable persons insofar as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability. The group treatment regime is not mandatory for the Member States, but each Member State decides whether it shall implement it. Accordingly, the Member States may treat as a single taxable person persons established in the territory of the country who, while legally independent, are closely bound to one another by financial, economic, and organizational links. The details of the group treatment regime are up to the Member States to decide. For example, Germany applies a mandatory group treatment regime that applies to all kinds of companies as soon as they fulfill specific requirements. In contrast, Finland applies a voluntary group treatment regime to only certain sectors.[114] The

107 Article 3 of the Korean VAT Act.

108 Article 3, paras. 2, 3, 4 of the Korean VAT Act & Article 3-2 of the Korean VAT Act and Article 52-2 of the Korean VAT Act.

109 See Sebastian Pfeiffer. 2015. *VAT Grouping from a European Perspective,* IBFD Doctoral Series 34 (Amsterdam: IBFD), 17.

110 Annex A, para. 2 of the Second VAT Directive.

111 See Giorgio Beretta. 2019. *European VAT and the Sharing Economy.* (Alphen aan den Rijn, The Netherlands: Wolters Kluwer), 76.

112 Article 4.3 of the Sixth VAT Directive.

113 Council Directive 91/680/EEC of 16 December 1991 Supplementing the Common System of Value Added Tax and Amending Directive 77/388/EEC with a View to the Abolition of Fiscal Frontiers.

114 See §2 Sec. 2, Nr. 2 of the German VAT Act, Umsatzsteuergesetz (UStG) in der Fassung der Bekanntmachung vom 21 Februar 2005 (BGBl. I S. 386) and §13 a of the Finnish VAT Act Arvonlisäverolaki 1501/1993.

financial, economic and organizational links, however, apply in all Member States which have chosen to allow group treatment for VAT purposes.

Article 4.5 of the Sixth VAT Directive clarifies under which circumstances public bodies are taxable persons. They are not taxable persons regarding the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions, or payments in connection with these activities or transactions. However, when they engage in such activities or transactions, they shall be considered as taxable persons in respect of these activities or transactions where treatment as non-taxable persons would lead to significant distortions of competition. Article 4.5 has its roots in Annex A of the Second VAT Directive.[115]

3.3.3 The Korean VAT Act of 1977

According to Article 2 of the Korean VAT Act of 1977, a person who independently supplies goods or services on a business basis, regardless of whether it is on a commercial basis or not, is liable to pay VAT. Taxable persons are called "entrepreneurs" in the English translation of the Korean VAT Act.[116] The scope of Article 2 is broad. It includes not only individuals and corporations but also the state and local governments, local government associations and unincorporated associations and foundations, and other organizations.[117]

The Supreme Court has clarified that a person who independently supplies goods or services on a business basis refers to someone with a sufficient business to create added value and supplies goods or services with a continuous intention.[118] In other words, "independence" and "repeatability" are the key factors determining whether you are an entrepreneur under the Korean VAT Act of 1977. Since VAT is not a tax on income but a tax on consumption, and the final consumer bears the VAT, the profit factor is not necessary in determining an entrepreneur who is liable for VAT.[119] The concept of entrepreneur should be interpreted more broadly and flexibly than the concept is stipulated in the VAT Act.[120] In other words, it is reasonable to understand that the business registration system is operated for the purpose of tax administration. Therefore, the business registration system is a reporting system, not a permit system. This means that just because a business is not registered it does not necessarily mean that persons cannot do business.[121] The Korean VAT Act of 1977 has no rules on group treatment.

3.3.4 The VAT Directive

The general definition of a taxable person, the clarification of "independently," the group treatment regime and the rules regarding public bodies have not changed substantially since the Sixth VAT Directive. However, they have been specified in greater detail. One provision, Article 9.2, is completely new compared to the original version of the Sixth VAT Directive. Under this provision, any person who supplies a new means of transport on an occasional basis, which is dispatched or transported to the customer by the vendor or the customer, or on behalf of the vendor or the customer, to a destination outside the territory of a Member State but within the territory of the EU, shall be regarded as a taxable person. This follows the fact that intra-Community acquisitions of new means of transport are taxable, also when carried out occasionally.[122]

The CJEU has developed a rich case law on taxable persons and economic activities. For instance, in *WEG Tevestrasse*, the CJEU states: "It is apparent from the Court's case-law that that definition shows that the scope of the term 'economic activities' is very wide and that the term is objective in character, in the sense that the activity is considered per se and without regard to its purpose or results. Thus, an activity is generally classified as economic where it is permanent and is carried out in return for remuneration which is received by the person carrying out the activity."[123] The CJEU has stated, regarding independence, that a member of a

115 Annex A, para. 2 of the Second VAT Directive.

116 Korean Value-Added Tax Act. 1995. https://elaw.klri.re.kr/kor_service/lawView.do?lang=ENG&hseq=3588.

117 Article 2 (2) of the Korean VAT Act of 1977.

118 Supreme Court Decision 87Nu876, decided on May 26, 1987; Supreme Court Decision 88Nu5754, decided on February 14, 1989.

119 Choi and Na, 112–13.

120 Doo Hyung Kim and Ho-Lim Yoo. 2020. *The Theory of VAT Act* (Gyeonggi-do Paju: Deep Reading), 45.

121 Of course, there is a disadvantage in that if a person does not register as a business in Korea, he or she cannot issue a tax invoice and thus cannot apply for input tax credits.

122 Article 2.1 (b) (ii) of the VAT Directive.

123 Case C-449/19, WEG Tevesstraße v. Finanzamt Villingen-Schwenningen, ECLI:EU:C:2020:1038, para. 34, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62019CJ0449.

supervisory board of a foundation is not independent of the foundation,[124] that a branch is not independent of the head office,[125] but that a member of a partnership is independent of the partnership[126]

3.3.5 The Current Korean VAT Act

There is a systematic difference between the original and the current Korean VAT Acts. In the original VAT Act, the definition of the entrepreneur in Article 2 was directly linked to the liability to pay tax. In the current VAT Act, Article 3 regulates who is liable to pay VAT. The entrepreneur is still liable to pay VAT. Still, the concept of the entrepreneur is independently defined in Article 2, item 3 as "any person who supplies goods or services independently for business, regardless of whether the business aims to make profit."

In Korea, independence is divided into human independence and material independence.[127] Human independence means that the person supplying goods or services may not be employed by others. According to a precedent in the Supreme Court, cosmetic salespersons are recognized as independent entrepreneurs when they have been supplied with cosmetics for a specific selling price from a cosmetic seller but still set their own selling price independently when the products are subsequently sold to the end consumer.[128]

Material independence means that the business should not be incidental or subordinate to other businesses. In another precedent in the Supreme Court, an individual businessperson paid a deposit and rented the canteen of the hospital and provided meals independently. Here, the service had not been provided subordinated to the hospital. Since there was continuity and repeatability with the individual businessperson with his or her own accounts, it was deemed that the individual should be considered an entrepreneur.[129]

When assessing continuity and repeatability, it is essential that a determination is not solely based on a certain number of transactions. Instead, it is also based on whether a business operates in such a way as to create added value, even if a transaction is made only once or twice.[130] In a precedent in the Supreme Court, the CEO of a company sold optical lens parts and machinery, which required a considerable degree of expertise, to other companies. It was necessary to mobilize four to five trucks to transport the goods, and the selling price was KRW 2.7 billion and KRW 380 million, respectively. The Supreme Court ruled that although the CEO did not have a formal business and made only two supplies, he was an independent supplier of goods for business as stipulated in the VAT Act.[131]

3.3.6 A Comparison

The original Korean VAT Act demonstrates similarities with the Second VAT Directive in regard of taxable persons, since it is brief and contains the three following elements: independence, a business basis and that it does not regard whether the activities are carried out on a commercial basis or not. The corresponding requirements in the Second VAT Directive are independence, economic activity and that it does not regard the purpose or result of the activity. The current Korean VAT Act still has almost the exact three requirements, namely independence, for business and regardless of whether the business aims to make a profit. EU VAT has diverged from Korean VAT, since the Korean legislation has been more stable. Already in the Sixth Directive, the activities of producers, traders and persons supplying services, including mining and agricultural activities and activities of the professions, as well as the exploration of tangible and intangible basis, were added. However, in both systems, the concept of a taxable person is perceived broadly, and thus a more profound study might well reveal more similarities or maybe even differences.

124 Case C-420/18, IO v. Inspecteur van de rijksbelastingdienst, ECLI:EU:C:2019:490, para. 44, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62018CJ0420.

125 Case C-210/04, Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v. FCE Bank plc, ECLI:EU:C:2006:196, para. 35, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62004CJ0210.

126 Case C-23/98, Staatssecretaris van Financiën v. J. Heerma, ECLI:EU:C:2000:46, para. 22, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61998CJ0023.

127 Kim and Yoo, 48–51.

128 Supreme Court Decision 96Nu19024, decided on December 26, 1997.

129 Supreme Court Decision 2001Du4849, decided on November 8, 2002.

130 Choi and Na, 111–112.; Na et al., 50–51.

131 Supreme Court Decision 90Nu7388, decided on April 9, 1991.

The main difference between Korean VAT and EU VAT is that there are no special rules for public bodies and no possibility to form VAT groups in Korean VAT. In EU VAT law, special rules for public bodies and VAT grouping rules were introduced through the Sixth VAT Directive, even though they first occurred in Annex A of the Second VAT Directive. From a legal transplants' perspective, a cautious conclusion could be drawn that the Second VAT Directive seems to have had the main influence over the Korean VAT Act and that this is still the case.

3.4 The Place of Supply

3.4.1 General Remarks

Determining the place of supply is a fundamental aspect of VAT regulations, as it governs the jurisdiction in which VAT is levied and the associated compliance obligations. This section provides a concise overview of the place of supply rules within VAT frameworks in the EU and in Korea. By exploring the factors that influence the place of supply, such as the nature of goods or services, the location of the supplier and the recipient, and the type of transaction, we gain insights into the complexities of correctly allocating VAT liabilities.

3.4.2 The Second and Sixth Directives

The place of supply rules in the Second Directive are brief. The place of supply of goods shall be deemed as being where the goods are at the time of dispatch or transport if the goods are dispatched or transported by the supplier, the consignee or a third person. In all other cases, the goods are supplied where they are at the time of the supply. Under the Second Directive, services are supplied where the services are provided, the right is transferred or granted, the object is hired, or where the service is used or enjoyed.[132]

The place of supply rules became more advanced already in the Sixth Directive. Goods installed or assembled by or on behalf of the supplier are deemed to be supplied where the installation or assembly is carried out.[133] Furthermore, special rules for goods where the place of departure of the consignment or transport of goods is in a country other than the country of import of those goods were introduced.[134] For services, a primary rule was introduced with several derogations.[135] This is a structural difference from the Second Directive, where no rule was superior or subordinate to another.

According to the new main rule in the Sixth Directive,[136] the place of supply of services was deemed to be where the supplier had established his/her business or had a fixed establishment from which the service was supplied. If there was no such place, the service was supplied where the supplier had his/her permanent address or usually resided. Through the Sixth Directive, the business establishment became a relevant proxy for the place of supply.[137] The main rule expressed the principle of origin for services. However, many derogations from the main rule were already included in the Sixth Directive[138] . Services connected with immovable property were deemed to be supplied where the property was situated. Transport services were supplied where the transport took place, taking into consideration the distances covered. Services relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities, and where appropriate ancillary services, ancillary transport services such as loading, unloading, handling and similar activities, valuations of movable tangible property and work on movable tangible property were supplied where they were physically carried out. The hiring of movable tangible property, with the exemption of transport, was deemed to be supplied at the place of utilization.

There was also a list of services which were deemed to be supplied where the customer had established his/her business or had a fixed establishment to which the service was supplied or, in the absence of such a place, the place where he/she had his permanent address or usually resided in accordance with the destination principle.[139] These are the listed services:

- transfers and assignments of copyrights, patents, licenses, trademarks and similar rights,
- advertising services,

132 Articles 5 and 6 of the Second VAT Directive.

133 Article 8.1 of the Sixth VAT Directive.

134 Article 8.2 of the Sixth VAT Directive.

135 Article 9 of the Sixth VAT Directive.

136 Article 9.1 of the Sixth VAT Directive.

137 Madeleine Merkx. 2013. *Establishments in European VAT*, Eucotax Series on European Taxation (Alphen aan den Rijn, The Netherlands: Wolters Kluwer Law & Business), 2.

138 Article 9.2 of the Sixth VAT Directive.

139 Article 9.2e of the Sixth VAT Directive.

– services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the supplying of information,
– obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this point (e),
– banking, financial and insurance transactions including reinsurance, with the exception of the hire of safes,
– the supply of staff,
– the services of agents who act in the name and for the account of another, when they procure for their principal the services mentioned above.

3.4.3 The Korean VAT Act of 1977

The Korean VAT Act of 1977 has provisions on place of supply in Article 10. However, although the title of the Article is "Transaction Place", the content is the place of supply.

Article 10 (1) of the VAT Act of 1977 stipulated the place of supply of goods. Article 10 (1) Item 1 states that where the movement of goods is required, the place where the movement of the goods starts is the place of supply for goods. In the case of exports, even if the goods are used or consumed abroad, the exporter is, in principle, liable to pay VAT in Korea because the place where the movement of goods starts is in Korea. However, as mentioned above, exports are zero-rated in Korea.[140] Article 10 (1) Item 2 states that where the movement of goods is not required, the place of supply for goods is the place of the goods when the goods are supplied. When goods do not need to be moved, the supply period is when the goods are available. Hence, if the goods are available in Korea, the place of supply will be domestic.

Article 10 (2) of the VAT Act of 1977 stipulates the place of supply of services. The place of supply of services is the place where services are supplied or goods, facilities or rights are used. International transportation services in Korea and abroad, where the entrepreneur is a non-resident or a foreign corporation, the place of supply is where passengers are boarding, or cargoes loaded.

3.4.4 The VAT Directive

In the current EU VAT system, many rules are the same as in the Sixth VAT Directive, but many more rules have been added, making the system more complex. The most important change regarding the supply of goods is the distance sales scheme implemented in the Member States on 1 July 2021. The distance sales scheme applies when goods are sold to private consumers (B2C), mostly over an internet platform. In that situation, the taxable persons are required to pay the VAT of the country of the consumers. This applies to intra-Community trade when the distance sales, together with electronic, telecommunication and broadcasting services, within the EU exceed EUR 10 000, but also, under some circumstances, when the goods are sold from a third country. To reduce the compliance costs and the administrative burden for the companies, taxable persons that are established within the EU have the option to register for one-stop-shop (EU OSS), or the Import One Stop Shop (IOSS) for distance sales of low value goods not exceeding EUR 150 which are imported from third territories or third countries.[141] If they do, they fulfill all reporting and payment obligations in one Member State. [142] Taxable persons that are established outside the EU have three options, the EU OSS and the IOSS like the taxable persons that are established within the EU, but also the non-EU OSS. Under the non-EU OSS, non-EU businesses may choose in which EU country they want to register.

Goods supplied onboard ships, aircrafts or trains during the section of a passenger transport operation effected within the EU are deemed to be supplied at the point of departure of the passenger transport operation.[143] The place of supply of gas, which is supplied through the natural gas distribution system, or of electricity, to a taxable dealer, is the place where that taxable dealer has established his/her business or has a fixed establishment for which the goods are supplied, or, in the absence of such a place of business or fixed establishment, the place where he/she has his/her permanent address or usually resides.[144] In all other situations, such as when the gas or electricity is not supplied to a taxable dealer, the place of supply is

140 Article 11 (1) 1 Korean VAT Act of 1977.

141 Madeleine Merkx. 2020. "New VAT Rules for E-Commerce: The Final Countdown Has Begun." *EC Tax Review* 4: 205.

142 Articles 33 and 34 of the VAT Directive.

143 Article 37 of the VAT Directive.

144 Article 38 of the VAT Directive.

where the customer effectively uses and consumes the goods.[145] The same applies for the supply of heat or cooling energy through heating or cooling networks to a taxable dealer.[146]

There are more new rules regarding the supply of services than regarding the supply of goods. The previous main rule on the supply of services is divided into two main rules: one for business-to-business (B2B) supplies and one for business-to-consumer (B2C) supplies.[147] For cross-border B2B supplies, the destination principle applies. The supply is subject to the reverse charge mechanism, meaning that the acquirer declares the output VAT.[148] The old main rule for the supply of services from the Sixth Directive based on the origin principle still applies for B2C supplies.[149]

Besides the main rules, the VAT Directive has no clear structure, meaning that separate rules apply for B2B and B2C transactions. Some rules apply only to B2B transactions, others to both B2B and B2C transactions, and again others only to B2C transactions.

The establishment of the seller or purchaser as proxies for the place of supply has become even greater focus than in the Sixth VAT Directive.[150] Compared to the original version of the Sixth Directive, a new rule is that services rendered to a non-taxable person by an intermediary acting in the name and on behalf of another person are deemed to be supplied where the underlying transaction is supplied.[151] The place of supply of transportation services has become more sophisticated with different rules for B2B and B2C, as well as for passenger transportation and transportation of goods, and intra and extra-Union transports.[152] Furthermore, the place of supply rules for hiring means of transport have become more detailed, differing between short and long-term hiring.[153]

The list of services supplied where they are physically carried out has been extended to include restaurant and catering services.[154] When such services are physically carried out on ships, aircraft and trains, the point of departure is the place of supply.[155] This applies to both B2B and B2C.

Telecommunications, broadcasting, and electronic services supplied to non-taxable persons (B2C) are supplied where that person is established.[156] Since the main rule applies when they are supplied to taxable persons (B2B), they are always supplied in the country of destination.

After the main rule for B2B supplies of services was introduced, the list of services supplied where the acquirer is established was given a slightly different function than in the Sixth VAT Directive. It applies to services to a non-taxable person who is established, has his/her permanent address, or usually resides outside the EU. The place of supply is where that person is established, has his/her permanent address or usually resides. The list has been extended and now includes the following items.[157]

- the hiring out of movable tangible property, with the exception of all means of transport
- the provision of access to a natural gas system situated within the EU or to any network connected to such a system, to the electricity system or to heating or cooling networks, or the transmission or distribution through these systems or networks, and the provision of other services directly linked thereto.

3.4.5 The Current Korean VAT Act

In the current VAT Act, the regulations on the place of supply have not changed significantly. The place of supply of goods is stipulated in Article 19 of the VAT Act. Article 20 of the VAT Act stipulates the place of service supply. The content is, however, almost the same. In particular, the place of supply and tax rate are provisions that have maintained their contents despite many revisions. Even though the tax rate has been explicitly changed from 13% to 10% in the VAT Act, it has always been 10% in the law in action, and the content of the place of supply has not changed at all.

The place of supply in Korea seems to be primarily understood as a criterion for judging whether a transaction is a taxable transaction under the jurisdiction of Korea. This is because the VAT Act of 1977 limits the

145 Article 39 of the VAT Directive.
146 Article 38 and 39 of the VAT Directive.
147 Article 44 of the VAT Directive.
148 Article 196 of the VAT Directive.
149 Article 45 of the VAT Directive.
150 Merkx, "New VAT Rules for E-Commerce," 2.
151 Article 46 of the VAT Directive.
152 Articles 48–52 of the VAT Directive.
153 Article 56 of the VAT Directive.
154 Article 53 of the VAT Directive.
155 Article 57 of the VAT Directive.
156 Article 58 of the VAT Directive.
157 Article 59 of the VAT Directive.

scope of the Korean government's right to tax VAT to Korea (specifically, the territory of South Korea in the Korean Peninsula). In other words, it has a dichotomous standard that views the place of supply of goods or services as domestic/foreign. In Korea, if the place of supply of goods or services is simply domestic, VAT is levied at a rate of 10%; if the place of supply is overseas, VAT is not levied. Similarly, imports are subject to VAT, and exports are subject to zero VAT.

Although the provision on the place of supply of goods is determined based on the necessity for movement, there is no mention of the provision on the place of supply of services except that it is the place of consumption of the service. Even delegation of legislation cannot be found in the Enforcement Decree for the place of supply of goods or the place of supply of services. So, the only source is the Supreme Court's interpretation. Therefore, looking at the following two Supreme Court precedents is necessary.

In a transaction with an overseas bank using a dedicated communication network operated by the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the plaintiff's bank was provided with transaction message transmission services such as fund settlement, financial transaction, and letter of credit opening from SWIFT. The plaintiff bank had paid a fee to SWIFT for the transaction message transmission services as consideration. The Supreme Court judged that even if the mechanical or technical work of message transmission and storage using the SWIFT communication network was performed abroad, the place where the SWIFT communication network was connected and where the message was transmitted was a domestic store. Thus, the service was provided in Korea. In addition, in this case, since the place of supply of services was centered on the recipient, the place of supply was judged based on the place of consumption of the service.[158]

The place of supply of services, which serves as a criterion for determining whether a transaction is within the scope of domestic taxation rights, shall be subject to Article 20 (1) of the VAT Act. However, if an important and essential part of the service provided by the foreign corporation was made in Korea, the place of supply of the service should be regarded as domestic, even if part of the service was performed abroad.[159]

According to Article 53-2 of the VAT Act, electronic services provided by foreign corporations or non-residents in Korea are deemed to be supplied and subject to taxation. Foreign corporations or non-residents pay VAT through simplified business registration in accordance with Article 53-2, paragraph 2 of the VAT Act. If they use a third party, such as an electronic marketplace, the third party must register for VAT. Electronic services include games, sound and video files, electronic documents, cloud computing, advertising services and mediation of renting, using, consuming, supplying and purchasing services in Korea.

3.4.6 A Comparison

The Korean VAT Act of 1977 has more similarities with the Second Directive than the Sixth. The principle of origin applies to the movement or transportation of goods both in the Second Directive and in the Korean VAT Act of 1977. When the goods are not transported, the place of supply is where they are at the time of the supply. The rules on the supply of services are also very similar.

Whereas the Korean VAT legislation on the place of supply has been very stable since the introduction of VAT up until now, the place of supply rules in the EU VAT system have become increasingly complex. The Korean Supreme Court case law has complemented the statutory law in Korea when needed. The only difference since the introduction of the Korean VAT is the scheme for electronic services provided by foreign corporations or non-residents in Korea. The destination principle applies for these services, which is similar to the EU system.

It seems from this comparison that place of supply is not a very difficult issue in Korean VAT but one of the most complicated areas of EU VAT. A possible explanation could be that all the VAT systems of the EU Member States need to be coordinated in detail to prevent double or non-taxation, which has the potential to distort competition within the EU, and to fairly share the tax base for VAT between the Member States. As things stand in the EU now, many different proxies are used for determining the place of supply.

158 Supreme Court Decision 2004Du7528 and 7535, decided on June 16, 2006.

159 Supreme Court Decision 2014Du13829, decided on February 18, 2016.

It seems, however, as if the EU is moving more and more towards taxation in the country of destination, which is also the objective of the current EU VAT policy.[160] If the place of supply could be in the country of destination for *all* transactions, the place of supply rules could be more straightforward. It would, however, require a technical change in the system regarding cross-border transactions of goods since they, according to the current law, are supplied in the country of origin,[161] the supply is exempt,[162] and the transaction is taxed in the country of destination as an intra-Community acquisition or an import of goods.[163]

3.5 Tax Rates

3.5.1 General Remarks

This section serves as a guide for understanding the complexities of VAT rates within the EU and Korea. By providing an overview of the legal frameworks and historical developments, readers will gain a deeper understanding of the factors shaping VAT rates and their implications for taxation within these jurisdictions. It is essential to remember that VAT rates are the least harmonized field in EU VAT Law, where the Member States have much flexibility and discretion. They are allowed to apply one standard rate and several reduced rates or only apply one rate, which is the case in Denmark.[164] There is normally no flexibility in the national VAT Acts of the Member States, but the VAT rates there are fixed. This is also the case in Korea.

3.5.2 The Second and Sixth Directives

When VAT was harmonized in the EU, the harmonization of the VAT rates was a sensitive issue. Article 9.1 of the Second VAT Directive stipulates that each Member State shall fix the standard rate of VAT at a percentage of the basis of the assessment, which shall be the same for the supply of goods and for the provision of services. Article 9.2 of the Second Directive allowed the Member States to apply increased or reduced rates in some instances. According to Annex A of the Second VAT Directive, reduced rates for transport services must be applied as to ensure equality of treatment between the different modes of transport.[165] The reduced rates should be determined so that the amount of VAT resulting from the application of this rate should usually permit the deduction of the whole of the input VAT. The rate applicable to the importation of goods should be the same, which was applied in the territory of the country to the supply of the same goods. In the original version of the Sixth VAT Directive, almost identical rules were to be found in Article 12. Consequently, both the Second and Sixth VAT Directives had a flexible approach towards VAT rates. Member States, motivated by political and practical considerations, predominantly exercised their freedom to adopt rate structures that closely resembled those implemented in their previous turnover tax systems.[166]

3.5.3 The Korean VAT Act of 1977

The Korean VAT Act of 1977 stipulates that the tax rate is 13% in Article 14(1). Considering this provision only, it could be assumed that Korea's VAT system has been operated on a flat rate from the very beginning. However, Article 14(2) stipulates that 3% may be added or subtracted. Therefore, when the first VAT system was introduced, the flexible tax rate system was probably what the legislators had in mind.

The government's concerns about the actual tax rate can, however, be found in an interview with former Prime Minister Nam Duk-woo, who dispatched the investigation team to the EC region at the time. In his memoirs, the following content can be read: "The most important thing among the reports of high-ranking officials and university professors (scholars) dispatched to the EC region as a research team was that it was the EC's the biggest error that it levied different tax rates on each good and service. Therefore, if Korea introduces a VAT system, it should be the flat tax rate, and the

160 European Commission. 2011. Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the Future of VAT: Towards a Simpler, More Robust and Efficient VAT System Tailored to the Single Market. COM (2011) 851 final (Dec. 6, 2011): 5.

161 Article 32 of the VAT Directive.

162 Articles 138 and 146 of the VAT Directive.

163 Articles 2.1 b and d of the VAT Directive.

164 33 §momsloven (LBK nr 966 af 14/10/2005), the Danish VAT Act.

165 Annex A, para. 15 of the Second VAT Directive.

166 Rita de la Feria. 2015. "Blueprint for Reform of VAT Rates," *Intertax* 2: 155.

tax rate recommends choosing a number that is easy to calculate."[167]

However, due to fears of rapid inflation and adverse effects, the actual tax rate was applied at 10% by subtracting 3% from the basic tax rate of 13% when the VAT system was implemented on 1 July 1977. Article 14 (3) of the VAT Act of 1977 stipulates that the period of application of the 3% increase or decrease in the tax rate shall not exceed two years. However, Article 14 (3) of the VAT Act, which is the provision period for the application period of Article 14 (2) of the VAT Act was rendered practically useless.

In conclusion, at the time of the enactment of the VAT Act, there was a flexible tax rate system that could be adjusted by enforcement decree within the range of adding or subtracting 3% to the tax rate (flexible range of 6%). Still, it has never been applied since enactment. In addition, the flexible tax rate system was abolished through the tax law revision in December 1988.

3.5.4 The VAT Directive

The EU VAT rules on the VAT rates were amended in 1992 when the common market was realized.[168] From 1 January 1993, the minimum rate has been 15 %.[169] The member states may apply two reduced rates, not lower than 5 %, for specific goods listed in Annex H to the Sixth VAT Directive.[170] Annex H included the following items:

1. Foodstuffs (including beverages but excluding alcoholic beverages) for human and animal consumption; live animals, seeds, plants and ingredients normally intended for use in preparation of foodstuffs; products normally intended to be used to supplement or substitute foodstuffs.
2. Water supplies.
3. Pharmaceutical products of a kind normally used for health care, prevention of diseases and treatment for medical and veterinary purposes, including products used for contraception and sanitary protection.
4. Medical equipment, aids and other appliances normally intended to alleviate or treat disability, for the exclusive personal use of the disabled, including the repair of such goods, and children's car seats.
5. Transport of passengers and their accompanying luggage.
6. Supply, including on loan by libraries, of books (including brochures, leaflets and similar printed matter, children's picture, drawing or colouring books, music printed or in manuscript, maps and hydrographic or similar charts), newspapers and periodicals, other than material wholly or substantially devoted to advertising matter.
7. Admissions to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities Reception of broadcasting services.
8. Services supplied by or royalties due to writers, composers and performing artists.
9. Supply, construction, renovation and alteration of housing provided as part of a social policy.
10. Supplies of goods and services of a kind normally intended for use in agricultural production but excluding capital goods such as machinery or buildings.
11. Accommodation provided by hotels and similar establishments including the provision of holiday accommodation and the letting of camping sites and caravan parks.
12. Admission to sporting events.
13. Use of sporting facilities.
14. Supply of goods and services by organizations recognized as charities by Member States and engaged in welfare or social security work, insofar as these supplies are not exempt.
15. Services supplied by undertakers and cremation services, together with the supply of goods related thereto.
16. Provision of medical and dental care as well as thermal treatment in so far as these services are not exempt.
17. Services supplied in connection with street cleaning, refuse collection and waste treatment, other than the supply of such services by bodies.

167 [Duk-Woo Nam. 2009] [My Life, My Path] <20> On the Road to Economic Development. [In Korean]. https://www.donga.com/news/article/all/20090423/8723529/1.

168 Council Directive 92/77/EEC of 19 October 1992 Supplementing the Common System of Value Added Tax and Amending Directive 77/388/EEC (approximation of VAT rates).

169 Article 12.3 of the Sixth VAT Directive amended through Directive 92/77/EEC and Article 97 of the VAT Directive.

170 Article 12.3 of the Sixth VAT Directive amended through Directive 92/77/EEC and Article 99 of the VAT Directive.

The general rules are overall the same in the VAT Directive, although the list of items subject to reduced rates has been updated and are now located in Annex III. A new item is the reception of radio and television broadcasting services. Furthermore, item 6 was changed in 2018 to include publications supplied "either on physical means of support or supplied electronically or both".[171]

The most recent amendment to the VAT Directive in regard to tax rates is Directive 2022/542 of 5 April 2022.[172] This Directive grants more flexibility to the Member States regarding VAT rates. It also aims to ensure all Member States have the same possibilities to apply reduced rates and to realize the EU environmental commitments on decarbonization and with the European Green Deal. Thus, the list of items subject to reduced rates includes, for example, rental of immovable property for residual use, solar panels, electric bikes, first-aid services, live plants and other floricultural products and children's clothes, footwear and supply of children's´ car seats. All Member States may, according to this Directive, apply two reduced rates of a minimum of 5 %, one super-reduced rate below 5 %, as well as an exemption with the right to deduct input VAT. The list of items for the reduced rates has been substantially expanded. There is, however, a limit of 24 items with reduced rates and seven items with zero-rating and the super-reduced rate. Furthermore, this Directive allows the Member States to apply a rate not lower than 12 % on some items.

The vast use of reduced rates in the EU raises questions about how reduced rates affect consumer prices and VAT revenue. Research shows that VAT changes affect rich more than poor households and that reduced rates are only partly reflected in consumer prices. Reduced rates have, however, further financial consequences than influencing the consumer price. They do not necessarily have any significant impact on state revenue.[173]

3.5.5 The Current Korean VAT Act

The VAT rate of 10% has continued until today. In short, there has been much discussion regarding the VAT rate, but the VAT rate in Korea is still 10%.[174] The VAT rate is currently stipulated in Article 30 of the VAT Act.

3.5.6 A Comparison

EU VAT and Korean VAT started similarly, with flexible VAT rates. Introducing flexible VAT rates in a national VAT system is unusual, but a possible reason could be the strong European influence. A national VAT system, however, requires more precise rules on VAT rates without any discretion. This is also the path the Korean VAT system took quite soon after introducing VAT.

A flexible system is suitable for a legal framework, such as EU VAT law, which is implemented into different national legal systems. A flexible system, where individual countries determine the reduced rates, enables the Member States to use reduced rates for their fiscal policies and economic priorities. This reflects a degree of tax sovereignty, allowing the Member States to decide on the VAT rates that align with their unique circumstances. The Member States have insisted on retaining sovereignty in tax matters overall and have not

171 Council Directive (EU) 2018/1713 of 6 November 2018 Amending Directive 2006/112/EC as Regards Rates of Value Added Tax Applied to Books, Newspapers and Periodicals.

172 Council Directive (EU) 2022/542 of 5 April 2022 Amending Directives 2006/112/EC and (EU) 2020/285 as Regards Rates of Value Added Tax.

173 Slavorivá Martinková and Anna Bánociová. 2016. "The Economic Impact of Reduced Value Added Tax Rates for Groceries." *Potravinarstvo* 10, no. 1: 660.

174 Myung-Ho Park and Jaeho Cheung. 2014. *The Distribution of the Effective VAT Burden in Korea, 1990-2012* (Sejong City: Korean Institute of Public Finance), preface. The above document argues that the policy of increasing the value-added tax rate is a means to prepare for the unification of South and North Korea.; Seung-Hoon Jeon. 2015. "On the Direction of the Tax Revision Plan for Expanding Tax Revenue." *Journal of Korean Social Trend and Perspective* 95: 109–110. In this article, the author argues that the discussion about raising the VAT rate is necessary because of the relatively unsound financial condition that prevails in Korea: After the global financial crisis, in the process of overcoming the ensuing economic crisis/recession, the demand for spending increased as the domestic demand for welfare increased. However, tax revenues stagnated due to the weakening of growth engines; National Assembly Research Service. 2021. *Analysis of Issues of the 2021 National Audit, Volume 4, Planning and Finance Committee, Political Affairs Committee* [In Korean] (Seoul: National Assembly Research Service), 267–69; National Assembly Research Service. 2022. *Analysis of Issues of the 2022 National Audit, Volume 4, Planning and Finance Committee, Political Affairs Committee* [In Korean] (Seoul: National Assembly Research Service), 215–17.

been willing to harmonize the VAT rates in detail.[175] The Member States' sovereignty is, however, to some extent, restricted not only by the list of items but also by the principle of neutrality because goods and services that compete may not be subject to different VAT rates.[176]

The Korean VAT system is a flat rate system, compared to the EU system, which allows for reduced rates and has recently extended the scope of reduced rates. One reason for the increased flexibility in the preamble of Directive 2022/542 is that when the current VAT rate rules were introduced, the EU VAT system was based on the origin principle.[177] The system with intra-Community acquisitions was considered as a transitional system that should be abolished when the tax rates were harmonized to a greater extent.[178] Now, the intention is that the definite VAT system for cross-border trade in goods shall be based on the destination principle.[179] In such a system, different reduced VAT rates neither disrupt the functioning of the Internal Market nor create distortions of competition.[180] A more practical reason why the Member States have reduced rates is that the average standard rate in the EU is approximately 21%, a major difference compared to the Korean 10%.

3.6 Exemptions

3.6.1 General Remarks

Exemptions result in suppliers, importers, and acquirers not having to charge VAT.[181] The main two categories are exemptions with and without the right of deduction.[182] The zero-rated supplies mentioned above in the chapter on tax rates are exemptions with the right to deduct input VAT. Most exemptions are exemptions without the right of deduction. However, exemptions in connection with cross-border trade are often associated with a right to deduct input VAT. Exemptions without deduction shall, according to the established case law of the CJEU,[183] as a general rule, be interpreted strictly.[184] Exemptions with the right of deduction are the only transactions that are in fact VAT-exempt. The most common exemptions, those without the right of deduction, are taxed until the supply chain's final stage.[185]

3.6.2 The Second and Sixth Directives

As is the case for reduced rates, the approach to VAT exemptions is flexible in the Second VAT Directive. Under Article 10, the following are exempt:"(a) the supply of goods consigned or transported to places outside the territory in which the State concerned applies value-added tax; (b) the provision of services relating to goods covered by (a) or in transit."

Through these exemptions, together with the fact that the import of goods was a taxable transaction, the

175 Eckhard Binder. 2021. VAT Gap, Reduced VAT Rates and Their Impact on Compliance Costs for Businesses and Consumers: European Implementation Assessment (Brussels: European Parliamentary Research Service), 2. https://op.europa.eu/s/y6kl.

176 C-3/09, Erotic Center BVBA v. Belgische Staat., https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62009CJ0003. See also Madeleine Merkx. 2018 "VAT Deduction and Member State Sovereignty: (Still) a Good Idea?" *World Journal of VAT/GST Law* 7: 19.

177 Paragraph 1 of the Preamble of Council Directive (EU) 2022/542 of 5 April 2022 Amending Directives 2006/112/EC and (EU) 2020/285 as Regards Rates of Value Added Tax.

178 Council Directive 91/680/EEC of 16 December 1991 Supplementing the Common System of Value Added Tax and Amending Directive 77/388/EEC with a View to the Abolition of Fiscal Frontiers.

179 European Commission. Communication from the Commission to the Parliament, the Council and the European Economic and Social Committee, on an action plan for VAT. Brussels, April 7, 2016, COM (2016) 148 final.

180 Paragraph 2 of the preamble of Council Directive (EU) 2022/542 of 5 April 2022 Amending Directives 2006/112/EC and (EU) 2020/285 as regards Rates of Value Added Tax.

181 See van Doesum et al., 306.

182 van Doesum et al.

183 For early case law, see Case C-348/87, Stichting Uitvoering Financiële Acties v. Staatssecretaris van Financiën, ECLI:EU:C:1989:246, para. 13, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61987CJ034; Case C-453/93, W. Bulthuis-Griffioen v. Inspecteur der Omzetbelasting, ECLI:EU:C:1995:265, para. 19, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61993CJ0453; and Case C-2/95, Sparekassernes Datacenter (SDC) v. Skatteministeriet, ECLI:EU:C:1997:278, para. 20, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61995CJ0002.

184 van Doesum et al., 308.

185 See Rita de la Feria and Richard Krever. 2013 "Ending VAT Exemptions: Towards a Post-Modern VAT," in *VAT Exemptions Consequences and Design Alternatives*, Eucotax Series on European Taxation, 37, ed. Rita de la Feria (Alphen aan den Rijn, The Netherlands, Kluwer Law International), 11.

Second VAT Directive realized the destination principle as a basic principle for cross-border trade in goods.

The Member States were also allowed to exempt the provision of services relating to imported goods.[186] Finally, each Member State was allowed to determine other exemptions that it considered necessary.[187] Before implementing such measures, the Member States were obliged to consult the Commission.[188] In Annex A of the Second VAT Directive, it was clarified that where the exemptions were applied to the transport and storage of goods, they must be applied as to ensure equality of treatment as between different modes of transport.[189]

A list of exemptions was introduced In the Sixth VAT Directive.[190] The aim of the list was for resources to be collected in a uniform manner,[191] which required a harmonized tax base for VAT. The examples were divided into exemptions within the territory of the country,[192] other exemptions,[193] optional exemptions,[194] exemption on importation,[195] exemption on exportation and similar transactions and international transport,[196] and special exemptions linked to international goods traffic.[197]

Among the exemptions within the territory, hospital and medical care and closely related activities, the supply of services and of goods closely linked to welfare and social security work, educational services, and activities of public radio and television bodies other than those of a commercial nature can be mentioned. The other exemptions include, for example, financial and insurance services.

The optional exemptions are optional both for the Member States and taxpayers. This means that the Member States are not obliged to implement the optional exemptions. If they are implemented, the taxpayers can opt for taxation. This is stipulated in the Sixth VAT Directive in that the Member States may allow taxpayers an option for taxation that applies for the letting and leasing of immovable property and some financial services.[198]

The exemption for exports is in practice a zero rating, provided that the supply of goods is not exempt for other reasons. There is a right to deduct input VAT when the transactions are exempt under Article 15, which is the exemption for exports.[199]

3.6.3 The Korean VAT Act of 1977

The Korean VAT Act of 1977 includes provisions on exemptions in Article 12. Since VAT is a general consumption tax, it is in principle levied on all goods or services. However, there are exemptions implemented to alleviate the economic burden of the low-income bracket and achieve policy goals in the public interest. Therefore, according to the Supreme Court, a strict interpretation of exemptions is required.[200] In the end, the exemption cannot be applied except for those that have been laid down in the VAT Act.

The Korean VAT Act of 1977 deals with the supply of goods or services exempt from VAT (Article 12 (1)) and the import of goods exempt from VAT (Article 12 (2)) separately. Moreover, it is not stipulated in detail which areas are exempt from VAT. Therefore, it has thereafter been narrowed down through many tax law amendments.

The Korean VAT Act of 1977 includes provisions for zero rating in Article 11. The zero-rating system is a system that applies zero rating (0%) to the supply of certain goods or services, which, according to the Supreme Court, means complete tax exemption.[201] According to the Supreme Court, the zero-rating system aims to prevent international double taxation and promote exports.[202] Items to which zero rating is applied are listed in Article 11(1), Item 1 to Item 4, all of which are related to overseas transactions.

Article 11 (Application of Zero Tax Rate)

(1) The zero tax rate shall apply to the supply of goods or services under the following subparagraphs:

186 Article 10.2 of the Second VAT Directive.
187 Article 10.3 of the Second VAT Directive.
188 Articles 10.2, 10.3, and 16 of the Second VAT Directive.
189 Annex A, para. 19 and Annex B, item 5, of the Second VAT Directive.
190 Articles 13–16 of the VAT Directive.
191 Preamble of the Sixth VAT Directive.
192 Article 13.A of the Sixth VAT Directive.
193 Article 13.B of the Sixth VAT Directive.
194 Article 13.C of the Sixth VAT Directive.
195 Article 14 of the Sixth VAT Directive.
196 Article 15 of the Sixth VAT Directive.
197 Article 16 of the Sixth VAT Directive.
198 Article 13.C of the Sixth VAT Directive.
199 Article 17 3 (b) of the Sixth VAT Directive.
200 Supreme Court Decision 84Nu391, decided on September 10, 1985.
201 Supreme Court Decision 84Nu15, decided on June 12, 1984.
202 Supreme Court Decision 88Nu2182, decided on December 20, 1988.

1. goods for export;
2. services supplied out of the Republic of Korea;
3. international navigation services by ships or aircraft; and
4. goods or services for earning foreign currency other than those provided in subparagraphs 1 through 3 as prescribed by the Presidential Decree.

3.6.4 The VAT Directive

The VAT Directive has maintained the system of listing the exempt transactions. The exemptions are listed in Articles 132–165 of the VAT Directive. The exemptions are very much the same as in the Sixth VAT Directive. The VAT Directive makes a difference between exemptions with and exemptions without the right to deduction of input VAT.[203] These exemptions with the right to deduct input VAT applied previously generally to cross-border transactions.[204] As mentioned above, the Member States now have the possibility to zero-rate up to seven items. In this regard, the exemptions have expanded compared to the Sixth VAT Directive.

3.6.5 The Current Korean VAT Act

Since the VAT Act was enacted in 1977, the scope of VAT exemptions, which was for nineteen items, has been partially adjusted every year. The current VAT Act stipulates the exemptions in Articles 26 to 27. Article 26 is the regulation of the supply of tax-free goods or services. Article 27 is the regulation on the importation of tax-free goods. The VAT Act of 1977 stipulated this separately in the same Article, but the current VAT Act separates it into two different Articles.

The significant tax exemptions listed in the current VAT Act apply to basic daily necessities such as feminine hygiene products and passenger transportation services; public welfare, such as medical health and education services; books, newspapers, broadcasting, and other areas related to culture; finance and insurance; and production factors such as human services; and other goods and services supplied by the state and local governments. In addition, under the Restriction of Special Taxation Act, tax exemption is provided for national housing construction services, diapers and formula for infants, petroleum products for agriculture, fisheries and coastal ships, and care products for homes for senior citizens.

Conversely, in 1982, real estate rental services and housing supplied by the Korea Housing Corporation, which had been tax-exempt, became taxable.[205] In 2004, human services for marriage counseling and animal training became taxable.[206] In 2011, plastic surgery for cosmetic purposes other than therapeutic purposes and medical services for pets became taxable.[207] In 2014, medical and health services for cosmetic purposes, like plastic surgery, became taxable.[208] Interestingly, it presents the standards of the OECD and EU as the basis for switching to taxation.

Although the scope of application of zero rating has increased, the reason for applying zero rating is the same as before. In the past, all zero-rating applications listed in the same article were dealt with separately. Specifically, Article 21 of the VAT Act regulates the exportation of goods, Article 22 provides for services supplied overseas, Article 23 regulates the supply of overseas navigation services, and Article 24 regulates the supply of goods or services for acquiring foreign currencies.

3.6.6 A Comparison

Similar to tax rates, the Second VAT Directive applied a flexible approach towards exemptions. Exports were the main exemption in both the original Korean VAT Act and the Second VAT Directive. Besides exports and services related to exports, the Second VAT Directive left it up to the Member States to decide which exemptions they wished to apply. The original Korean VAT Act did not stipulate exemptions other than those connected to international trade. Consequently, the original Korean VAT Act did not adopt a list of exemptions, such as those in the Sixth VAT Directive.

203 van Doesum et al., 306.

204 van Doesum et al., 306.

205 Seung-Rae Kim, Myeong-Ho Park, and Bum-Gyo Hong. [2007] *Economic Analysis of Korea's Value-Added Tax System Policy Tasks: Focusing on the Expansion of the Tax Base* (Seoul: Korea Institute of Taxation), 33.

206 National Tax Service. 2004. *Explanation of the Revised Tax Act* (Seoul: National Tax Service), 340–41.

207 National Tax Service. 2011. *Explanation of the Revised Tax Act* (Seoul: National Tax Service), 202–03.

208 National Tax Service. 2014. *Explanation of the Revised Tax Act* (Seoul: National Tax Service), 246–47.

In Korea, different exemptions were implemented subsequently. Interestingly, some exemptions, like the ones for feminine hygiene products, passenger transportation services, books, newspapers, the reception of broadcasting services and many services related to culture, are on the list for reduced VAT rates in the Sixth VAT Directive and in the VAT Directive but are exempt under the Korean VAT Act. Most other transactions that are exempt under the Korean VAT Act are also exempt under the VAT Directive. It may be that EU VAT law has influenced Korean VAT law regarding exemptions. However, the similarities may also be coincidental and are found in many VAT systems, since there is a rationale behind exempting services that are largely funded by public means, that are of public interest, or where it may be challenging to establish a fair taxable amount, such as financial and insurance services.

3.7 The Deduction of Input VAT

3.7.1 General Remarks

The deduction of input VAT constitutes a crucial element of VAT systems in both the EU and Korea. It is the right to deduct input VAT that makes an indirect tax a VAT.[209] Within the EU, the general rules are harmonized, meaning, for instance, that the right to deduct input VAT is connected to taxable output transactions. The Member States have, however, a lot of latitude to set their own rules.[210] One example is the apportionment of input VAT between economic and noneconomic transactions, which is at the discretion of the Member States.[211] Also, in the VAT Acts of the Member States and in the Korean VAT Act, the apportionment rules are not very specific. This does not mean that the tax authorities apply a flexible approach in relation to the taxpayers. Still, the technical rules are often found in lower-level acts, such as acts adopted by the executive power.[212] This chapter explores the principles, procedures, and considerations involved in deducting input VAT, and analyzes the similarities and differences between these two jurisdictions. As in the other sections, the focus is on the EU Directives and on the Korean VAT Act and not on technical issues within the discretion of the Member States.

3.7.2 The Second and Sixth Directives

The Second VAT Directive contains the central components for the deduction of input VAT. The right to deduct applies where goods and services are used for the purposes of a taxable person's undertaking. The taxable person is allowed to deduct the VAT invoiced to him/her in respect of goods supplied to him/her or in respect of services rendered to him/her, the VAT paid in respect of imported goods, and VAT on some deemed supplies of goods. The Second Directive clearly states that input VAT on goods and services used in nontaxable or exempt transactions shall not be deductible. However, if the transactions are not taxed because the supply takes place abroad or they are exempted because it is an export or some other cross-border supplies, the taxable person is allowed to deduct input VAT.[213]

The Second Directive includes a general rule on the mixed use of goods or services for both transactions that do give entitlement to deduction and those that do not give entitlement to deduction. The rule is called the "pro rata rule." It stipulates that a deduction shall only be allowed for the part of the input VAT, which is proportional to the amount relating to transactions giving entitlement to a deduction.[214] According to Annex A of the Second VAT Directive, the pro rata figure shall generally be determined in respect of all the transactions carried out by the taxable person but may exceptionally be determined for specific sectors.[215]

The Second Directive connects the right to deduct input VAT to the period in which the deductible tax is invoiced. A five-year period, including the year when the goods were acquired, is required to adjust the input VAT for capital goods. The adjustment applies each year to one-fifth of the tax borne by the capital goods.[216]

The Sixth Directive has a different approach to the deduction of input VAT than does the Second Directive. Instead of connecting the right to deduct input VAT

209 Tait, 9.

210 Merkx, "VAT Deduction," 54.

211 C-437/06, *Securenta*, ECLI:EU:C:2007:777, and CJEU, Directorate General for Research and Documentation. 2018. Research Note: Scope of the Principle of Legality of Taxation, Particularly in Relation to Value Added Tax," 1, 12.

212 The Korean Enforcement Decree of Value-Added Tax and CJEU 2018:11.

213 Article 11.1 and 2 and Article 10.1 and 2 of the Second VAT Directive.

214 Article 11.2 of the Second VAT Directive.

215 Annex A, para. 22 of the Second VAT Directive.

216 Article 11.3 of the Second VAT Directive.

to the taxable person's undertaking, it connects it to the purposes of the taxable person's transactions.[217] A direct and immediate link between the costs and the taxed output transactions must exist.[218] Consequently, the Sixth Directive introduces a transaction-based approach. Hence, no rule that excludes the right to deduct when the goods and services are used for nontaxable or exempt transactions is needed.

The Sixth Directive has a slightly different approach to the time of the deduction. Instead of connecting it to when the VAT is invoiced, the time when the tax becomes chargeable is the relevant point in time.[219] Under the main rule in the Sixth Directive, the VAT becomes chargeable when the goods are delivered or the services are performed.[220] Another novelty in the Sixth Directive is that the refund of input VAT is expressly stated and the list of exemptions with deduction is expanded.[221]

The pro-rata rule became more detailed in the Sixth Directive.[222] The deductible proportion shall be made up of a fraction having as a numerator, the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible under, and as a denominator, the total amount of the turnover.[223] Furthermore, the Sixth VAT Directive allows the Member States to derogate from the pro rata rule to a certain extent. For example, the Member States may authorize or compel the taxable person to make the deduction based on the use of all or part of the goods and services or provide that where the VAT is not deductible by the taxable person is insignificant, it shall be treated as nil.[224]

The adjustment of a deduction was further developed in the Sixth Directive. In the Second Directive, it refers only to capital goods. The Sixth Directive includes a general rule stating that the initial deduction shall be adjusted where the deduction was higher or lower than that to which the taxable person was entitled.[225] The input VAT shall also be adjusted where, after the return is made, some change occurs in the factors used to determine the amount to be deducted, particularly where purchases are canceled or price reductions are obtained.[226] An extended adjustment period for immovable property was introduced in the Sixth Directive, allowing the Member States to have an adjustment period of up to ten years.[227]

3.7.3 The Korean VAT Act of 1977

The Korean VAT Act of 1977 deals with the deduction of input VAT in Article 17. To be more precise, rather than specifying the conditions for receiving an input tax credit, the conditions for an input tax credit can be inferred by listing cases where input tax credit is not received.[228] Among them, if approached from the theoretical aspect of the VAT Act, item 1 and item 2 are essential. Item 1 is a case where there is a defect in the tax invoice, and item 2 is a case where business relevance is not satisfied. Furthermore, input VAT related to the business supplying goods or services, which are exempt from the VAT as well as input VAT before the VAT registration, is not deductible (items 4 and 5).

A defective tax invoice not only concerns a tax invoice that has not been issued, but it also concerns an invoice where the requisite entry items of the tax invoice are incorrect. The requisite entry items of the tax invoice are in Article 16. There are four in total: the registration number and name or denomination of the entrepreneur who makes the supply, the registration number of the person receiving the supply, the value of the supply and the amount of VAT, and the date of preparation. Since registration numbers can be issued only after a business has been registered, the business registration must be preceded by the input tax credit. There are entry items other than requisite entry items in the tax invoice, but whether they are entered or not does not affect the input tax credit. This condition is

217 Article 17.2 of the Second VAT Directive.

218 Case C-98/98, Commissioners of Customs and Excise v. Midland Bank, ECLI:EU:2000:300, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61998CJ0098. In this case, the input transactions had a direct and immediate link with the economic activity as a whole. In such a case, there is no difference in practice between the undertaking/business-based and the transaction-based approaches.

219 Article 17.1 of the Sixth VAT Directive.

220 Article 10.2 of the Sixth VAT Directive.

221 Articles 17.3 and 17.4 of the Sixth VAT Directive.

222 Articles 17.5 and 19 of the Sixth VAT Directive.

223 Article 19 of the Sixth VAT Directive.

224 Article 17.5 of the Sixth VAT Directive.

225 Article 20.1 (a) of the Sixth Directive.

226 Article 20.1 (b) of the Sixth VAT Directive.

227 Article 20.2 of the Sixth VAT Directive.

228 Article 17(2) Item1 to Item5 of the Korean VAT Act of 1977.

perceived as a procedural requirement for the input tax credit.[229]

Regarding business relevance, a correct invoice is perceived as a practical requirement for input tax credit. This requirement aims to credit only the amount an entrepreneur purchases for his or her business as an input tax. If this is not recognized, the tax burden of VAT will fall not only on the end consumer but also on the normal entrepreneur. Also, an amount unrelated to a business transaction cannot be called an input tax amount, and there is no justification for subtracting that amount.[230]

Moreover, the Korean VAT Act of 1977 Article 14(4) stipulates that goods subject to VAT (goods to which input tax credit has been applied) can be recalculated as tax payable when used in a tax-free business (when no output tax amount is generated). However, there is no provision on how to recalculate tax payable. Thus, it is entrusted to the Presidential Decree.

Conversely, Article 14(3) of the Korean VAT Act of 1977 describes the fictitious input tax credit. It stipulates that goods[231] exempt from VAT may be deducted as input tax if they are used for a taxable business (where input tax credit is not applied). However, provisions on how to recalculate input tax credit specifically is entrusted to the Presidential Decree.

To conclude, the Korean VAT Act of 1977 does not have many regulations on the deduction of input VAT, and the existing regulations are not systematic. It seems that the input tax credit is stipulated only from the perspective of simply subtracting it. Above all, there is no regulation on goods subject to depreciation.

3.7.4 The VAT Directive

In the current VAT Directive, all the above-mentioned rules on the deduction of input VAT in the Sixth Directive have remained, but there are some novelties. There are optional rules on cash accounting in Article 66(b). Consequently, when cash accounting is applied, the right to deduct input VAT arises at the time of the payment,[232] not when the transaction occurs.[233] Following the case law of the CJEU, starting with C-97/90 Lennartz,[234] which entitles taxable persons to a full deduction even when the assets are used partly for private purposes, a new Article 168a was introduced. Accordingly, in the case of immovable property, the Member States may restrict the right to a full deduction and grant only a partial deduction when the property is used partly for private purposes.

3.7.5 The Current Korean VAT Act

The current VAT Act has detailed provisions on input tax amounts. Article 38 is a provision regarding input tax amounts to be deducted. Article 39 stipulates when input tax amounts may not be deducted. Article 40 deals with situations when taxable and tax-free operations are combined. Article 41 regulates the recalculation of common input tax amounts on depreciable assets. Article 42 is a provision on fictitious input tax credit. At the same time, Article 43 has a provision that allows the input tax credit to be applied when depreciable assets for tax-free businesses, for which input tax is not deducted, are used or consumed by taxable businesses.

Where an entrepreneur carries out both a taxable business and a tax-free business, an input tax amount related to the taxable business or tax-free business shall be calculated based on the actual attribution. An input

229 Kim and Yoo, 323–30.

230 Kim and Yoo, 331–32.

231 Most of them are agricultural products and livestock products.

232 Article 167a of the VAT Directive.

233 Case C-9/20, Grundstücksgemeinschaft Kollaustraße 136 v. Finanzamt Hamburg-Oberalster. ECLI:EU:C:2022:88, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62020CJ0009.

234 Case C-97/90, Hansgeorg Lennartz v Finanzamt München III„ ECLI:EU:C:1991:315, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61990CJ0097; Case C-291/92, Finanzamt Uelzen v. DieterArmbrecht, ECLI:EU:C:1995:304, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61992CJ0291; Case C-434/03, P. Charles and T. S. Charles-Tijmens v. Staatssecretaris van Financiën, ECLI:EU:C:2005:463 https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:62003CJ0434; Case C-515/07, Vereniging Noordelijke Land- en Tuinbouw Organisatie v. Staatssecretaris van Financiën, ECLI:EU:C:2009:88, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62007CJ0515; Case C-118/11, EON Aset Menidjmunt OOD v. Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto' — Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite, ECLI:EU:C:2012:97, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62011CJ0118. See also Case C-269/00, Wolfgang Seeling v Finanzamt Starnberg, ECLI:EU:C:2003:254, which makes clear that the exemption for leasing or letting of immovable property does not apply on private use by the taxable person of a dwelling in a building forming part of the assets of the business.

tax amount for which the actual attribution is not clear shall be calculated on a pro rata basis, as prescribed by Presidential Decree, by applying the criteria prescribed by the Presidential Decree, including the ratio of the value of tax-free supplies to the total value of supplies. In summary, the input tax amount is divided and deducted based on turnover. Further details, such as the inability to divide input tax by turnover, are stipulated in Article 81 of the Enforcement Decree of the VAT Act.

3.7.6 A Comparison

Both the Second VAT Directive and the Korean VAT Act of 1977 have a business-, not a transaction-oriented approach to the deduction of input VAT. Input VAT on business-related acquisitions are deductible. In both these systems, a provision stipulates that if the goods or services are used for exempt activities, the right of deduction is excluded. There are general rules on the adjustment of input VAT and for goods acquired for taxable and tax-free activities.

Whereas the Sixth Directive made the rules on the deduction of input VAT more detailed and also moved from a business to a transaction-oriented approach, the Korean VAT Act has very much remained the same. However, the Enforcement Decree of Value-Added Tax contains detailed provisions both on the pro rata calculation and the adjustment (recalculation) of input VAT on capital goods. Another difference is that the Korean VAT focuses on calculating the nondeductible proportion, whereas the VAT Directive focuses on calculating the deductible proportion. Besides that difference, the rules demonstrate a significant similarity with the Sixth and the current VAT Directives.

Another difference is that the Korean VAT Act focuses on calculating the nondeductible proportion, while the VAT Directive focuses on calculating the deductible proportion. This indicates a difference in the approach to determining the extent to which input VAT can be deducted or excluded when goods or services are acquired for both taxable and exempt activities.

3.8 Have the Systems Moved toward or Away from Each Other?

This study has demonstrated that the EU and Korean VAT systems have many similarities. The Korean VAT Act has many similarities with both the Second and the Sixth VAT Directives—perhaps slightly more with the Second than with the Sixth VAT Directive. Applying a legal transplants perspective, you could say that what was transplanted was the EC VAT system, but neither the Second nor the Sixth VAT Directive. Since VAT was introduced, the EU VAT system has become more complex. The rules on intra-Community acquisitions but also on the place of supply have changed the EU VAT system significantly since VAT was introduced.

Besides intra-Community acquisitions, two significant differences between the Korean and the EU VAT systems have been identified in this article. Korea applies a single, relatively low VAT rate, and the place of supply rules are much fewer in number. Within the EU, tax rates vary from country to country. In addition, although the intra-Community acquisition does not exist in the Korean VAT system, it is only a difference that arises due to different political and geographical characteristics. It is not a fundamental difference. Lastly, the regulation on the place of supply is understood as a standard for exercising taxation in Korea. In the EU VAT system, the place of supply does not necessarily coincide with the place of taxation. Overall, the Korean VAT system is much cleaner than the EU system but still very similar to the original EU VAT system. Since the EU VAT system has developed differently, the two VAT systems have drifted apart.

The Korean VAT system is not an untouched legal transplant. It is not as if Korea had introduced a copy of the Second VAT Directive and applied it in today's society. However, it has reformed its system more slowly than the EU has done in order not to disrupt the economy. The most important revision of the VAT Act in Korea is the full revision in 2013 (Wholly Amended by Act No. 11873, June 7, 2013). From then on, Articles 1 (Purpose) and 2 (Definition) were newly added to the VAT Act. The preliminary VAT return filing has been abolished to ease the burden on sole proprietors.[235] Furthermore, for many Koreans, difficult legal terms of the VAT Act, previously written in Chinese characters, were replaced with the Korean language.[236]

Even though the two VAT systems have moved away from each other and are more different now than by the time of the introduction of VAT in Korea, Korea follows the developments in Europe regarding VAT. In fact, most scholars studying VAT in Korea refer to

235 Ministry of Economy and Finance. [n.d.] 2018 Korean Taxation, 19. https://english.moef.go.kr/upload/eco/2018/11/FILE_20181119165109_2.pdf. Accessed on August 5, 2023.
236 Na et al. 31.

European cases.[237] The main reason for this is historical. Korea has always used Europe or OECD countries as a comparison target, from the introduction of VAT to the discussion of the current VAT rate increase. In 2013, when European countries discussed raising their VAT rates to solve their fiscal deficits after the global economic crisis, Korea also argued for an increase in VAT rates. At this time, the countries referred to as "major countries" are all European countries and in the private sector; Europe is regarded as a major country in the VAT system.[238]

In 2022, the National Assembly Research Service published a report on the increase in VAT.[239] Both the increase in the VAT rate and a reform of the tax exemption system through the introduction of the reduced tax rate are discussed in this report.[240] In the discussion on the VAT rate increase, Japan, Germany, the OECD average, France, the UK, and Sweden are mentioned.[241] Most of the countries in the VAT rate increase comparison are EU countries.[242] Reforming the tax exemption system by introducing the reduced tax rate is based on evidence that the EU and Member States, such as Germany, France, and the UK, are implementing it.[243] This example demonstrates that the National Assembly uses the EU VAT system, but also other countries' VAT systems as sources of inspiration for legal change.

Not only the National Assembly, but also the government shows interest in the EU's VAT system. This is demonstrated in a publication titled *Consumption Tax Systems in Major Countries*, published by the Korea Institute of Public Finance. The publication aimed to address foreign consumption tax systems. The only foreign countries analyzed were the UK,[244] France,[245] Germany,[246] Japan,[247] Australia,[248] and the EU.[249] The reason why the EU was analyzed, even though it is an association rather than a country is, as stated in the preface to the publication, the EU serves as the backbone of Korea's VAT.[250] It is unreasonable to conclude that the above books and studies alone represent the government's position. However, it cannot be denied that the EU is one of the huge reference points in Korea's VAT policy.

Another reason for Korea's VAT system and the EU's VAT system becoming similar is the global economy. Currently, in Korea, according to Article 53-2[251] and Article 20, Paragraph 1, Item 3[252] of the VAT Act, electronic products are regarded as services, and the place of consumption of electronic products is regarded as the place of supply of services. Therefore, electronic products used in Korea are subject to VAT in Korea because the country is the place of consumption. As such, the new VAT regulations created by the global economy and the new economy are similar to those in Europe. There is, however, a rapid development in the field of VAT in the digital economy.

237 In-Gi Jeong and Sung-Mo Kang. 2021. "The Range of Misrepresented Tax Invoices Whose Value of Supply Is Written Differently from the Facts." *Seoul Tax Law Review* 27, no. 2: 161.

238 Myeong-Gyu Lim. 2013. [Tax Is Too Expensive] 2-① Is VAT the Answer? [In Korean]. http://news.bizwatch.co.kr/article/tax/2013/08/21/0030; Min-Jeong Kim. 2014. Value-Added Tax Hike Theory 'Coming up Little by Little'... Will the State Touch It for the First Time in 37 Years? [In Korean]. https://www.newspim.com/news/view/20140620000488.

239 Seung-Hyun Kim. 2021. "Will the President Moon Administration Raise the Value-Added Tax Rate after the Last Corporate Tax and Income Tax?" http://www.sejungilbo.com/news/articleView.html?idxno=33685.

240 National Assembly Research Service, *Analysis of Issues of the 2021 National Audit*, 215, 217. https://www.nars.go.kr/report/view.do?categoryId=&cmsCode=CM0019&brdSeq=35774.

241 National Assembly Research Service, *Analysis of Issues of the 2022 National Audit*, 215.

242 National Assembly Research Service, *Analysis of Issues of the 2022 National Audit*, 216–17.

243 National Assembly Research Service, *Analysis of Issues of the 2022 National Audit*, 218–20.

244 Jeong-Soo Park. 2019. *Consumption Tax Systems in Major Countries(I)-VAT:UK* (Sejong City: Korea Institute of Public Finance), 1–119.

245 Chang-Nam Ahn and Seung-Yeon Son. 2019. *Consumption Tax Systems in Major Countries(I)-VAT: France* (Sejong City: Korea Institute of Public Finance), 1–122.

246 Yoo-Chan Kim and Yoo-Hyang Kim. 2019. *Consumption Tax Systems in Major Countries(I)-VAT: Germany* (Sejong City: Korea Institute of Public Finance), 1–123.

247 Jung-Ho Kuk. 2019. *Consumption Tax Systems in Major Countries(I)-VAT: Japan* (Sejong City: Korea Institute of Public Finance), 1–168.

248 Jung-Hee Choi. 2019. *Consumption Tax Systems in Major Countries(I)-VAT: Australia* (Sejong City: Korea Institute of Public Finance), 1–155.

249 Chang-Nam Ahn. 2019. *Consumption Tax Systems in Major Countries(I)-VAT: EU* (Sejong City: Korea Institute of Public Finance), 1–93.

250 Ahn.

251 A system called "Commission Agent" has also been implemented in Europe since 2015.

252 As a new provision, as of December 22, 2020, the English version had not yet been updated. In the case of electronic products, this is a provision that considers the place of consumption as the place of supply of services.

When Korea adopts a VAT system resembling that of the EU, it is not definitively traceable to EU law alone. The determination of its origin, whether stemming from the OECD or the EU, hinges on whether a legal transplant necessitates a basis in hard law, as seen in EU legislation, or if soft law instruments, like Base Erosion and Profit Shifting (BEPS) andInternational Value Added Tax/Goods and Services Tax(VAT/GST) Guidelines, can also qualify as legal transplants. Our current assessment maintains that the EU VAT continues to influence revisions to the Korean VAT Law. Still, this influence extends to other jurisdictions, such as Australia, the UK, and the OECD. For instance, the OECD's BEPS Action 1[253] recommended specific approaches, subsequently incorporated into the International VAT/GST Guidelines.[254] One of these recommendations pertained to mandating foreign suppliers to register and collect VAT on cross-border Business-to-Consumer (B2C) transactions involving electronic services. The EU implemented this collection mechanism through the Mini-One-Stop-Shop (MOSS), which has since evolved into the One-Stop-Shop (OSS).[255] If a foreign supplier supplies electronic services B2B, the same system as in the EU applies, namely, the reverse charge.

In Korean Law, there are not yet any provisions on deemed supplies for electronic interfaces facilitating B2C supplies of goods, like the ones in Article 14a of the VAT Directive.[256] In the OECD report "VAT Digital Toolkit for Asia Pacific" from 2022, it is proposed that the efficiency of VAT collection should be boosted by requiring digital platform operators to collect and remit the VAT on sales carried out through their platforms.[257] One way to achieve this would be by introducing similar deemed supply rules as in the EU, which would be a move towards EU VAT, even though the influence would come from the global economy rather than from the EU. Overall, this report contains many tools for VAT in the digital economy, which may be implemented throughout the Asia Pacific region in the future, and of which several are already in place in the EU VAT system.

3.9 Final Analysis and Concluding Remarks

At the beginning of this article, three research questions were identified:

1. Was there any European influence on the Korean VAT Act by the time of its introduction, and if so, how did this influence take place?
2. What are the similarities and differences between the two systems, both at the time of the introduction of Korean VAT and today?
3. Have the two VAT systems moved toward each other or drifted apart?

There was a European influence on the Korean VAT Act at its introduction. In his report before the introduction of VAT, Duignan draws parallels with the state of affairs in many European countries, such as Denmark, Sweden, Belgium, the UK, and West Germany, as well as to the draft Sixth VAT Directive. The Ministry of Finance's working group visited the UK, West Germany, Belgium and the Commission of the EC, and the British system was inspected in greater detail at a later stage. Our study found that the Second VAT Directive has influenced the Korean VAT system to a large extent, but so has the Sixth Directive. Knowledge about the Second Directive was probably largely gained indirectly through its implementation in the Member States.[258]

As has been demonstrated above, many similarities are so close that they can hardly have occurred spontaneously. Such examples are the place of supply rules and the deduction rules. There are very few unique differences when comparing the Korean VAT Act of 1977 with the Second and Sixth Directives. The tax rates and the exemptions stand out. By the time of the introduction of the Korean VAT system, the flexible 13% VAT rate was, from an international perspective, not extraordinarily low, and not all Member States in

253 OECD. 2015. *Addressing the Tax Challenges of the Digital Economy* (Paris: OECD).

254 Chapter III.C of the OECD 2017 International VAT/GST Guidelines.

255 OECD. 2017. "OECD Delivers Implementation Guidance for Collection of Value-Added Taxes (VAT/GST) on Cross-Border Sales. https://web-archive.oecd.org/2017-10-24/452982-oecd-delivers-implementation-guidance-for-collection-of-value-added-taxes-on-cross-border-sales.htm.

256 See also Article 9 a of the Implementation Regulation.

257 OECD. 2022. *VAT Digital Tool-Kit for Asia-Pacific* (Paris: OECD), 47. https://www.oecd.org/tax/consumption/vat-digital-toolkit-for-asia-pacific.pdf.

258 As a curiosity, it can be mentioned that the Swedish VAT system that was studied by Duignan was strongly influenced by the EC system already at the time of its introduction in 1969, even though Sweden was not yet a member of the EC.

the EU applied reduced tax rates, although most of them did. The exemptions seem to have been inspired by the EU lists for reduced rates and exemptions, but probably, there are also societal explanations for the differences. From the perspective of the reduced rates and exemptions, the Korean VAT system is less imperfect than the EU VAT system, since there is only one tax rate, and the list of exemptions is short.[259]

Korea seems to follow European developments, and many tax scholars study CJEU cases. Thus, in the future, there may perhaps be more diffusion of VAT Law from the EU to Korea, either directly or via the OECD. One future development in the EU, which might develop into a role model for other countries, is the ViDA proposal (VAT in the Digital Age).[260] This proposal contains a real-time digital reporting system based on e-invoicing; updated VAT rules for the platform economy (PDS, platforms and deemed supplies); and a single VAT registration (SVR) for businesses selling to consumers across the EU. To conclude, the two systems are more different than when Korea introduced its VAT in 1977, but the EU remains an essential source of inspiration for the Korean VAT.

259 See de la Feria and Krever, 4.

260 Proposal for a Council Directive Amending Directive 2006/112/EC as Regards VAT Rules for the Digital Age, COM/2022/701 final, 8 December 2022.