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Korea's Experience of Individual Income Taxation

- Structural Changes, Administrative Reforms, and Their Effects -

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I. Introduction

The individual income tax is one of the most important components of the Korean tax structure, providing some 19 percent of total and over 24 percent of national government tax revenue. This income tax share exceeds that of most developing countries. It is widely accepted that this feature of Korean tax system is desirable and that it should be preserved and strengthened.

Of all taxes, the individual income tax affords the most direct and effective way of adapting tax burden to the taxpayer's personal ability to pay. It thus comprises an essential component of a tax structure that otherwise must rely heavily upon indirect and property taxes, neither of which is related to the taxpayer's personal circumstances. The individual income tax can take account of taxpayer's family circumstances and other individual conditions in a way that is not possible under an indirect tax which is collected from business establishments in the expectation that they will pass it on to customers.

The individual income tax has also been widely accepted because of its directness and adaptability to graduated rates. By providing for personal exemptions and graduated rates, the income tax may cause an individual's tax to increase faster than his income, with the result that the proportion of income absorbed by the tax rises with income. Although individual income taxation does not play the same leading role in a developing economy of Korea as it does in highly developed economies such as Japan and the United States, its role in the former is nevertheless of great importance.

The present form of individual income taxation was first introduced in Korea in 1949, following the establishment of the first Republic in 1948. The role of this tax at that time was rather limited. Korea's initial experience with the individual income tax was not successful mainly because of administrative inefficiency and the lack of tax compliance. No strict penalties were imposed for tax evasion, and tax officials failed to enforce equitable assessment. Because of this weakness, the amount of revenue collected from the individual income tax was relatively small and the distribution of the tax burden was far from equitable. Well-to-do individuals were able to evade or reduce their tax liabilities by bribing poorly paid tax officials.

Thus the tax law which was not uniformly enforced led to grave inequity. In order to improve the structure and enforcement of the tax, the Korean government adopted over the years a series of new laws and decrees governing the administration of the individual income tax law. The tax has been subjected to various reforms and numerous improvements over the last forty-six years, including the most recent (1994) attempts at adjusting tax rates, closing loopholes and expanding tax base. As a consequence, the present Korean individual income tax law is a relatively well-developed and sophisticated statute in comparison with those in other developing economies. The law is enforced with much improved administrative enforcement and efficient collection methods.

What can other developing countries including China learn from the Korean experience about individual income taxation and its consequences? The primary purpose of this paper is to examine the background and nature of individual income tax changes and related administrative reforms in Korea, with particular reference to dramatic events that took place during the 1966-67 period. It also attempts to offer some generalizations about the major elements of Korea's successful experiences in collecting and managing individual income tax that will be instructive for China as well as other developing economies.

II. The Korean Tax System and Structural Reforms

Numerous tax reforms were undertaken since the early 1960s. In eight instances(1961, 1967, 1971, 1974, 1976, 1988, 1993, and 1994) the changes were substantial enough to be labeled "comprehensive".

The objectives of these comprehensive tax reforms during the 1960s and the early 1970s were to make the tax system more supportive of economic development programs. Thus the tax reforms of 1961, 1967, and 1971 were undertaken in conjunction with the Five-Year Economic Development Plan and constituted an integral part of the government's efforts to promote rapid economic growth. One of the most important reforms in the evolution of Korea's tax institution was the creation of the Office of National Tax Administration in 1966. This reform signaled the government's long-term commitment to increasing the tax effort, and a sustained period of growth in revenue mobilization followed.

The economic adjustment period of the 1970s was marked by severe economic difficulties which had largely originated from the worldwide oil crises, and two emergency tax measures adopted in 1972 and 1974. The major highlight of this period is, of course, the introduction in 1976 of a broad-based value-added tax system in place of eight of eleven existing indirect taxes. The 1970s also saw the introduction of two other taxes--the local inhabitants tax in 1973 and the defense surtax in 1975.

The decade of the 1980s is one of economic restructuring and stabilization with much less tax reform activities. In keeping with a policy of structural adjustment and liberalization, the range of tax incentives was reduced in the early 1980s. The education surtax was adopted in 1981 as a temporary tax measure to boost public financing of elementary and secondary schools. The issue behind the 1988 comprehensive tax reform which took place following the declaration of political liberalization in 1987, was the fair distribution of the fruits of economic growth and of the tax burden among different social groups. One of the most drastic measures adopted in the early 1990s was the 1993 implementation of the real name financial transaction (RNFT) system.

Eight "comprehensive" tax reforms and major tax changes that have taken place since the early 1960s are summarized below.

1961 Comprehensive tax reform (First Five-Year Plan)

· Total number of taxes reduced from 38 to 28

(15 national taxes and 13 local taxes)

· Revised 10 tax laws

1967 Comprehensive tax reform (Second Five-Year Plan)

· 13 tax laws revised

· Two new tax laws enacted (Land Speculation Control Tax Law)

1971 Comprehensive tax reform (Third Five-Year Plan)

· 10 tax laws affected

· Interest income subject to 5 percent tax

· Corporate tax rates reduced

· Investment tax credit expanded

1974 Comprehensive tax reform

· Introduced the global personal income tax system

· Land speculation control tax replaced by a capital gains tax (real estate)

· Enacted the Basic Law for National Taxes

· Established the National Tax Tribunal

1976 Comprehensive tax reform (Fourth Five-Year Plan)

· Adopted the value-added tax

· Replaced 8 of 11 indirect taxes

1988 Comprehensive tax·reform

· Revised 7 tax laws

· Reduced personal income tax, special excise tax, telephone tax, liquor tax, and customs duties

1993 Comprehensive tax reform (The New Economy Plan)

· Implementation of the real name financial transaction system

· Introduced the transportation tax

· 12 other tax laws are affected

1994 Comprehensive tax reform

· Objective was to broaden the tax base and lower tax rates

· Interest and dividends become subject to global taxation, beginning in 1986

· Revised 11 tax laws

Thus the current tax system has gradually evolved from the history of numerous discretionary changes in tax laws and institutions. The Korean tax system is composed of a large number of national and local taxes (Figure 1). As of 1994, twelve different kinds of internal taxes were levied by the central government. Of these, six were direct taxes, accounting for 52 percent of total internal tax revenues. The remaining six indirect taxes accounted for 48 percent of total internal tax revenues, and the value-added tax alone contributed nearly 31 percent of the total.

The local government units--provincial, municipal, and county--also levy fifteen different kinds of taxes, three of which are provincial taxes. Municipal and county taxes include eight ordinary taxes and three special earmarked taxes. Local government sources provided some 20 percent of all taxes collected in the nation in 1994. There is little overlap in the tax bases for the national and local taxes. The major tax revenue source of local units of government is property-related taxes, whereas that for the central government is income and consumption taxes.

Figure 1 Korean Tax Structure by Percentage, 1994

- TAX
  - National (79.6) — (100.0%)
    - Internal (80.9)
      - Direct (42.0)
        - Income (24.2)
        - Corporation (15.3)
        - Inheritance/gift (1.9)
        - Assets revaluation (0.3)
        - Excess profits (0.0)
        - Excessively-increased land value (0.2)
      - Indirect (38.9)
        - Value-added (30.6)
        - Special excise (5.3)
        - Liquor (0.7)
        - Stamp (0.6)
        - Securities transaction (0.8)
        - Others (0.9)
    - Customs duties (6.4)
    - Defense (0.1)
    - Education (5.7)
    - Transportation (6.9)
  - Local (20.4) — (100.0%)
    - Provincial (39.2)
      - Acquisition (16.8)
      - Registration (21.1)
      - License (1.3)
    - City and county ordinary (51.8)
      - Inhabitant (11.2)
      - Property (4.0)
      - Automobile (10.3)
      - Farmland (0.0)
      - Butchery (0.2)
      - Horserace (0.9)
      - Aggregate land (8.6)
      - Tobacco (16.6)
    - City and county earmarked (8.9)
      - City planning (4.7)
      - Community facilities (1.5)
      - Business establishments (2.2)
      - Regional development (0.5)

III. The Organizational Reform of Tax Administration

Despite tax law reforms undertaken by the government during the early 1960s to improve the revenue productivity of the tax system, the results were disappointing. Various corrections in tax codes and in administrative procedures failed to produce the expected additional revenues. It was not until the president exerted his enormous political influence and gave full support to drastic administrative reform and to the tax collection effort that tax revenues began to rise rapidly.

In March, 1966 the Office of National Tax Administration (ONTA) was created as an independent agency to improve the efficiency of tax administration and collection methods. Thus the year 1966 marked the beginning of a new era in tax administration in Korea. Recognizing that weak tax administration was a source of public discontent, President Park Chung Hee took a strong personal interest in the improvement of tax enforcement, and appointed one of his trusted associates in the 1961 military coup as Commissioner of National Tax Administration. The president gave him his full-fledged support against mounting political pressures brought about by those who sought relief from strong enforcement and higher taxes.

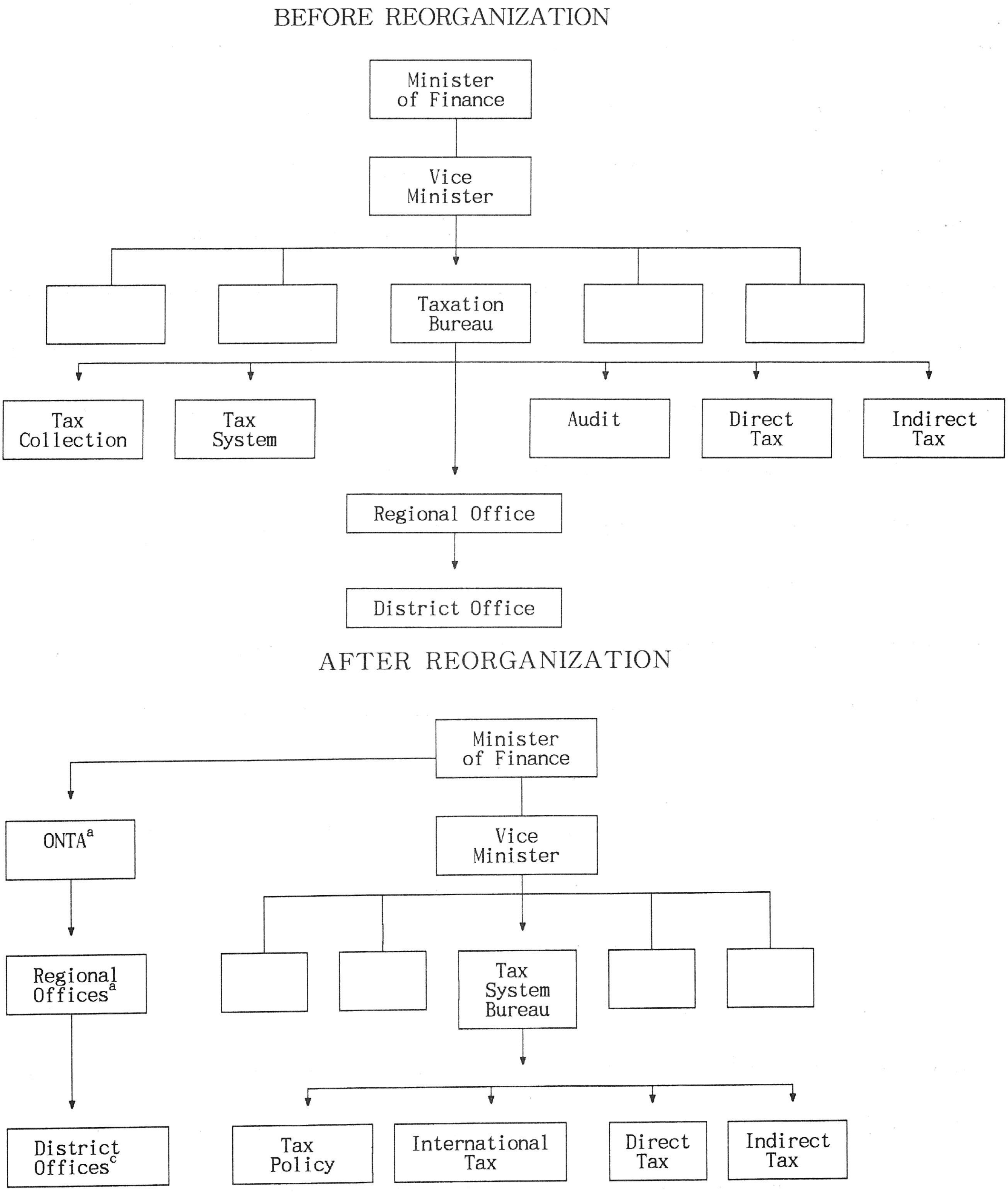
Dubbed the "quiet revolution" by President Park, the developments of the last nine months of 1966 thrust the tax administration authority into a position of previously unparalleled prominence. Created during a period of considerable uncertainty, facing an enormous responsibility and burden under the forthcoming Second Five-Year Development Plan(1967-1971), and headed by a relatively unknown individual with no experience in the tax field, ONTA compiled a remarkable record.

The existence of substantial tax evasion and avoidance was at the time widely recognized. In the face of rapidly rising domestic revenue requirements for the economic development programs, it was imperative that this revenue requirement be met by those who were not paying their fair share of tax imposed by existing law. Unless these people met their tax obligations, additional burdens would have to be placed on those who paid their taxes honestly, and the inequity in the distribution of tax burdens would be further aggravated. For these reasons, the tax commissioner firmly believed that improved enforcement through reduction of evasion and intensification of collection efforts was the most urgent task facing the new tax administration authority.

The establishment of ONTA was part of a reorganization that split the organizational function of the former Bureau of Taxation in the Ministry of Finance into the semi-autonomous Office of National Tax Administration and the Tax System Bureau (Figure 2). The former was charged with responsibility for the administration of national tax laws; the latter, which remained in the ministry as one of several bureaus, became responsible for tax policy, legislation, tax treaties, and tax analysis and research. In addition to the separation of these functions, the reorganization provided an upgrading of the status of the tax administration agency and an expansion of investigation and inspection activities.

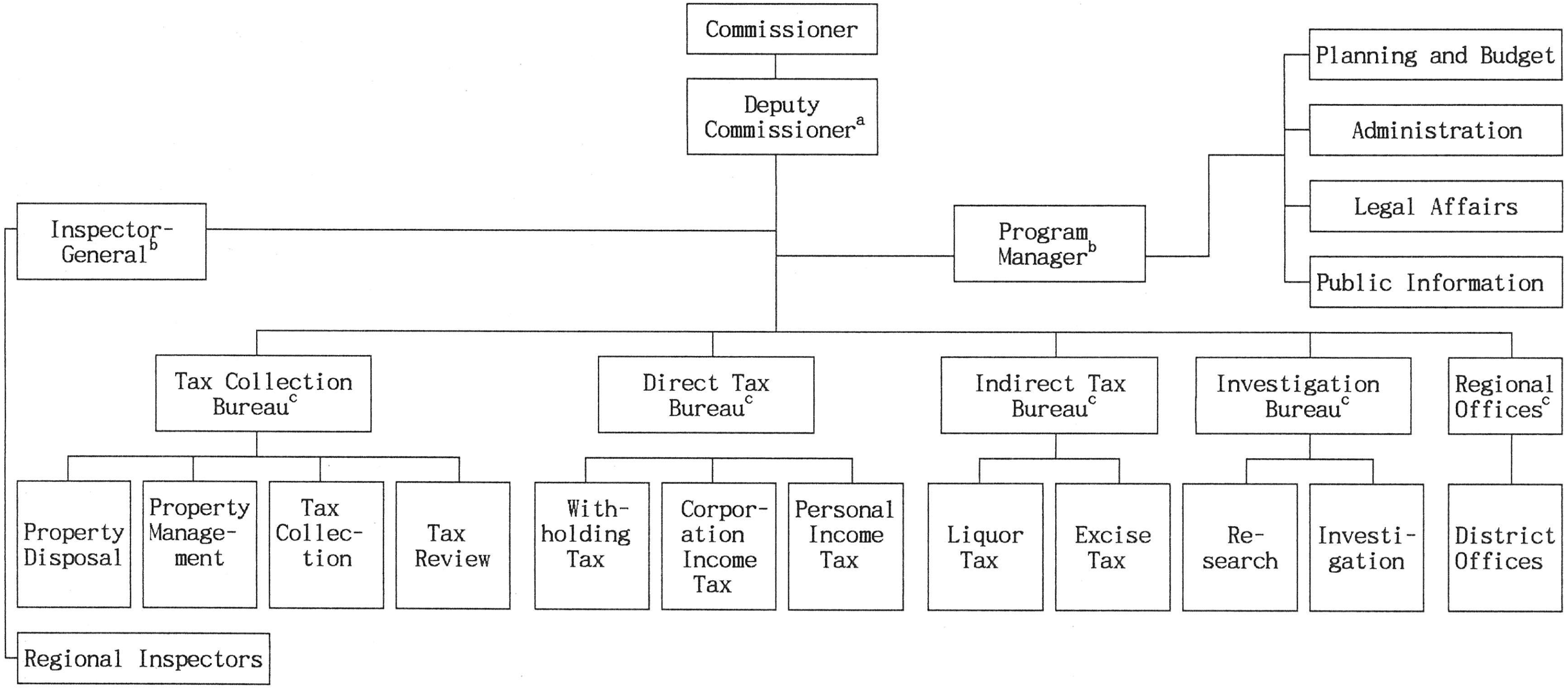
The primary concentration of the initial effort of ONTA was on fraud investigation and internal audit, and it is in these areas that the most significant breakthrough in organizational and operational concepts occurred, that is, the creation of the new position of inspector-general reporting directly to the commissioner (Figure 3). For the first time,

Figure 2 Tax Administration Before and After the Reorganization of 1966



a. Headed by a commissioner with vice minister rank.
b. Headed by a regional commissioner with bureau director rank (Grade II civil servant).
c. Headed by an officer with division chief rank (Grade Ⅳ civil servant).

Figure 3 Organizational Chart of the ONTA, 1966.



Source: ONTA, ROK, *An Outline of Korean Taxation*(1967).

a. Grade I civil servant.

b. Grade II civil servant.

c. Grade II or III civil servant.

permanent audit and inspection staff were internally organized to investigate misconduct of all tax officials. The primary responsibility of the inspector-general is to audit the service performance and accounting practices of the ONTA national office as well as the field offices and to take disciplinary action against corrupt tax officials.

With the inauguration of ONTA on March 3, 1966, the government set a tax revenue target for 1966 at 70 billion won, a substantial increase of 66 percent over the previous year. As an expression of his strong commitment and determination to achieve this goal, the newly-appointed tax commissioner used the number "700" on the license tag of his official car. Consequently this revenue target was reached, by mainly concentrating tax effort on hidden and potential tax sources.

During the early stages of Korea's economic development, bargaining and payoff have been common practices of the tax assessment process. These conditions implied that the way to increase tax collections was not to raise nominal tax rates but simply to increase assessment. The major tool used by the new tax administration for this purpose was to allocate collection quotas among regional tax offices, district offices, and even individual tax officials. Another method was to maintain a system of rewards and penalties for the tax collectors who met or failed to meet their quotas.

IV. Individual Income Taxation

Individual income taxes are the mainstay of tax revenues in advanced industrial countries, while they are much less important in developing countries. In Korea individual income tax is a critical component of tax revenue, rising from 10 percent to over 19 percent of total tax revenues in 1980-94. Its role in the overall tax structure is much more significant in Korea than in other neighboring countries in similar stages of development (Table 1). The present state of Korea's individual income tax, however, largely reflects the underlying structural changes that have undergone over the last thirty years.

Table 1 Individual Income Tax: Asian Countries, 1986-92

	As percent of GDP	As percent of total tax
Bangladesh	0.6	8.6
India	1.0	5.1
Indonesia	0.8	9.4
Korea	**3.0**	**19.2**
Malaysia	2.2	11.5
Myanmar	1.0	17.2
Philippines	1.3	9.8
Thailand	1.7	10.7

Source: International Monetary Fund (1995).

As in many other developing countries, lack of compliance, corruption, and inept administration have been persistent problems in the tax system of Korea until the early 1960s. Recognizing that tax laws and enforcement administration need to be changed and overhauled, the military government that came to power on May 16, 1961 began to work on structural tax reforms and measures to improve tax administration.

To encourage voluntary taxpayer compliance, two new laws were enacted in 1961, whereby the government relinquished all existing claims to penalties for past tax delinquencies but pledged to deal more stringently with future delinquencies. In addition, a tax reduction was allowed for voluntary filing of tax returns. To assist taxpayers in filing voluntary tax returns, a tax accountant system was instituted through enactment of the Tax Accountant Law. Additional measures included the strengthening of the tax withholding system.

1. Major Tax Law Changes

In December 1961 the government undertook tax reform through extensive revisions in the individual income tax law. Subsequently there were relatively minor revisions of tax laws between 1962 and 1966 in conjunction with the implementation of the First Five-Year Development Plan. The tax reform of November 29, 1967 was the most comprehensive reform since that of 1961.

As a first step toward a gradual transition to a "global" income tax system, the 1967 reform introduced a partial globalization of the existing "schedular" system of individual income tax, under which tax rates varied among five schedules (sources) of income: wages and salaries, business income, real estate income, dividends and interest, and other income. If a taxpayer had an annual income in any one of the five categories of the schedular income taxes equal to or greater than the specified amounts, then all of his income was subject to the global income tax, provided that total income from all sources exceeded a given amount (5 million won in 1967).

Korea adopted in 1967 global income tax in form though it is administered similarly to a schedular tax with heavy reliance on withholding and few taxpayers being assessed on global income. One of the major advantages of a global income tax is that objectives of vertical equity more easily can be achieved since the tax is based on an aggregate measure of income.

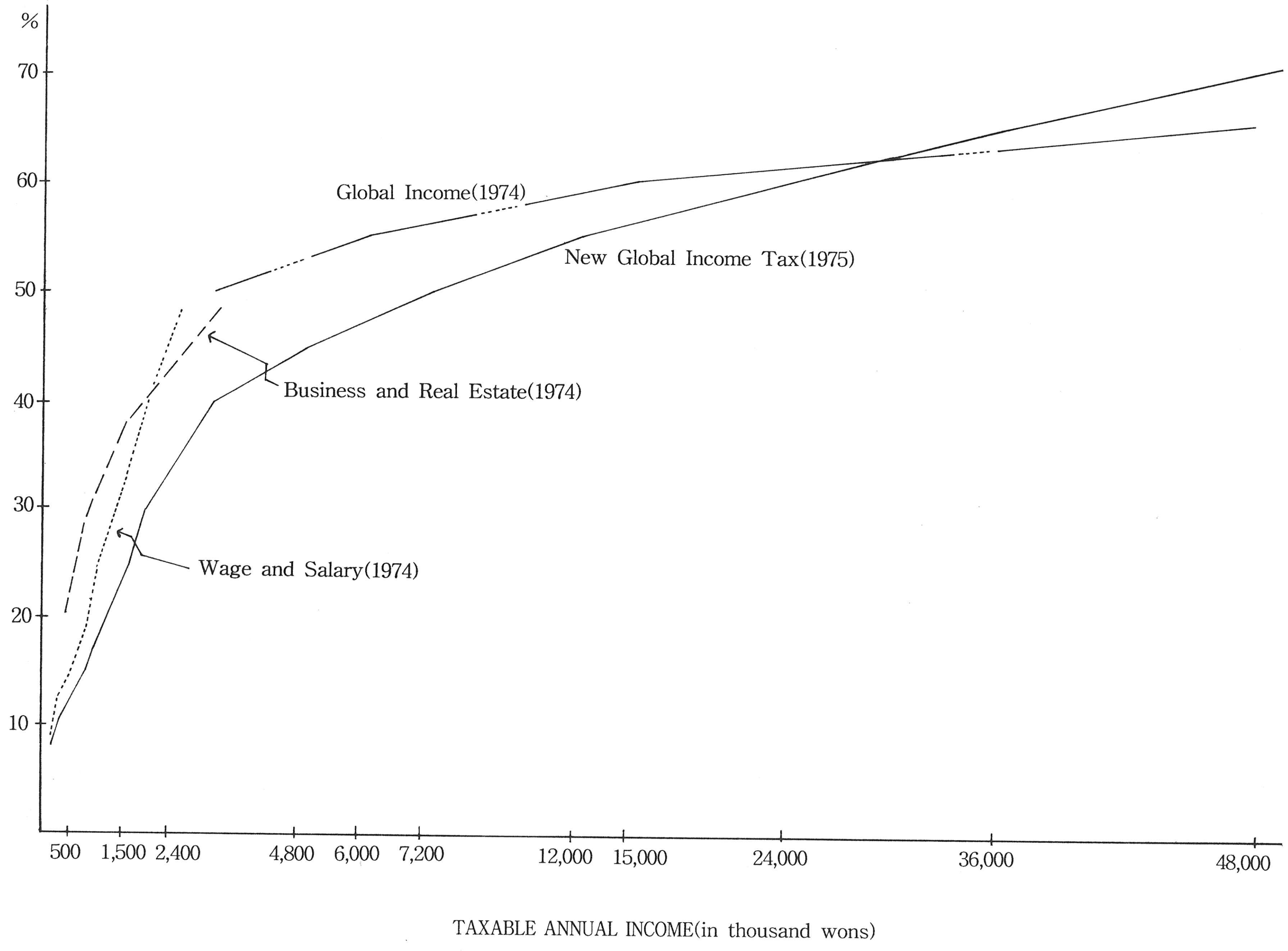
As a tax relief for low-income taxpayers, the exemption level for wages and salary earners was raised. This rise in the exemption amount was accompanied by a partial tax credit system under which a low-income taxpayer was allowed to credit against tax liability a specified amount. Similar provisions were made for business and real estate income. The statutory rate structure was also revised by increasing the number of income tax rate brackets from five to seven for wage and salary income and from five to six for business and real estate income. Tax rates for each income bracket were adjusted accordingly.

Another important changes in individual income tax took place in 1974. Until 1974 Korea's individual income tax system had both schedular and global features. Under the schedular system, exemptions, deductions, and rate structures varied considerably depending on the type of income. The system was complex and difficult to administer and produced haphazard incidence effects.

The primary objective of the 1974 reform was to correct these defects in the individual income tax by replacing the schedular system with one that was completely global. Under the new system, virtually all individual incomes (except interest and dividend incomes), which were previously included in the five different schedules, are taxed only under the global system. Dividends and interest on certain forms of savings are taxed at lower rates and not included in the global income base. The new system also provided an additional exemption for bonus income, widened the range of deductions to reduce the tax burden on families, reduced tax rates over most ranges of taxable income. Although different from the previous system, the global income tax rate structure closely resembled that of the schedular taxes and a global tax combined. Only in part of the highest income brackets are marginal tax rates above those of the previous global income tax. As shown in Figure 4, the new rate structure contained the feature of a slight increase in the degree of progression in the upper income brackets.

In 1982 the government adopted a substantial reduction in the highest marginal rate for individual income tax in an attempt to minimize distortions in resource allocation caused by an extremely progressive tax rate structure. The range of tax rates was gradually reduced from 8--70 percent in 1979 to 6-55 percent in 1982. The tax reform of 1988 represented a first step toward achieving an equity goal in response to a mounting social and political demand for greater economic democracy. The reform reduced the individual income tax burden on low-income people by raising the tax exemption levels and expanding various tax deductions, as well as adjusting the tax rate structure. The number of tax brackets was also

Figure 4 Comparison of 1975 Income Tax Rate with Old Schedular Tax Rates



reduced from sixteen to eight (Table 2). Subsequently it was further reduced to six. Current progressive tax rates range from 5 to 45 percent, and are expected to become 10~40 percent next year.

Table 2 Individual Income Tax Rates, Before and After the Reform of 1988

Pre-reform		Post-reform	
Taxable income (1,000 won)	Rate(%)	Taxable income (1,000 won)	Rate(%)
<1,800	6	<2,500	5
1,801-2,500	8	2,501-5,000	10
2,501-3,500	10	5,001-8,000	15
3,501-4,800	12	8,001-12,000	20
4,801-6,300	15	12,001-17,000	25
6,301-8,000	18	17,001-23,000	30
8,001-10,000	21	23,001-50,000	40
10,001-12,500	24	>50,000	50
12,501-15,500	27		
15,501-19,000	31		
19,001-23,000	35		
23,001-29,000	39		
29,001-37,000	43		
37,001-47,000	47		
47,001-60,000	51		
>60,001	55		

Source: Ministry of Finance, Korea (1989)

2. Administrative and Procedural Improvements

Once the newly-created Office of National Tax Administration was put into operation, the initial efforts of the tax authority were concentrated on extensive fraud investigations and internal audits. The new investigation procedure used by ONTA involved a centrally controlled and coordinated information production, processing, and evaluation system. Information was then channeled to the appropriate field investigation teams for final disposition or referred to regional or district offices for disposition after preliminary investigation. The new procedure was particularly relevant to business conditions and taxpayer practices then existed in Korea. These operations also involved close coordination and cooperation with other pertinent investigative agencies on an unprecedented scale, which in itself was a significant development. Implementation of the improved investigative procedures was impressive, even at the earlier pilot stage.

Table 3 Results of Fraud Investigations, 1965 and 1966: Number of Cases and Amount of Tax Collected

Item	1965	1966
Completed cases	924	13,242
Taxes and fines collected (million won)	303	2,209
Additional tax (million won)	177	1,744
Fines (million won)	126	435

Source: Office of National Tax Administration (1967).

Table 3 shows the outcome of fraud investigation conducted in 1965-66 with the number of cases investigated and additional taxes collected as a result. The number of investigations completed increased sharply from 924 in 1965 to 13,242 in 1966. Additional taxes and penalties collected as a result of implementing new investigation procedures amounted to 2,209 million won in 1966. This compares with only 303 million won in 1965. The revenue effect of the improved investigation procedure was manifest in the 1966 figure. The fact that a considerable sum of taxes was collected as a result of fraud investigation suggested that there still existed a great number of tax evaders.

Abuse by tax officials was one of the widespread grievances against the government. The Office of Inspector-General was thus created within ONTA under the direct supervision of the commissioner with a view to strengthening the internal audit function of ONTA, and several new inspection methods and procedures have also been introduced. The new units under the inspector-general were charged with the important tasks of investigating tax officials' misconduct and examining the operations of all segments of ONTA. The significance of the new internal auditing function was its independent status.

During the nine-month period after the inauguration of ONTA on March 3, 1966, a total of 59 district tax offices underwent extensive internal audits. As a result, a total of 350 million won in penalty taxes was collected. Of this total, individual income tax accounted for almost 26 percent (Table 4). The incidence of tax delinquencies detected through the audits reached 2,887 in 1965 and 1,237 in 1966, but the sum of penalty tax collected amounted to 18.9 billion won in 1965 and 350.4 billion won in 1966. Thus the revenue impact of the internal audit has been enormous.

Table 4 Result of Internal Audits: March 3-December 31, 1966

Item	Amount of Penalty Taxes (million won)	Percent of Total
Individual income tax	**89.5**	**25.6**
Corporate income tax	225.5	64.4
Inheritance and gift tax	3.3	0.9
Business activity tax	11.7	3.5
Liquor tax	0.7	0.2
Stamp tax	0.3	0.1
Excise taxes	1.7	0.4
Other	17.5	4.9
Total	350.4	100.0

Source: Office of National Tax Administration (1967).

In addition, ONTA experimented with another application of a new tax compliance procedure: the voluntary disclosure program. Two voluntary disclosure programs of tax evasion were carried out in the last half of 1966. As a new concept adopted in Korea's tax administration policies, these programs encouraged tax violators to confess past evasion in return for immunity from civil and criminal action. Proclaimed as grace periods preceding intensified fraud investigation efforts, the programs achieved noteworthy results. During the first period, which lasted for forty-five days between June and July, taxpayers in 771 cases voluntarily disclosed and paid 282 million won in additional taxes. During the 20-day period in September, however, the number of voluntary disclosure of tax evasion increased sharply to 9,794 cases with an additional tax payment of 1,059 million won (see Table 5).

One of the most important aspects of the improvement in tax administration was the introduction of the "green return" system. Labeled the "green return" simply because of the color of the form used, this system represented a transitional measure taken to encourage individuals and firms to file tax returns on a self- assessment basis rather than under government supervision. Adoption of a voluntary return filing system was thus the first major step toward movement away from the traditional method of having tax officials prepare returns for taxpayers. Under this system, taxpayers who kept satisfactory accounting records and whose accounting books were open to the public were allowed to file their tax returns on a self-assessment basis without interference from tax officials.

For those who fail to keep proper accounting records, their individual business income is determined on the basis of standard procedure fixed by the government--the "standard income ratio." This ratio refers to the rate of income (net profit) to gross profits, and by applying these ratios to different groups of business activities, the taxable base is derived. For correct tax assessment is to be achieved, however, a high degree of accurate information and relevant economic indicators are required on the side of tax administration. Should assessing officials fail to have such requirements and the taxable income either be overassessed or underassessed, the tax burden might be allocated among taxpayers in an inequitable fashion.

Because of such difficulties involved in achieving correct assessments, the Office of National Tax Administration has made every effort to encourage taxpayers to keep proper books and accounts. These records, supplemented by cross-checking with information from other taxpayers, are used for assessment purposes.

To pave the way for expanding the self-assessment program and bringing all taxpayers under a voluntary system, the government continued to promote voluntary filing and payment by taxpayers through various activities, such as conducting lectures and town meetings, extensive coverage by the news media, and establishment of taxpayer information and service centers.

Table 5 Voluntary Disclosure Program of Tax Evasion: 1966 (Number of cases)

	Cases			Taxes (million won)		
Region	First Period[a]	Second Period[b]	Total	First Period[a]	Second Period[b]	Total
Seoul	204	3,022	3,226	92	717	809
Daijon	36	724	760	11	30	41
Gwangju	284	1,975	2,259	23	85	109
Busan	247	4,073	4,320	156	227	382
Total	771	9,794	10,565	282	1,059	1,341

Source: Office of National Tax Administration (1967).
[a]Refers to 45-day period during June-July 1966.
[b]Refers to 20-day period during September 1966.

To stimulate an awareness among the public of the importance of complying with tax laws and to secure the active support and cooperation of taxpayers, the government officially designated March 3 as "National Tax Day," to be observed annually. President Park Chung

Hee took a strong personal interest in this event. He regularly attended the tax day ceremonies to encourage tax officials to increase tax enforcement efforts and to give public recognition to the large, honest taxpayers by awarding distinguished metals.

V. Effects of 1966-67 Tax Law Changes and Administrative Reforms

Tax policy played only a minor role in the development process of Korea until the early 1960s. Compliance problems were severe, tax collection was lax, and a continuing rapid rate of inflation limited what could be accomplished through structural reform. It was not until the government began to make more conscious and systematic efforts to correct serious deficiencies in the whole tax system that there were dramatic increases in tax collections and in the efficiency of tax administration. A major breakthrough in the tax effort came in 1966-67. The substantial improvement in tax administration was probably the most important single factor in this breakthrough. Korea was well aware that efficient administration was a crucial aspect of tax policy, and no system could be better than its actual implementation.

The creation of the Office of National Tax Administration on March 3, 1966 marked a turning point in the history of tax enforcement in Korea. This epoch-making reform, combined with substantial statutory revisions in 1967 to strengthen the revenue potential of the individual income tax system, brought about dramatic increases in the efficiency of tax law enforcement and in tax revenues.

These two back-to-back reforms resulted in a doubling of the tax/GNP ratio between 1965 and 1969, a shift in revenue emphasis toward modern individual income taxation, and a very large increase in the savings rate. National internal tax revenue as a percentage of GNP increased from 5.2 percent to 10.5 percent in the 1965-69 period. The share of individual income tax in total tax revenue also increased, from 27.8 percent in 1965 to 32 percent by 1969. These spectacular increases in tax revenue were accompanied by increased savings in the government sector, boosting the government saving share in total domestic savings from 23 to 31.4 percent (Table 6). Substantial improvement in the tax effort in 1966-67 may have contributed significantly to the rapid growth in government saving.

Table 6 Revenue Impact of the 1966/67 Tax Reforms

	1965	1966	1967	1968	1969
Tax revenue as % of GNP	5.2	6.8	8.2	9.8	10.5
Annual growth rate of tax revenue	44.1	66.5	48.3	50.6	39.4
Individual income tax as % of total tax revenue	27.8	28.9	29.8	30.5	32.0
Government saving rate	1.7	2.8	4.1	6.1	5.9
Domestic saving rate	7.4	11.8	11.4	15.1	18.8
Government saving as % of domestic saving	23.0	23.7	36.0	40.4	31.4

Source: ONTA (1970); Bank of Korea (1970)
Note: Tax revenue refers to national internal tax revenue.

What can other developing economies learn about taxation and its effect from the Korean experience? The Korean experience provides evidence for the general expectation that the tax structure changes in the course of economic development. During the course of economic development since 1961, the composition of the tax structure in Korea gradually shifted from commodity-oriented indirect taxation to income-based direct taxes and back again to indirect taxation.

One of the most important lessons that can be learned from the Korean experience is that, contrary to what has often been widely observed, the individual income tax has an important role to play even on a limited scale in the revenue system of developing countries. Income taxation was found to be an important source of government revenue in Korea, where revenue yields from both individual and corporate income taxes represented 34 percent of total tax revenue of the national government in 1968, compared with only 15-25 percent in the early 1960s. Currently it accounts for almost 40 percent. Despite such inhibitions as the lack of tradition in income tax compliance and enforcement, Korea has made significant progress in developing a system of taxing individual incomes. Korea's experience clearly shows that individual income tax is a potentially productive source of tax revenue in the context of rapidly rising revenue requirements of developing economies.

APPENDIX: The "Real-Name" System and the Global Income Tax

The real-name financial transaction system was put into effect on August 12, 1993. The enforcement of this system, which was widely supported by the public, had long been postponed although its need was first admitted in the early 1980s. The two previous presidents failed to keep their public pledges to carry out the system. The real-name system, designed to eliminate the use of fictitious or borrowed names in all financial transactions, is considered essential for equity in taxation.

When President Kim Young-sam suddenly announced the enforcement of the real-name financial transaction system in 1993, he put off introduction of the global tax system on dividends and interest income until 1996 in a move to minimize adverse effects on the economy. Currently, dividends and interest incomes are separately taxed as financial institutions withhold a specific amount of tax from deposit accounts. Thus, depositors do not have to prepare tax returns. The present real-name system is nothing more than requiring the people to use their real names when they deal with financial institutions.

The 1994 comprehensive tax reform made it official that global individual income tax will be levied on interest and dividends of over 40 million won from 1996 while tax rates on wages and salaries will be trimmed by 20 percent. Those whose dividend and interest income falls below the threshold will continue to be taxed separately at the source. The withholding tax rate will fall from the present level of 20 percent to 15 percent in 1996 and further to 10 percent in 1997. On the other hand, the government will eliminate 20 types of tax-incentive deposit accounts, except for private pension trust accounts and long-term deposit accounts for home buying. The government will consider levying capital gains tax on stocks and bonds only after 1998.

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