

# Income Shifting Between Personal and Corporate Income Tax Bases

December 2013 | Byung Mok Jeon

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## Summary and Policy Implications

### 1 Abstract

This paper analyzes the shifting of tax base between individual and corporate income tax. As a first step, we examined the differences in the personal income tax burden between personal business entities and incorporated ones in order to identify the existence of any economic incentives on business form choice. Four types of compensation scheme are considered, such as, business income, wage, dividend, mix of wage and dividend. The results show that while tax burden were fluctuated by income type, the mixed form of compensation features the lowest tax burden in the over-100 million won bracket. It can be seen that the tax system itself is providing economic incentives toward the incorporation of private businesses. In the case of owner-managed corporations, capital was seen to be shifted to the corporation as income tax gaps between personal and corporate tax widened. Every increase of 1 percent point in the tax rate gap resulted in 2.89 percent growth of assets among owner-managed corporations. Such transfer of capital suggests that interconnectivity between these two tax sources must be considered when establishing policies for personal and corporate income taxes.

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# I

## Introduction

Policies regarding personal and corporate income tax have been recently drawing public attention as means for enhancing social equity and supporting economic growth while supplying financial resources. As a major tax source, personal income tax simultaneously plays an important role in improving redistribution. Corporate income tax is also closely related with economic growth and job creation. For this reason, the direction of policy reform for these two taxes has become a major issue in elections and discussions in the National Assembly. However, it is very limited to discuss policy options based on tax base interconnectivity. Policy suggestions for personal income tax reform have only prioritized equity and those of corporate income tax have only accounted for corporate-related activities such as investment. The question remains if it is indeed appropriate to regard and reform these two tax burdens as separate policy issues.

This paper reviews the possibility of income shifting between personal and corporate income tax based on the aforementioned query. When we operate an actual business, business income may bear personal income tax or corporate income tax according to incorporation. The issue becomes how tax policy would affect the foundation of businesses or those currently in operation. This is due to the fact that policy differences between personal and corporate income tax affect the overall taxable incomes, in the end, tax amounts, of the two categories.

Studies on changes in tax bases have mainly been conducted from the perspective of behavioral adjustments among economic agents. If a tax is imposed only on labor income, both the relative price between labor and leisure and



real income levels change, which then results in behavioral changes of economic agents. Taxation brings about a substitution effect where the price of leisure is lowered, boosting the demand for relatively inexpensive leisure and an income effect in which leisure demand is reduced due to a decrease of after-tax income. Due to behavioral changes, economic agents are paying costs exceeding tax revenues, so called excess burden.<sup>1)</sup> The efficiency of tax policy lies in the reduction of such additional burden. Among the changes resulting from by tax policies, there are those that trigger no real behavioral changes. While changes such as in labor supply, consumption structure, and investment decisions, which result from variations in the relative price structure of goods and services, are indeed real changes, reshaping the forms of tax bases or income to lower the tax burden is not a real change. Shifting tax bases or income to ease the tax burden may not impact levels of economic activity, but instead bring about changes such as the categorization of tax items within tax law or the distribution among income earner and country. Such income shifting may be classified into either tax avoidance (legal) or evasion (illegal) based on its legal status (Sandmo, 2005).

There could be priorities on the part of taxpayers when considering various tax avoidance strategies in the face of an increase in tax burden. Slemrod (1990, 1995) argued that the first taxpayer response was inter-temporal income shifting through adjustment of transaction points. The second is tax burden reduction through alteration of the nature of income type. He added that the final effort is directed at real behavior changes, such as to labor supply or investment. Reshaping the taxation system may increase incentives for illegal tax evasion. As taxpayers' responses to an increase in tax burden vary, it is important to do research analyzing the influences of such factors and reflect the findings into policies.

Existing studies have mainly focused on behavioral changes, such as labor supply, but researches on income shifting have not been up to par. Such a

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1) This is the same concept as Harberger Triangle—deadweight loss—as defined under the Marshallian demand function; more precisely, corresponding to the concept as defined in the Hicksian demand function (compensated demand function).

tendency is also apparent in researches on Korea. Whereas there have been various studies regarding estimates of labor supply elasticity (Jeon Seung-hoon, Hong Inkee, 2009; Na Sung-lin, Nam Jae-ryang, Moon Choon-Geol, 2002; Shim Uk-gee, 2006; Jeon Byung Mok, Jang Yong-sung, 2005), it is difficult to find studies on income shifting. Jeon Byung Mok (2006) estimated taxable income elasticity, but did not decompose by factor.

The focus of analysis regarding income shifting has been directed at changes in income type among various factors. Due to South Korea's relatively large self-employed population, the possibility of changes in income type is likely to be high and its scale could also be extensive. The results verified that the tax system in Korea is indeed providing incentives for mitigating tax burden through income shifting between personal and corporate income. The analysis of tax burden by income types (business income, wage, dividends, mix of wage and dividend income) here shows that wage income bears the lowest tax burden. The greatest tax burden falls on dividends and, in the over 100 million won bracket, mixed compensation of wage and dividends appeared to bear the lowest tax burden. Under the 100 million won, relative size of tax burden by income type varies according to the income bracket, and was influenced by various deductions, comprehensive taxation on financial income, and imposition of health insurance premium based on non-wage income. The results show that the higher the income level, the stronger is the incentive to shift the tax burden from personal businesses to corporations in order to relieve it. The analysis also confirms income shifting between individuals and corporations. The corporate assets overseen by owner-managers showed a quite sensitive response to the personal-corporate income tax rate gap. One percent point increase in the income tax rate gap translates into a 10.3 billion won extra increase in corporate assets in owner-managed businesses compared to their counterparts, totaling 2.89 percent of average corporate assets. The remainder of the study is as follows: the second section deals with tax burden gap by income type along with the characteristics of the South Korean income tax system; the third defines types of income shifting and establishes analysis models; the fourth covers the data used for analysis and the results; the final section concludes.

## II

### Characteristics of the Income Tax System and Tax Burden Gap by Income Type

Gaps in tax burden by income type should be reviewed in order to identify the presence of economic incentives for tax-related income shifting. The types of income can be divided into labor and capital income. Labor income includes wage and business income, while capital income includes dividend, interest and capital gains income. A tax burden gap by income type occurs based on whether or not it is paid in the form of wages. Unlike that on business income, South Korea allows a relatively low tax burden on wage income through exemption schemes such as wage income deductions and wage income tax credit. While it is true that wage income is preferred to business income due to the various deductions reflecting labor cost and income transparency gaps, additional social insurance premiums are imposed, such as unemployment insurance and workers' compensation insurance. As for national health insurance and national pension system, wage workers' tax burden could be lowered compared to business income by sharing these costs with employers.<sup>2)</sup>

As corporations are involved in the income acquisition process, the tax burden on dividend varies according to changes in the corporate tax system. Dividend income, which is taxed on both a personal and corporate stage, bears a relatively high tax burden despite a tax credit to relieve double taxation. Dividend income,

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2) Employer contributions have to be included to explain the total cost of labor, but a gap in tax burden may occur due to differences in the entity (personal and corporate income tax) to which nominal costs are attributable, as well as the tax ratio.

however, does not carry an additional social insurance premium burden such as unemployment or worker's compensation insurance. It also has an advantage in that it is exempt from health insurance premium if a taxpayer's global income is 72 million won or less. Interest income, a different kind of capital income, bears a lower tax burden in a certain income bracket, unlike dividend income, because there's no tax on corporate stage. It is taxed at a 14 percent flat tax rate unless it falls on the comprehensive taxation scheme, but it bears a higher tax burden than that of labor income, which starts at a 6 percent tax rate.

In order to utilize a tax burden gap by income type, taxpayers must be in a position to shift among income types, which are possible in the case of the owner-manager of a corporation. Owner-managers of corporations have both an economic incentive to adjust their income types and the authority to implement such changes.

## 1 Characteristics of the Tax System by Income Type

### A. Labor Income

South Korea is currently operating a tax system which is fairly favorable to labor income. The gross salary and wages for tax year 2011 amounted to 437.8 trillion won, but the tax base following all allowed deductions reached a mere 161.8 trillion won, which accounts for 37 percent of gross salary and wages. On the other hand, global income including business income and capital income has a relatively high tax base ratio. Tax base for global income taxation attributable to 2011 was drawn from a 111.4 trillion won taxable income, of which is 84.1 trillion won, or 75.5 percent of taxable income. This is fairly high when compared with wage income.<sup>3)</sup> The total income deduction for wage earners in 2011 was 271.4 trillion won, with the wage income deduction

3) As for global income, the cost of income acquisition has already been deducted from business income. But the cost of wage acquisition is included in gross wages, so the ratio of tax base is wider.

accounting for 138.7 trillion won, or 51.1 percent of total deductions. The wage income deduction plays a role of lump-sum deduction toward wage earning-related costs. The deduction ratio decreases as income rises and the marginal deduction rate applied over 100 million is 2 percent of the wage income.<sup>4)</sup> The reason that the deduction for wage income is regressive is to strengthen redistribution effect.

〈Table II-1〉 Income Deduction of Global Income and Wage Income

(Unit: 100 million won, %)

	Global income tax			Wage income tax			(Global income tax+ Wage income tax) Tax base ratio
	Taxable income	Tax base	Tax base ratio	Gross wages	Tax base	Tax base ratio	
1996	262,648	n.a	n.a	1,345,613	472,089	35.1	n.a
1997	263,301	201,077	76.4	1,482,893	497,952	33.6	40.0
1998	214,097	152,080	71.0	1,332,680	427,660	32.1	37.5
1999	246,763	176,641	71.6	1,370,133	402,067	29.3	35.8
2000	321,671	231,979	72.1	1,702,929	533,123	31.3	37.8
2001	364,054	287,920	79.1	1,911,214	617,562	32.3	39.8
2002	421,634	328,510	77.9	2,153,938	614,868	28.5	36.6
2003	452,239	349,292	77.2	2,288,675	671,217	29.3	37.2
2004	491,798	374,717	76.2	2,490,617	746,477	30.0	37.6
2005	541,033	417,387	77.1	2,793,723	835,198	29.9	37.6
2006	650,011	501,790	77.2	3,178,721	954,662	30.0	38.0

4) Deduction rates for wage income by income range are as follows: 70 percent (till 5 million won)—40 percent (till 15 million won)—5 percent (till 45 million won)—2 percent (over 100 million won). The rates are 80 percent (till 5 million won)—50 percent (till 15 million won)—15 percent (till 30 million won)—10 percent (till 45 million won)—5 percent (over 45 million won) until 2013.

〈Table II-1〉 Continue

	Global income tax			Wage income tax			(Global income tax+ Wage income tax) Tax base ratio
	Taxable income	Tax base	Tax base ratio	Gross wages	Tax base	Tax base ratio	
2007	771,241	599,381	77.7	3,248,093	1,120,322	34.5	42.8
2008	850,825	646,648	76.0	3,526,381	1,180,479	33.5	41.7
2009	902,257	666,667	73.9	3,695,706	1,213,182	32.8	40.9
2010	1,002,668	752,594	75.1	4,010,860	1,446,574	36.1	43.9
2011	1,114,464	841,090	75.5	4,378,384	1,618,404	37.0	44.8

Sources: National Tax Service, *Statistical Yearbook of National Tax*, annual.

〈Table II-2〉 Trend of Wage Income Deduction

(Unit: 100 million won, %)

	2009	2010	2011
Recipients	8,533,081	9,234,075	9,924,404
Wage income tax credit amount (A)	22,956	25,765	28,304
Calculated tax amount of wage income (B)	152,627	182,936	207,566
A/B	15.0	14.1	13.6

Sources: National Tax Service, *Statistical Yearbook of National Tax*, annual.

A tax benefit for wage income also exists in tax credit stage, where a wage income tax credit is allowed. The wage income tax credit eases the tax burden by applying a credit rate of 55 percent for the tax amounts 500,000 won or less and 30 percent for amounts exceeding this threshold, with a credit limit of 500,000 won. There is also a gap in the tax credit ratio between global income and wage income due to the additional tax credit for wage income. The tax

credits share for taxpayers who file global income tax returns for 2011 was 11.0 percent, but that of wage income earners showed 14.2 percent, higher by 3.2 percentage points. Tax credits for wage income attributed to 2011 was 2.9 trillion won, which accounted for 14.2 percent of the calculated tax amount of wage income, 20.8 trillion won. The wage income tax credit also plays the role of relieving the tax burden for wage income only. The operation of both income deduction and tax credit for wage income serves as a factor to actually reduce the tax burden when compared with other types of income. This gives economic incentives to increase the ratio of wage income against the overall economy.

Providing tax breaks for wage income is also a measure to balance tax burdens of two different tax bases which show significant gap on transparency. The direction of income shifts between wage income and business income, therefore, could be determined according to the gap in income transparency and size of tax breaks.

〈Table II-3〉 Tax Credits by Income Type

(Unit: 100 million won, %)

Year	Global income tax			Wage income tax			(Global income tax+ wage income tax) Tax credits share
	Calculated tax amount (A)	Determined tax amount (B)	Tax credits share	Calculated tax amount (A')	Determined tax amount (B')	Tax credits share	
1997	44,143	36,898	16.4	n.a	50,106	n.a	n.a
1998	33,530	30,156	10.1	n.a	43,472	n.a	n.a
1999	41,014	35,578	13.3	n.a	43,372	n.a	n.a
2000	54,448	48,031	11.8	n.a	60,770	n.a	n.a
2001	64,024	55,373	13.5	91,982	71,461	22.3	18.7
2002	66,946	57,453	14.2	84,914	69,334	18.3	16.5
2003	72,543	62,887	13.3	93,622	76,412	18.4	16.2
2004	79,263	69,438	12.4	108,388	89,131	17.8	15.5
2005	86,349	74,372	13.9	117,570	97,782	16.8	15.6
2006	104,631	92,324	11.8	137,473	115,664	15.9	14.1
2007	126,854	112,775	11.1	165,859	141,138	14.9	13.3
2008	132,583	117,298	11.5	167,148	141,821	15.2	13.5
2009	130,898	116,993	10.6	152,627	128,519	15.8	13.4
2010	148,443	131,782	11.2	182,936	155,863	14.8	13.2
2011	170,373	151,707	11.0	207,566	178,019	14.2	12.8

Note: Tax credits share =  $\left(1 - \frac{B}{A}\right) \times 100, \left(1 - \frac{B+B'}{A+A'}\right) \times 100$

Sources: National Tax Service, *Statistical Yearbook of National Tax*, annual.



〈Table II-4〉 Wage Income Tax Credit

(Unit: 100 million won, %)

	2009	2010	2011
Recipients	8,533,081	9,234,075	9,924,404
Wage income tax credit amount (A)	22,956	25,765	28,304
Calculated tax amount of wage income (B)	152,627	182,936	207,566
A/B	15.0	14.1	13.6

Sources: National Tax Service, *Statistical Yearbook of National Tax*, annual.

Various social security contributions are imposed on personal global income (wage income for employees). The social contributions which are currently being withdrawn from wage income are national health insurance, national pension, employment insurance, workers' compensation insurance, and long-term care insurance. While employment insurance and workers' compensation insurance are social insurance premiums imposed only on wage income, national health insurance, national pension, and long-term care insurance are imposed on global income and the gap by income type is not significant. However, in the case of national health insurance, even when there are multiple sources of income, insurance premiums are imposed based only on the wage income if global income does not exceed 72 million won.

The combined tax rates (as of fiscal year 2013) of employment and workers' compensation insurances is 3.05-3.65 percent, out of which income earners pay 0.55 percent and employers pay the remaining 2.5-3.1 percent. Additional tax burdens imposed only on wage income serve as an economic incentive for changing income type. If some portion of business income is not detected by the government tax administration, it would also be excluded from the estimation of national health insurance and national pension insurance and of income tax, which could enlarge the burden gap for social security contributions compared to wage income.

〈Table II-5〉 Rates of Social Security Contributions for Wage Income (2013)

(Unit: %, million won/year)

	National health insurance	National pension insurance	Employment insurance	Workers' compensation	Long-term care insurance
Premium rate	5.89	9.0	1.35–1.95	1.70	0.3858
– income earner	2,945	4.5	0.55	0.00	0.1929
– employer	2,945	4.5	0.80–1.40	1.70	0.1929
Income ceiling	937.2	45.0	–	–	937.2

Note: An income ceiling is the maximum income level at which social security contributions increase according to income level; the rate of employment insurance contribution by employer varies by the number of employees; The rate of workers' compensation insurance is average over industry; the rate for long-term care insurance, 6.55% of that of national health insurance premium, is converted to the rate on income.

Sources: Homepages of National Health Insurance Service, National Pension Service, and Ministry of Employment & Labor.

## B. Capital Income

This section will focus on interest income and dividend income.<sup>5)</sup> Interest and dividend income are included in global income taxation, but separate taxation is applied on income under a certain threshold. When financial income (interest and dividend incomes) totals 20 million won or less,<sup>6)</sup> the tax payment duty is fulfilled through a 14 percent withholding tax. If financial income is over 20 million won, it is taxed according

5) Capital gains income is excluded, as it is a form of capital income that occurs only once at the point of asset transfer from the perspective of voluntary changes in income type, and it means a cessation of business, thus making it difficult to consider it being caused purely by incentives for income shifting.

6) Income threshold for global income taxation was 40 million won until 2012, but it was lowered to 20 million won from 2013.

to progressive global income tax rates together with other forms of income. The financial income tax system in Korea prevents effective tax rate from falling below withholding tax rates through comparative taxation.

As for dividend income, a gross-up system is applied in order to relieve double taxation where corporate tax (income acquisition stages) and income tax (shareholder distribution stages of corporate income) are imposed together. That is to say, dividend income is profit distributed after the payment of corporate income tax and upon which personal income tax is imposed for shareholders who received it, doubling the related tax burden. To tackle the problem of double taxation, personal income tax is calculated by adding the corresponding corporate tax (which is called ‘imputation tax’) to total dividend and deducting imputation tax from the calculated amount of global income tax. The corporate tax rate which is applied for the estimation of imputation tax is 11 percent.

The financial income in 2011 was 52.1 trillion won, which consisted of 37.3 trillion won in interest income and 14.7 trillion won in dividend income, with interest income accounting for 71.7 percent of financial income. The number of income earners who were subject to global income taxation totaled roughly 51,000, accounting for 1.3 percent of the 3.957 million filers of tax returns. As of 2011, the share of financial income liable to progressive global taxation was 19.6 percent of total fiscal income. This is a more than 2 percent point increase compared with the 17.5 percent from 2008 when the financial crisis began, showing the concentration of financial income. Accordingly, the average income of taxpayers subject to global income taxation was raised from 300 million won in 2009 to 380 million won in 2011. As the financial income has moved to higher income earners, the financial income-to-global income ratio of taxpayers subject to global income taxation dropped: the ratio of financial income declined from 56 percent during 2009~2010 to 53 percent in 2011.

Comprehensive taxation on financial income plays a role in balancing tax burden by income type. Considering high capital mobility, tax on financial income is at relatively low level but comprehensive taxation prevents a widening of the individual income tax gap at higher income level.

〈Table II-6〉 Financial Income and Global income Taxation

(Unit: billion won, persons, %)

	2009	2010	2011
Total financial income (A)	50,193.2	50,153.5	52,075.7
– Interest income	37,324.3	35,751.0	37,338.3
– Dividend income	12,868.9	14,402.5	14,737.4
Financial income under Global income taxation (B)	8,793.4	9,852.7	10,207.4
– Income earner (persons)	51,261	48,907	51,231
– Gross income (C)	15,551.9	17,313.7	19,264.1
– Average income (million won)	303.4	354.0	376.0
Share of Global income taxation (B/A)	17.5	19.6	19.6

Source: National Tax Service, *Statistical Yearbook of National Tax*, annual.

### C. Corporate Income

In the corporate income tax system, corporate income (profit) can be defined as the amount of profits derived through transactions which increase the net assets of a corporation excluding capital and investment. It includes business income, capital gains, appraisal profit, and fictitious dividends. Business income for the tax year is calculated by subtracting expenses from revenue. The tax base is calculated by adjusting corporate income, upon which the tax amount is worked out by applying three levels of corporate income tax rate (10, 20, 22 percent respectively). The determined tax amount is calculated by deducting various tax credits from the calculated tax amount.

The corporate income tax system does not discriminate in terms of tax burden by income type: it applies the corporate tax rate after summing all income which caused an increase in net assets, regardless of income type, and deducting the costs. However, a progressive tax rate system has been adopted to favor

low-income corporations: the system maintained two levels of progressive rates until 2012 and was expanded to three levels from 2013.

Among companies which filed corporate income tax returns, the net profit ratio, the ratio of current net income to revenue, is 8.0 percent for corporations with assets less than 500 million won, which is higher than the 6.6 percent of average net profit ratio of all corporations. Though small corporations face fierce market competition, but there is big gap in profitability among them so that profitable ones enjoy increased profitability. The net profit ratio for corporations with the asset of 0.5~10 billion won is around 4~5 percent, which is the lowest level. This is not a structure where a few corporations enjoy large profits, but rather one where multiple corporations compete for a small profit, showing the fiercest competition within small and medium size firms.

The average effective tax rate, tax amount-to-tax base ratio, increases as the asset increases, which mimics the intention of the progressive tax structure. In general, supposing there is no remarkable gap in the profit rates on assets, an increase in asset results in an growth of profit amount and effective tax rates increase by the progressive tax rate structure. Various types of tax credit or deductions could slightly alter effective tax rates, but the general trend of effective tax rates is maintained. The lowest effective tax rate (9.6 percent) can be found at asset level of 0.5~1 billion won, which might be explained by the various deductions and exemptions allowed to small and medium-sized corporations.

〈Table II-7〉 Tax Burden Distribution of Corporations by Assets  
(based on 2011 filing)

(Unit: billion won, %)

Scale of assets	Revenue	Net profit	Net profit ratio	Tax base	Tax amount	Effective tax rate
0.5 billion or less	67,978	5,447	8.0	2,956	307	10.4
1 billion or less	87,854	3,825	4.4	3,557	342	9.6
2 billion or less	133,184	5,578	4.2	5,670	587	10.4
5 billion or less	221,113	9,612	4.3	10,082	1,231	12.2
10 billion or less	199,892	9,651	4.8	10,281	1,501	14.6
20 billion or less	118,212	6,782	5.7	7,227	1,155	16.0
50 billion or less	174,335	11,077	6.4	11,635	1,927	16.6
100 billion or less	153,529	11,057	7.2	11,173	1,901	17.0
500 billion or less	370,663	25,876	7.0	24,995	4,382	17.5
over 500 billion	1,923,377	140,498	7.3	140,478	24,628	17.5
Total	3,450,138	229,403	6.6	228,056	37,962	16.6

Note: (Net profit/Revenue)×100, Effective tax rate=(Tax amount/Tax base)×100. Included firms only with positive net profit

Source: National Tax Service, *Statistical Yearbook of National Tax*, annual.

## 2 Differences in Tax Burdens by Income Type

Significant economic incentives stemming from differences in tax burdens by income type is a necessary condition of income shifting. South Korea has adopted a global income taxation system which imposes tax based on sum of all types of income. It is a method of progressive taxation that cares only not the income type but income level. As for interest and dividend income, separate taxation through withholding is allowed for up to 20 million won annually in order to promote convenience in taxation. Therefore, a gap in nominal tax rates between labor income and capital income almost does not exist.

Tax burden gap exists not between labor income and capital income, but

between wage income and other incomes. The gap in tax burden between wage income and business income is designed to reflect the differences in income transparency. Additional exemptions are allowed regarding wage income verifiable through employers in order to balance the tax burden with that of business income, which relatively lacks transparency. Wage income deductions and wage income tax credits are allowed only on wage income in order to lower the effective tax rate.

Another factor that triggers a tax burden gap between income types, which is a cause of income shifting, is social security contributions. While social security system covers all citizens, other insurance programs such as employment insurance are aimed at a specific class, such as wage earners. In this case, the burden of social security is added to wage income. Employment insurance is a form of social insurance designed to protect against unemployment risk and is applied to both employees and employers alike.<sup>7)</sup>

Four different types of income were analyzed in order to examine the level of tax burden for each income type that may offer an incentive for income shifting: business income, wage income, dividend, and mix of wage (50%) and dividend (50%). These income types are available remuneration methods that owner of a business can choose. Receiving an equal proportion of wage income and dividend represents a form of wage-dividend mixed compensation available through incorporation. The range of income for analysis was set at 20 to 400 million won, to cover small-sized businesses which may confront a choice on organizational form.

The overall tax burden (sum of personal income tax, corporate income tax, health insurance, national pension, and unemployment insurance)<sup>8)</sup> based on income type was the lowest for the wage-dividend combination type. Effective tax rates gradually increased from 19.0 percent to 33.0 percent as income rises. The income type with the greatest tax burden was pure dividend income. In

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7) Worker's compensation insurance is a system which protects wage workers in the case of accidents in the workplace, but regarding which employers are responsible for the payments. It is operated for gross wages, the burdens upon which are considered in a later analysis.

8) For the sake of convenience of analysis, the imposed local tax totaling 10 percent of national tax was excluded.

order to receive income in the form of dividends, corporate tax should be paid at firm stage, and then 14 percent withholding tax rate is applied afterwards. Thus, when receiving income in the form of dividends, the tax burden is at least 26.7 percent<sup>9)</sup> and if the dividends exceed 20 million won, it will be taxed under global income taxation scheme, thereby further increasing the tax burden. Effective tax rate goes up to 38.5 percent if, for example, income of 400 million won is received from a corporation through dividends. For the 100 million won or lower income level, the effects of the favorable deductions for wages and the burden of social security contributions coexist, so it is not easy to determine which is more beneficial. However, this shows that for those in a high income level where the effect of social security contributions grow, it is the most beneficial to choose an income based on mixed salary and dividends. Meanwhile, regarding wage and dividend mixed compensation, the reason why the tax burden level surges at the 120 million won or higher income level is that health insurance premium is additionally imposed for global income (excluding wage income) if it is over 72 million won.

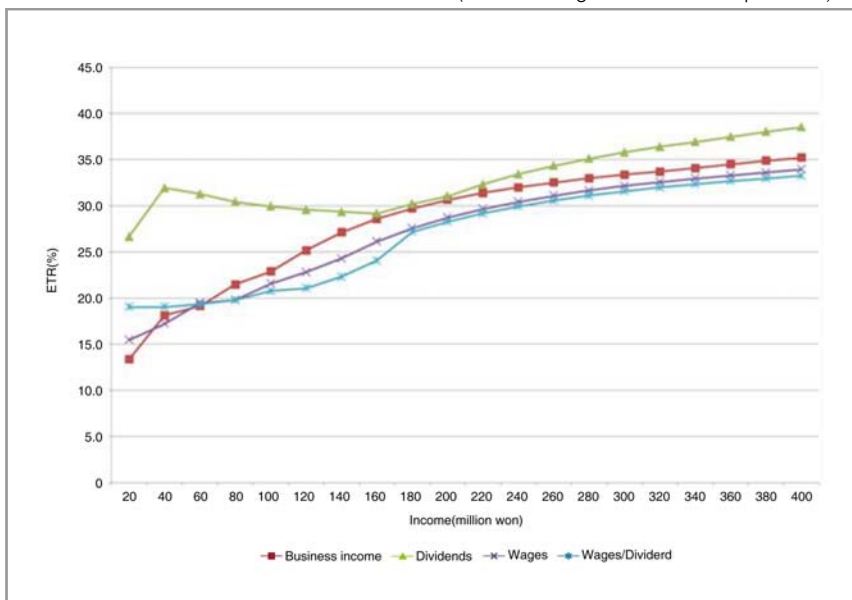
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9) The sum of the lower income tax rate of corporate tax (10 percent), dividend tax rate (12.6 percent) (= 90 percent x 14 percent) and the national insurance rates (4.1 percent).



[Figure II-1] Effective Tax Rate by Income Types/Income Level

(Unit: Including social insurance premiums, %)



Note: Social insurance includes health insurance, national pension insurance, and unemployment insurance.

The amount of income on the horizontal axis is the sum of profit before corporate tax and employment cost (employer's burden of the wages and social security contributions).

Sources: Calculation by the author applying income and corporate tax law.

In order to avoid a high tax burden, personal income could be invested in corporations. In other words, income that is not urgently needed can be parked in a privately owned corporation, thereby lowering the tax burden, and be returned in the form of wages, dividend, and/or capital gains in times of need. This method enables not only income types to be changed, but also the adjustment of the point of receipt of income and the payer of personal expenses, thereby providing incentives for shifting income.

The income level at which personal marginal tax rate<sup>10)</sup> is higher than the statutory maximum corporate tax rate has decreased remarkably since the 1980s. This income level is the point where an individual income earner begins to experience an economic incentive for income shifting.<sup>11)</sup> As of 1982, the individual income level that showed a higher marginal tax rate than the maximum corporate tax rate was 13.40 million won annually, which was considerably higher (by 9.5 times) than the per capita income of the time of 1.41 million won, but it plunged due to a rise in income levels and a reduction in the maximum corporate tax rate. In 2012, the individual annual income level that faced a higher marginal tax rate than the maximum corporate tax rate was lowered to 63.16 million won, allowing more private business owners to have an incentive for shifting their personal income to corporate as a means to alleviate their tax burden. An annual income of 63.16 million won was only 2.5 times higher than the national per capita income for the year of 25.59 million won.

Moreover, when the corporate profit level is not high, the lower corporate tax rate set at less than half the level of the maximum corporate tax rate can serve to provide an incentive to shift income. In this case, the income level that alters the tax burden is lowered. In other words, most owners of private business face an economic incentive for tax burden reduction through income shifting.

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10) This is calculated by applying the wage income deduction, personal allowance and the standard deduction for a single income earner.

11) Because they can benefit from a lowered tax burden compared to that on personal income by keeping their income in corporations.

〈Table II-8〉 Top Tax Rates for Personal Income and Corporate Income

Year	Top income tax rate ( $\theta_{\max}$ )	Corporate tax		Gap between personal and corporate top tax rate	Income level $\theta \geq \tau_{\max}$	Per capita income
		Top rate ( $\tau_{\max}$ )	Bottom rate			
1981	62	38	22	24	—	124
1982	60	30	20	30	1,340	141
1983	55	30	20	25	1,750	164
1984	55	30	20	25	1,750	185
1985	55	30	20	25	1,750	205
1986	55	30	20	25	1,750	238
1987	55	30	20	25	1,750	280
1988	55	30	20	25	1,750	332
1989	50	30	20	20	1,978	373
1990	50	34	20	16	2,578	446
1991	50	34	20	16	3,038	534
1992	50	34	20	16	3,038	602
1993	50	32	18	18	3,860	674
1994	45	30	18	15	3,892	782
1995	45	28	16	17	3,962	905
1996	40	28	16	12	4,960	1,007
1997	40	28	16	12	5,060	1,094
1998	40	28	16	12	5,060	1,064
1999	40	28	16	12	5,060	1,163
2000	40	28	16	12	5,360	1,277
2001	40	28	16	12	5,405	1,372
2002	36	27	15	9	5,537	1,514
2003	36	27	15	9	5,563	1,604
2004	36	27	15	9	5,589	1,726
2005	35	25	13	10	5,632	1,796
2006	35	25	13	10	5,632	1,882

Note: The income level at which the marginal income tax rate becomes higher than the maximum rate of corporate tax was calculated by applying the wage income deduction, personal allowance, and standard deduction based on a single income earner.

The evidence of income shifting between personal and corporate sectors can be found in the tax revenue changes between the two tax items. Until the mid-1990s, corporate tax revenue and personal income tax revenue (a global income tax and grade A wage income tax) maintained similar levels, but corporate tax revenue increased rapidly thereafter. The rapid growth of corporate tax revenue was sustained despite the fluctuations in economic conditions since the 2000s.

[Figure II-2] Revenues of Personal Income Tax and Corporate Income Tax

(Unit: 100 million won, year)



Sources: National Tax Service, *Statistical Yearbook of National Tax*, annual.

The relatively rapid increase in corporate tax revenue can be reviewed in comparison to the gap between personal and corporate income tax rates, which could cause income shifting between these two taxes. The share of non-corporate in overall operating surplus was calculated using the operating surplus of non-financial enterprises and that of private businesses as described in national

accounts of the Bank of Korea.<sup>12)</sup> The portion of non-corporate operating surplus remained at 60 percent until the mid-1990s, and then showed a plunge afterwards reaching the level of 35 percent in 2012. It is not a simple matter to associate changes in the tax rate gap with those of the share of non-corporate operating surplus. The proportion of non-corporate in operating surplus showed little change from the 1980s, even with the reduction in the tax rate gap, until the 2000s when the non-corporate share of operating surplus remarkably decreased along with the increase in the tax rate gap.

With the introduction of global taxation of financial income, interest and dividend income that had formerly been taxed separately at a 10-20 percent rate, much lower than the personal income tax rate, was progressively taxed along with other forms of income when interest and dividend income exceeded 40 million won for married joint filers (based on individual income since 2002). This is a policy shift that greatly raised the income tax burden for major shareholders who had once reduced their tax burden by receiving their income through dividends rather than wage. In addition, this policy with a real-name financial transaction system considerably heightened overall income transparency as it reduced the applicability of financial irregularities such as using bank accounts under borrowed names, thereby enabling tracking of the formation, growth and mobility of individual wealth. This served as a factor to increase the tax burden on personal assets or income for which the related transparency had been relatively low. In other words, it became very difficult to pay less tax and increase wealth by dispersing it under a variety of different names, and as a result, the overall personal income tax burden increased. In this manner, the real-name financial transaction system and the global taxation of financial income increased the tax burden on personal income for unincorporated businesses, but at the same time the tax burden on dividends also increased. Raising the tax burden on personal income serves as a stimulus for shifting to corporate income, while an increase in taxes on dividend acts as a suppressor of income shifting. The effects of the financial transaction system and the global

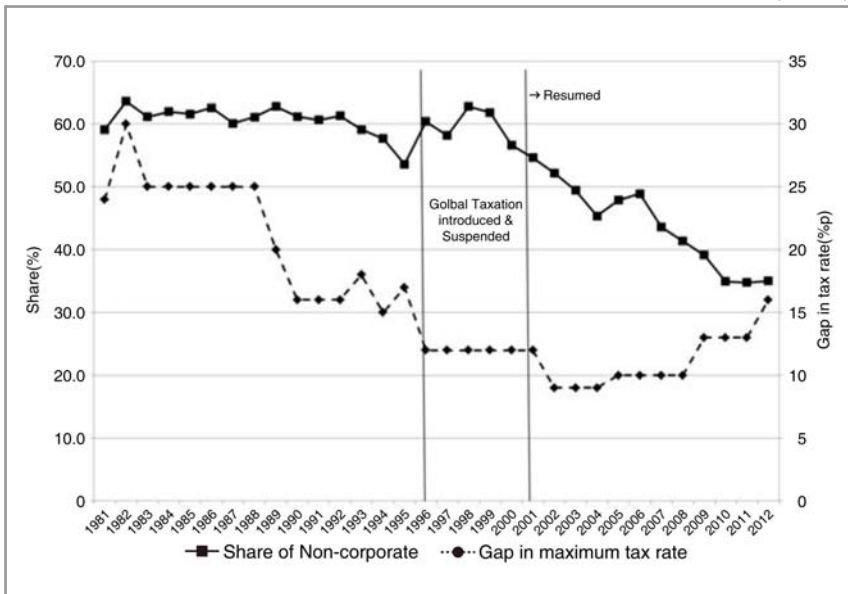
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12) Though the operating surplus of nonprofit organizations was included since it was not possible to separate out the data, but the size may not significant to change the share.

taxation of financial income on income shifting is a subject of empirical analysis.

[Figure II-3] Proportion of Non-corporate Operating Surplus and the Gap between Personal-Corporate Maximum Income Tax Rates ( $\theta_{\max} - \tau_{\max}$ )

(Unit: %, year, %p)



Note: 1. The operating surplus of corporations is based on non-financial corporations; personal operating surplus includes nonprofit organizations.

2. Maximum tax rate on personal income ( $\theta_{\max}$ ), Maximum tax rate on corporate income ( $\tau_{\max}$ )

Sources: Bank of Korea, *National Income Accounts out of the Economic Statistics system*, 2013.



# III

## Models

A gap in tax burden by income type offers economic incentives for income shifting, which is then actualized in various forms. According to Gordon and Slemrod (1998), studies on income shifting have been carried out in three different ways. The first is to examine changes in debt-to-equity ratio. Among others, MacKie-Mason (1990), Auerbach (1985), and Gordon (1982) have all performed empirical analysis on the effect of tax burden on companies' borrowing. However, there are few studies that have drawn significant conclusions. The second technique relates to the changing of organizational form of business. This type of study attempts to ascertain whether differences in tax burden influence decisions to incorporate and whether this influence could be stronger than other non-tax factors. Studies by Gordon and MacKie-Mason (1994), MacKie-Mason and Gordon (1997) and Goolsbee (1998) provide empirical evidence that the effect of a tax incentive for incorporation was found to have statistical relevance. More specifically, they carried out empirical analysis to test decisions to incorporate new businesses or shift business assets to a corporation. The third method is to examine changes in compensation for labor. Studies in this category have focused on whether the difference in tax burden by income type influenced income-dividend decisions, specifically whether the decisions of income-dividend for major shareholders of corporations have changed or income was shifted from personal to corporate status. Gordon and Slemrod (1998) analyzed changes in return on assets and showed that the influence of the tax rate gap was meaningful.

This study attempts to analyze the effect of the tax rate gap on changes

in corporate income and verify its relationship with income shifting. Its influence on incorporation can be partly tested by income shifting, and changes in remuneration can be observed through the fluctuation in return on assets. If the assets of a corporation are impacted by a gap in tax rates, it could be interpreted that income shifting through asset movement is indeed occurring. In addition, changes in return on assets can be grounds for income shifting that is not accompanied by asset shifting. Examining both together is one available way to verify these two manners of income shifting in the absence of basic research on income shifting methods between personal and corporate incomes.

This study employed a modified version of the empirical analysis models used by Gordon and Slemrod (1998) and Goolsbee (1998, 2004).<sup>13)</sup> According to income shift types, dependent variables such as return on assets and level of assets were included. For the major independent variable, the gap in tax rates<sup>14)</sup> between personal and corporate income was used to reflect the relative tax burden. Other than the tax rate gap, there are various factors<sup>15)</sup> that influence changes in type of business between private business and corporation, but the gap in tax rates takes precedence in terms of relative magnitude and measurability.

The empirical analysis model is as follows:

$$y_{i,t} = \beta_0 + \beta_1 TD_{i,t} + \beta_2 MG_i + \beta_3 (TD_{i,t} \times MG_i) + \beta_4 Oth_{i,t} + \varepsilon_{i,t}$$

$y_{i,t}$  refers to return on assets and the asset level of a corporation, the subject

13) The original model analyzed the influence of the gap in tax rates using a modified data. However, due to limited data, the author can not use the same model. I separated the forms of management in which income shifting is facilitated (owner-manager) and included the matching variable with the gap in tax rates and examined the effect.

14) As a variable for gap in tax rates, the difference between the maximum personal and corporate income tax rates ( $\theta_{\max} - \tau_{\max}$ ) of Gordon and Slemrod (1998) and the tax rate gap of Goolsbee (1998, 2004), which factored in the maximum corporate tax rate and even the dividend tax rate  $t_c + (1 - t_c)t_o - t_o$ , were used together ( $t_c = \tau_{\max}, t_o = \theta_{\max}$ ). Considering the conditions in Korea, where the tendency of distributing dividend income in corporations is low and there are more frequent cases of corporate expense deductions, ( $\theta_{\max} - \tau_{\max}$ ) seems to be more realistic.

15) Simplified taxation, obligatory double-entry bookkeeping, additional tax, provisional return on value added tax, tax audit, etc.



of this analysis. In the case of asset levels, to control the natural growth in assets following economic growth, the asset level of corporations was discounted to reflect the growth rate of nominal GDP. In other words, when the asset levels of a corporation increase at the same rate as the GDP growth rate, those changes in asset level will be treated as a natural growth.  $TD_{i,t}$  is a variable representing the tax gap (maximum personal income tax rate ( $\theta_{\max}$ ) – maximum corporate tax rate ( $\tau_{\max}$ )).  $MG_i$  is a variable representing the type of management of a business (run by the business owner=1, Other=0). The variable,  $TD_{i,t} \times MG_i$  represented by the difference in tax rates ( $TD_{i,t}$ ) multiplied by the form of management ( $MG_i$ ), is to capture the possibility of income shifting, as there is greater opportunities for income shifting when a business is run by its owner. The difference in personal and corporate income tax rates provides an economic impetus for income shifting, but if the ownership of a corporation and the management structure are not suitable for allowing income shifting or income distribution, it is less likely for such a shift to be realized. If the ownership structure is well distributed, shifting income to reduce the tax burden of one major shareholder while adjusting the dividends for other shareholders would be difficult. Even when a company is managed by a professional manager, there may be obstacles to transferring income in various ways such as wages or dividends in an effort to reduce the tax burden of a major shareholder. Given this condition, a shift in income and adjustment of the distribution structure will be easier in the case of an owner-manager with a moderate gap in personal-corporate tax rates. A new variable defined by the multiplication of the two variables was created to reflect this.  $Oth_{i,t}$  represents independent variables (economic conditions or trends, etc.) apart from the tax gap.

# IV

## Data

For analysis, this study applied data from the Workplace Panel Survey (WPS) by the Korea Labor Institute. Since 2006, the WPS has been conducted every other year in 1,900 workplaces.<sup>16)</sup> This present analysis uses the data currently available up until 2009; survey data from 2005, 2007 and 2009 to be more specific. Based particularly on questions regarding the financial status of the businesses from WPS data, the analysis will examine income shifting at the company level.

During the survey period of 2005-2009, there were no changes in the maximum personal income rate, but the maximum corporate tax rate was lowered from 25 percent to 22 percent. Moreover, the marginal tax rate changed due

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16) The general population for the Workplace Panel Survey was all operations nationwide as collected in Elementary Statistics Survey of Establishments by Statistics Korea, excluding agriculture, forestry, fishery and mining industries and establishments with less than 30 regular employees. Through proportional sampling, 1,600 workplaces from the private sector and 300 workplaces from the public sector were extracted as a sample. The human resources manager, recruiter, CFO or a labor representative from each company are supposed to respond to the items on the Workplace Panel Survey, which were designed based on the information on workplaces gained from the previous year. Among them, information on employment and financial status is sent by mail or fax or downloadable online prior to the surveyor's visit. The relevant person in charge is supposed to provide information on employment status, statement of profit and loss (sales figures, operating expenses, operating profit, net income or net loss), balance sheet (total assets, total liabilities), etc. However, in the case of financial status, the response rate is lower than for other survey items, since respondents feel reluctance in directly answering the questions. The response rate for financial status in 2005 surveyed in 2006 was 59 percent, 77 percent in 2007 and 71 percent in 2009. Thus, the workplaces which responded to questions on financial status for all three years make up 61 percent of all the workplaces that participated in the survey.

to fluctuations in net profit resulting from business operations. These two changes offer a basis for estimating the models for the analysis.

**〈Table IV-1〉 Changes in Corporate Tax rate and Personal Income Tax Rate during the Analysis Period**

	2005	2007	2009
Corporate tax rate			
– Low rate	13%	13%	11%
– High rate	25%	25%	22%
Personal income tax			
– Maximum rate	35%	35%	35%

**〈Table VI-2〉 Descriptive Statistics of Data**

Asset size	2005		2007		2009	
	Owner management	Other types of management	Owner management	Other types of management	Owner management	Other types of management
5 billion won and less	16	7	16	7	19	4
share (%)	69.6%	30.4%	69.6%	30.4%	82.6%	17.4%
5 –10 billion won	36	12	36	12	37	11
share (%)	75.0%	25.0%	75.0%	25.0%	77.1%	22.9%
Total	225	269	235	259	270	224
share (%)	45.5%	54.5%	47.6%	52.4%	57.7%	45.3%

Source: Korea Labor Institute, *Workplace Panel Survey*, annual.

# V

## Results

The analysis of return on assets ( $ROA = \text{current net income} / \text{total assets}$ ) aims to examine changes in the ROA of corporations that may result from shifting income between personal and corporate income. In other words, when income shifting occurs in an effort to reduce a tax burden by exploiting the gap between personal and corporate income without a fundamental change in business assets, the ROA of a corporation shows a change compared to under normal conditions. For other explanatory variables, annual dummy variables were included in order to control the effect of economic cycle or other year specific events.

The estimation results revealed that for owner-managed corporations (a major variable of interest), the wider the tax gap, the higher was the ROA. In other words, the odds ratio estimate for  $(TD \times Mg)$  variable was positive (+), confirming that income shifting is being performed in order to minimize the tax burden. Also, the smaller a corporation, the larger was the odds ratio estimate, verifying the level of difficulty of income shifting. However, the related statistical significance was low, statistically meaningful below the 5.6 percent significance level only for corporations with 5-10 billion won in assets. This demonstrates that despite the economic incentive, it is apparent that income shifting without asset movement through existing corporations did not occur. In addition, it showed that the effect of owner management on ROA is negative (-) and the statistical significance was also low, showing no enhancement of management effectiveness for owner management compared to that by a professional CEO.

On the other hand, differences in tax rate served as a factor that generally lowers the ROA of corporations, a phenomenon that cannot be observed in the

case of a decentralized ownership structure lacking an incentive for income shifting. This comes from 2 rate tax structure. Lower marginal rate is applied to less profitable firms, which have a higher tax rate gap.<sup>17)</sup>

Changes in ROA were examined in order to analyze only income shifting without a transfer of assets, and analysis is only possible when an owner-manager is simultaneously operating a corporation and a private business. Otherwise, efforts to minimize the related tax burden through shifting assets cannot be identified. Additional analyses are required to determine the influence of establishing a corporation or transferring small private business assets (buildings, etc.) to corporations.

**(Table V-1) Effect of Tax Rate Gap on ROA (REML)**

	Businesses in total		Businesses with 5 billion won or less in assets		Businesses with 5–10 billion won in assets	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
TD	−0.0087***	0.001	−0.0979**	0.015	−0.0199***	0.000
Mg	−0.0580	0.331	−1.2044	0.187	−0.0746	0.466
(TD×Mg)	0.0012	0.738	0.0516	0.273	0.0117*	0.056
D2005	0.1991***	0.000	2.4305***	0.003	0.2841***	0.002
D2007	0.1171***	0.010	0.9543	0.227	0.2245**	0.020
D2009	0.2263***	0.000	2.0901**	0.012	0.2973***	0.003
Prob. > Chi2	0.0000		0.0061		0.0000	
No. of Obs.	1,542		96		159	

Note: \*\*\*, \*\*, \* means they are meaningful within 1%, 5%, 10% significance levels, respectively.

17) Indeed, the economic growth rates of 4.5/5.2/5.1 percent for 2005, 2006 and 2007, respectively, was high enough to result in an increase in assets, while the growth rates for 2008 and 2009 were notably low at 2.3 percent and 0.3 percent, respectively, undermining profitability. Thus, the corporate tax rate decreased in 2009, widening the gap between personal and corporate tax rates.

To this end, this study analyzed changes in assets that could be a result of the gap between personal and corporate income tax rates. For an analysis model, the dependent variable was set as the level of assets based on the aforementioned basic model. To control the natural increase in assets resulting from economic growth, the assets of corporations were discounted according to the nominal GDP growth rate.

The analysis showed that in owner-managed corporations, the larger the income gap, the more significant was the asset movement that occurred. In other words, profit was also shifted to lower tax brackets by transferring assets in private businesses to corporate businesses. This trend is similarly apparent in small corporations with 5 billion won or less in assets, but for corporations with 5-10 billion won in assets, the statistical significance is low.<sup>18)</sup> Considering the tax gap's considerable significance on businesses overall, owner-managed enterprises appeared to respond to it with greater sensitivity. More specifically, for every 1% point increase in the tax rate gap between personal and corporate income, the asset size of owner-managed corporations was found to increase by approximately 10.3 billion won more than that of other types of corporations. This figure accounts for up to 2.89 percent of the 35.63 billion won (as of 2009, adjusted)<sup>19)</sup> average asset size of owner-managed corporations. Given that the share of owner-managed corporations is around 50 percent (45.5 percent in 2005, 48.2 percent in 2007 and 54.9 percent in 2009) and the average asset size of such corporations is 23.0 percent of that of other types of corporations, the effect of a 1 percent point increase in the tax rate gap on the asset level of all corporations is estimated to be around 0.66 percent points.<sup>20)</sup> Based on the same estimation, the effect of a 3 percent point increase (from 35 percent to 38 percent) in the maximum personal income tax rate is likely to increase corporate assets by approximately 1.99 percent from the base year by means

18) As private enterprises with smaller asset sizes can reduce their tax burden through conversion into corporations, this is still an effective income shifting method.

19) When (adjusted) asset sizes for 2009 were calculated using analysis samples based on the 2005 forms of management, the average of all samples was 1 trillion won, 35.63 billion won for owner-managed corporations, and 1.55 trillion won for corporations with other management types.

20)  $23 \text{ percent} \times 2.89 \text{ percent} = 0.66 \text{ percent points}$

of the corresponding expansion of the gap between personal and corporate tax rates. Compared to the case that there is no income shifting, personal income tax base thus decreases by the amount of profit from the increased assets (asset increase of corporates  $\times$  ROA of owner-managed corporations),<sup>21)</sup> and as a result overall tax revenues decline by an amount equal to the value of the assets increased through income shifting multiplied by the rate of tax gap between personal and corporate income taxes. The change in tax revenues for individual tax items is even greater. Compared to the increase in tax revenue where there is no shifting of income, the revenue for income tax declines by a value equal to tax revenue for income shifting multiplied by the marginal tax rate. On the other hand, the revenue for corporate tax increases by an amount equal to the value of tax revenue for income shifting multiplied by the marginal tax rate, decreasing the total tax revenue compared to when income shifting was not taken into account by an amount equal to the value of tax revenue for income shifting multiplied by the marginal tax rate. As for the influence of management type, asset increases were found to be relatively low in the case of owner-managed companies (i.e.,  $MG_i=1$ ). This signifies that the attitude of a manager-owner of a company is rather passive compared to that of professional managers. However, the level of assets for corporations in general decreased with an increase in the gap in tax rates. There is the possibility that the economic crisis had a considerable enough impact on the worsening of the profitability of companies to overwhelm the influence from the expansion of the gap in tax rate between personal and corporate income.

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21) Here, the ROAs for personal enterprises and corporations are assumed to be the same.

〈Table V-2〉 Effect of the Tax Rate Gap on Level of Assets (REML)

	All businesses in total		Businesses with assets of 5 billion won or less		Businesses with assets of 5–10 billion won	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
TD	−10206.8***	0.003	−1639.482**	0.033	−65.44317	0.394
Mg	−364429***	0.000	−43274.86**	0.013	523.9966	0.712
(TD×Mg)	10301**	0.027	1589.755*	0.077	28.23097	0.739
D2005	381409.5***	0.000	48978.66***	0.002	1702.438	0.185
D2007	386381.2***	0.000	47404.51***	0.002	1753.603	0.189
D2009	417880.8***	0.000	50270.89***	0.002	1805.89	0.187
Prob.)Chi2	0.0000		0.0178		0.0000	
No. of Obs.	1,542		96		159	

Note: \*\*\*, \*\*, \* means they are meaningful within 1%, 5%, 10% significance levels, respectively.

The following inferences can be drawn from the results. Private business owners in South Korea appear to have attempted to shift their assets to corporations rather than simply shifting their incomes alone. That is, by transferring private assets to corporations, they intended to lower the tax burden on the subsequent profit. Shifting assets to a corporation directly managed by the owner tended to occur regardless of the size of the assets involved. This is because even though regression analysis for the entire sample was significant at the 95 percent confidence level, the significance for the sample of relatively smaller corporations with 10 billion won or below in assets declined. This does not indubitably indicate that there is no income shifting in the case of small-scale corporations, since there is a possibility that small private enterprises have not considered the option of moving their income or assets by incorporating. Generally, an owner-managed corporation tends to be relatively inactive in terms of increasing assets, which they make up for by showing a rapid response to an expansion of the gap between personal and corporate income tax rates.

These changes are aimed at reducing tax burdens by keeping personal



incomes within corporations they own, taking advantage of the expanded gap in the personal and corporate income tax rates. In the case of high-income earners whose income exceeds their spending, they do not need to collect their income in the form of personal income with a high tax burden when it is not required for expenditures. Moreover, even though they earn profit under a corporate entity, consumption expenditures with an indistinct boundary between the personal and corporate can be appropriated as fringe benefits at corporate expense. Therefore, shifting income or assets to corporations is a way for high-income earners to immediately increase their after-tax income.

Incorporating personal assets or income also enable personal income to be converted into dividend income or capital gains. There is no knowing how the tax burden by income type will change on a long-term basis, but it can be a favorable structure in the sense that it can affect income types in diverse ways.

# VI

## Conclusion

This study analyzed the shifting of income between personal and corporate income tax. First, the institutional analysis verified that there were economic incentives for income shifting due to the tax burden gap by income type. Among the various methods of income shifting, we confirmed that owner-managers of corporations were moving their assets (i.e., incomes) to take advantage of a gap between personal and corporate income tax burden. Specifically, with every 1 percent point increase in the gap between personal and corporate income tax, the asset size of an owner-managed corporation increased by 10.30 billion won compared to that of other types of corporations. This is 2.89 percent of the average asset size of the corporations. On the contrary, income shifting unaccompanied by asset movement was not statistically significant.

This shifting of personal assets to those of corporations calls for a change in perspectives on policy regarding personal and corporate income tax. Policies that broaden the gap between personal and corporate income tax rates create a lower tax revenue effect than expected. In addition, as individuals vary their income types according to the relative tax burden, designing policies based on a relevant tax only could lead to policy error. Therefore, it is seen to be undesirable to establish policies that widen the gap between personal and corporate tax burdens if they are not intended for producing behavioral changes among taxpayers. Narrowing the gap is what in fact reduces excess burden resulting from taxation.

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