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Gift through Related Party Transaction and Gift Tax Act

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서울대학교 대학원

경영학과 회계학 전공

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Gift through Related Party Transaction and Gift Tax Act

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Abstract

I examine the gift through related party transaction (Gift-through-RPT). I measure the magnitude of Gift-through-RPT using two components: the amount of related party sales for gift (RPS-for-gift) and the operating margin ratio of the RPS-for-gift. I find that the group owner's relatives' equity holding in unlisted related companies is the main determinant for RPS-for-gift and that the operating margin ratio of the RPS-for-gift is not different from similar transactions with the third parties. When I classify related party sales (RPS) into RPS between parent and subsidiaries and RPS between non-parent-subsidiaries relationship, I find that RPS between non-parent-subsidiaries relationship is more adequate to measure RPS-for-gift than the aggregated RPS. For additional test, I compare the

difference in the amount of RPS-for-gift and the operating margin ratio of the RPS-for-gift between 2008 ~ 2011 and 2012, to see the effect of the enforcement of the article 45(3) in Inheritance and Gift Tax Act (the Gift Tax Act regarding Gift-through-RPT), effective in 2012. I find the Gift Tax Act is not effective in diminishing the amount of RPS-for-gift as well as the operating margin ratio of the RPS-for-gift in 2012.

Keywords: gift, related party transaction, related party sales, operating margin ratio, RPT, parent, subsidiaries, relative shareholder, gift tax

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1. Introduction

Recently in Korea, the gift of group owner to the group owner's relatives through related party transactions (which is called '일감 몰아주기' in Korean; hereafter, Gift-through-RPT) is heavily criticized, because such transactions often shift a firm's resource to owner's relatives in the expense of the firm's shareholders' wealth. While the gift between related parties could occur through all kinds of related party transactions (RPT), such as sales, purchases, loan, and borrowing, I only focus on the related party sales (RPS), because this paper focuses on the transfer of a firm's wealth to other firm's shareholder by providing its services or products in view of the beneficiary company. I measure the magnitude of the recently criticized Gift-through-RPT using two components: the amount of related party sales for gift (RPS-for-gift) and the operating margin ratio of the RPS-for-gift.

First, I test the determinants of RPS-for-gift. To successfully allow the substantial gift from group owner to the group owner's relatives, the group owner's relatives should have a large equity holding in the beneficiary company. RPS-for-gift is more likely to occur through transactions with unlisted companies,

because listed companies are under a public surveillance from government, minority interests, and outside directors. In addition, it is difficult for the group owner's relatives to get a large equity ownership in listed related companies due to relatively large market value. Therefore, I hypothesize that RPS-for-gift is more likely to appear in the company where the group owner's relatives have a large equity ownership and where it is unlisted. In other words, the higher the ownership of the group owner's relatives in unlisted company is, the more RPS-for-gift is generated.

While prior researches examine whether RPTs are associated with firm value, firm's profitability or earnings management from the view of interest conflict (between group owner and minority shareholder, or between managers and owners) (Gordon and Henry 2005; Cheung et al. 2009; Jian and Wong 2004; Kim 2011; Lee 2005; Kim and Woo 2008), there are few researches that directly examine the determinants of RPTs. The possible reason is that RPTs can be attributable to the motivation of efficient transactions and the interest conflict together and that it is difficult to decompose RPTs into those two components. Therefore, Ryngaert and Thomas (2011) divide RPTs of U.S. sample firms into "ex ante" RPTs, transactions that predate a counterparty becoming a related party, and "ex post" RPTs which are initiated after a counterparty becomes a related party. They find that ex ante RPTs support the efficient contracting view and ex

post RPTs support for interest conflict view. As for research on RPTs among Korean firms, Kang et al. (2006) use illegal internal transactions detected by Fair Trade Commission (FTC) as proxy for the RPTs from the interest conflict (tunneling or propping). However, using illegal internal transactions detected by FTC as a proxy of RPTs from the interest conflict is very restrictive and contains the detection bias.

In this regard, I classify RPS into 2 groups: 1) RPS between parent and subsidiaries, and 2) RPS between non-parent-subsidiaries relationship. RPS between parent and subsidiaries are supposed to be mainly efficient transaction and to be assumed as transactions within same economic entities because a large portion of subsidiaries' ownership is held by the parent company and such RPS are should be in the consolidated financial statements, based on economic same entities. Therefore, RPS between non-parent-subsidiaries relationship might be more adequate to measure RPS-for-gift or RPS based on the interest conflict view than the aggregated RPS.

Second, I examine whether the operating margin ratio of the RPS-for-gift, which is estimated as the change in RPS attributable to the relatives' ownership in unlisted related companies from the first test, is higher than similar transactions with the third parties. There could be two possibilities. First, to increase the benefit of Gift-through-RPT, the operating margin ratio of the RPS-

for-gift would be adjusted to be larger than similar transactions with the third parties. Second, the operating margin ratio of the RPS-for-gift would not be different from similar transactions with the third party because the operating margin ratio of RPS is strongly scrutinized by Tax authority in Korea on the provision of the rejection of unfair act and calculation between related parties in Corporate Tax.

Additionally, I compare the difference in the amount of RPS-for-gift and the operating margin ratio of the RPS-for-gift between two time period, 2008 ~ 2011 and 2012 to examine the effect of the enforcement of the article 45(3) in Inheritance and Gift Tax Act (the Gift Tax Act regarding Gift-through-RPT), effective in 2012.

I analyzed recent 5 years'(from 2008 to 2012) RPS of Korean largest 10 business groups, which have group owners, presented as of April 1, 2013 by Fair Trade Commission in Korea. My empirical tests show following findings. First, I find that the group owner's relatives' ownership in unlisted related companies is the determinant of RPS. Second, the operating margin ratio of the RPS-for-gift is not different from other similar transactions with the third parties. Lastly, the Gift Tax Act regarding Gift-through-RPT is not effective in diminishing the amount of RPS-for-gift as well as the operating margin ratio of the RPS-for-gift in 2012.

This paper contributes to the literature for following reasons. First, I find

empirical evidence that RPS-for-gift occurs through the unlisted related companies in which group owner's relatives have a large equity ownership. Second, by using RPS between non-parent-subsidiaries relationship as a measure of RPTs based on the interest conflict, I test both RPTs hypotheses (the efficient transaction hypothesis and the interest conflict hypothesis). Finally, this is the relatively early attempt to test the effectiveness of the tax regulation (the article 45(3) in Inheritance and Gift Tax Act) because the first effective year of the Gift tax is 2012.

The remainder of the paper proceeds as follows: I explain institutional background and related gift tax in section 2. In section 3, I review literature on RPTs. Section 4 presents hypothesis and research design. Section 5 details the sample selection and descriptive statistics. I present results in section 6. I conclude and discuss in section 7.

2. Institutional Background and Related Gift Tax Act

Recently, transactions to support related parties especially within Korean conglomerates caused disputes over regulatory measures, because group owners and their relatives of benefited company can make unfair profits through related party transactions (RPTs). For example, the case of Innocean Worldwide in Hyundai Motor Group suggests implication of the transaction to support related parties within conglomerate (Yoo et al. 2013). Citizens' Coalition for Economic Justice also insisted Korean top 5 group's tunneling is noticed from the fact that unlisted companies owned over 50% by a group owner and his family record net earnings 2 times more than other group member firms and RPTs are 1.25 times more than average on June 20, 2013.

Cognizant that RPT activity is of important relevance to outside shareholders, the Financial Supervisory Service in Korea (FSS) and K-IFRS require relatively detailed disclosure on RPTs.

In relation to RPTs, K-IFRS No. 1024 requires that financial statements disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial

statements. In addition, K-IFRS require RPTs shall be disclosed separately for each of the following categories: the parent, entities with joint control of, or significant influence over, the entity, subsidiaries, associates, joint ventures in which the entity is a joint venture, key management personnel of the entity or its parent, and other related parties.

Although transfer of economic wealth through RPTs to related parties could be wrongful transaction from the Commercial Law (usurpation of corporate opportunity), Fair Trade Law (unfair trade practices), Corporate tax law (Repudiation of wrongful calculation), these laws is supposed not to be enough to limit transfer of economic wealth through RPTs because the burden of wrongdoing is mostly imposed on the supporting company.

Recently in Korea, the gift of group owner to the group owner's relatives through related party transactions (which is called '일감 몰아주기' in Korean; hereafter, Gift-through-RPT) is heavily criticized, because such transactions often shift a firm's resource to owner's relatives in the expense of the firm's shareholders' wealth.

As with these concerns, the article 45(3) in Inheritance and Gift Tax Act regarding Gift-through-RPT was enacted and effective in 2012. The article 45(3) in Inheritance and Gift Tax Act provides that deemed gift is computed as the beneficiary company's after-tax operating income times RPTs over half 'the

normal transaction ratio' times owner and relatives' equity ratio over 'the marginal holding ratio'. As the article provides that the normal transaction ratio (sales to related party divided by total sales) is 30% and the marginal holding ratio (owner and relatives' equity ratio) is 3%, there are some limits that RPTs under 30% and holding ratio under 3% are not subject to the article and gift through related party transactions other than sales and purchases are not subject to gift tax, as well.

3. Literature Review

3.1. Two Alternative Hypotheses on RPTs

There are two contrasting hypotheses of RPTs as interest conflict and efficient transaction. In general, the view that RPTs represent conflict of interests is consistent with agency issues. Jensen and Meckling (1976) portray the agency conflict between a manager and outside shareholders as the manager's tendency to appropriate the firm's resources for personal consumption, like perquisites. As such, RPTs present the potential for the expropriation of the firm's resources. To control potential agency costs, companies can use various corporate governance mechanisms to better align the interests of managers and owners, including CEO compensation and board structure. For this view, Bertrand, Mehta, and Mullainathan (2002) examine that owners of business groups expropriate minority shareholders by "tunneling" resources from firms where they have low cash flow rights to firms where they have high cash flow rights.

The alternative view to the interest conflict hypothesis is that RPTs are efficient transactions that rationally fulfill economic demands of a company. A business group is in essence a leverage device. Firms within the group band

together to fund investments and startups and to share production, R&D, and marketing knowledge. The group also enables a single entrepreneur to control vast knowledge-creating resources with a fraction of the capital that would be needed by a stand-alone entity. Such groups thus make possible complex recombination of inputs beyond the reach of a stand-alone firm (Siegel and Choudhury 2012). In this view, RPTs are for efficient transaction, not for tunneling or propping.

3.2. Literature on RPTs

Most literatures deal with three motivations behind RPTs - tunneling, propping (the flip side of tunneling, Friedman et al. 2003), and earnings management from the view of interest conflict.

The earliest published paper to document RPT activity for U.S. firms was Gordon, Henry, and Palia (2004b), which find lower subsequent stock returns for firms with more RPT activity, consistent with RPTs damaging outside shareholders and weaker corporate governance mechanisms, associated with more and higher dollar amounts of RPTs. Ryngaert and Thomas (2011) find that ex post RPTs, transactions initiated after counterparty becomes a related party serve as means for insiders to expropriate outside shareholders. As for relation between RPTs and earnings management, Gordon and Henry (2005) find that certain types of RPTs are associated with earnings management.

While research on RPTs for U.S. firms is scant, ther0e is evidence of RPTs expropriating minority shareholders via tunneling activities by dominant shareholders in emerging markets. Tunneling and propping are of particular significance in companies with concentrated ownership. Concentrated ownership structures are very common in many countries around the world and particularly

in East Asia (La Porta et al., 1999, Claessens et al. 2000). Controlling shareholder in such firms has power to expropriate minority shareholders but can also use their private wealth to prop up firms in distress.

For instance, Cheung, Rau, and Stouraitis (2006) document that Hong Kong listed firms experience negative abnormal stock returns when they announce that they are undertaking connected transactions. Cheung et al. (2009) find that minority shareholders in the firms related with RPTs seem to be subject to expropriation through tunneling but also gain from propping up. Jian and Wong (2004) find that Chinese companies frequently engage in RPTs and that the volume of RPT activity is negatively related to firm value.

Prior studies regarding RPTs associated with firm value and earnings management in Korea find that RPTs negatively associated with ratio of gross profit to sales and return on assets (Kim, 2011), Firms undertaking RPTs earn significantly negative excess returns at the initial announcement (Lee, 2005), the RPTs in Korea are used as a way of earnings management and the companies in 30 large enterprise group manage earnings more than others using RPTs (Kim and Woo 2008).

While the determinants of RPTs are scant, Choi (2009) finds that firms with stronger shareholder rights engage in less RPTs and whether the large Chaebol firms have been closely regulated by Fair Trade Commission (FTC) or not, does

not affect such results. Kang et al. (2006) find that debt guarantees are mainly used for the purpose of propping financially weak member firms, while illegal internal transactions are mainly used for the purpose of tunneling corporate wealth from minority shareholders to controlling shareholders.

4. Hypothesis and Research Design

4.1. Main test

While the gift between related parties could occur through all kinds of related party transactions (RPT), such as sales, purchases, loan, and borrowing, I only focus on the related party sales (RPS), because this paper focuses on the transfer of a firm's wealth to other firm's shareholder by providing its services or products in view of the beneficiary company. I measure the magnitude of the recently criticized Gift-through-RPT using two components: the amount of related party sales for gift (RPS-for-gift) and the operating margin ratio of the RPS-for-gift.

4.1.1. Analyses of RPS-for-gift

First, I test the determinants of RPS-for-gift. To successfully allow the substantial gift from group owner to the group owner's relatives, the group owner's relatives should have a large equity holding in the beneficiary company. RPS-for-gift is more likely to occur through transactions with unlisted companies, because listed companies are under a public surveillance from government,

minority interests, and outside directors. In addition, it is difficult for the group owner's relatives to get a large equity ownership in listed related companies due to relatively large market value.

Therefore, I hypothesize that RPS-for-gift is more likely to appear in the company where the group owner's relatives have a large equity ownership and where it is unlisted. In other words, the higher the ownership of the group owner's relatives in unlisted company is, the more RPS-for-gift is generated.

H1: RPS will increase in the group owner's relatives' equity holding in unlisted related companies.

While prior researches examine whether RPTs are associated with firm value, firm's profitability or earnings management from the view of interest conflict (between group owner and minority shareholder, or between managers and owners) (Gordon and Henry 2005; Cheung et al. 2009; Jian and Wong 2004; Kim 2011; Lee 2005; Kim and Woo 2008), there are few researches that directly examine the determinants of RPTs. The possible reason is that RPTs can be attributable to the motivation of efficient transactions and the interest conflict together and that it is difficult to decompose RPTs into those two components. Therefore, Ryngaert and Thomas (2011) divide RPTs of U.S. sample firms into

“ex ante” RPTs, transactions that predate a counterparty becoming a related party, and “ex post” RPTs which are initiated after a counterparty becomes a related party. They find that ex ante RPTs support the efficient contracting view and ex post RPTs support for interest conflict view. As for research on RPTs among Korean firms, Kang et al. (2006) use illegal internal transactions detected by Fair Trade Commission (FTC) as proxy for the RPTs from the interest conflict (tunneling or propping). However, using illegal internal transactions detected by FTC as a proxy of RPTs from the interest conflict is very restrictive and contains the detection bias.

In this regard, I classify RPS into 2 groups: 1) RPS between parent and subsidiaries, and 2) RPS between non-parent-subsidiaries relationship. RPS between parent and subsidiaries are supposed to be mainly efficient transaction and to be assumed as transactions within same economic entities because a large portion of subsidiaries’ ownership is held by the parent company and such RPS are should be in the consolidated financial statements, based on economic same entities. Therefore, RPS between non-parent-subsidiaries relationship might be more adequate to measure RPS-for-gift or RPS based on interest conflict view than the aggregated RPS. Therefore, I develop following dependent variables:

1) *RPS_A* : RPS divided by total sales

2) *RPS_E* : RPS between parent and subsidiaries, divided by total sales

3) *RPS_T* : RPS between non-parent-subsidiaries relationship, divided by total sales

I develop the following model to examine the extent to which RPS will increase in the relatives' equity holdings in unlisted related companies:

$$RPS(RPS\_A,RPS\_E,RPS\_T) = \beta_0 + \beta_1\ UNLIST + \beta_2\ GO\_EQTY + \beta_3\ RELATIVE\_EQTY + \beta_4\ OTH\_RELATED\_EQTY + \beta_5\ UNLIST \times RELATIVE\_EQTY + \beta_{6,7,8,9}(Firm\ Characteristic\ Variables:\ LN\_ASSET,\ LEV,\ CFO\_S,\ YEAR\_INCORP.) + Year\ dummies + \varepsilon \quad (1)$$

Where, *UNLIST* is the dummy variable which equals 1, if the company is not listed, others 0. I predict *UNLIST* have positive sign in relation with *RPS_T*, because RPS from the interest conflict are generally supposed to be generated through the unlisted firms. Since *GO_EQTY* captures the group owner's ownership in listed or unlisted companies, I predict *GO_EQTY* have positive relation with *RPS_T* based on the interest conflict view (tunneling or propping).

For the test of H1, I include the interaction term (*UNLIST*×*RELATIVE_EQTY*) which represent the relatives' equity holdings in unlisted related companies. Therefore, I predict the interaction term (*UNLIST*×*RELATIVE_EQTY*) have

positive relation with *RPS_T*. However, I predict *RELATIVE_EQTY* have insignificant relation with *RPS_T,* because *RELATIVE_EQTY* captures the relatives' ownership in listed companies. It implies that the RPS-for-gift usually does not occur through listed companies. *OTH_RELATED_EQTY* means the other related party's ownership which mainly represents the affiliates' ownership. I predict *OTH_RELATED_EQTY* have insignificant relation with *RPS_T,* because *OTH_RELATED_EQTY* probably has nothing to do with RPS based on the interest conflict view.

While prior literatures predict RPTs have negative relation with corporate governance based on the interest conflict view, I do not include corporate governance controls, because it is difficult to differentiate the degree of corporate governance among 10 largest business groups.

Following prior RPT literatures, I include other firm-specific controls: firm size (*LN_ASSET*: the logarithm of total asset), firm leverage (*LEV*), operating cashflow scaled by total sales (*CFO_S*), and year of incorporation (*YEAR_INCORP.*). I do not predict the sign of *LN_ASSET* and *YEAR_INCORP.*, because prior literatures do not suggest consistent results. Also, I do not predict the sign of *LEV* and *CFO_S*, because higher leverage and lower cashflow companies might be beneficiary (propping) whereas already beneficiary companies could represent lower leverage and high cashflow.

As for dependent variable *RPT_E*, I predict that all independent variable have insignificant relations with *RPT_E*, because prior studies about determinants for RPTs based on the efficient transaction view are few.

4.1.2. Analyses of the operating margin ratio of the RPS-for-gift

Second, I examine whether the operating margin ratio of the RPS-for-gift, which is estimated as the change in RPS attributable to the relatives' ownership in unlisted related companies from the first test, is higher than similar transactions with the third party. There could be two possibilities. First, to increase the benefit of Gift-through-RPT, the operating margin ratio of the RPS-for-gift would be adjusted to be larger than similar transactions with the third parties. Second, the operating margin ratio of the RPS-for-gift would not be different from similar transactions with the third parties because the operating margin ratio of RPS is strongly scrutinized by Tax authority in Korea on the provision of the rejection of unfair act and calculation between related parties in Corporate Tax. Following the second possibility, I hypothesize as follows:

H2: The operating margin ratio of the RPS-for-gift is not higher than similar transactions with the third parties.

I develop the following model to examine whether the operating margin ratio of RPS-for-gift is higher than those of similar transactions with the third parties. This model is similar to Bertrand et al. (2002).

$$OI = \gamma_0 + \gamma_1 \, OWN\_SHOCK + \gamma_2 \, RPS\_GIFT \times OWN\_SHOCK + \gamma_3 \, LN\_ASSET + \gamma_4 \, YEAR\_INCORP. + Year \ Dummies + \varepsilon \quad (2)$$

Where, *OI* (operating income) is dependent variable. I estimate the portion of RPS-for-gift (*RPS_GIFT*) from the regression (1) with dependent variable *RPS_T* as follows. To more accurately estimate RPS-for-gift (*RPS_GIFT*) from the regression (1), I regard only the direct change in RPS attributable to the relatives' equity holding in unlisted related companies from the regression (1) with dependent variable *RPS_T* as RPS-for-gift.

$$RPT\_GIFT = \beta_5 \times UNLIST \times RELATIVE\_EQTY$$

I include industry shock variable (*OWN_SHOCK*) as independent variables following Bertrand et al. (2002). I measure industry shocks and then calculate a predicted profit (operating income) for each firm based on the profit shock experienced by the other firms in the same industry. The first step is to add up the profits and total assets of a given industry, which is based on 3-digit K-SIC code classification, in each year (subtracting out those of the focal firm). The next step is to take the industry's OI for a given year (subtracting out that of the

focal firm) and multiply it by the focal firm's asset size in that year to predict what the firm would earn given the industry shock (*OWN_SHOCK*). For the test of H2, I include the interaction term (*RPS_GIFT*×*OWN_SHOCK*). Following H2, I expect *RPS_GIFT*×*OWN_SHOCK* have insignificant relation with the company's operating income that capture whether the operating margin ratio of *RPS_GIFT* is different from similar transactions with the third parties. Following Bertrand et al. (2002), I add *LN_ASSET*, *YEAR_INCORP.*, and *Year Dummies* as control variables.

4.2. Additional Test – Effect of Gift Tax Act

Additionally, I compare the difference in the amount of RPS-for-gift and the operating margin ratio of the RPS-for-gift between two time period, 2008 ~ 2011 and 2012 to examine the effect of the enforcement of the article 45(3) in Inheritance and Gift Tax Act (the Gift Tax Act regarding Gift-through-RPT), effective in 2012.

As the amount of RPS-for-gift and the operating margin ratio of the RPS-for-gift are two major components of the Gift-through-RPT, I examine which component is influenced by the enforcement of the Gift Tax Act. As year 2012 is the first year of the enforcement of the Gift Tax Act, many taxpayers might not comprehend well whether they are taxed on the Gift-though-RPT and how the Gift Tax Act is applied and so that they might not have prepared for the Gift Tax. Therefore, I hypothesize that the Gift Tax Act regarding Gift-through-RPT is not effective in diminishing the amount of RPS-for-gift as well as the operating margin ratio of the RPS-for- gift.

H3: The amount of RPS-for-gift and the operating margin ratio of the RPS-for-gift is not different between two time period, 2008 ~ 2011 and 2012.

For the test of *H3*, namely, to see the effect of the enforcement of the article in the Inheritance Tax and Gift Tax Act, effective from 2012, I examine t-tests on the difference of coefficients of the interaction term, *UNLIST×RELATIVE_EQTY* from the regression (1) with dependent variable *RPS_T* and *RPS_GIFT×OWN_SHOCK* from the regression (2), respectively, between two time periods, 2008 ~ 2011 and 2012.

5. Sample Selection and Descriptive Statistics

I apply this test to Korean data. The number of all groups designated as mutual investment banned corporate group by the FTC is 62 and the number of all companies in the mutual investment banned corporate groups is 1,768 as of April 1, 2013. From the mutual investment banned corporate group, the group which have a group owner number 43 groups and 1,519 companies as of April 1, 2013, because the companies which don't have a group owner or is classified as government-owned group, are expected not to be involved in Gift-through-RPT.

In my research, I analyze 5 year, namely from 2008 to 2012 RPS of Korean 10 largest business groups, which have group owners, presented as of April 1, 2013 by FTC in Korea: Samsung, Hyundai Motors, SK, LG, Lotte, Hyundai Heavy Industries, GS, Hanjin, Hanwha, Doosan group.

The Ownership data is collected from materials presented every year by FTC in Korea that provide all classified ownership data of related companies in the groups. I use the accounting and related data from KIS-value that does not include the companies which are not audited by Korean Law. Furthermore, detailed RPTs information is collected from individual audit report provided in DART (which is 'electric disclosure system by Financial Supervisory Service').

As this research is on the Gift-through-RPT, the industries, where RPT barely occurs due to their customers being individuals, are excluded in the sample. The K-SIC code of such excluded industries are A0(agriculture), B0(mining), D3(utilities), E3(environment), G4(wholesale, retail), I5(lodging), J5(publication), J60(broadcasting), J61(communication), K6(finance), O8(public administration), P8(education), Q8(health), R9(entertainment), S9(personal service). And, I finally truncate sample at 5% and 95% by the size of total sales. Truncated minimum size of sales is 5.9 billion Won and maximum size of sales is 15.3 trillion Won. It is reasonable that the companies of very large sales or very small sales should be excluded from the sample, because the companies of very large sales might be donators and the companies of very small sales might not be beneficiary. Table 1 shows overall sample selection process and final sample size.

In addition to truncation, the companies of relatively large sales are not adequate for the RPS-for-gift test due to probably not being beneficiary. Therefore, I divide the overall sample into 4 groups based on sales volume: 1) sales volume of group1 is from 6 billion Won to 55 billion Won, 2) sales volume of group2 is from 55 billion Won to 239 billion Won, 3) sales volume of group3 is from 241 billion Won to 1,305 billion Won, 4) sales volume of group4 is from 1,313 billion Won to 15,380 billion Won.

As the firms of group4, which have a minimum sale of 1.3 trillion Won, are not supposed to be beneficiaries, I use group123 made from group1, group2, and group3 as the main sample.

Table 2, Panel A, presents mean value of overall sample and t-test results of the difference between listed firms and unlisted firms. Listed firms and unlisted firms, respectively, account for 254 and 634 of the observations in overall sample. While group owner's equity ownership ratio is higher in listed companies which are larger in size, unlisted companies are more owned by related companies. It is supposed that a group owner is normally controlling the group through listed companies. Group owners' relatives have more ownership in unlisted companies than listed companies so that there could be motivations for supporting unlisted companies through RPTs. In addition, unlisted companies are more involved in RPS than listed companies. Table 2, Panel B reports mean value of subgroup sample.

Table 3 reports mean value of ownership and RPS change by year. Sample size during the sample period 2008-2012 increase with lapse of time, because I select sample firms as of April 1, 2013 and therefore sample firms increase due to inclusion as a member of group during the sample period whereas I do not include the firms as sample which was excluded from group during the period. From the table 3, *RPS_E* increased during the period with increase of other

related party's equity ownership. However, the main dependent variable *RPS_T* changes little throughout the period.

<Table 1> Sample selection process

Stage	Adjustments	Adjusted Sample size
1	All listed and unlisted companies in KIS-value (2008~2012)	129,065
2	No data of sales or asset was excluded from 1 stage	93,943
3	Only companies classified as 10 largest business group from 2 stage	1,701
4	K-SIC code (A0, B0, D3, E3, G4, I5, J5, J60, J61, K6, O8, P8, Q8, R9, S9) is excluded from 3 stage	1,090
5	Sample, where ownership data is not presented by FTC, is excluded from 4 stage	986
6	Truncated final sample by the size of sales (5% ~ 95% sales included) from 5 stage	888

a. K-SIC code: A0(agriculture), B0(mining), D3(utilities), E3(environment), G4(wholesale, retail), I5(lodging), J5(publication), J60(broadcasting), J61(communication), K6(finance), O8(public administration), P8(education), Q8(health), R9(entertainment), S9(personal service).

<Table 2> Descriptive Statistics

Panel A*: *Overall samples

	All firms	**Listed Firms**	**Unlisted firms**	**Difference**
Total sales	1,345	3,320	553	2,767***
Total assets	1,735	4,592	590	4,002***
LEV	0.53	0.47	0.56	-0.09***
CFO_S	0.08	0.09	0.07	0.02
YEAR_INCORP.	21.26	37.90	14.55	23.35***
GO_EQTY	1.43	3.25	0.70	2.54***
RELATIVE_EQTY	7.83	5.73	8.67	-2.93***
OTH_RELATED_EQTY	63.39	34.43	74.99	-40.56***
RPS_A	0.44	0.28	0.50	-0.22***
RPS_E	0.30	0.17	0.36	-0.19***
RPS_T	0.14	0.11	0.15	-0.03**
Sample Size	888	254	634	

Panel B*: *Subgroup samples

	group1	**group2**	**group3**	**group123**	**group4**
Sample size	222	222	222	666	222
Total sales - Min	6	55	241	6	1,313
Total sales - Max	55	239	1,305	1,305	15,380
Mean value:					
Total sales	29	122	640	264	4,588
Total assets	82	290	1,137	503	5,431
LEV	0.52	0.57	0.49	0.52	0.55

CFO_S	0.11	0.03	0.10	0.08	0.06
YEAR_INCORP.	11.55	16.32	24.55	17.52	32.41
GO_EQTY	0.61	0.70	1.31	0.87	3.11
RELATIVE_EQTY	8.35	7.63	11.15	9.05	4.17
OTH_RELATED_EQTY	72.56	75.75	58.36	68.89	46.90
RPS_A	0.52	0.45	0.46	0.48	0.32
RPS_E	0.43	0.33	0.28	0.35	0.16
RPS_T	0.09	0.12	0.17	0.13	0.16

a. *, **, *** represent statistical significance from t-tests at a minimum of 0.1, 0.05, and 0.01 levels, respectively.
b. Data source: KIS-Value, DART, Fair Trade Commission, for the years 2008-2012
c. All monetary values are expressed in billions of Won.
d. Panel A presents means and difference of means between listed firms and unlisted firms. Panel B reports means for subgroups quartered based on sales volume: 1) sales volume of group1 is from 6 billion Won to 55 billion Won, 2) sales volume of group2 is from 55 billion Won to 239 billion Won, 3) sales volume of group3 is from 241 billion Won to 1,305 billion Won, 4) sales volume of group4 is from 1,313 billion Won to 15,380 billion Won, and 5) additionally I use group123 made from combining group1, group2, and group3.

e. Variable Definitions:
LEV: total liabilities divided by total assets
CFO_S: Operating cashflow divided by total sales
YEAR_INCORP.: the number of years, prior to the year 2012 from the incorporation of the firm.
GO_EQTY: the group owner's ownership ratio presented by FTC
RELATIVE_EQTY: the group owner's relatives' ownership ratio presented by FTC
OTH_RELATED_EQTY: the other related party's ownership ratio which is mainly the affiliates' ownership ratio, presented by FTC
RPS_A: RPS divided by total sales
RPS_E: RPS between parent and subsidiaries, divided by total sales
RPS_T: RPS between non-parent-subsidiaries relationship, divided by total sales

<Table 3> Ownership and RPS change by year

Year:	2008	2009	2010	2011	2012
GO_EQTY	1.80	1.50	1.33	1.10	1.53
RELATIVE_EQTY	8.25	7.34	7.69	8.11	7.77
OTH_RELATED_EQTY	60.47	62.22	63.74	64.56	64.85
RPS_A	0.41	0.41	0.43	0.46	0.47
RPS_E	0.25	0.28	0.30	0.32	0.33
RPS_T	0.16	0.13	0.13	0.13	0.14
Sample size	141	161	179	199	208

a. Table 3 reports means of ownership and RPS change by year.
b. All variables are defined in the notes to Table 2.

6. Empirical Results

6.1. Main Test Result

6.1.1. RPS-for-gift

Table 4 reports tests of the first regression (RPS-for-gift). Table 4, Panel A, reports the results of OLS regressions (1) for overall sample. While Model 1 reports the results of OLS regressions with standard errors without clustering, Model 2, 3, and 4, report the results of OLS regressions with standard errors clustered by 33 industries. In model 1 and 4, dependent variable is *RPS_T*. In model 2 and 3, dependent variables are *RPS_A* and *RPS_E*, respectively. As for main dependent variable, *RPS_T*, I find that the interaction term of *UNLIST* and *RELATIVE_EQTY* (*UNLIST*×*RELATIVE_EQTY*) is positive and significant at the 1 percent level in Model 1, whereas positive and insignificant in Model 4.

I examine further tests based on subgroups. Table 4, Panel B, reports the results of OLS regressions (1) with *RPS_T* as dependent variable for quartered subgroups with standard errors clustered by 33 industries. In all groups except group4, which are not supposed to be involved in RPS-for-gift, the interaction term of *UNLIST* and *RELATIVE_EQTY* (*UNLIST*×*RELATIVE_EQTY*) is

positive and significant at the 1 percent level with *RPS_T*. These results suggest that the group owner's relatives' ownership in unlisted related companies is the determinant of RPS. These results also means RPS-for-gift occur through the unlisted related companies in which the group owner's relatives have a large equity.

Different from my prediction, *UNLIST* is negative and significant at 5 percent level with *RPS_T* only in group 2. It suggests that after controlling other variable, the attribute of only unlisted company has no relation with RPS. *GO_EQTY* is positive and significant at 1 percent level with *RPS_T* in group2 and group123. It suggests that there is plausible incentive for increasing RPS to companies in which group owner have a large equity. It is consistent with interest conflict view (tunneling or propping incentive). *RELATIVE_EQTY* is rather negative and significant at 5 percent level with *RPS_T* in group2 and group123. It suggests that as *RELATIVE_EQTY* captures the relatives' ownership in listed companies, there is no incentive for RPS in listed companies. As *OTH_RELATED_EQTY* is significant at 5 percent level only in group2, it implies that other related party's ownership is roughly not associated with RPS based on interest conflict view. While *LN_ASSET*, *LEV*, and *YEAR_INCORP*.is not associated with *RPS_T*, *CFO_S* is negatively and significant with *RPS_T* in group1 and group123. It is conceivable that lower cashflow companies are more supported trough RPS due

to financial distress.

Table 4, Panel C, reports the results of OLS regressions (1) with *RPS_E* as dependent variable for quartered subgroups with standard errors clustered by 33 industries. As for the *RPS_E*, I find that all independent variables except for *LN_ASSET* have insignificant relation with the *RPS_E* in relatively large sample size (overall sample and group123). *LN_ASSET* is negative and significantly associated with *RPS_E*. it is conceivable that small companies are more vertically integrated with other related companies than large companies and therefore more involved in RPTs from efficient transaction.

<Table 4> Regression Analysis: RPS-for-gift

Panel A*: *Overall Samples

	Predicted Sign	Without clustering	Clustering with robust standard errors on 33 industries		
Dependent variable:	***RPS_T***	***RPS_T*** **(Model 1)**	***RPS_A*** **(Model 2)**	***RPS_E*** **(Model 3)**	***RPS_T*** **(Model 4)**
UNLIST	+	0.040 (1.8*)	0.083 (1.50)	0.042 (0.66)	0.040 (1.07)
GO_EQTY	+	0.006 (6.17***)	0.007 (2.21**)	0.000 (0.01)	0.006 (3.89***)
RELATIVE_EQTY		0.002 (1.82*)	0.002 (0.48)	-0.000 (-0.03)	0.002 (0.55)
OTH_RELATED_EQTY		0.001 (3.19***)	0.002 (1.40)	0.001 (0.43)	0.001 (1.89)
UNLIST ×RELATIVE_EQTY	+	0.003 (2.82***)	-0.001 (-0.20)	-0.004 (-1.13)	0.003 (0.84)
LN_ASSET		0.019 (4.89***)	-0.032 (-1.66)	-0.051 (-3.56**)	0.019 (1.95*)
LEV		-0.007 (-0.27)	-0.160 (-2.00*)	-0.153 (-1.58)	-0.007 (0.11)
CFO_S		-0.015 (-1.46)	-0.012 (-0.79)	0.003 (0.17)	-0.015 (3.26***)
YEAR_INCORP.		0.000 (0.99)	-0.001 (-0.49)	-0.001 (-0.92)	0.000 (0.35)
Year Dummies		Yes	Yes	Yes	Yes
R^2		27.1%	13.2%	21.6%	27.1%

***Panel B*: *Subgroup Samples* (Dependent variable: *RPS_T*) with clustering**

	Pred-Sign	group1	group2	group3	group123	group4
Sample size		222	222	222	666	222
Total sales – Min		6	55	241	6	1,313
Total sales – Max		55	239	1,305	1,305	15,380
UNLIST	+	0.099 (1.09)	-0.065 (-1.61**)	0.059 (0.89)	0.039 (0.90)	0.029 (0.36)
GO_EQTY	+	0.000 (0.08)	0.008 (10.7***)	-0.001 (-0.40)	0.005 (3.15***)	0.006 (2.14**)
RELETIVE_EQTY		-0.014 (-2.46**)	-0.001 (-0.62)	0.000 (0.05)	-0.002 (-2.35**)	0.010 (1.38)
OTH_RELATED_EQTY		0.000 (0.23)	0.002 (2.41**)	0.000 (0.30)	0.001 (1.50)	0.002 (1.72)
UNLIST×RELATIVE_EQTY	+	0.016 (3.33***)	0.008 (4.65***)	0.006 (3.92***)	0.007 (7.45***)	-0.006 (-0.68)
LN_ASSET		0.030 (2.18**)	-0.017 (-1.47)	0.036 (1.42)	0.014 (1.39)	-0.010 (-0.45)
LEV		-0.039 (-1.00)	-0.001 (-0.0)	0.242 (1.26)	0.009 (0.13)	-0.133 (-1.21)
CFO_S		-0.013 (-2.01*)	-0.027 (-0.92)	-0.210 (-1.26)	-0.016 (-3.70***)	0.126 (1.42)
YEAR_INCORP.		0.003 (1.86*)	0.003 (0.85)	0.001 (0.77)	0.002 (1.56)	-0.001 (-0.82)
Year dummies		Yes	Yes	Yes	Yes	Yes
R^2		37.1%	34.7%	48.7%	33.3%	26.2%

***Panel C*: *Subgroup Samples* (Dependent variable: *RPS_E*) with clustering**

	Pred-Sign	group1	group2	group3	group123	group4
Sample size		222	222	222	666	222
Total sales – Min		6	55	241	6	1,313
Total sales – Max		55	239	1,305	1,305	15,380
UNLIST		-0.333 (-1.12)	0.373 (4.83***)	0.030 (0.33)	0.060 (0.62)	0.060 (0.86)
GO_EQTY		-0.006 (-0.85)	-0.008 (-4.67***)	0.011 (2.91***)	-0.001 (-0.29)	0.005 (1.77*)
RELETIVE_EQTY		0.029 (1.18)	-0.002 (-0.44)	0.006 (2.30**)	0.004 (0.87)	-0.008 (-1.94*)
OTH_RELATED_EQTY		0.004 (1.52)	-0.005 (-3.99***)	0.003 (1.80*)	0.001 (0.80)	0.000 (0.00)
UNLIST×RELATIVE_EQTY		-0.029 (-1.22)	-0.008 (-2.09**)	-0.009 (-3.8**)	-0.007 (-1.66)	-0.003 (-0.94)
LN_ASSET		-0.028 (-0.65)	-0.128 (-5.75***)	-0.121 (-2.12**)	-0.053 (-2.64**)	-0.083 (-1.93*)
LEV		-0.139 (-0.99)	-0.235 (-2.19**)	-0.050 (-0.22)	-0.140 (-1.29)	-0.232 (-1.36)
CFO_S		-0.016 (-0.77)	0.146 (3.66***)	0.759 (5.62***)	0.000 (0.02)	0.321 (2.56**)
YEAR_INCORP.		-0.006 (-0.82)	-0.004 (-1.94*)	0.002 (0.96)	-0.002 (-0.85)	0.001 (0.55)
Year dummies		Yes	Yes	Yes	Yes	Yes
R^2		21.5%	40.3%	26.8%	18.4%	22.7%

a. Table 4 presents tests of OLS regressions (1) (RPS-for-gift). Table 4, Panel A, reports the results of OLS regressions (1) for overall sample. While Model 1 reports the results of OLS regressions with standard errors without clustering, Model 2, 3, and 4, report the results of OLS regressions with standard errors clustered by 33 industries. In model 1 and 4, dependent variable is *RPS_T*. In model 2 and 3, dependent variables are *RPS_A* and *RPS_E*, respectively. Table 4, Panel B, reports the results of OLS regressions (1) with *RPS_T* as dependent variable for quartered subgroups with standard errors clustered by 33 industries. Table 4, Panel C, reports the results of OLS regressions (1) with *RPS_E* as dependent variable for quartered subgroups with standard errors clustered by 33 industries.

b. T-statistics are reported in parentheses below coefficients. *, **, *** represent significance at the 10 percent, 5 percent, and 1 percent levels, respectively, in two-tailed tests.

c. All other variables are defined in the notes to Table 2.

d. Variable Definitions:
UNLIST: an indicator variable equal to 1 if the firm is unlisted, and 0 otherwise
UNLIST×*RELATIVE_EQTY*: interaction term of *UNLIST* and *RELATIVE_EQTY*
LN_ASSET: natural logarithm of total assets

6.1.2. Operating margin ratio of the RPS-for-gift

Table 5 presents tests of the operating margin ratio of the RPS-for-gift (the second regression). The interaction term of *RPS_GIFT* and *OWN_SHOCK* (*RPS_GIFT×OWN_SHOCK*) is negative and insignificant in group123. This result supports *H2* that the operating margin ratio of RPS-for-gift is not higher than similar transactions with the third party. This result also means the operating margin ratio of RPS is strongly scrutinized by Tax authority in Korea on the provision of the rejection of unfair act and calculation between related parties in Corporate Tax.

<Table 5> Regression Analysis: Operating margin ratio of RPS

	Dependent Variable: *OI*		
	Without Clustering	**Clustering with robust standard errors on 33 industries**	
	Overall sample	**Overall sample**	**Group123**
OWN_SHOCK	0.64 (12.82***)	0.64 (4.91***)	1.04 (11.08***)
RPS_GIFT×OWN_SHOCK	-8.92 (-1.34)	-8.92 (-1.95*)	-1.37 (-1.08)
LN_ASSET	43.09 (7.98***)	43.09 (2.45*)	3.49 (1.33)
YEAR_INCORP.	-2.39 (-4.43***)	-2.39 (-1.97*)	-0.80 (-1.68)

Year Dummies	Yes	Yes	Yes
R^2	37.3%	37.3%	64.1%

a. *, **, *** represent statistical significance from t-tests at a minimum of 0.1, 0.05, and 0.01 levels, respectively.
b. All monetary values are expressed in billions of Won.
c. Table 5 presents tests of operating margin ratio of the RPS-for-gift
d. All other variables are defined in the notes to Table 2.

e. Variable Definitions:

OWN_SHOCK: I measure industry shocks and then calculate a predicted profit (operating income) for each firm based on the profit shock experienced by the other firms in the same industry. The first step is to add up the profits and total assets of a given industry in each year (subtracting out those of the focal firm). The next step is to take the industry's OI for a given year (subtracting out that of the focal firm) and multiply it by the focal firm's asset size in that year to predict what the firm would earn given the industry shock (*OWN_SHOCK*).

RPS_GIFT: I estimate the portion of RPS for gift (*RPS_GIFT*) from the regression (1) with dependent variable *RPS_T* as follows.

$$RPT\_GIFT = \beta_5 \times UNLIST \times RELATIVE\_EQTY$$

6.2. Additional Test Result – Effect of Gift Tax Act

Table 6 presents results of t-tests on the difference of coefficients of the interaction term, *UNLIST×RELATIVE_EQTY* from the regression (1) with dependent variable *RPS_T* and *RPS_GIFT×OWN_SHOCK* from the regression (2), respectively, between two time periods, 2008 ~ 2011 and 2012.

Both The differences of coefficients of *UNLIST×RELATIVE_EQTY* and *RPS_GIFT×OWN_SHOCK* between two time periods, 2008 ~ 2011 and 2012 are insignificant in group123. This result suggests that the Gift Tax Act regarding Gift-through-RPT is not effective in diminishing the amount of RPS-for-gift as well as the operating margin ratio of the RPS-for-gift in 2012. It is conceivable that as the year 2012 is the first year of the enforcement of the Gift Tax Act, many taxpayers might not comprehend well whether they are taxed on the Gift-though-RPT and how the Gift Tax Act is applied and so that they might not have prepared for the Gift Tax.

<Table 6> Test of effect of the Gift Tax Act regarding Gift-through-RPT

	UNLIST×RELATIVE_EQTY **(Model A)**		***RPS_GIFT×OWN_SHOCK*** **(Model B)**	
	Overall sample	**Group123**	**Overall sample**	**Group123**
2008 ~ 2011	0.0032	0.0065	-8.14	-1.32
2012	0.0017	0.0068	-14.36	-0.17
Difference	0.0015*	-0.0003	6.22	-1.14
t-statistic	(2.57)	(-0.38)	(1.61)	(-0.86)

a. *, **, *** represent statistical significance from t-tests at a minimum of 0.1, 0.05, and 0.01 levels, respectively.

b. Table 6 presents results of t-tests on the difference of coefficients of the interaction term, *UNLIST×RELATIVE_EQTY* from the regression (1) with dependent variable *RPS_T* and *RPS_GIFT×OWN_SHOCK* from the regression (2), respectively, between two time periods, 2008 ~ 2011 and 2012. Model A presents average annual coefficients of β_5 from estimating the regression (1) each in both time period:

$$RPS\_T = \beta_0 + \beta_1 UNLIST + \beta_2 GO\_EQTY + \beta_3 RELATIVE\_EQTY + \beta_4 OTH\_RELATED\_EQTY + \beta_5 UNLIST \times RELATIVE\_EQTY + \beta_{6,7,8,9}(Firm\ Characteristic\ Variables:\ LN\_ASSET,\ LEV,\ CFO\_S,\ YEAR\_INCORP.) + Year\ dummies + \varepsilon$$

Model B presents average annual coefficients of γ_2 from estimating the regression (2) each in both time period:

$$OI = \gamma_0 + \gamma_1 OWN\_SHOCK + \gamma_2 RPS\_GIFT \times OWN\_SHOCK + \gamma_3 LN\_ASSET + \gamma_4 YEAR\_INCORP. + Year\ Dummies + \varepsilon$$

7. Conclusions and Discussions

This paper tests the gift through related party transaction (Gift-through-RPT). I measure the magnitude of Gift-through-RPT using two components: the amount of related party sales for gift (RPS-for-gift) and the operating margin ratio of the RPS-for-gift. I find that the group owner's relatives' equity holding in unlisted related companies is the main determinant for RPS-for-gift and that the operating margin ratio of the RPS-for-gift is not different from similar transactions with the third parties. When I classify related party sales (RPS) into RPS between parent and subsidiaries and RPS between non-parent-subsidiaries relationship, I find that RPS between non-parent-subsidiaries relationship is more adequate to measure RPS-for-gift than the aggregated RPS.

For additional test, I compare the difference in the amount of RPS-for-gift and the operating margin ratio of the RPS-for-gift between 2008 ~ 2011 and 2012, to see the effect of the enforcement of the article 45(3) in Inheritance and Gift Tax Act (the Gift Tax Act regarding Gift-through-RPT), effective in 2012. I find the Gift Tax Act is not effective in diminishing the amount of RPS-for-gift as well as the operating margin ratio of the RPS-for-gift.

My research is subject to two main caveats. First, representative, our sample

covers only 5 years of 10 largest Korean business groups. A sample over more business group or a longer period could provide other insights. Second, the classification of RPS into RPS between parent and subsidiaries and RPS between non-parent-subsidiaries relationship could be inaccurate, because RPS between parent and subsidiaries could be used for gift or interest conflict, and vice versa.

However, my results present some implications. First, this paper presents powerful evidence for the existence of Gift-through-RPT. Second, this paper presents some tax implication. Even though RPS are different according to the purpose of RPS as efficient transaction and interest conflict (tunneling or propping), the Gift Tax Act do not consider the attributes of RPS and only provide the normal transaction ratio (sales to related party divided by total sales: 30%) and the marginal holding ratio (owner and relatives' ownership ratio: 3%), which might be arbitrary and have no rational grounds. In addition, the restriction on RPS from efficient transaction could cause improper resource allocation and be more harmful to overall economy. Furthermore, my research also shows the Gift Tax Act regarding Gift-through-RPT is not effective in diminishing the amount of RPS-for-gift as well as the operating margin ratio of the RPS-for-gift.

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국문 초록

본 연구에서는 특수관계자에게 일감몰아주기를 통해 수혜법인의 주주에게 이익을 증여하는 것에 대해 일감몰아주기 관계회사거래의 규모와 영업이익율에 대해 구분하여 분석하였다. 재벌총수가 있는 10 대 그룹을 분석한 결과, 일감몰아주기 관계회사거래는 재벌총수 친족의 지분율이 높은 비상장회사를 통해 주로 일어나고, 일감몰아주기 관계회사거래의 영업이익율은 제 3 자와의 정상거래와 차이가 적은 것으로 나타났다. 추가적인 연구로 일감몰아주기를 통한 증여에 대해 과세하는 상속세및증여세법 45 조의 3(특수관계법인과의 거래를 통한 이익의 증여의제) 유효성 여부에 대해 분석하였는데, 최초 과세연도인 2012 년에는 관련 상속세및증여세법의 시행이 일감몰아주기 관계회사거래를 줄이는 데 유의한 효과를 나타내지는 아니하였다. 또한, 본 연구에서 관계회사거래를 분석시 관계회사거래를 지배종속간의 관계회사거래와 비지배종속간의 관계회사거래로 나누어 분석하였는데, 비지배종속간의 관계회사거래가 일감몰아주기 관계회사거래의 분석에 보다 더 적절한 것으로 나타났다.

주요어: 증여, 일감몰아주기, 관계회사거래, 증여세, 증여의제

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