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Who Gains Benefits from Tax Incentives for Foreign Direct Investment in Korea?

Seong-Bong Lee*

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I. Introduction

With the newly implemented tax incentive system in 1998, foreign investors have been able to reduce the tax burden of their Korean business activities. There are three types of tax incentives for foreign direct investment (FDI) in Korea 1) income or corporate tax for business income, 2) local taxes such as acquisition tax, registration tax, property tax and aggregate land tax for acquired properties on invested businesses, and 3) customs duties, special excise tax and value-added tax on imported capital goods.[1] The most important tax exemption or reduction among those tax incentives is the exemption of corporate tax on business income.

When a foreign invested enterprise (FIE) is nominated as a qualifying project for tax exemption under the Special Tax Treatment Control Act (STTCA), not only does it become tax-exempt with regard to the corporate tax on the project's business income for 7 years, but also receives a 50 per cent deduction on taxes for the next 3 years. Moreover, in cases where foreign-invested company pays a foreign investor a dividend, the foreign investor becomes exempt as well from the corporate or income withholding tax on the dividend for 7 years, and can enjoy the same 50% tax deduction for the following 3 years. However, not all foreign investors receive the same level of tax benefits. This paper deals with the question "Who really gains benefits from tax incentives for FDI in Korea?"

In this paper the varying tax benefits accorded to the different situations of foreign

* Research Fellow, Korea Institute for International Economic Policy

1) For details of tax incentives, refer to Lee S-B.(2001), pp. 396~399

investors will be thoroughly analyzed, followed by a discussion of tax strategy for foreign investors. This paper analyses corporate tax reduction effects on FDI, not only in Korea's jurisdiction but also in the jurisdiction of the country where the investors have their residence, since taxation in the country of the parent company must also be considered in order to accurately evaluate the overall tax benefits of incentives for FDI.

II. Research Design

When a foreign investor establishes an FIE in Korea and receives dividends from the FIE, the taxation procedures both in Korea and in the resident country of the foreign investor are as follows: In Korea, the FIE must pay the corporate tax on their profits. In addition, when the FIE distributes dividends to foreign investors with its profits after tax, the recipient foreign investors must also pay corporate tax on those dividends in Korea. However, such tax payments are made by the FIE, by withholding the corporate tax when distributing dividends and paying the Korean Tax Authority on behalf of its foreign investors. Thus, taxation on FDI in Korea consists of corporate tax on the profits of FIEs and withholding tax on the dividend income of foreign investors.

Meanwhile, in the resident country of a foreign investor, the dividends received from an FIE in Korea are fully taxable for the purpose of corporate tax. That is, foreign investors who have already paid withholding tax on dividends must also pay the corporate tax of their resident country. However, in order to prevent this international double taxation, Korean withholding tax may be considered in taxation of dividends in the resident country of the foreign investor. Specifically, international double taxation can be prevented either by a tax treaty signed between Korea and the country of the investor, or by the National Tax Law of the investor's country.

Considering this process of taxation, there are various factors that affect the benefits of tax incentives for FDI in taxation both in Korea and in the investor's country. First of all, the following questions are important in relation to taxation in Korea:

- Is FDI a greenfield investment or an M&A investment?
- Is there a tax treaty between Korea and the investor's country?[2)]

Taxation in the investor's country can vary according to how international double taxation on dividends is prevented. Regarding this, it is important to ask the

2) In addition to these two questions, another question could be also considered: Is FDI an investment by a permanent establishment? And if so, can the branch profit tax be levied on the permanent establishment?. However, this question is excluded from this analysis, because it is not the usual case in real-life situations. For an analysis of this question, refer to Lee, S-B.(2001), pp. 399~401.

following two questions:
- Which is used, the exemption method or the tax credit method?
- Is the tax sparing system applied?

The paper will distinguish between different types of foreign investors and anaylze the varying effects of tax benefits on the basis of the above questions. First, it will address each question, explaining the significance of the factors mentioned above, and then illustrate the degree to which these factors affect tax benefits through a quantitative analysis of a model investment case. Table 1 shows the basic assumptions related to the model investment case.

<Table 1> Assumptions for Model Investment Case

① FIEs and foreign investors are all corporations (i.e., liable to pay the corporate tax in Korea as well as in the resident countries of the foreign investors).
② Foreign investors own a 100% share in the FIEs.
③ All the business of FIEs can be considered to be qualifying projects
④ The FIE creates annual profits of 100 for ten years from the start-up date of the business.
⑤ FIEs fully and immediately distribute after-tax profits.

III. Who Gains Benefits from Tax Incentives for FDI in Korea?

1. Greenfield or M&A Investments?

The tax benefits for FDI are granted only for greenfield investments. That is, foreign investors can apply for reduction and exemption from taxes only when their investments are in the form of setting up new business in Korea. In other words, the benefits are applied only to FDI regarding the acquisition of newly issued stocks. On the other hand, M&As are not eligible since they are investments in already-issued stocks of existing Korean corporations.

However, if a foreign investor establishes an FIE in Korea, pays an investment fund to the FIE, and allows the FIE to acquire all or part of the business of a domestic company, the investor can then enjoy the tax reduction under the conditions of the STTCA. This form of investment is known as the purchase and assumption(P&A) investment. A considerable amount of foreign investments in Korea since the financial crisis have been achieved through this method.[3] In fact, many foreign

investors who had planned to invest in Korea through M&As changed to use the purchase and assumption method just to receive the tax benefits.
Table 2 shows the differences in tax burdens of FDIs, with and without incentives based on the above mentioned assumptions for the model case. Not being eligible for tax incentives, FDI projects are obliged to pay the annual corporate and inhabitant taxes[4] by 29.7 at the FIE level. In addition, the withholding tax on the dividend[5] has to be paid by 19.33 at the foreign investor level. Thus, the total tax amount on FDIs without exemptions is 49.03. This tax burden is applicable to all M&A investments, even if a project meets all other conditions for tax incentives.

<Table 2> Tax Benefits of Incentives for FDI in Korea

	M&A Investments or without Tax Incentives	Greenfield or P&A Investments with Tax Incentives	
	Year 1-10	Year 1-7	Year 8-10
Profits before Tax of FIE	100.0	100.00	100.00
Corporate Tax of FIE	27.00	0.00	13.50
Inhabitant Tax of FIE	2.70	0.00	1.35
Subtotal Tax of FIE	29.70	0.00	14.85
Dividend to FI*	70.30	100.00	85.15
Corporate Tax of FI	17.58	0.00	10.64
Inhabitant Tax of FI	1.76	0.00	1.06
Subtotal Tax of FI	19.33	0.00	11.71
Total Tax Burden in Korea	49.03	0.00	26.56
Tax Benefits of Incentives	0.00	49.03	22.47

* FI means foreign investor.

On the other hand, when FDI projects are provided with tax incentives, there is no

3) Official statistics on P&A investments are not yet available. According to a survey of the Ministry of Commerce, Industry and Energy on foreign investments through acquisition of newly issued stocks amounting to US$6 billion, greenfield investments amounted to US$3.1 billion and P&A investments to US$2.9 billion. See Jang(2000), p. 9

4) Korean corporate tax rates are as follows: 15 per cent for taxable income up to 100 million won, and 27 per cent for taxable income over 100 million won. The inhabitant tax is levied on the amount of corporate taxes due, as a surtax at a rate of 10 per cent.

5) The withholding tax rate on dividends is 25 per cent. Including the inhabitant tax, the effective withholding tax rate on dividends is 27.5 per cent.

tax payable for seven years since corporate taxes on the profits of FIEs, as well as on the dividends of foreign investors, are fully exempted, as shown by Table 2. In addition, for the three subsequent years, these taxes are deducted by 50%, reducing the total tax burden to as little as 26.56. Tax benefits of the incentives are 49.03 for the first seven years and 22.47 for the following three years.

2. Tax Treaty Beneficiary or Not?

Should there be a tax treaty between Korea and the foreign investor' s home country, such tax benefits can be affected by its provision on reduced withholding tax rates on dividends. As mentioned earlier, the Korean Corporate Tax Law(CTL) assigns a fixed withholding tax rate of 25% on dividends paid to foreign recipients. Nevertheless, this withholding tax rate can be lowered if Korea has signed a tax treaty with the foreign investor' s residential country.[6]

When dividends are paid from the FIEs' profits that are fully tax-exempt, such tax rates provided in a treaty is irrelevant. The treaty rate is not influential because the dividends have already been fully exempted from taxation under the STTCA. The treaty rates can be applied, however, in cases where the dividends are attained from the FIE's profits on which the tax is only reduced by 50%. With regard to this, The National Tax Administration(NTA) follows the interpretation that applications by the STTCA and the tax treaty are separated and either one of the two may be applied.[7] Hence, foreign investors can select a more beneficiary tax loads. The tax burden under a tax treaty may be lower than the 50% of tax deduction for dividends provided by the STTCA. In this case, the tax reduction under the STTCA has virtually no effect, given that the foreign investor would almost certainly choose the more advantageous application by the tax treaty.[8]

Even with tax treaties, the tax burden is zero for the first seven years. For the following three years, however, the tax burden differs depending on the corresponding treaty's reduced tax rate. In Table 3, the tax amount has been estimated assuming that the tax treaty's given rate on dividends is 10%. If this rate is applied, the tax burden on dividends becomes 8.52 (85.15*10%), which is lower than 11.71, the case without a tax treaty as in Table 3.

Thus, the tax deduction for dividends by the STTCA is ineffective. This implies that the STTCA's provision of tax reduction for dividends becomes irrelevant, if the reduced tax rate prescribed in a treaty is below 13.75%, the effective reduced tax rate by the STTCA (27.5%*0.5).

<Table 3> Tax Benefits of Incentives for FDI in Korea with a Tax Treaty

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6) For the reduced tax rates on dividends in the Korean tax treaties, see Lee Y-S (2000), p. 201

7) See NTA(2001), p. 90.

8) See Lee S-B.(1995), p. 213.

	Without Tax Treaty		With Tax Treaty	
	Year 1-7	Year 8-10	Year 1-7	Year 8-10
Profits before Tax of FIE	100.00	100.00	100.00	100.00
Corporate Tax of FIE	0.00	13.50	0.00	13.50
Inhabitant Tax of FIE	0.00	1.35	0.00	1.35
Subtotal Tax of FIE	0.00	14.85	0.00	14.85
Dividend to FI	100.00	85.15	100.00	85.15
Corporate Tax of FI	0.00	10.64	0.00	7.74
Inhabitant Tax of FI	0.00	1.06	0.00	0.77
Subtotal Tax of FI	0.00	11.71	0.00	8.52
Total Tax Burden in Korea	0.00	26.56	0.00	23.37
Tax Benefits of Incentives	49.03	22.47	49.03	25.67

It is assumed that the reduced tax rate on a dividend in a treaty is 10%.

3. Double Taxation Relief on Dividends: Exemption or Foreign Tax Credit?

When foreign investors receive the tax-reduced dividends from their FIEs in Korea, their resident countries can also levy corporate tax on those dividends. The reason for this is that these dividends are included in the taxable base for corporate tax purposes of the foreign investors in their resident countries. This taxation on the dividends in the resident countries of foreign investors can have influence on the overall benefits of tax incentives with which the foreign investors are provided by the Korean government. Namely, depending on the taxation method taken by the resident country of a foreign investor, the foreign investor may either maintain the tax benefits constantly, or lose at least a portion of them. The main factor affecting the tax benefits in the resident country of a foreign investor is the method of double taxation relief applied by the government of the resident country.

For income from international business activities, double taxation can take place. While the country from which the source of income arises may tax the income, the country in which a taxpayer has his residence may do the same. As previously explained, both Korea, which is the country of the source of dividend income, and the resident country of the foreign investor which receives the dividend income can levy corporate tax respectively when an FIE in Korea distributes dividends to a foreign investor. Such overlapping assertions of tax jurisdictions may result in double taxation.

In general, the resident countries of taxpayers apply several different methods in order to avoid such double taxation on the foreign source income. These methods are legally based upon both the tax treaties and the National Tax Laws of the resident countries. For instance, if there is a tax treaty between Korea and the resident country of a foreign investor, potential double taxation for the dividends from an FIE in Korea can be avoided through the methods of double taxation relief stipulated within the tax treaty which has legal priority over the domestic National Tax Law. However, if there are provisions for the methods in the domestic National Tax Law, which bring about more advantageous consequences than the tax treaty with Korea, those favorable methods of double taxation relief are applied.

The methods of double taxation relief can be divided into two categories: the *exemption method* for foreign dividend income and the *credit method* for foreign tax payments. Currently, each country takes one of these two methods, or applies a mixture according to the type of income.

When the exemption method is applied, the foreign source income can be exempted from taxation in the investor's country of residence. If the resident country of a foreign investor applies this as the method of double taxation relief for the Korean source dividend income, the dividends are exempted from the foreign investor' s taxation in his resident country, regardless of the provision, with tax benefits by the Korean government on those dividends. In this case, tax benefits received from

Korea can be maintained without any change, as a consequence. In other words, the foreign investor can retain the benefits of tax reduction and exemption.
At present, among the countries which have concluded a tax treaty with Korea, only four-Germany, Belgium, Switzerland and New Zealand-stipulate the application of the exemption method for the dividend income of Korean source within their tax treaties. Even in the cases of these countries, the dividend income of Korean source is only exempted provided that it meets the special requirements described in Table 4.
When the credit method is applied, the foreign income is included in the taxable income of the investor in his resident country, in order to compute the total amount of taxes to be paid. Then the taxes payable are reduced by the amount of taxes that the investor has already paid to the country of the source of dividend income.
When the foreign investor's resident country applies the credit method for double taxation relief of the dividend income from the FIE in Korea, the foreign investor may not be able to enjoy benefits from tax reduction and exemption provided by the Korean government. The reason for this is that the foreign investor has not paid the amount of taxes in Korea, that equal

<Table 4> Korean Tax Treaties and Their Requirements for Application of the Exemption Method

Country	Requirements
Germany	Direct holding of at least 25 % of capital of the Korean company 1)
Belgium	Accordance with the requirements applied to tax exemption of inter-corporate dividends between Belgian resident corporations 2)
Switzerland	Accordance with the requirements applied to tax exemption of inter-corporate dividends between Swiss resident corporations 3)
New Zealand	Accordance with the requirements applied to tax exemption of inter-corporate dividends between New Zealander resident corporations 4)

1) *Korea-Germany Tax Treaty, Art. 22, Para. 2, Subpara. (a)* - According to German Corporate Tax Law, foreign dividends can be exempted if the participation exceeds 10% of the foreign corporation which distributed the dividends. See *Jacobs(1999), p. 455.*
2) *Korea-Belgium Tax Treaty, Art. 22, Para. 2, Subpara. (c)* - According to Belgian Corporate Tax Law, the requirements for tax exemption of inter-corporate dividends between Belgian resident corporations are as follows: the minimum participation of 5%; or the participation of which the acquisition value is at least 50 million Belgian francs. See *IBFD (1999), p. 60.*
3) *Korea-Switzerland Tax Treaty, Art. 22, Para. 5* - According to Swiss Corporate Tax Law, the requirements for tax exemption of inter-corporate dividends between Swiss resident corporations are as follows: the minimum participation of 20%; or the participation of which the acquisition value is at least 2 million

Swiss francs. See *IBFD(1997), p. 454*.

4) *Korea-New Zealand Tax Treaty, Art. 23, Para. 2, Subpara. (b)*–“…being dividends which, in accordance with the taxation law of New Zealand in existence at the date of signature of this Convention, would be exempt from New Zealand tax.”

the benefits from tax reduction and exemption, and that amount is not considered for double taxation relief. In other words, the tax incentives received in Korea cannot contribute to the benefits of the foreign investor, only to increase the tax revenues of his resident country.

The following analysis gives numeric examples of tax benefits when the taxation in the resident countries of foreign investors is also considered. In addition to the above-mentioned assumptions, it is assumed that the corporate tax rate in a resident country is 27.5%, which is the same as the Korean withholding tax rate on dividends. This allows the tax benefits effects to stand neutral to the corporate tax rate difference between Korea and the resident country.

<Table 5> Tax Benefits Difference between the Exemption and Credit Methods

	In Case of Exemption Method		In Case of Credit Methods	
	Year 1-7	Year 8-10	Year 1-7	Year 8-10
Profits before Tax of FIE	100.00	100.00	100.00	100.00
Corporate Tax of FIE	0.00	13.50	0.00	13.50
Inhabitant Tax of FIE	0.00	1.35	0.00	1.35
Subtotal Tax of FIE	0.00	14.85	0.00	14.85
Dividend to FI	100.00	85.15	100.00	85.15
Corporate Tax of FI	0.00	7.74	0.00	7.74
Inhabitant Tax of FI	0.00	0.77	0.00	0.77
Subtotal Tax of FI	0.00	8.52	0.00	8.52
Subtotal Tax in Korea	0.00	23.37	0.00	23.37
Taxable Income in the Country X	100.00	85.15	100.00	85.15
Tax Exempted Income	100.00	85.15	-	-
Tax Base for FI in the Country X	0.00	0.00	27.50	85.15
Tax Payable in the Country X	0.00	0.00	27.50	23.42
Foreign Tax Credit	-	-	0.00	8.52
Subtotal Tax in the Country X	0.00	0.00	27.50	14.90
Total Tax Burden	0.00	23.37	27.50	38.27
Tax Benefits of Incentives	49.03	25.67	21.53	10.76

It is assumed that the reduced tax rate on a dividend in a treaty is 10% and the corporate tax rate in the resident country is 27.5%.

<Table 5> shows the overall tax benefits of incentives when the exemption method and credit method are applied respectively for avoiding double taxation in the resident country of a foreign investor.

In case of exemption, regardless of whether a treaty exists or not, there is no more taxation in the resident country on the Korean source dividend income. Therefore, the tax benefits of the incentives are equal to those in Table 3 that showed the tax benefits of the incentives in taxation of only the Korean jurisdiction. Hence, the tax incentives provided by the Korean government can be maintained without any change.

However, tax benefits can be changed, if the credit method is applied for avoiding double taxation in the resident country. Compared to the results from the application of the exemption method, the tax benefits in the case of the credit method decrease considerably. Those results can be attributed to additional taxation in the resident country, owing to the application of the credit method. Compared to the case of exemption method, the additional tax burden in case of credit method is 27.5 for the first seven years, and 14.9(=38.27-23.37) for the next three years.

5. *Tax Sparing System Beneficiary or Not?*

The tax sparing system is a variant of the credit method. As previously discussed, there is a possibility that the foreign investor may not be able to enjoy benefits from tax reduction and exemption when the credit method is applied for double taxation relief. The tax sparing system has been devised as a solution to such problems. Under the tax sparing system, the resident country treats foreign income as if it were fully taxed without benefiting from the tax incentives provided by the country of the source of income.[9]

The deemed paid tax, which is calculated by assuming that the dividends of the FIE were fully taxed in Korea, is then deducted from the foreign investor's tax payables in its resident country. This ensures that the benefits of tax incentives provided by the Korean government go to the foreign investor and not the foreign investor's resident country as tax revenues. The tax sparing system is usually included in the tax treaties. Among the 54 tax treaties Korea has signed with other countries thus far, 33 of them include provisions for the tax sparing system.

The tax sparing system stipulated in the tax treaties can be grouped into two large categories: one is the *tax sparing method*, and the other is the *matching credit method*.

The tax sparing method treats the amount of taxes reduced or fully exempted in

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9) See OECD(1995), p. 51. For the recent trends of tax sparing provisions, see OECD(1998), pp. 31~33.

Korea as being deductible Korean taxes under the application of the credit method. For example, if the dividends are fully exempted from taxation in Korea, the deductible Korean tax payable is 27.5% of the total amount of dividends. The 27.5% of the total amount of dividends that is fully exempted from taxation is considered to have been paid in Korea, and therefore, is deducted from taxation in the resident country of the foreign investor. To sum up, in case of the tax sparing method, the Korean tax payables that are tax-exempted can be deducted from the foreign investor's tax payables in its resident country.

Among the countries that Korea has signed tax treaties with, the following ten countries include the provisions for the tax sparing method: Japan, the U.K.,[10] Denmark, Finland, New Zealand, Israel, Papua New Guinea, Portugal, Greece and Kuwait. Foreign investors from these 10 countries can constantly maintain their benefits from tax reduction and exemption for dividends in Korea.

On the other hand, the matching credit method regards only a certain portion of reduced or exempted Korean taxes as being deductible Korean taxes. That certain portion is specified in each tax treaty by the specific percentage.

Among the countries that have signed tax treaties with Korea, more than 26 apply provisions for the matching credit method. These countries are as follows: Germany, Belgium, Canada, Singapore, the Netherlands, Sweden, New Zealand, Ireland, Norway, Bangladesh, Luxembourg, Sri Lanka, India, Turkey, Egypt, Austria, Indonesia, Malaysia, Brazil, Pakistan, Tunisia, Italy, China, Bulgaria, Czech Republic, the Republic of Malta, Uzbekistan and Malaysia.[11] In case of the matching credit method, the maximum amount of deductible Korean taxes can be 5%, 7.5%, 10%, 15% or 20% of the total amount of dividends<Table 6>.

Those foreign investors that come from countries other than the four countries applying the exemption method and 36 countries[12] applying the tax sparing system, may not be able to enjoy the benefits of tax incentives provided by the Korean government at all if there are no provisions in their domestic laws for tax deduction on their dividend income.

It is assumed that the reduced tax rate on a dividend in a treaty is 10% and the corporate tax rate in the resident country is 27.5%.

It is assumed that the matching credit in a tax treaty is 10%.

Table 7 shows tax benefits of incentives when the tax sparing system is applied as

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10) This will not be applied to the dividend income received after Dec. 31, 2003, according to *the Korea-U.K. Tax Treaty, Art. 23, Para. 5.*

11) In the cases of Germany, Belgium and New Zealand, the matching credit method is applied only to those dividends in which the FIE's participation is lower than 25%. If the participation exceeds 25%, the exemption method is applied as mentioned previously.

12) Germany, Norway and New Zealand, which apply both the exemption method and the tax sparing , system are not included in this number. In their cases, the tax sparing system is applied to the dividends that have been reduced or exempted in taxation in Korea, as the dividends to which the exemption method is not applicable

a credit method for avoiding double taxation. When the tax sparing method is applied, the taxes that would have been paid if there were no tax exemptions in Korea are deducted. Therefore, assuming that the tax rate in the resident country is the same 27.5% as in Korea, there is no additional tax burden in the resident country. Tax benefits in <Table 7> are equal to those of Table 5 in which the exemption method is applied. As a consequence, the tax benefits of the incentives provided by the Korean government can be maintained.

<Table 6> Amount of Matching Credit in the Tax Treaties Signed by Korea

Amount of Matching Credit	Relevant Countries
7.5% of the total amount of dividends	Italy
10% of the total amount of dividends	Sri Lanka, Indonesia, China, Bulgaria, Egypt
5 or 10% of the total amount of dividends	Czech Republic
5 or 15% of the total amount of dividends	Uzbekistan, Malta
10 or 15% of the total amount of dividends	Singapore, Bangladesh
15% of the total amount of dividends	Canada, the Netherlands, Ireland, Austria, Pakistan, Tunisia
15 or 20% of the total amount of dividends	India, Turkey
20% of the total amount of dividends	Germany, Belgium, Sweden, Malaysia, Norway, Luxembourg, Brazil

<Table 7> Tax Benefits in Case of Tax Sparing System

	In Case of Normal Tax Credit*		In Case of Tax Sparing Method*		In Case of Matching Credit Method**	
	Year 1-7	Year 8-10	Year 1-7	Year 8-10	Year 1-7	Year 8-10
Profits before Tax of FIE	100.00	100.00	100.00	100.00	100.00	100.00
Corporate Tax of FIE	0.00	13.50	0.00	13.50	0.00	13.50
Inhabitant Tax of FIE	0.00	1.35	0.00	1.35	0.00	1.35
Subtotal Tax of FIE	0.00	14.85	0.00	14.85	0.00	14.85
Dividend to FI	100.00	85.15	100.00	85.15	100.00	85.15
Corporate Tax of FI	0.00	7.74	0.00	7.74	0.00	7.74
Inhabitant Tax of FI	0.00	0.77	0.00	0.77	0.00	0.77
Subtotal Tax of FI	0.00	8.52	0.00	8.52	0.00	8.52
Subtotal Tax in Korea	0.00	23.37	0.00	23.37	0.00	23.37
Taxable Income in Country X	100.00	85.15	100.00	85.15	100.00	85.15
Corporate Tax in Country X	27.50	23.42	27.50	23.42	27.50	23.42
Foreign Tax Credit	0.00	8.52	27.50	23.42	10.00	8.52
Subtotal Tax in Country X	27.50	14.90	0.00	0.00	17.50	14.90
Total Tax Burden	27.50	38.27	0.00	23.37	17.50	38.27
Tax Benefits of Incentives	21.53	10.76	49.03	25.67	31.53	10.76

The tax benefits of the incentives are decreased if the matching credit method is applied as the method for avoiding double taxation, compared to cases in which the tax sparing method is applied. This is due to the fact that the tax amount assumed to have been paid in Korea is limited by the amount stipulated in the tax treaty in the case of the matching credit method. If the matching credit in a tax treaty is 10% of the total amount of dividends, the tax benefits are 31.53 for the first seven years and 10.76 for the next three years.

IV. Conclusions

This paper has provided an analysis of the tax benefit effects for FDI in Korea. The analysis shows that the tax benefits of incentives provided by the Korean government may not be maintained by foreign investors to the extent intended by the Korean government. According to various factors, such as the existence of a tax treaty, and the application of different methods for double taxation relief, the provision of tax reduction and exemption can either become ineffectual or the tax benefits for foreign investors can be diminished considerably. Even in a certain case, as shown in Chapter III, the benefits could increase the tax revenues of the investor' s home country only.

All these results of the analysis suggest important matters of consequence to foreign investors. Foreign investors who are qualified for tax incentives need to build appropriate tax strategies by a thorough understanding of their situation. With this analysis as a basis, several strategies for foreign investors can be suggested, which can minimize the tax burden and maximize the tax benefits of incentives.

To begin with, foreign investors planning to acquire existing Korean companies can possibly benefit from the tax incentives.[13] As previously explained, the tax benefits for FDI are granted for greenfield investments only. M&A investments are excluded since these are investments in already- issued stocks of existing Korean corporations. Nevertheless, if a foreign investor adopts a P&A investment form in Korea(paying an investment fund to the FIE and allowing it to purchase a domestic company with that fund), the investor can enjoy tax deductions under the conditions set by the STTCA.

Secondly, foreign investors should sufficiently examine what methods are applied to prevent double taxation on dividends in their resident countries. First of all, they need to find out if the exemption method can be applied. It requires specific examination because even if the exemption method cannot be applied according to tax treaties, there is still a possibility that it can be applied by domestic National Tax Laws. If the credit method is applied, then foreign investors should examine whether or not the tax sparing system in tax treaties can be applied. Especially, they must confirm if the tax sparing method is applied instead of the matching credit method. Because the tax benefits provided by Korea are maintained only in the cases applying the exemption methodor the tax sparing method, foreign investors can have more discretion on the dividend policy of FIEs. As most of the tax benefits for dividends are liable to vanish in the other cases, various situations of foreign investors and FIEs should be considered to decide whether the tax-benefited profits of FIEs should be distributed to foreign investors or retained

13) Lee S-B.(2001), p. 401.

within FIEs.

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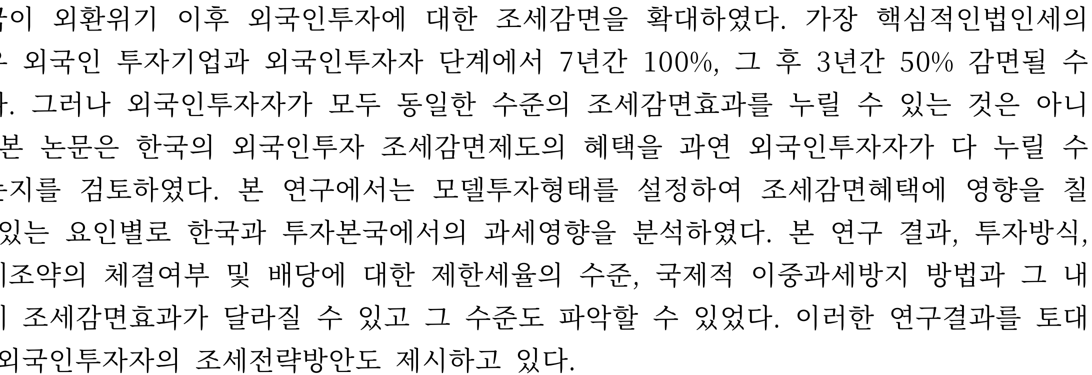
국 문 요 약



한국이 외환위기 이후 외국인투자에 대한 조세감면을 확대하였다. 가장 핵심적인법인세의 경우 외국인 투자기업과 외국인투자자 단계에서 7년간 100%, 그 후 3년간 50% 감면될 수 있다. 그러나 외국인투자자가 모두 동일한 수준의 조세감면효과를 누릴 수 있는 것은 아니다 본 논문은 한국의 외국인투자 조세감면제도의 혜택을 과연 외국인투자자가 다 누릴 수 있는지를 검토하였다. 본 연구에서는 모델투자형태를 설정하여 조세감면혜택에 영향을 칠 수 있는 요인별로 한국과 투자본국에서의 과세영향을 분석하였다. 본 연구 결과, 투자방식, 조세조약의 체결여부 및 배당에 대한 제한세율의 수준, 국제적 이중과세방지 방법과 그 내용에 조세감면효과가 달라질 수 있고 그 수준도 파악할 수 있었다. 이러한 연구결과를 토대로 외국인투자자의 조세전략방안도 제시하고 있다.