Charitable Giving, Tax Reform, and Self-selection of Tax Report: Evidence from South Korea

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Introduction

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In many countries, governments set a tax relief for charitable giving. This is because, if subsidizing charitable giving induces a large increase in donations, it is desirable for public good provision. To evaluate the effect of tax relief, many papers investigate the elasticity of charitable donations with respect to their tax price (Almunia et al., 2020; Auten et al., 2002; Bakija and Heim, 2011; Fack and Landais, 2010; Randolph, 1995). Focusing on the tax deduction or tax credit on the charity, they show that the price elasticity of giving is about -1 or more in terms of absolute value, which means that the tax relief for the charitable giving is good in the sense that 1% tax relief derives more than 1% donation.

However, if the government can provide public good more efficiently than the direct donation, the donation may not be preferable because the public good provision via donation would be costly then. Moreover, when the government is much more efficient than charities, people may not donate so much even if they have a warm-glow preference. Saez (2004) suggests that the change of the relative price between public good provision by donation and government will change the behavior of people and the price elasticity of donation. However, the evaluation about the efficiency of the government is usually subjective and different for people. If someones regard the

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In this section, we describe the income tax relief for charitable giving in Korea and used dataset.

Tax relief for charitable giving by tax deduction and tax credit

In the South Korea, the tax policy about charitable giving drastically changed in 2014. Before then, tax relief of charitable giving was provided by tax deduction while, from 2014, tax relief by tax credit was introduced instead of tax deduction.

The tax deduction and tax credit may have different effects on giving behavior. This subsection summarize the difference of tax deduction and tax credit. Consider that a household has a choice between private consumptions (x_i) and charitable giving (g_i). Let y_i be pre-tax total income. Then, the budget constraint is

$$x_i + g_i = y_i - T_i(y_i, g_i).$$

T_i is tax amount which depends on the pre-tax income and charitable giving. On one hand, tax deduction reduces taxable income by giving. The amount of tax is

$$T_i = \tau(y_i - g_i) \cdot (y_i - g_i),$$

where $\tau(\cdot)$ is the income tax rate which is determined by $y_i - g_i$.[2] The budget constraint will be

Our Identification Strategy

In 2014, aiming at the relaxation of regressivity of giving price, the Korean government reformed tax system again, where the tax credit was introduced instead of tax deduction. Since then, 15% of the total amount of charitable giving has been allowed as a tax credit, which means that the giving price from 2014 is 0.85 irrelevant to the income level.

Summarizing this, compared to tax credit system, the high income household, whose (average) income tax rate is more than 15%, get benefit from charitable giving under the tax deduction system. However, middle or low income households would enjoy tax relief in tax credit system more than tax deduction system. We exploit this policy change as an identification strategy.

Korean tax reform in 2014

The tax incentives for charitable giving in Korea stared in 1967 and the market of charitable giving in Korea totaled 10.9 trillion KRW (approximately 1.09 bilion USD, 0.761% of GDP) in 2012 according to the national tax statistics. Since the income tax deduction was initially used as a tax incentive and the marginal income tax rate was determined as Table 1, the minimum giving price before 2014 was 0.62.

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Data

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In this paper, we use panel data from the National Survey of Tax and Benefit (NasTaB). NasTaB survey is an annual financial panel survey implemented by The Korea Institute of Taxation and Finance to study the tax burden of households and the benefits that households receive from government. The subjects of this survey are general household and household members living in 15 cities and provinces nationwide. This survey is based on a face-to-face interview. If it is difficult for investigators to meet subjects, another family member answers on behalf of him.[3]

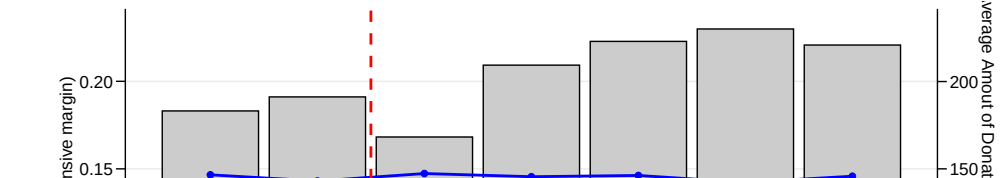
In the analysis, we use data from 2013 to 2019 since we focus on the 2014 tax reform. By this restriction, the most giving price variation relies on the 2014 tax reform because the marginal income tax rate is same in 2012 and 2013. In addition, we exclude the subject of the sample, whose age is under 23, since they are not likely to have income or asset.

Table **??** is summary statistics of our sample. We used four types of variables in this paper: sets of variables about Income and Giving Price, Charitable Donations, Government Efficiency, and Individual Characteristics. A set of variables about Government Efficiency is constructed from the value survey of NasTaB data. Current

Charitable Giving

NaSTaB asks respondents to answer the amount of donation.[4] We use this variable as an first outcome variable when estimating the price effect on the amount of donations among donors (intensive margin). Using this variable, we make a dummy variable taking 1 if repsondents donate (Dummy of Donation). This is the second outcome variable to estimate the price effect on the decision of donations (extensive margin).

Table **??** shows that the average amount of donation is almost 300,000 KRW, and the proportion of donors is roughly 20%. Figure **??** shows the time-series of two variables. The blue line shows the average amount of donation among donors. In each year, its value is nearly 1.5 million KRW, which is 7% of average annual taxable income. The grey bar shows the proportion of donors. After the tax reform, the proportion of donors decreases by 2%. After that, the proportion of donors is greter than 20%.



Income and Giving Price

NaSTaB asks respondents to answer the annual income last year. For example, in the 2014 survey, respondents answer the annual income at 2013. In our sample, the average annual taxable income is 18.76 million KRW. According to the National Tax Statistical Yearbook published by Korean National Tax Service, the average annual taxable income is 32.77 million from 2012 to 2018 for employees who submited the tax return. Since our sample includes subjects with no labor income, such as housewife, our sample mean of income is lower than average income calculated by the public organizations. In Figure **??**, the grey bars show the distribution of annual taxable income in 2013. The income distribution is left-skewed.

Using this variable, we construct the giving price under the tax deduction system (2012 and 2013). After the tax reform (after 2014), the giving price is 0.85 under the tax credit system, as we explained in the section **??**. In Figure **??**, the blue line shows giving price in 2012 and 2013, while the red dashed line shows the giving price after 2014. From this figure, those whose annual income is less than 1200 in 2013 could receive benefit by the 2014 tax reform bacause the tax reform decreases the giving price. On the other hand, those whose auunal income is greater than 4600 in 2013 had a loss by the 2014 tax reform since the tax reform increases the giving price.

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