

Problems in Local Tax Incentives In Korea

Heung - Re, Kim

전 행정자치부 차관, 현 KDI국제정책대학원 객원교수

I . Introduction

The purpose of this report is to review and find out problems of local tax incentives in Korea.

The size of tax reduction in local government is too huge in comparison with the total amount of local tax revenue and the tax reduction ratio is around 10% every year.

The tax reduction leads to revenue loss and it brings fiscal shortages to local governments.

Here I'd like to analysis the

problems with local tax incentive system and to suggest answers to it as far as I know.

To do this, I'd like to overview outline of the revenues in local finance, and the present situations in relation with the tax incentives.

I will introduce some problems facing local tax incentive system and finally I'd like to give some comment on this.

II. Local Public Finance and Local Revenue in Korea

① Some problems facing local public finance

Sound and sufficient local revenue is one of the important elements to develop local government, local autonomy in Korea.

When comparing the net total of general accounts in national public finance and local public finance,

local finances make up only 39% of total government finance and the ratio of local tax revenue to national tax revenues stood at about 25% in 1997, as shown(Table 1).

Inequity of the local revenues between the each local governments in Korea in creating unbalance of local development.

Most of the local governments in Korea are depending on the central government(government finances) in their revenues and expenditures.

And local expenditure demand has been increasing since local auto-

<Table 1> Size of Central Government and Local Government in Finance

(Unit : billion Won)

| Year | Expenditure(general account) | | | | Tax Revenue | | |
|------|------------------------------|----------|----------|----------|--------------|-----------|----------|
| | Total | Central | Local | Ratio(%) | National Tax | Local Tax | Ratio(%) |
| 1991 | 52,832.5 | 32,928.7 | 19,903.8 | 38 | 28,209.4 | 8,035.1 | 28 |
| 1992 | 56,612.8 | 34,534.1 | 22,078.7 | 39 | 35,118.3 | 9,462.2 | 27 |
| 1993 | 60,968.3 | 37,268.0 | 23,700.3 | 39 | 39,206.6 | 11,025.8 | 28 |
| 1994 | 73,074.7 | 42,794.7 | 30,280.0 | 41 | 47,261.9 | 13,227.8 | 28 |
| 1995 | 83,128.0 | 51,498.1 | 31,629.9 | 38 | 56,774.5 | 15,316.9 | 27 |
| 1996 | 97,072.3 | 58,822.8 | 38,249.5 | 39 | 64,960.2 | 16,575.1 | 26 |
| 1997 | 111,214.4 | 67,578.6 | 43,635.8 | 39 | 72,409.4 | 18,149.7 | 25 |

Source : Annual Statistical Report by the MOGAHA. Major Statistics of Korean Economy by National Statistical Office(Moon, Chang-Soo, *Local Government in Korea*. 1999, p.207)

<Table 2> Gross-Total of 1997 Settled Account of Local Government Revenue

(Unit : billion Won)

| Classification | Gross-Total | | | |
|----------------------|-------------|-----------------|-----------------------------------|------------------------|
| | Total | General Account | Public Enterprise Special Account | Other Special Accounts |
| Total | 85,238.9 | 62,017.6 | - | 12,032.1 |
| Local Tax | 18,497.7 | 18,497.7 | 8,717.4 | - |
| Non-Tax | 36,311.9 | 18,858.9 | - | 8,735.5 |
| Local Allocation Tax | 6,785.6 | 6,785.6 | 255.6 | - |
| Subsidies | 12,860.8 | 10,823.3 | - | 1,781.9 |
| Local Transfer Tax | 2,877.1 | 2,876.3 | - | 0.8 |
| Adjustment Grant | 2,085.1 | 2,085.1 | - | - |
| Additional Grant | 228.9 | 228.9 | 2,216.1 | - |
| Local Borrowing | 5,591.5 | 1,861.5 | | 1,513.8 |

Source : Financial Yearbook of Local Government by the Ministry of Government Administration and Home Affairs(1998)

nomy(1995).

Insufficient local finance all over the local government, inequity between the each local government, dependence on the central government and continuous increasing in expenditure are the important problems facing local public finance nowadays and in the near future in Korea.

② How to increase local finance (revenues)?

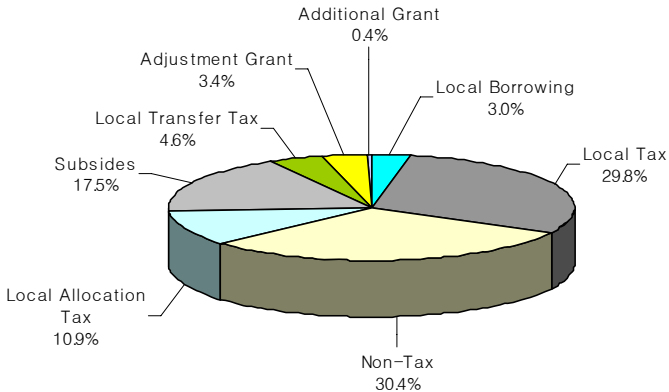
Local finance(in revenues) is

composed of local revenues made by local governments in their region and revenues from the central government in cope with the shortage and inequity of local finance.

Local revenues are classified as local tax revenues, non-tax revenues and local borrowings. Of those local revenues, local tax revenues are the most important and fundamental financial source of local revenues(Table 2 and Figure 1).

But as we know, local tax

<Figure 1> Ratio of Local Government Revenue



Note : Figures are for only general account.

Source : *financial Yearbook of Local Government* by the Ministry of Government Administration and Home Affairs(1998)

revenues itself is not sufficient to the needs of expenditure and comparing to the amount of national tax revenues, it is too small.

There are many ways to increase the local tax revenues. Here I'd like to evaluate the tax incentives systems and it's management in local taxation in Korea.

III. Tax Incentives in Local Government

1. Definition of Tax Incentives

Tax incentives refer to the reduction and the exemption of taxes in order to achieve certain specific goals such as economic development and social security.

Tax incentives can be defined as a kind of inducement policy for the government to achieve economic and social goals, etc. Generally tax incentives include tax exemptions, tax deductions, income deductions, low tax rates and postponement of tax liabilities, etc.

Reviewing the tax incentives in Korea during the 20 years last, it played an important role in aiding economic development process.

But the loss of government(local government) tax revenue through these tax incentives is huge. The stability of fiscal revenues, the fairness and equity of taxation and other problems began to emerge.

Especially the loss of local tax revenue by the tax incentives in local government is too much in its size. And the tax incentive policy in local areas is recognized not to achieve its goals as it had done by the central government in economic development.

(※ Korean Local Administration Insti-

tution, *Analysis on Local Tax Incentives in Local Government*, 1989)

2. Loss of Local Tax Revenues from the Local Tax Incentives in Korea.

① The total size of local tax reduction(tax deduction + tax exemptions) is 2020 billion won in 1998. This figure indicates 11.7% compared to total local tax revenues.

The ratio of local tax reduction is huge compared to local tax revenues, the ratio of Japan.(table 3 and 4)

Considering the fact that most of all the local government are facing financial difficulties from the shortage of revenues to fit the expenditure, local tax incentive policy should be examined carefully.

② The operations of local tax incentives are generally regulated by the laws and local ordinance (regulations).

The ratio of local tax reduction

<Table 3> Trend of Local Tax Incentives by Year

(measure : 1,000,000 won, %)

| Year | Local Tax Revenue(A) | Local Tax Reduction(B) | Ratio(B/A) |
|------|----------------------|------------------------|------------|
| 1980 | 767,691 | 108,393 | 14.1 |
| 1981 | 914,372 | 137,943 | 15.1 |
| 1982 | 1,119,206 | 123,994 | 11.1 |
| 1983 | 1,397,167 | 172,657 | 12.4 |
| 1984 | 1,508,354 | 150,584 | 10.0 |
| 1985 | 1,654,942 | 139,993 | 8.5 |
| 1986 | 1,809,753 | 140,805 | 7.8 |
| 1987 | 2,192,323 | 134,577 | 6.1 |
| 1988 | 3,099,969 | 224,476 | 7.2 |
| 1989 | 4,690,844 | 399,556 | 8.1 |
| 1990 | 6,367,400 | 402,121 | 6.3 |
| 1991 | 8,035,143 | 543,789 | 6.8 |
| 1992 | 9,462,217 | 1,587,982 | 16.8 |
| 1993 | 11,026,067 | 1,554,940 | 14.1 |
| 1994 | 13,230,911 | 1,520,638 | 11.4 |
| 1995 | 15,315,965 | 1,488,985 | 9.7 |
| 1996 | 17,394,685 | 1,550,833 | 8.9 |
| 1997 | 18,405,681 | 1,803,889 | 9.8 |
| 1998 | 17,149,712 | 2,020,363 | 11.7 |

Source : Financial Yearbook of Local Government by the Ministry of Government Administration and Home Affairs(1982-1999)

<Table 4> Ratio of Local Tax Reduction in Japan and Korea

| Country \ Year | 1980 | 1982 | 1984 | 1986 | 1988 | 1990 | 1992 | 1993 |
|----------------|------|------|------|------|------|------|------|------|
| Korea | 14.1 | 11.1 | 10.0 | 7.8 | 7.2 | 6.3 | 16.8 | 14.1 |
| Japan | 3.9 | 4.2 | 4.5 | 4.2 | 4.7 | 4.6 | 4.4 | 4.2 |

Source : Korea-Financial Yearbook of Local Government(MOGAHA)

Japan-Whitepaper on Local Autonomy in Japan

by the laws in 1988 is as following :reduction by the local special ordinances 36.1%, local tax law 59.8% and tax exemption law, etc.(Table 5)

This implies that most of the local tax reductions are decided by the

central government without considering the special conditions of each local government.

Because, most of the local special ordinances are established on the base of a standing rule given by the central government and the central

<Table 5> Trend of Local Tax Incentives by Laws

(measure : 1,000,000 won, %)

| 연도 | 지방세법 | % | 외자 도입법 | % | 특별조례 | % | 조세감면 규제법 | % | 기타 | % |
|------|-----------|------|-----------|-----|---------|------|-------------|------|--------|------|
| 1980 | 58,627 | 54.1 | 1,255 | 1.1 | 20,808 | 19.2 | 27,305 | 25.2 | 399 | 0.4 |
| 1981 | 83,287 | 60.4 | 1,663 | 1.2 | 26,903 | 19.5 | 23,810 | 17.3 | 2,280 | 1.6 |
| 1982 | 79,284 | 64.0 | 2,783 | 2.2 | 37,287 | 30.1 | 1,782 | 1.4 | 2,858 | 2.3 |
| 1983 | 93,362 | 54.1 | 2,552 | 1.5 | 75,460 | 43.7 | 999 | 0.6 | 284 | 0.1 |
| 1984 | 100,378 | 68.7 | 2,510 | 1.7 | 44,235 | 29.4 | 3,101 | 2.0 | 359 | 0.2 |
| 1985 | 95,499 | 68.2 | 1,476 | 1.0 | 36,553 | 26.1 | 6,380 | 4.6 | 84 | 0.1 |
| 1986 | 86,663 | 61.6 | 5,266 | 3.7 | 42,996 | 30.5 | 5,860 | 4.2 | 21 | - |
| 1987 | 91,209 | 67.8 | 3,875 | 2.9 | 35,286 | 26.2 | 4,202 | 3.1 | 4 | - |
| 1988 | 148,031 | 65.9 | 3,974 | 1.8 | 57,374 | 25.6 | 13,662 | 6.1 | 1,434 | 0.6 |
| 1989 | 164,212 | 41.1 | 5,009 | 1.3 | 156,703 | 39.2 | 30,115 | 7.5 | 43,519 | 10.9 |
| 1990 | 153,636 | 38.2 | 3,361 | 0.8 | 233,052 | 58.0 | 8,699 | 2.2 | 3,371 | 0.8 |
| 1991 | 265,616 | 48.8 | 2,795 | 0.5 | 255,989 | 47.1 | 15,142 | 2.9 | 3,746 | 0.7 |
| 1992 | 702,520 | 44.2 | 4,086 | 0.3 | 868,255 | 54.7 | 12,040 | 0.7 | 111 | - |
| 1993 | 614,897 | 39.5 | 895 | 0.1 | 902,184 | 58.0 | 37,004 | 2.4 | 0 | - |
| 1994 | 716,214 | 47.0 | 1,162 | 0.1 | 776,888 | 51.1 | 25,981 | 1.7 | 391 | 0.1 |
| 1995 | 787,611 | 52.9 | 900 | 0.1 | 685,467 | 46.0 | 14,305 | 0.9 | 701 | 0.1 |
| 1996 | 716,532 | 46.2 | 327 | - | 812,120 | 52.4 | 21,479 | 1.4 | 373 | - |
| 1997 | 930,747 | 51.6 | 6,200 | 0.3 | 846,792 | 46.9 | 19,670 | 1.1 | 478 | 0.1 |
| 1998 | 1,209,633 | 59.8 | 5,792 | 0.3 | 729,863 | 36.1 | 74,352 | 3.7 | 719 | 0.1 |

Source : Financial Year book of Local Government by the Ministry of Government Administration and Home Affairs(1982-1999)

government makes the standing rule in favor of economic development.

The central government recognizes the tax incentive as an important policy measure in aiding economic development process and in solving inequity income disparity.

But we should approve the fact that local incentive policy is not

proper to achieve the macro-economic effects.

③ Most of the tax incentives are given to the property tax and majority of local tax reductions come from the property tax revenues in Korea. (Table 6)

Here is an answer to the question

**<Table 6> Composition Ratio of Local Tax Incentives B/T
Property/Non-Property Tax**

(measure : %)

| Item \ Year | 1994 | 1995 | 1996 | 1997 | 1998 |
|--------------------------|------|------|------|------|------|
| Property Tax | 96.2 | 96.5 | 96.0 | 95.5 | 95.7 |
| Acquisition Tax | 37.8 | 34.1 | 38.6 | 37.1 | 45.2 |
| Registration Tax | 32.5 | 38.0 | 40.0 | 37.2 | 33.8 |
| Property Tax | 2.6 | 2.4 | 2.1 | 3.1 | 3.2 |
| Urban Planning Tax | 3.1 | 5.3 | 4.4 | 5.0 | 3.2 |
| Community Facility Tax | 0.4 | 0.8 | 0.5 | 1.3 | 0.6 |
| Aggregate Land Tax | 15.3 | 14.8 | 8.6 | 9.2 | 7.3 |
| Automobile Tax | 4.5 | 1.0 | 1.8 | 2.6 | 2.5 |
| Non-Property Tax | 3.8 | 3.5 | 4.0 | 4.5 | 4.3 |
| License Tax | 0.3 | 0.1 | 0.2 | 0.1 | 0.2 |
| Registration Tax | 1.1 | 0.4 | 0.2 | 1.0 | 0.2 |
| Farmland Tax | - | - | 0.01 | 0.02 | - |
| Race-Parimutuels Tax | - | - | - | - | - |
| Regional Development Tax | 1.7 | 2.2 | 2.4 | 2.3 | 2.7 |
| Business Place Tax | 0.7 | 0.8 | 1.2 | 1.0 | 1.2 |
| Total | 100 | 100 | 100 | 100 | 100 |

Source : Financial Yearbook of Local Government by MOGAHA

**<Table 7> Local Tax Revenues classified by Property Tax,
Non-Property Tax(In 2000 Year)**

(Unit : A Hundred Million Won)

| | Local Tax | Revenues | % |
|---------------------------------------|--|--------------------|----------------|
| Total | 15 Taxes | 185,209 | 100 |
| ○ Income Tax(2) | Inhabitant Tax, Farmland Tax | 26,563 | 14.3 |
| ○ Consumption Tax(3) | Tobacco Consumption Tax, Butchery Tax, Race-parimutuels Tax | 27,149 | 14.7 |
| ○ Property Tax - Procession Tax(4) | Property Tax(Buildings), Aggregate Tax(Land), Urban Planning Tax, Community Facility Tax | 99,819 (30,436) | 53.9 (16.4) |
| - Transaction Tax(2) | Aquisition Tax, Registration Tax | (69,383) | (37.5) |
| ○ Others(4) | License Tax, Business Place Tax, Regional Development Tax, Automobile Tax | 26,896 | 14.5 |
| ○ Revenues Past Year | | 4,782 | 2.6 |

Source : Local Finance and Tax Bureau, Ministry of Government Administration and Home Affairs(2000)

why does the most of local tax reductions come from the property tax. They are as followings.

First, of the 16 kinds of local taxes, the size of tax revenues in the property tax such as aquisition tax, registration tax, aggregate tax is larger than the rest other tax revenues. (Table 7)

Second, property tax reduction

system is aimed at solving the problems of industry concentration in Seoul areas and also industry, public corporate transfer from Seoul areas to other local areas. To do this, governments are giving kinds of supporting system containing local tax incentives.

IV. How to Solve the Problems of Local Tax Incentives Facing Local Government in Future

Problems emerged in relation to local tax incentives nowadays in Korea.

The major functions of good tax system is to secure enough and stable funds for expenditure, to insure the fairness and equity of taxation, and also simplicity in tax system and tax administration is described for the tax payers.

As a result of the emphasis placed on incentives for formation of domestic capital and development in national tax incentives during the 1970's, the fairness and equity of taxation, the stability of fiscal revenues and other such problems began to emerge.

It is very difficult to check the fairness and equity of taxation in local taxation. But tax loss with relation to the local tax incentives is

a bottleneck facing local government in security the necessary and enough fiscal revenues nowadays.

First of all, tax loss around 10% of local tax revenues every year is a big problem in local finance in Korea.

Second, local tax incentives is not suitable for the development of regional economics and local development.

The main purpose of local tax incentives to the industries is recognized to induce many industries to local areas. If industries increase in number and quantity in local areas by the incentives of tax reductions, the local tax bases will be getting stronger.

But during the time local tax incentive system failed to attract sound industries to local areas because private firms have to consider more skilled labor force, market area, enough and convenient SOC and accessing to harbor, airport, etc. to increase their projects.

As a result, local tax incentives to industry failed to achieve its purpose only resulted in loss of local revenues.

Third, local tax incentive system is against local autonomy itself. On this time, most of the laws, regulations in relation with the local tax incentives were made by the central government without consideration of local government conditions and that of local tax revenues.

We can't expect the sound and rapid development of local government without security the enough and necessary fiscal revenues in local areas. In addition to this, most of the local government officials (especially local governors) neglect to find out new tax bases typical to their regions and also to adjust tax rates in order to secure more tax income.

So, it is desirable to permit the local government to make local tax ordinances by themselves as far as possible and it is recommendable for

the central government to make laws and to give directions related to local tax incentives suitable for local government.

V. Conclusion

Local tax revenue is one of the most important and fundamental source of local revenues and it is necessary for the every local government to secure enough local finance necessary for the sound development of local autonomy in future.

There are many ways to increase local finance. But most of revenues such as non-tax revenues, local borrowings and several types of grants from the central government are very changeable according to the situations. Therefore every local government should do their best to secure enough and increasing local revenues through the local taxation. But, sorry to say, there are limits for the local government to get enough

<국가 및 지방재정 비교분석>

(단위: 억원)

| 구 분 | | | 1980 | 1985 | 1990 | 1995 | 1999 | 2000 |
|---------------------------|-------------------|-------------------------|--------|------------------|------------------|--------------------|----------------------|----------------------|
| 국가전체예산(1980년 기준 신장률 %) | | | 85,806 | 167,447 (195) | 429,467 (501) | 881,655 (1,027) | 1,280,439 (1,492) | 1,269,837 (1,480) |
| 중앙예산총액(1980년 기준 신장률 %) | | | 66,352 | 125,324 (189) | 274,557 (414) | 514,981 (776) | 836,851 (1,261) | 864,740 (1,303) |
| 국세 | 1980년기준 신장률(%) | | 58,077 | 118,765 (204) | 268,474 (462) | 567,745 (978) | 716,466 (1,234) | 797,029 (1,372) |
| | | 중앙예산총액대비국 세비중(%) | 88 | 95 | 98 | 110 | 86 | 92 |
| | 기타 | | 8,275 | 6,559 | 6,083 | -52,764 | 120,385 | 67,711 |
| 지방예산총액(1980년 기준 신장률 %) | | | 19,454 | 42,123 (217) | 154,910 (796) | 366,674 (1,885) | 443,588 (2,280) | 405,097 (2,082) |
| ① 중앙예산 : 지방예산(%:%) | | | 77:23 | 75:25 | 64:36 | 58:42 | 65:35 | 68:32 |
| ② 의존재원 : 자체재원(%:%) | | | 38:62 | 35:65 | 31:69 | 29:71 | 40:60 | 40:60 |
| 의 존 재 원 | | 소계(1980년기준 신장률 %) | 7,369 | 14,748 (200) | 48,065 (652) | 107,604 (1,460) | 176,775 (2,399) | 161,288 (2,189) |
| | | 교부세(") | 4,100 | 10,061 (245) | 27,647 (674) | 56,713 (1,383) | 68,947 (1,682) | 70,909 (1,729) |
| | | 양여금 | - | - | - | 18,701 | 28,237 | 33,520 |
| | | 보조금 | 3,269 | 4,687 | 20,418 | 32,190 | 79,591 | 56,859 |
| 자 체 재 원 | | 소계(1980년기준 신장률 %) | 12,085 | 27,375 (227) | 106,845 (884) | 259,069 (2,144) | 266,813 (2,208) | 243,809 (2,017) |
| | | 지방세(") | 7,678 | 16,546 (215) | 63,786 (831) | 153,169 (1,995) | 178,613 (2,326) | 185,209 (2,412) |
| | | 세외수입(") | 4,407 | 10,829 (246) | 39,796 (903) | 90,325 (2,050) | 70,195 (1,593) | 55,282 (1,254) |
| | | 지방채(1990년기준 신장률) | - | - | 3,263 | 15,575 (477) | 18,005 (552) | 3,318 (102) |
| | | ③ 지방예산총액대비 지방세 비중(%) | 39 | 39 | 41 | 42 | 40 | 46 |
| | | ④ 자체재원대비 지방세 비중(%) | 64 | 60 | 59 | 59 | 67 | 76 |

1. 예산액: 순계액(일반회계 기준)

① 중앙·지방재정규모 추계비교 ② 지방재정의 의존성 비교

③ 지방재정 증가에 지방세의 기여도 ④ 지방자체재원중 지방세의 기여도

주) 1998년까지는 결산액, 1999년도 최종예산액, 2000년도 당초예산액

자료출처) ① 지방재정세제 현황(2000. 3. 현재), 행정자치부

② 2000년도 지방자치단체 예산개요, 행정자치부

local tax income in proportion to the expenditure demands increasing year by year.

Because in reality local tax source are very poor in the composition of tax sources between national tax and local tax. In addition to this, it is very difficult to adjust the local tax rates and the standard of assessment in property taxes.

Here I suggest that huge revenue loss by local tax incentive system in Korea should be carefully examined and local tax incentives that are in effective and harmful to local revenue should be avoided accordingly.

In conclusion, the scope of local tax incentives should be reduced in size and each tax incentive policy measures should be evaluated according to the changes in local autonomy.

References

- Hyun, Jin-Kwon, "*A Preliminary survey on Tax Incentive Policy in Korea*," Korea Institute of Public Finance, Seoul, 1999.
- Yoo, Il-Ho, "*Experience with Tax Reform in Korea*," Korea Institute of Public Finance, Seoul, 2000.
- Moon, Chang-Soo, "*Local Government in Korea*," Chp. 7(Local Public Finance)
- "*A Analysis on Local Tax Incentives in Korea*," Korea Research Institute of Local Administration, Seoul, 1989.
- "*Problems and Remedies of Local Tax Incentives in Korea*," Chollanamdo Province, 1995.
- "*Reformation of Local Tax Incentives in Korea*," Korea Research Institute of Local Administration.
- "*Reformation of Local Tax Deduction and Exemption system in Korea*," Korea Institute of Public Finance, 1997.
- Others("地方税", 1995. 5호, 1994. 3호, 1993. 4호, 1993. 4호, 1993. 5호, 1991. 2호, 1994. 4호) ☺