Korean Investment in Tax Havens since 2000[1]

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1. Introduction

The attempt by corporations and individuals to evade tax imposition by moving wealth and capital to tax havens has long been a problem for governments and national economies. Tax haven investment for the purpose of tax evasion has been criticized in that it causes distortions in the distribution of wealth, increasing disparities between the rich and the poor. In addition, the capital stock sheltering in tax havens does not contribute to productivity of the economy.

Therefore, governments and international organizations have made efforts to monitor and restrict the flow of capital into tax havens. The OECD began conducting research on tax havens as early as the mid-1980s, and the EU is currently strengthening regulation on capital flows into tax havens. Outside officialdom, non-government organizations part of the tax justice movement are doing their own research and urging governments to take bolder action.

However, these attempts thus far have not been successful and the volume of capital stock in tax havens has consistently grown — and Korea is no exception to this trend. As capital flows into tax havens have increased, it has become necessary to grasp the reality of capital flight to tax havens in a comprehensive manner. Yet there is no extant research on the Korean case, although the government has occasionally performed spot investigations. In this article, I want to describe the macroeconomic characteristics of capital flight into tax havens that takes the form of overseas investment by Korean firms and individuals using data on outward direct investment. In doing so, I want to help illuminate the potential problem of tax evasion risk in Korea that assumes the form of overseas investment.

1 This article is a translated summary abstract of Moon (2020), "The Current State of Korean Investment in Tax Havens Korea and its Implications", KIET Issue Paper 2020-01, Korea Institute for Industrial Economics and Trade: Sejong, Korea.

2. Definition and Identification of Tax Havens

(1) Definition of a Tax Haven and Identification Criteria

Before we investigate the current status of tax haven investment, it is necessary to define what a tax haven is and how to identify a country (or a jurisdiction) as a tax haven.

Unfortunately, there is no clear definition of a tax haven. The OECD, which has undertaken research on tax havens since the mid-1980s, recognized the difficulties involved in providing an objective definition of a tax haven in its own report (1998).[2] The report says while the concept of "tax haven" does not have a precise technical meaning, it offers that a useful distinction may be made between, on the one hand, countries that are able to finance their public services with no or nominal income taxes and that offer themselves as places to be used by non-residents to escape tax in their country of residence and, on the other hand, countries which raise significant revenues from their income tax but whose tax systems have features constituting harmful tax competition.[3]

However, there are some criteria that can be used to identify a jurisdiction as a tax haven. The aforementioned OECD report provides key factors in identifying tax havens. They are: ① no or only nominal taxes, ② a lack of effective exchange of information, ③ a lack of transparency, and ④ no substantial activities.

Besides the OECD criteria, other organizations have posited their own methodologies for identifying tax havens. For example, non-government organizations part of the tax justice movement such as Oxfam apply their own standards when identifying a jurisdiction as a tax havens and release their own lists of tax havens.

(2) Identification of Tax Havens

In this article, I will apply my own criteria to identify tax havens. These criteria mainly consist of those found in official reports from the OECD, the EU and the Korean government as well as those found in the arguments of non-government organizations in the tax justice movement.

The basis of the list of tax havens in I use for this article is a list of such havens found in a 2011 report of the Korea Customs Service.[4] But, instead of using the list as is, I built my own list of tax haven, adjusting the Customs Service list by removing and adding some destinations with reference to the lists of other sources. The criterion to remove an invest-

2 OECD (1998), "Harmful Tax Competition: An Emerging Global Issue" .
3 Ibid, p.20.
4 Office of Korea Customs Service (2011), "Capital Flights to Tax Havens Taking Advantage of Global Economic Crisis: An Analysis of Overseas Transaction with Tax Havens", press release, 26 February 2011.

Table 1. List of Tax Havens to be Investigated in this Article

American Samoa	Costa Rica	Maldives	Seychelles
Bahamas	Cyprus	Malta	Solomon Islands
Bahrain	Fiji	Marshall Islands	South Georgia & the South Sandwich Islands
Barbados	Gibraltar	Mauritius	St. Lucia
Belize	Guam	Monaco	Tonga
Bermuda	Guernsey	Nauru	Trinidad and Tobago
British Indian Ocean Territory	Isle of Man	Netherlands Antilles	Tuvalu
British Virgin Islands	Jersey	New Caledonia	US Virgin Islands
Brunei	Liberia	Palau	Vanuatu
Cabo Verde	Luxembourg	Panama	
Cayman Islands	Macau	Samoa	

ment destination from the Customs Service list is, roughly speaking, whether the identification criterion corresponds with OECD criteria[5] or not. If the identification criterion is not mentioned by the OECD, a destination is removed from the list and not considered as a tax haven. The criteria to add a destination to the list are the size of its population and whether or not the destination is on the lists of tax havens from other sources, such as the EU list of tax havens or lists in the research reports of non-government organizations. I set the population size criterion at one million people, which is generally considered to be the baseline population of a metropolis in Korea. Using this as a standard to identify a tax haven is based on the assumption that a jurisdiction should support at least a certain level of population to function as an independent market worthy of investment on its own terms. If a jurisdiction has less than one million people and is on the lists of tax havens from other sources, but is absent from the Customs Service list, it will be added to the list of tax havens in this article.

Applying the criteria discussed above, the following 42 jurisdictions in Table 1 are identified as tax havens and will be investigated in this article.

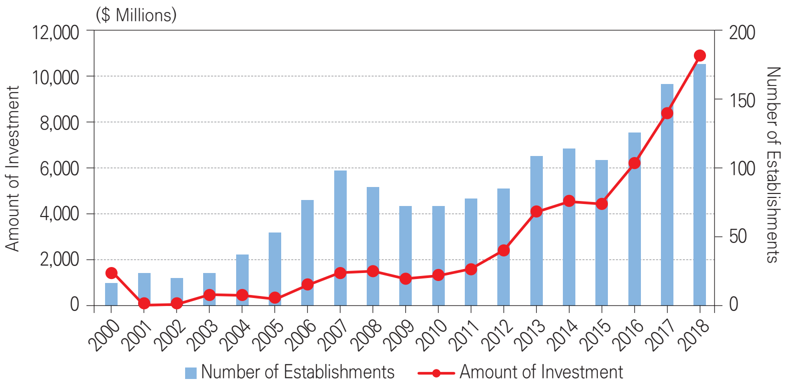
3. Trends and Characteristics of Investment in Tax Havens

(1) Overall Trends

Figure 1 shows investment flows from Korea

5 There are three OECD criteria used to identify tax havens in the Customs Office Report. They are: 1) whether or not a jurisdiction is included in the OECD study group, 2) whether or not a jurisdiction had been designated as a tax haven by the OECD at least once by the time the report was released, and 3) whether or not a jurisdiction had been designated as uncooperative as of December 2003.

Figure 1. Korean Investment in Tax Havens Since 2000



Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

into the tax haven countries listed in Table 1 since 2000.

As is seen in Figure 1, investment flows into tax havens started to grow from 2005, gradually accelerating into the 2010s and then surging after 2015. Even the financial crisis of 2008 did not significantly depress the upward trend.

During the period under investigation in this paper, the total amount of investment in tax havens reached about 52.2 billion US dollars, while the number of new establishments was 1,531. Investment flows into tax havens accounted for about 12.3 percent of total outbound investments from Korea, amounting to 422.8 billion USD, and the number of establishments in tax havens constituted 2.3 percent of 65,671 total overseas establishments between 2000 and 2018. This implies that dollar value per investment into tax havens is larger than that of average outbound investments from Korea.

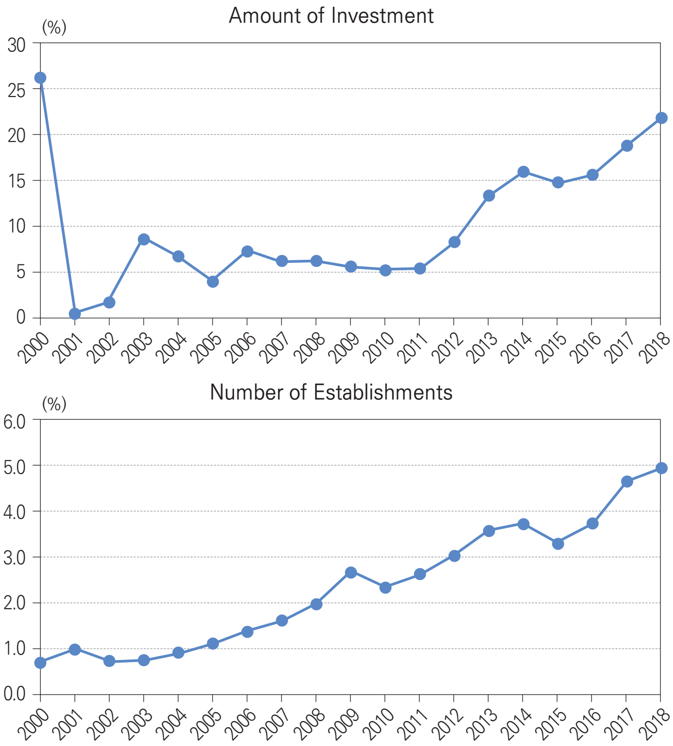
Figure 2 shows trends in tax havens' share of total overseas investment during the period in question.

As Figure 2 shows, tax havens' share of total investment outflows has increased since 2000. In particular, the dollar value investments into tax havens, which as recently as 2010 had accounted for just five percent of all overseas investments, had grown to account for over 20 percent of total outbound investment by 2018, discarding the outlier recorded in 2000. In terms of the number of new overseas establishments, tax havens also account for an increasing share of those, though at a lower rate. Together these trends imply that tax haven investment is growing much faster than total investment.

(2) Investment Characteristics by Investment Purpose

I will here examine the purposes of investment in tax havens. As we can see in Figures

Figure 2. Tax Havens' Share of Korean Overseas Investment



Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

3 and 4, the most outstanding characteristic of tax haven investment is that the share of investment whose purpose is to build bases to access other markets is dominating, compared with total overseas investment from Korea.

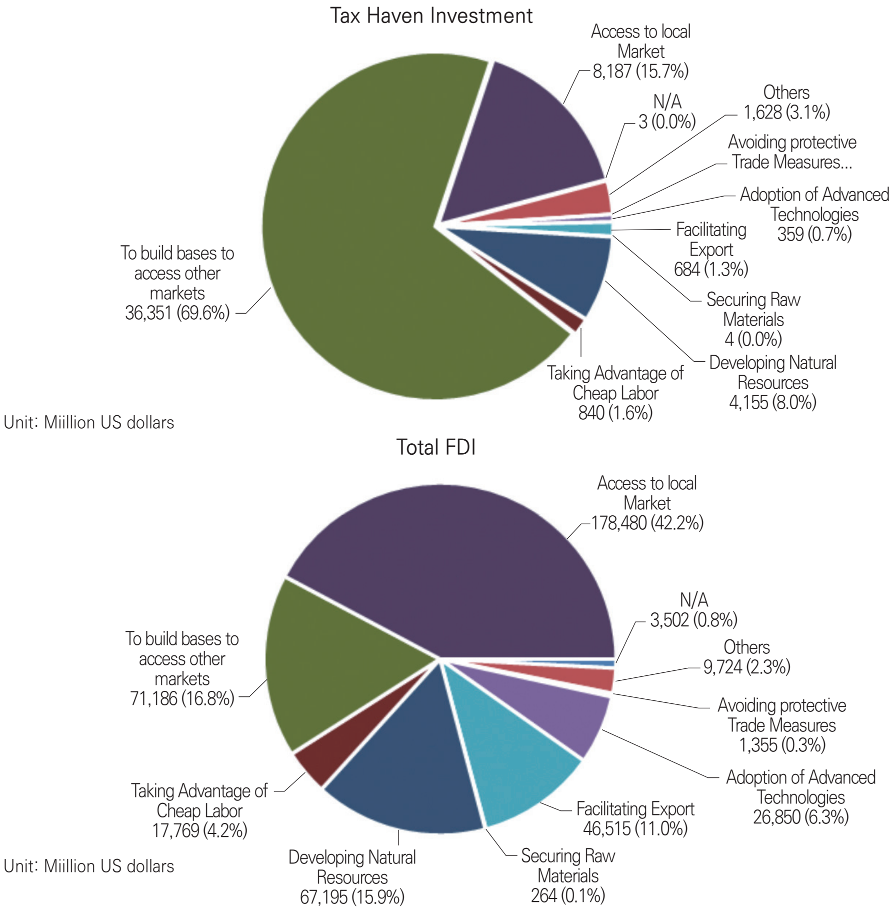
In terms of dollar value, investments for building bases to access other markets account for about 70 percent of all tax haven investments. This stands in sharp contrast to the primary purpose for foreign direct investment as a whole, which is to access local markets. Though building bases to access other markets is the second-most common purpose of FDI investment dollars, other purposes such as the facilitation of exports, the development of natural resources and the taking advantage of cheap labor account for a substantial share, especially when compared to tax haven investment. Investment by number of establishments carries similar implications. The share of investment to build bases to access other markets is smaller than it was in terms of investment amount, yet it is still it is the most popular reason to invest in tax havens. On the contrary, we find that access to the local market, taking advantage of cheap labor and facilitating exports are not as important as they are in the case of total FDI.

From the implications of Figures 3 and 4, we can infer that tax havens are not a final destination for investment but rather a stopover a substantial number of investors are taking advantage of when making investment decisions. The most peculiar advantage that tax havens offer lies in trimming tax costs from the origin and destination countries by allowing for the establishment of independent subsidiaries in their jurisdictions.

(3) Characteristics by Destinations

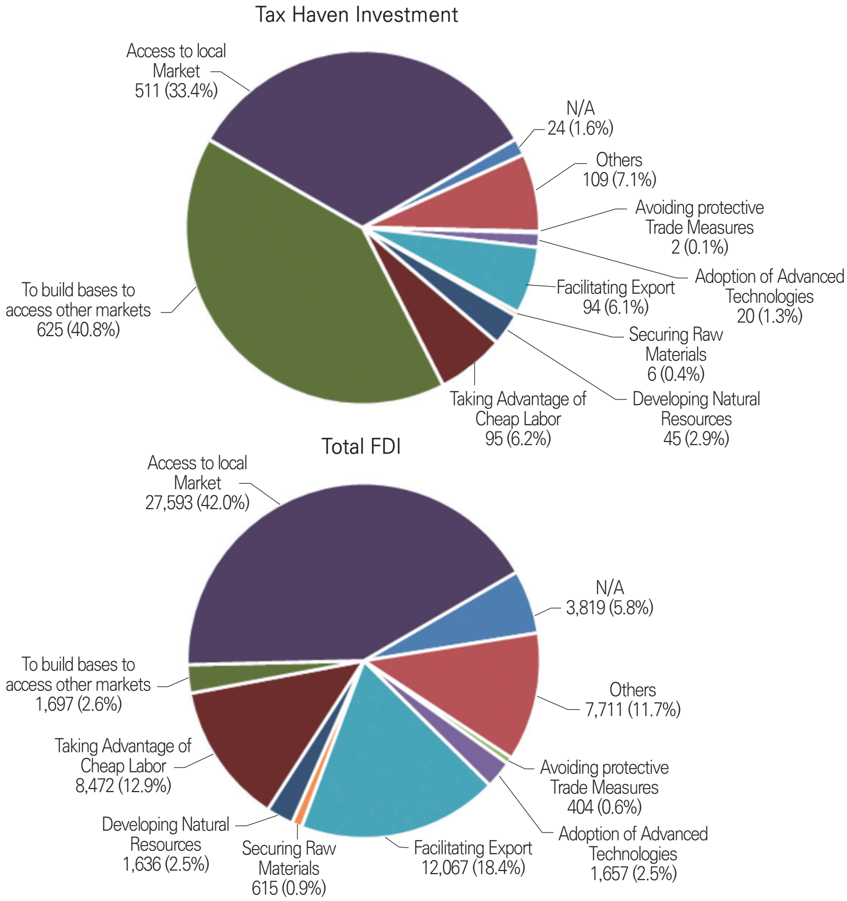
Figure 5 shows which tax haven destinations Korea has invested most in since 2000 in terms of the dollar value and the number of new establishments, respectively. As is shown in Figure 5, the Cayman Islands dominate other destinations by both measures. By amount, the flows into the Caribbean Islands and small European jurisdictions such as Luxembourg, Jersey and Guernsey are standout. The Cay-

Figure 3. Composition of Korean FDI by Purpose (Investment Amount, 2000 to 2018)



Source: Arranged by the author using Overseas Investment Statistics by the Korea Export-Import Bank.

Figure 4. Composition of Korean FDI by Purpose (Number of Establishments, 2000–2018)

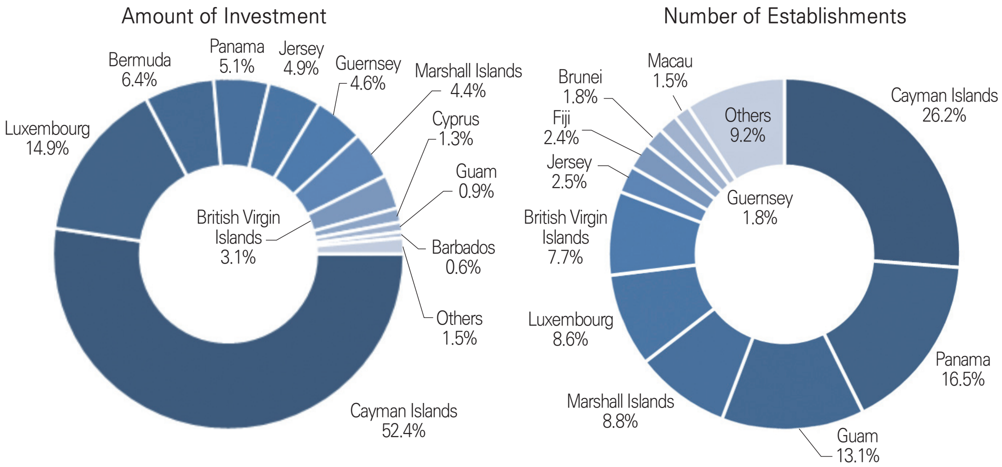


Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

man Islands accounts for about 52.7 percent of total investment flows into tax havens, or about 3.5 times more than Luxembourg, which received the second-largest amount of investment. Behind Luxembourg, Bermuda, Panama, Jersey, and Guernsey follow as the principal recipients of Korean tax haven investment. The number of new establishments in the Cayman Islands was 1.6 times as many as that in Panama, the second-most popular destination. Besides those two destinations, Guam, the Marshall Islands, and the British Virgin Islands have also recorded more than 100 new Korean establishments since 2000, in slight contrast with trends in investment measured by dollar amounts.

Among tax haven destinations, the Cayman Islands, Luxembourg, Jersey, Guernsey, Panama, the Marshall Islands, the British Virgin Islands, and Guam make the list of top 10 destinations in terms of both investment amount and the number of establishments.

Figure 5. Main Destinations of Korean Tax Haven Investment (2000–2018)



Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

From this, we find two facts. One is that the investment flows to tax havens are concentrated on specific destinations. The other is that some renowned tax havens such as Barbados and Trinidad and Tobago are not so popular among Korean investors. However, the statistical data offers no clues as to why Korean investors prefer certain tax havens to others. We can only conjecture that some features of those tax havens looked more attractive in the eyes of investors.

(4) Characteristics by Industry

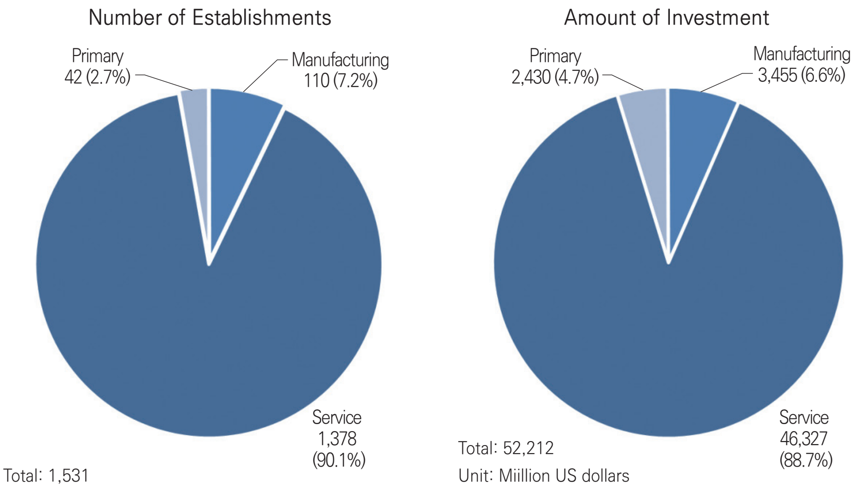
Figure 6 illustrates the origins of tax haven investment by industrial sector using two measures: the amount of investment and the number of establishments. As is seen in Figure 6, about 90 percent of the investment into tax havens is from the service sector by both measures.

Figure 7 shows tax haven investment trends in the manufacturing and the service sectors. As investments originating from the manufacturing center jumped drastically in 2018,[6] I truncated the observation of 2018 to better illustrate the movement of the trend up to 2017.

Let us look at the trend in the manufacturing sector first. The graph of manufacturing sector in Figure 7 shows investments began exhibiting an upward trend in the early 2010s before entering a downward trend in 2015; the trend line is on the whole irregular. On

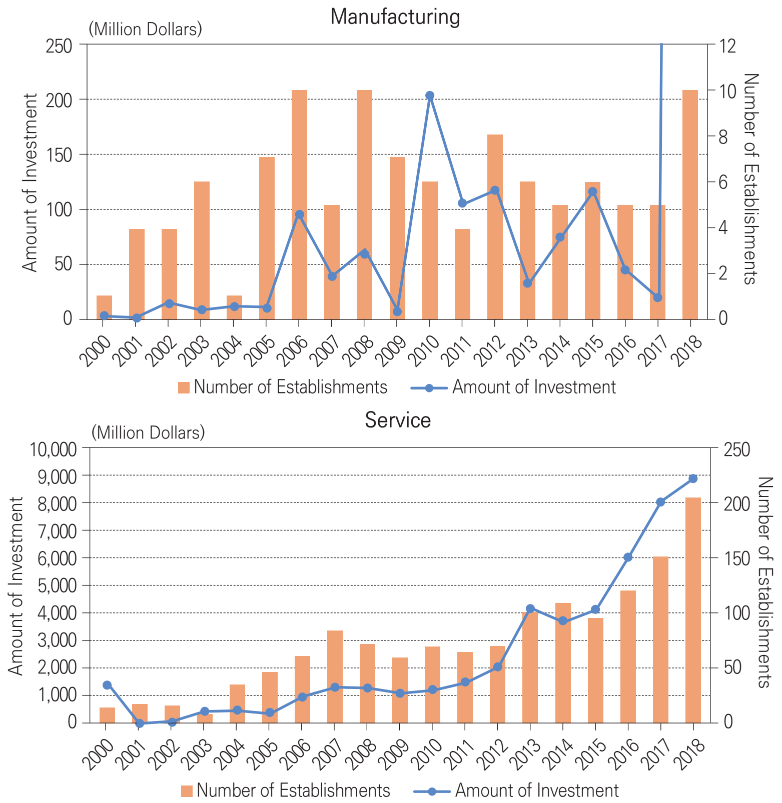
6 In case of investments originating from the manufacturing sector, 2.48 billion US dollars of investment flows were observed in 2018, which accounted for about 72 percent of total manufacuring investment in tax havens during the observation period. Whether this number is merely an outlier from the ordinary trend or reflects a sudden and extreme shift in tax haven investment tendencies can only be speculated upon until future data are accumulated. Because the number from 2018 is too big, it can lead us misinterpreting the trend of the investment of other years by flattening the shape of the graph. Therefore, I decided to truncate the statistic of 2018 when I draw the graph and postponed determining the implication of the number.

Figure 6. Origin of Tax Haven Investment by Industrial Sector (2000 to 2018)



Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

Figure 7. Tax Haven Investment Trends by Industrial Sector



Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

the other hand, the service sector trend line's movement enters an incline phase in 2005 before seeing explosive growth in the 2010s. This movement resembles the movement exhibited by overall investment into tax havens in the same period, which we have seen in Figure 1. Because the service sector accounts for the dominant majority of investment in tax havens originating from Korea, we can conclude that total tax haven investment illustrated in Figure 1 was in fact led by the service sector.

In the service sector, which accounts for about 90 percent of investment in tax havens, it was found that most investment originates from the finance and insurance, real estate and business service subsectors. More than 80 percent of investment dollars and 60 percent of new establishments are accounted for by those three subsectors (see Table 2). In particular, the finance and insurance sectors occupy a dominant share of investment dollars, with more than 57 percent.

This implies that tax haven investment trends after 2000 have been largely influenced by the finance and insurance sector. Also, the amount of dollars per investment in the finance and insurance sector is larger than that of other subsectors, as exemplified by a higher

Table 2. Service Sector Investment in Tax Havens by Subsector (2000 to 2018)

Numbers of New Establishments		Amount of Investment (Unit: Million US Dollars)	
Sector	Numbers	Sector	Amount
Finance and Insurance	423 (30.7%)	Finance and Insurance	26,575 (57.4%)
Business Facilities Management / Business Support / Rental and Leasing	303 (22%)	Real Estate	7,782 (16.8%)
Wholesale and Retail Trade	136 (9.9%)	Business Facilities Management/ Business Support/ Rental and Leasing	4,014 (8.7%)
Real Estate	130 (9.4%)	Electricity, Gas, Steam and Air Conditioning supply	3,074 (6.6%)
Transportation and Storage	125 (9.1%)	Transportation and Storage	2,586 (5.6%)
Construction	64 (4.6%)	Information and Communication	711 (1.5%)
Information and Communication	49 (3.6%)	Wholesale and Retail Trade	633 (1.4%)
Accommodation and Food Service	42 (3.0%)	Construction	324 (0.7%)
Professional, Scientific and Technical Services	31 (2.2%)	Professional, Scientific and Technical Services	168 (0.4%)
Electricity, Gas, Steam and Air Conditioning supply	26 (1.9%)	Human Health and Social Work	159 (0.3%)
Others	49 (3.6%)	Others	300 (0.6%)
Total	1,378	Total	46,327

Source: Arranged by the author using the Overseas Investment Statistics, Korea Export-Import Bank.

investment value-to-new establishment ratio. Therefore, if the government is going to monitor the investment flows into tax havens, it is necessary to focus on the service sector, and especially on the finance and insurance, real estate and business service subsectors.

(5) Characteristics by Type of Investor

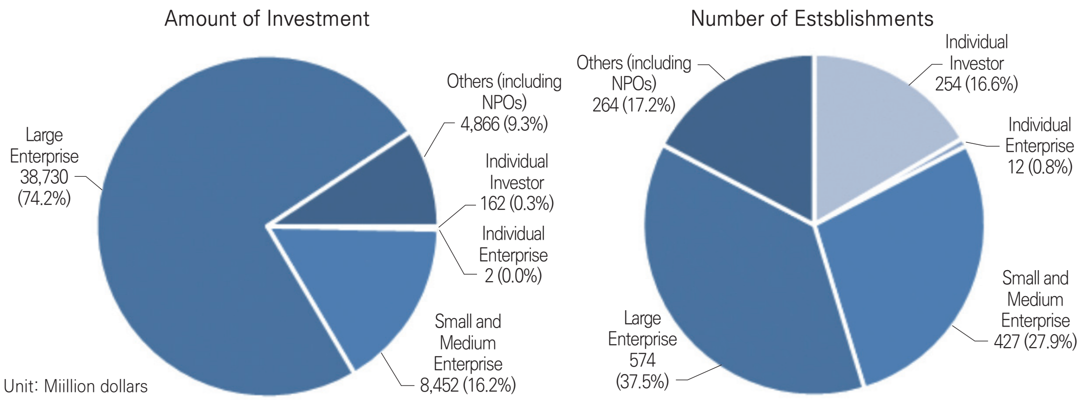
Figure 8 illustrates tax haven investors by size and describes their investment in tax havens proportionally.

By investment dollars, we can see large enterprises predominate with a large share of the total tax haven investment. On the other hand, small and medium enterprises (SMEs), individual investors, and other investors including non-profit organizations (NPOs) account for a substantial number of new establishments in tax havens. This implies that the volume per investment is larger with large enterprises than for other types of investors. On the contrary, investments from SMEs, individual investors, and NPOs are relatively small in terms of volume but more frequent than large enterprise investors.

However, these trends are also observable in overseas investments as a whole. Therefore, it is necessary to compare the two groups more specifically to see how different tax haven investments are from ordinary overseas investments. Table 3 can help do so: in it we can see that the structure of investment does not differ significantly between tax haven investment and total overseas investment. But large enterprises account for a significant portion of new establishments in tax haven with the share of 37.5 percent, in sharp contrast to the fact that SMEs, individuals and other investors (including NPO) dominate total overseas establishments at a rate of more than 80 percent. This implies that large enterprises establish bases in tax havens more often than SMEs or individual investors.

Another characteristic of tax haven invest-

Figure 8. Investment in Tax Havens by Size of Investors (2000 to 2018)



Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.

Table 3. Comparison of Tax Haven Investment to Ordinary Overseas Investment (2000 to 2018)

	Number of Establishments			Investment Amount (Unit: Million US Dollars)		
	Tax Havens	Entire Investment	Share of Tax Havens (%)	Tax Havens	Entire Investment	Share of Tax Havens (%)
N/A	0 (0.0%)	2 (0.0%)	0.0	0 (0.0%)	1 (0.0%)	0.0
Individual Investors	254 (16.6%)	22,605 (34.4%)	1.1	162 (0.3%)	8,976 (2.1%)	1.8
Individual Enterprises	12 (0.8%)	3,387 (5.2%)	0.4	2 (0.0%)	1,114 (0.3%)	0.2
Small & Medium Enterprises	427 (27.9%)	29,753 (45.3%)	1.4	8,452 (16.2%)	66,368 (15.7%)	12.7
Large Enterprises	574 (37.5%)	9,332 (14.2%)	6.2	38,730 (74.2%)	335,877 (79.4%)	11.5
Others (including Non-profit Organization, etc.)	264 (17.2%)	592 (0.9%)	44.6	4,866 (9.3%)	10,504 (2.5%)	46.3
Total	**1,531**	**65,671**	**2.3**	**52,212**	**422,840**	**12.3**

Source: Arranged by the author using Overseas Investment Statistics of the Korea Export-Import Bank.
Note: Numbers in brackets refer to percentage of total investment in each column.

ment is the strong presence of tax haven investment within the investment of other investors (including NPOs). Other investors (including NPOs) account for a small percentage of both tax haven investments and total overseas investments. But the investments they do make are heavily oriented toward tax havens: they account for about 45 percent of other investors' (including NPOs') overseas investments. This stands in contrasts to other categories, where tax havens account for a small share of investment. With regards to the investments of large enterprieses, tax havens account for less than 12 percent in terms of overall investment dollars and 6.2 percent in terms of new establishments. With SMEs, tax havens account for about 13 percent of money invested and a mere 1.4 percent of new establishments.

Thus I have observed two main characteristics of tax haven investment by investor size. First, the share of large size enterprises is relatively larger in terms of new establishments compared with total investment, and large size enterprises invest comparatively more money in tax havens relative to other types of investors. Second, other investors (including NPOs) category invests a substantial portion of resources in tax havens. This carries implications for government monitoring of investors when it is deemed necessary to control or regulate investment flows into tax havens.

4. Summary and Concluding Remarks

This paper has described the macroeconomic characteristics of the investment flows to tax havens from Korea. Since 2000, investment in tax havens has been consistently increasing, exhibiting rapid recent growth, both in terms of the investment amount and the number of new establishments in tax havens. The most common reason to invest in tax havens is to build bases to access other markets. From the results of the analysis, we can infer that substantial numbers of investors are attempting to avoid tax imposition by establishing subsidiaries in tax havens and moving their capital stocks and assets to those subsidiaries. When we decompose tax haven investment by destination, we find that the investments are concentrated in specific destinations. In particular, the Cayman Islands receives more than half of all tax haven investment dollars and hosts a quarter of all new establishments among the destinations investigated in this article. No explanation could be found answering why investment flows concentrate in certain destinations. If we look at investment by industrial sector, the service sector accounts for a dominant majority of investment in tax havens, comprising nearly 90 percent of all tax haven investment. Among service industries, the investment comes mainly from the finance and insurance, real estate and business service subsectors. When we decompose aggregate tax haven investment by investor size, we find that large enterprises account for a relatively greater share of tax haven investment compared to total foreign investment. We also find that other investors (including non-profit organizations) category invests a substantial portion of dollars in a larger number of new establishments in overseas tax havens than other types of investors on a relative basis.

These observations and analyses of statistical data carry implications for policy. First, to keep capital stocks and wealth from disappearing from the tax base without making any productive contributions, the monitoring of capital flows into tax havens should be enhanced. Such a policy would reflect the increasing volumes of tax haven investment in recent years. In particular, the authorities should strictly check the capital flows into destinations such as the Cayman Islands. And investment originating from the financial sector, real estate sector and business support sector should be supervised more rigorously than other sectors. Among the various types of investors, the observations outlined in this paper suggest that investment flows from large enterprises and non-profit organizations should be more intensively monitored than those from other types of investors. Most of all, the authorities should pay more attention to investment flows into tax havens and analyze the factors that determines the motivations for such investments, the features of popular destinations, and the structures of capital flight.

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