

Developing Trusts and Their Jurisprudences: Real Estate Trusts in Korea

Seoul National Univ. School of Law
Prof. Hyeok-Joon RHO

I. Introduction

The concept of trust was introduced in Korea by the Trust Act of 1961, which had 72 articles. Based upon a typical civil law system, however, the Korean trust took on unique jurisprudence different from common law trust.¹ For example, no split between the legal ownership and equity ownership is allowed in the Korean Civil Act, and therefore the rights of beneficiaries tend to be characterized as rights *in personam*.² Another important feature of Korean trust is that it is mostly commercial, not gratuitous. Because the Capital Market and Financial Investment Business Act (CMFIBA) regulates an entity that is engaged in a trust business in a regular and commercial way, professional trustees were most likely to be subject to the CMFIBA as well as the Trust Act. A criticism of the Trust Act of 1961 is that the Act, which was designed long ago upon gratuitous trust, failed to reflect commercial aspect of trust and to adopt various usages by modern trust, hence the overall revision in the Trust Act of 2011. The new Act, with its detailed 147 articles, introduced new provisions including those on limited-liability trust, trust with certificates of beneficial interests, declaration of trust, merger and demerger of trust, and trust with successive beneficiary. Because most of the newly adopted provisions are helpful devices for developing structured transactions, commercial usages of trust in Korea are expected to further flourish.

What types of commercial trust are available in Korea? Basic classification can be made based upon the CMFIBA, which regulates commercial trust. The CMFIBA has an exhaustive list of qualified trust properties: ① money, ② securities, ③ monetary claims, ④ chattels, ⑤ real estate, ⑥ rights relating to real estate {including superficies (地上權), a right to lease on a deposit basis (傳賃權), a right to lease real estate (不動產賃借權), and a claim for registration of transfer of ownership of real estate (不動產所有權 移轉登記請求權), and ⑦ intangible property rights. If a trustee company is licensed to cover all types of trust property, it would be named as a comprehensive trustee; if a trustee company covers only ① through ③, it would be called (exclusive) pecuniary trustee; a trustee company with ⑥ and ⑦ as its inherent business can be classified as (exclusive) real estate trustee. Many Korean banks, securities companies, and insurance companies with their comprehensive trustee licenses are engaged in real estate trust. However, the real estate businesses available to a comprehensive trustee are limited: The banks are not allowed to practice Land Trust (the definition of which

¹ More and more civil law countries have adopted trust-like institutions. Some observers feel the trust is likely to become the most important contribution of the common law tradition to the civil law countries. Henry Hansmann and Ugo Mattei, *The Function of Trust Law: A Comparative Legal and Economic Analysis*, 73 *New York University Law Review* 434, 435-436 (1998).

² One of the major technical obstacles to the introduction of trusts in civil law jurisdictions is the split ownership over the trust assets, where the trustee has legal title and the beneficiary has equitable title. Tory Honoré, *On Fitting Trusts into Civil Law Jurisdictions*, University of Oxford Legal Research Paper No. 27/2008, p.10 (2008) (available at www.ssrn.com).

shall be explained in Chapter II. A.); the securities companies and insurance companies may only practice Real Estate Sale Trust and Real Estate Management. Table 1 shows statistics on professional institutions engaged in trust business.

[Table 1] Trustee Companies Subject to the CMFIBA³

		No.	Name of Trust Companies	Type of License		
				Comprehensive	Pecuniary Trust	Real Estate Trust
Bank	Domestic	17	Shinhan, Woori, SC Korea Limited Hana, KEB, Citi, KB, DGB, BNK, Kwangju, Kyongnam, KDB, IBK, NH, Suhyup	○		
			JB, Jeju		○	
	Foreign	3	Deutsche Bank, HSBC, Bank of NY Mellon Corp.		○	
Securities Co.		21	Shinhan, Kyobo, Daishin, KDB, Hana Daetoo, Yuanta, Samsung, Miraeasset, Woori Investment, NH Investment, Korea Investment, Hyundai, Hanwha, Meritz, Shinyoung, Eugene Investment, HMC Investment, Dongbu, SK	○		
			Hi Investment, IBK		○	
Insurance Co.		5	Miraeasset, Samsung, Hanwha, Heungkuk	○		
			Kyobo		○	
Real Estate Trustee Company		11	Koreit, KB, Daehan Real Estate, Saengbo, Kait, Hana, Koramco, Asia, Kukje, Mugunghwa, Korea			○

Among various types of trusts, this paper focuses upon real estate trusts in Korea. Compared to pecuniary trust, which is another major area of the commercial trust, real estate trusts tend to invite more disputes and lawsuits in Korea: While the financial institutions engaged in structured financing via trust vehicle tended to cautiously consult with regulatory authorities and legal professions, real estate developers using trust structure often proceeded with legal uncertainty. Large land development projects are especially vulnerable to legal claims from various parties including landowners and investors. Those disputes, while unfortunate to the parties concerned, have been providing rich sources to refine Korean trust jurisprudence. Further, the real estate trusts account for 34.2% of the total assets transferred to the trustee, and more and more land development projects are based upon trust structure. Following up the jurisprudence on real estate trust is essential to correctly understand the Korean trust law.

The rest of this paper proceeds as follows. Chapter II offers a bird's-eye view of Korea's real estate trust. By introducing trust types, performances of real estate trustees, and major regulations over real estate trust in Korea, this chapter will help readers understand the usage and major legal issues of real estate trust. Against this backdrop, the following chapters review major jurisprudence on real estate trust, issues pertaining to outside the trust and inside the trust, respectively. Issues regarding outside the trust are mostly associated with the protection of settlor's creditors. Under the separation of assets doctrine and the principle of complete ownership by the trustee, settlor's creditors may not enforce upon legitimately

³ Financial Supervisory Service, Analysis of the Business of Trust as of June 30, 2014 (in Korean, available at http://www.fss.or.kr/fss/kr/promo/bodobbs_view.jsp?url=&seqno=18116).

established trust properties.⁴ However, the inability of settlor's creditors often seems unreasonable, and the Korean statutes and case laws have developed various theories tackling the status of settlor's creditors. The topics in Chapter III include ① the cancellation by settlor's creditors of fraudulent trust; ② the priority among settlor's creditors who have unsecured, secured by mortgage, or secured by Trust for Security Purpose, respectively; and ③ the status of tax authority as the creditor of the settlor. On the other hand, the issues regarding inside the trust in this paper are concerned with the reimbursement of expenses obtained by the trustee. Chapter IV has two sections: In the first section, the possibility and the range of reimbursement against trust property will be explored, especially where a loan from a trustee's own account to trust account has been made; the second section will deal with a further reimbursement against a beneficiary. Finally, Chapter V summarizes and concludes this paper.

II. Real Estate Trusts in Korea Overview

A. Types of Real Estate Trusts

Real estate trusts are generally classified into four categories in Korea: (a) Trust for Security Purpose, (b) Land Trust, (c) Real Estate Sale Trust, and (d) Real Estate Management Trust.

A Trust for Security Purpose is created in order to provide creditors with security by designating them as beneficiaries over the trust property: On receiving a loan from creditors, the settlor establishes a Trust for Security Purpose in which the superior beneficial interest is given to creditors while the settlor has the subordinated beneficial interest. Once the settlor is in default on his debt, the trustee will sell the property and pay back the loan, with the remainder being returned to the settlor.

A Land Trust is made to explore a project on undeveloped land. The trustee of a Land Trust invests funds of its own or from outside, builds houses or business buildings, and receives the rent or proceeds from the sale of those houses or buildings. The earnings from the development project shall be distributed to the beneficiaries, most of whom are landowners, and the trustee will get commission and incentive. Land Trusts have two subcategories according to the responsibility of financing: While the settlor is responsible for financing the project in Settlor-Responsible Land Trust, the trustee has the responsibility of financing in Trustee-Responsible Land Trust. In the case of Settlor-Responsible Land Trust, the role of trustee is limited to the management of trust property and the sale of houses or buildings successfully constructed.

A Real Estate Sale Trust is established for the sale of the trust property. If the estimated price of the real estate is very high or special promotion activities are necessary, the real estate owner often turns to Real Estate Sale Trust. Also, if the real estate has a complicated legal relationship with multiple owners and secured obligees, the sale through a Real Estate

⁴ Henry Hansmann and Ugo Mattei (supra note 1, at 454) analyzed theoretically the reason why the settlor's creditors generally cannot reach the trust property: They have no reason to rely on the value of the trust property in extending credit to the settlor, as the title to the property is in the hands of the trustee and no material benefits are flowing to the settlor from the property.

Sale Trust, which may clarify the rights and obligations of interested parties, is preferred by sellers and purchasers.

A Real Estate Management Trust is mainly for the management of trust property. The roles of trustee are different according to the type of Real Estate Management: In an Active Style (so called *Kap-chong* [甲種]), the trustee is expected to actively maintain and manage real property. Receiving rent and paying expenses on the real property operation are also the trustee's responsibility. The Active Style is generally used by owners of real property who lack professional knowledge of building management or live abroad; in a Passive Style (so called *Ul-chong* [乙種]), the trustee's role is limited to keep the ownership of the trust property. A Passive Style is used in a real estate development project to guarantee bankruptcy-remoteness, which can be accomplished through trust structure.⁵

B. Performance of Real Estate Trust Companies in Korea

Periodically the Financial Supervisory Service in Korea (FSS) publishes statistics on the trust industry. Because donative trust is underdeveloped in Korea, the commercial trusts supervised by the FSS account for a major part of trusts in Korea. Table 2 shows the importance of real estate property compared to other types of trust in terms of the value of trust properties. As of June 30, 2014, trust properties owned by the trustee company for real estate (i.e. exclusive real estate trustee company) account for 23.8%. The percentage reaches 28.8% with the addition of the real estate trusted onto the banks, securities companies, and insurance companies (i.e. comprehensive trustee company), which is 26.3 Trillion KRW.

[Table 2] Value of Trust Property Owned by Trustee Companies (as of June 30, 2014)⁶

		Value of Trust Property (Trillion KRW)	Share (%)
Financial Institutions with Trust Business License	Bank	258.1	48.6
	Securities Company	144.1	27.1
	Insurance Company	2.5	0.5
	Sub-total	404.7	76.2
Real Estate Trustee Companies		126.7	23.8
Total		531.4	100

Among real estate trusts, the Trust for Security Purpose is the most common form: It occupies 65.2% of real estate trusts as shown in Table 3. While the amount decreased from its peak of 102.6 Trillion KRW in 2011, arguably due to a recession in the real estate market, it still champions other types of real estate trusts by a large margin. The reason that the Trust for Security Purpose is so popular in Korea is associated with the unique feature of bankruptcy remoteness accomplished by this type of trust and shall be examined in Chapter III, section B.

⁵ Another type of a Real Estate Management Trust can be made on the Act of the Parceling-out of Buildings. According to the Sec. 1 of the Art. 4 of the Act, if a seller of buildings in units is to parcel out units of the building, he should have a management contract with a trustee company on the land for the development project. The purpose of the requirement is to secure the buyer's ownership of the unit in case of the bankruptcy by seller, developer or constructor. The trust based upon this Act is often called Parceling-out Management Trust, one of the Real Estate Management Trust in a broad sense.

⁶ Financial Supervisory Service, Analysis of the Business of Trust as of June 30, 2014 (in Korean, available at http://www.fss.or.kr/fss/kr/promo/bodobbs_view.jsp?url=&seqno=18116).

[Table 3] Value of Trust Property Owned by Real Estate Trust Companies⁷

(Trillion KRW, %)

		2009	2010	2011	2012	2013	2014 (Jun.30)	Share(%)
Land Trust	Trustee - Responsible	1.5	1.5	1.9	2.4	2.9	2.9	2.3
	Settlor - Responsible	15.3	17.7	21.3	23.6	25.1	27.6	21.8
Real Estate Management Trust		7.7	9.0	7.3	6.4	6.4	6.5	5.1
Real Estate Sale Trust		17.5	18.1	15.7	8.2	7.9	7.0	5.5
Trust for Security Purpose		82.0	95.8	102.6	80.3	76.4	82.6	65.2
Total		124.0	142.2	148.7	120.9	118.7	126.6	100.0

Table 4 explains the net income of real estate trustee companies. Despite the fact that the size of trusted assets was reduced in 2012, as shown in Table 2, the net income increased by 96.7%. Another notable feature in Table 4 is that operating earnings have increased since 2010. This increase of earning, for example 9.4 billion KRW in 2012, may well be attributable to the activation of Trustee-Responsible Land Trust as shown in Table 2.⁸ Because the trustee is responsible for financing land development projects, a Trustee-Responsible Land Trust may generate decent income for the trustee from reaping commission and interest on investment using its own funds and intermediated funds. Under the Trustee-Responsible Land Trust, however, a loan from a trustee's inherent account to a trust account might be made, a transaction that looks problematic because the trustee might pursue its own profit. The issue over the transaction between a trustee's own account and a trust account shall be explored in detail in Chapter IV, section A.

[Table 4] Net Income of Real Estate Trustee Company

(0.1 billion KRW, %)

	2009	2010	2011	2012	2013	2013 (Jan.-Jun)	2014 (Jan.-Jun.)	Growth rate (2014)

⁷ Financial Supervisory Service, Analysis of the Performance by Real Estate Trust Companies as of June 30, 2014 (in Korean, available at http://www.fss.or.kr/fss/kr/promo/bodobbbs_view.jsp?url=&seqno=18080). Real Estate Management Trust in this table includes Parceling-out Management Trust.

⁸ The Financial Supervisory Service analyzed that the growth of net income is attributable to the increased operating earnings from Trustee-Responsible Land Trust and Trust for Security Purpose, 5.8 billion KRW, 11.1 billion KRW, respectively. Financial Supervisory Service, Analysis of the Performance by Real Estate Trust Companies as of June 30, 2014 (in Korean, available at http://www.fss.or.kr/fss/kr/promo/bodobbbs_view.jsp?url=&seqno=18080).

Operating Earning	3,616	3,268	3,832	3,926	4,491	2,144	2,209	3.0%
Operating Cost	2,430	3,511	2,975	2,426	2,841	1,226	1,245	1.5%
Operating Income	1,186	△242	857	1,500	1,650	918	964	5.0%
Net Income	907	△153	575	1,132	1,222	695	735	5.8%

C. Regulation on Real Estate Trust Companies: Brief History and Major Rules

Most trusts on real estate in Korea are operated by professional trustee companies. Thus a quick review of the history and current provisions of the regulation over real estate trustee companies would aid understanding in further discussions on the jurisprudence inside and outside a real estate trust.

Real estate trusts were encouraged by the Korean government in the early 1990s in order to boost the supply of houses and business buildings: In consideration of the chronic lack of real estate supplies, the Korean government wanted trustee companies to launch various real estate development projects and to use the land more efficiently. Behind this backdrop, real estate trustee companies aggressively expanded their business, especially in Land Trust, but they soon faced financial crisis in the late 1990s. Daehan Realty Trust and Hankook Realty Trust, two biggest real estate trustee companies, were suspended from business in 2001 and their business licenses were cancelled in 2002. Following the bankruptcy of real estate trustee companies, the government tightly regulated the business of trustee companies, limiting new licenses of real estate trusts to those companies whose major shareholders are financial institutions. While the strict regulation has been loosened, there are still complicated provisions in the CMFIBA on the establishment and operation of real estate trust companies. Among the regulations applicable to trust companies, the regulation specific to real estate trust shall be briefly reviewed below.

To enter the real estate trust business, the threshold of minimum capital requirement of 10 billion KRW is lower than 13 billion KRW for the pecuniary trust business.⁹ In order to engage in the real estate business, a real estate trustee company should have two or more specialized personnel in the real estate business and three or more in the securities business.¹⁰

The same rules of governance of other trustee companies shall apply to real estate trustee companies: A person who was sentenced imprisonment or heavier punishment shall be disqualified as an executive or a director¹¹; if the worth of the trustee company's assets is not less than 2 trillion KRW or the worth of the trusted properties is not less than 6 trillion KRW, the trustee company shall have three or more outside directors, and the number of outside directors shall account for at least half of the board¹²; and the trustee company, through the board's resolution, shall designate not less than one compliance officer who shall be responsible for monitoring compliance with the internal control guidelines and reporting to

⁹ Sec. 2 of Art. 12 of the CMFIBA, Sec. 3 of Art. 16, and the attached table (1) of the Enforcement Decree of the CMFIBA.

¹⁰ Art. 2-6 and the attached table (2) of the Regulation on the Financial Investment Business (金融投資業規程).

¹¹ Sec. 1 of Art. 24 of the CMFIBA. If five years have elapsed since the completion of the imprisonment, the qualification of the person will be resumed, though.

¹² Sec. 1 of Art. 25 of the CMFIBA and Sec. 1 of Art. 28 of the Enforcement Decree of the CMFIBA.

the audit committee or the auditors.¹³

In practicing real estate trust, a trustee company should follow the rules of conduct stipulated in the CMFIBA and its Enforcement Decree. One of the most important rules in the context of trust is the separation of inherent assets and trust properties. While Sec. 2 of Art. 34 of the Trust Act adopted exceptions to the separation rule by allowing a transaction based upon the trust instrument or the beneficiary's approval, Sec. 1 of Art. 104 of the CMFIBA maintains the strict separation rule.¹⁴ Accordingly, the trust instrument or the beneficiary's approval may not justify a purchase of the trust property by the trustee's own fund.¹⁵ Under the CMFIBA, a trustee company may purchase the trust property on its inherent account in two cases only: (a) If it is necessary for performing the obligation that it owns to beneficiaries as a consequence of its trust activities, or (b) if it is unavoidable in order to terminate the trust contract or to protect beneficiaries for any other reason. Also, a loan from the inherent account to the trust account is strictly regulated.¹⁶

Further, real estate trustee companies shall be subject to strict regulations on how to manage surplus cash, if any: If they have obtained surplus cash in the operation of real estate trust, they should invest it in a conservative way, such as purchasing national bonds and depositing the money in a financial institution.¹⁷

III. Outside the Trust: The Protection of Settlor's Creditors

A. Cancellation of Fraudulent Trust

1. Overview

(1) Why Does the Trust Act Need to Regulate Fraudulent Trust?

Under Art. 406 of the Civil Act in Korea, a creditor may cancel a fraudulent transaction made by a debtor: If the debtor has disposed of his property rights with the knowledge that the disposal would prejudice the creditor, the creditor may file a suit to the court for its revocation and the restitution of property rights. The right of cancellation is to preserve the debtor's properties that had been subject to enforcement by creditors but was transferred to others to the detriment of creditors as a whole.¹⁸ Similar cancellation rights are given to administrators in a bankruptcy or rehabilitation process,¹⁹ the purpose of which is to preserve the foundation for creditors as a whole.

In creating a trust, a settlor transfers his property rights to a trustee, and those property rights shall no longer be subject to enforcement by settlor's creditors.²⁰ By using such a trust

¹³ Sec. 2 of Art. 28 of the CMFIBA.

¹⁴ Sec. 1 of Art. 104 of the CMFIBA excludes the application of Sec. 2 of Art. 34 of the Trust Act.

¹⁵ Sec. 2 of Art. 104 of the CMFIBA.

¹⁶ According to Sec. 2 of Art. 105 of the CMFIBA and Sec. 4 of Art. 106 of the Enforcement Decree of the CMFIBA, a loan from a trustee's inherent account to trust account is allowed for limited surroundings: (a) If the amount of cash as trust property is quite small compared to the scale of real estate development project (i.e. only 15% or less of the project size), or (b) if a partial termination of the trust is required and the division of the trust property is implausible.

¹⁷ Art. 106 of the CMFIBA.

¹⁸ 2000Da 44348, Feb. 27, 2001 (the Supreme Court of Korea).

¹⁹ Art. 100 and Art. 391 of the Debtor Rehabilitation and Bankruptcy Act (the DRBA).

²⁰ Art. 22 of the Trust Act.

feature, the settlor may avoid creditors' enforcement, a situation quite similar to what Art. 406 of the Civil Act tries to regulate. Hence comes Art. 8 of the Trust Act, which provides creditors of the settlor with special right to cancellation. What if no provision has been adopted in the Trust Act? Is a creditor of settlor still able to cancel the establishment of trust based upon Art. 406 of the Civil Act? There is no provision that prohibits the application of Art. 406 to establishment of trust. For example, if a settlor's real estate was transferred to the trustee as trust property and was legitimately resold to a third party by the trustee, the creditor of settlor may turn to Art. 406 of the Civil Act for the restitution of the real estate.

The structure of deal in a trust, however, is unique as shown in two examples. ① While Art. 406 assumes a transaction from A (debtor) to B (counterparty) and further to C (subsequent purchaser) in which B and C each pursues its own interest, the basic scheme of trust is the transfer of asset from P (debtor/settlor) to Q (trustee), giving beneficial interest to R (beneficiary). Unlike B, who has purchased the asset for his own benefit, Q is supposed to serve R's benefit. Thus Q, with good faith in the trust creation, might have a different status from B with good faith as far as the fraudulent conveyance of jurisprudence is concerned. This was an approach taken by Art. 8 of the old Trust Act. ② What if the settlor created a so-called self-interest trust (自益信託), a trust in which a settlor also has the status as a beneficiary as opposed to a trust for another's interest (他益信託)? In a case where A sold its land to B and received proceeds, A's asset value looks maintained throughout the sale. The Supreme Court of Korea, however, stated that the sale is subject to the cancellation right of A's creditors under Art. 406 of the Civil Act.²¹ According to the court, the sale might threaten the claim of A's creditors by transforming the land into cash, an asset which is easily dispensable and hardly traceable. In a self-interest trust, P transfers its property to Q and receives beneficial interest as a beneficiary. It looks similar to the sale of A's asset to B because P's property is changed into another form, the value of which is equivalent to transferred property. But in this case the Supreme Court tended to adopt a stricter standard in declaring the creation of the trust is fraudulent: Because the disposal of beneficial rights in a confidential way is quite difficult compared to disposal of cash, and the transfer of assets is generally made to a professional trustee who is under strict regulation by the government, the Court did not think the risk to settlor's creditors from the creation of self-interest trust was high.²²

In consideration of the feature of a trust scheme, Art. 8 of the Trust Act adopted a complicated provision regulating the establishment of a fraudulent trust. Because the origin and purpose are similar, though, the interpretations of Art. 406 of the Civil Act are often referred to in applying Art. 8 of the Trust Act.

(2) 2011 Trust Act Reform on the Cancellation of Fraudulent Trust

The earlier provision on cancellation of fraudulent trust, Art. 8 of the old Trust Act was quite simple: If the debtor has created a trust with the knowledge that the creation would prejudice the creditor, the creditor, as in Art. 406 of the Civil Act, may file a suit to the court for its cancellation and the restitution of property rights even where the trustee has acted in good faith; the cancellation and the restitution shall not affect any benefit that the beneficiary has already obtained provided that he was not aware of the creation's being detrimental to

²¹ 66Da1535, Oct. 4, 1966 (the Supreme Court of Korea).

²² 2009Ma1176, May 23, 2011 (the Supreme Court of Korea).

settlor's creditors and his unawareness was not from gross negligence. There are, among others, three major criticisms against the provision, though. First, it failed to protect innocent trustees. As mentioned above, most trusts in Korea are for commercial purposes and are operated by professional trustee companies. It is true that the trust they have assumed does not operate for their benefit, but they are expecting to reap commissions from the management of trust properties. That perspective made a persuasive argument that retrospective cancellation of trust based upon the old Art. 8 should be limited. Secondly, it also failed to provide sufficient protection for beneficiaries with good faith. While the cancellation shall not affect any benefit that the good-faith beneficiary has already obtained, even a good-faith beneficiary cannot prevent the trust being cancelled by creditors of a fraudulent settlor. Thirdly, it did not address the issue of protecting those who have transacted with the trustee property and obtained claim ("obligees of trust"). Once the trust was cancelled and the trust property was returned to the settlor, the claim of such creditors might get difficult to exercise: They can still enforce their claim against the former trustee, but their claim shall not be fully satisfied especially where the main trust property is returned to the settlor and the trustee goes bankrupt. The result looks absurd because their claims are closely associated with the trust property even though the counterparty of their claim is the former trustee. The cancellation of fraudulent trust is for the benefit of settlor's creditors as a whole, and the limitation on it for protecting other parties such as trustee, beneficiary, and obligees of trust will be disadvantageous to settlor's creditors. Three revisions on these points by the 2011 Reform Act will be reviewed in turn below.

2. Exception (1): For Trustees

The initial draft provision on the fraudulent trust in the reform bill by the government, widely supported by trustee companies, provided strong protection for the trustee who has assumed and operated trust property for a commercial purpose: As far as those trustees are concerned and if the trustees are in good faith, a creditor of settlor may not cancel the trust even though the settlor created the trustee knowing that it would be prejudicial to creditors.²³ A typical example that the government pointed to was as follows: If a trust is nullified after the trustee has finished distributing trust property to beneficiaries, the trustee, whether or not he is in good faith, shall suffer not only from the loss of commission but also from being obliged to return the amount equivalent to the trust property.²⁴

The initial proposal, however, invited severe criticism from practitioners and academia. The trustee, who is supposed to serve beneficiaries, should not be placed in the shoes of a purchaser, and no legislation associates the possibility of canceling a fraudulent trust with the subjective condition of trustee, they argued.²⁵ After lengthy discussions, a midway solution was adopted by Sec. 3 of Art. 8: The right to cancellation and restoration may be exercised even against a good-faith trustee; the claim of restoration against a good-faith trustee, however, shall be limited to the existing trust property as of the cancellation. The new provision tried to compromise conflicting interests between trustee companies and settlor's creditors. While the trustee companies are professional, it is not always easy to identify whether the creation of trust is detrimental to creditors of settlor. From that perspective the protective device adopted by the new provision looks reasonable.

²³ For the draft Art. 8 of the initial bill, please see The Ministry of Justice, Commentaries on the Trust Act of 2011 (2012), p.81.

²⁴ See *id.* at 81.

²⁵ The Ministry of Justice, *supra* note 23, at 82.

3. Exception (2): For Beneficiaries

Before the 2011 reform, the old Trust Act allowed the cancellation of a fraudulent trust whether the beneficiary was in good faith or not (the old Sec. 1 of Art. 8). While a beneficiary with good faith may keep the benefit already obtained from the trust even after the nullification of trust (the old Sec. 2 of Art. 8), he could not save the trust from being cancelled. The rationale behind the provision was that beneficiaries tended to receive beneficial interest gratuitously.

The initial draft prepared by the government protected a trust created with detrimental intention by a settlor against his creditors if the beneficiary of the trust ① was in good faith and ② had obtained his beneficiary interest for value. The final version, however, deleted the requirement of ②, based upon the consideration that even the gratuitous beneficiary with good faith deserves protection, and whether a trust is gratuitous or not is hard to clarify.²⁶

What if there are multiple beneficiaries and only some of the beneficiaries are in good faith? Creditors of the settlor may cancel the trust in its entirety? In order to protect those beneficiaries in good faith, creditors should not be allowed to cancel the trust and restore the trust property. Instead, the creditors may nullify the trust as far as the beneficiary in bad faith is concerned and let him return the cash equivalent to what he received to the settlor. Further, the creditors may force beneficiaries in bad faith to transfer their beneficial interest to the settlor under Sec. 5 of Art. 8 of the Trust Act.

4. Exception (3): For Obligee

Under Sec. 4 of Art. 8 of the Trust Act, if a fraudulent trust is canceled and the trust property is reinstated, the settlor shall, with respect to the canceled trust, be responsible to the obligee in good faith who has conducted a transaction with the trustee on trustee property to the extent of the trust property so reinstated. This is a new article adopted in 2011 in order to protect those obligees who lent or invested money to the trustee concerning the operation of the trust property. The article, however, is not meant to give obligees any exclusive or prior right over other creditors of the settlor.²⁷

If the trustee reimbursed the obligee's claim over the trustee property and, by application of Art. 481 of the Civil Act, automatically entered into the obligee's shoes, he may argue the obligee's right under Sec. 4 of Art. 8 of the Trust Act. What if the trustee in good faith himself has paid some expenses on the trust property and is entitled to indemnification from the trust property but the trust was canceled? Can he still rest on Sec. 4 of Art. 8, arguing that he is an obligee on the trust property? While not closely examined in academia or in the courts of Korea, the obligee here should imply a third party other than the parties to the trust instrument.²⁸ A possible alternative for protecting such a trustee in good faith should be, instead of returning (improved) trust property itself, to make the trustee return the cash equivalent to the value of trust property after the trustee has written off his investment. Such alternative reinstatement (價額返還) is acknowledged by the interpretation of Art. 406 of the

²⁶ The Ministry of Justice, *supra* note 23, at 84-85.

²⁷ Min Han, The cancellation of a fraudulent trust and the draft bill on the Debtor Rehabilitation and Bankruptcy Act, BFL (Business, Finance and Law) No. 53, p.14.

²⁸ See *id.* at 15-16.

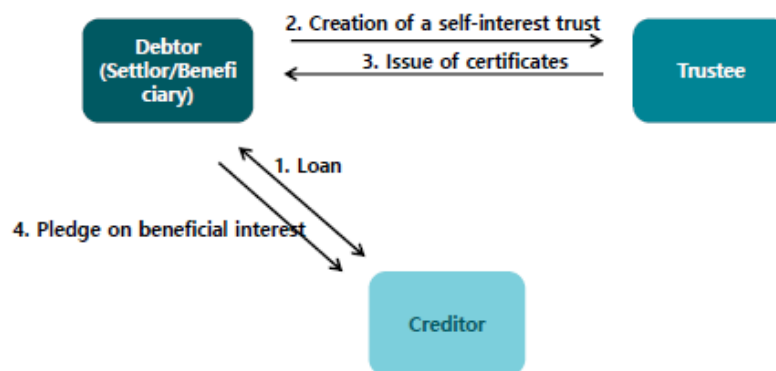
Civil Act where the original reinstatement (原物返還) is implausible.²⁹

B. Bankruptcy Remoteness: Mortgage v. Trust for Security Purpose

1. The Structure of Real Estate Trusts with Security Function

The simplest way for a creditor to secure his claim against the owner of real estate is to establish a mortgage right on the estate. More complicated structures using a trust, which serves the same security function as a mortgage, have been widely used in Korea. At the core of the use of a trust is the bankruptcy remoteness of trust properties: Once a trust is validly created, settlor's creditors as well as trustee's creditors may not enforce their claims against trust properties. Among others, the major possible schemes under the Trust Act are as follows:

[Diagram 1] Real Estate Trusts with Security Function Type (1)

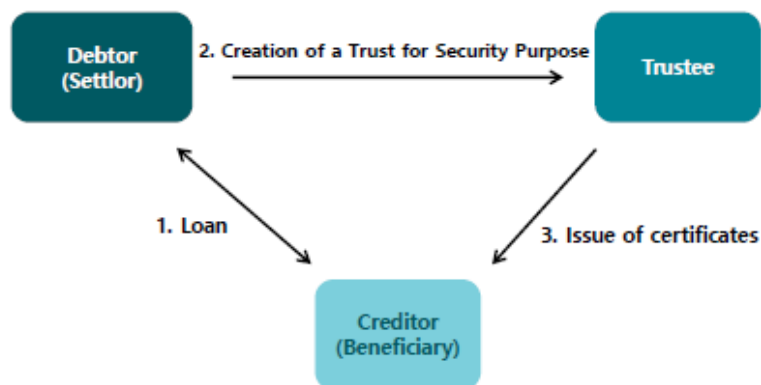


First, as in Diagram 1, a self-interest trust may be used to serve a security function: Asked by a lender (creditor) to provide security interest, the borrower (debtor/settlor) may create a trust and receive beneficial interest; as a next step the borrower, by transferring beneficial interest, establishes a pledge over beneficial interest for the lender.³⁰ Now that the property has been transferred to the trustee, other creditors of the settlor may not enforce against the property. If the settlor fails to discharge his debt, the lender may satisfy his claim by executing his pledge right.

[Diagram 2] Real Estate Trusts with Security Function Type (2)

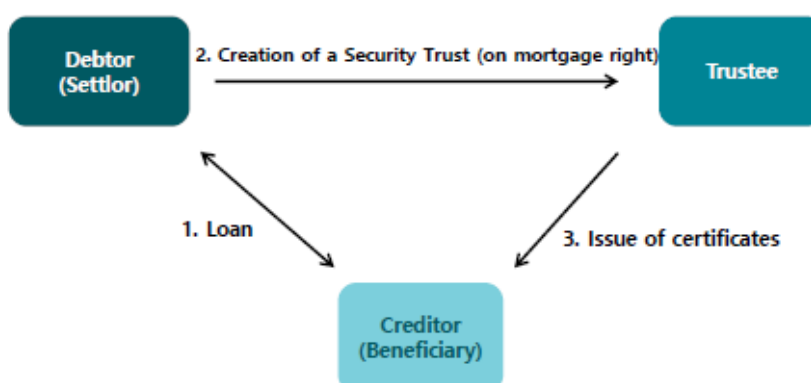
²⁹ 2004Da54978, Dec. 7, 2006 (the Supreme Court of Korea).

³⁰ The beneficiary may create a pledge over his beneficial interest (Sec. 1 of Art. 66).



Secondly, a trust for another’s interest may also be used as in Diagram 2: Under the structure, a borrower/settlor creates a trust, the beneficiary of which is the lender. In most cases the settlor receives secondary beneficial interest that is inferior to preferred beneficial interest belonging to the preferred beneficiary (i.e. settlor’s creditor). Like a mortgage, a creditor with such beneficial interest may secure his claim against the settlor.

[Diagram 3] Real Estate Trusts with Security Function Type (3)



The third type has become plausible in 2011 via Art. 2 of the Trust Act: The trust may be created by transferring security rights (including mortgage right and pledge right). Before the revision, a structure in which the claim is owned by a beneficiary while its backing security interest is enjoyed by a trustee was not allowed³¹ under the traditional theory that a claim and the security right should belong to the same person. Now that the separation of claim and the security right are possible under the new Trust Act, so-called security trust (擔保權信託) as in Diagram 3 can be established. In the diagram, the borrower/settlor creates a security trust by establishing a mortgage right to trustee, the beneficiary of which is the lender/creditor. Once the settlor fails to discharge the loan, the lender may direct the trustee to exercise mortgage rights for the benefit of the lender, the beneficiary of the trust.

Among those three types, the most common scheme is the second one, and when we mention a “Trust for Security Purpose (擔保信託),” it typically refers to this. But why is this

³¹ One exception, however, is provided under the Secured Debentures Trust Act.

type so popular in Korea? The strength of type (2) is based upon its complete bankruptcy remoteness and regulatory arbitrage, as shown below.

2. Merits of a Trust for Security Purpose

Table 5 shows the difference between a mortgage and a Trust for Security Purpose. As noted in the table, both lenders and borrowers are more likely to prefer establishing a Trust for Security Purpose. ① The cost of establishing a mortgage is much higher due to the tax burden and the obligation to purchase state/national bonds. The establishment of a Trust for Security Purpose, while entailing the commission to the trustee, costs a lot less thanks to tax exemptions.³² ② The enforcement under a Trust for Security tends to be quite efficient and produce more proceeds. Unlike a public auction by the courts, such enforcement is presided over by a trustee company that has business networks and can make quick and flexible decisions.

[Table 5] Mortgage vs. Trust for Security Purpose: In Case of Borrower’s Solvency³³

	Mortgage	Trust for Security Purpose
Cost to create and operate	High - Acquisition tax and education tax: 0.24% of the maximum secured amount - Mandatory purchase of state/national bond: 1% of the maximum secured amount	Low - Acquisition tax and education tax: exempt ³⁴ - Mandatory purchase of state/national bond: not applicable - Trust commission: less than 0.5% of the beneficial interest
Difficulty of enforcing claim	Difficult - Sale through auction by the court - Complicated and time consuming	Easy - Sale by the trustee company - Simple (negotiated sale is possible)
Expected proceeds from enforcement	Low - In auction process, no effort for encouraging sale is made by the court	High - Trustee companies tend to be professional and active in sales

Table 1, which focuses upon the case of borrower’s solvency, however, misses one major point that lenders consider most: What if the borrower gets insolvent and enters into a rehabilitation process (similar to the U.S. Chapter 11 process) under the Debtor Rehabilitation and Bankruptcy Act (the DRBA)? From that perspective, a Trust for Security Purpose provides almost complete bankruptcy remoteness from settlor’s other creditors, a goal that cannot be achieved by other devices.

If a borrower enters into the rehabilitation process, the court will reduce and reschedule the claims against the borrower according to the rehabilitation plan. Mortgaged or pledged creditors as well as unsecured creditors shall be subject to the reorganization and even the rights of secured creditors shall endure reductions. One important exception to this rule, however, is provided by Sec. 2 of Art. 250 of the DRBA: The rehabilitation plan shall not influence a creditor’s rights to security if the security has been provided by any person other

³² The rationale of the tax exemption is that to create a trust shall not change economic substance.

³³ The table was modified from presentation material from the Financial Services Commission (2013).

³⁴ Sec. 3 of Art. 9 of the Local Tax Act.

than the debtor. For example, having received loans from lender Y and Z respectively, borrower X, for security purposes, created a mortgage on his property for Y and another mortgage on Q's property for Z. In this case, Q, X's friend who was asked to provide his property for X, is a person other than the debtor under Sec. 2 of Art. 250. Where X enters into the rehabilitation process, Z maintains his status as a secured creditor under Sec. 2 of Art. 250 and may exercise his claim as ever before, while Y shall experience reduction of his secured claim according to the rehabilitation plan. Regarding the purpose of such an exception, the Supreme Court once explained³⁵: "The purpose of the corporation rehabilitation process is to assist in reorganizing and reconstructing a corporation that is facing bankruptcy due to financial distress. To achieve this, the process reduces the corporation's debts or obligations, so that the corporation may continue its business operations and gain profit....However, reducing the obligation of a third party including a grantor for the debtor corporation is unrelated to the purpose of the corporation rehabilitation process."

In applying Sec. 2 of Art. 250 of the DRBA, how will a trust with security function be treated? For a Type (1) scheme, which is based upon self-interest trust, a lender may not enjoy the bankruptcy remoteness. It is the debtor/settlor who owns certificates of beneficial interest and has established a pledge by transferring them to the creditor. Accordingly, the pledged creditor shall be subject to the rehabilitation plan. It's unlikely he may get fully repaid if the debtor/settlor enters into the rehabilitation process and the rehabilitation plan stipulates extensive adjustment of secured and unsecured claims against the debtor/settlor.

Type (3), a security trust, is also incomplete in terms of bankruptcy remoteness. While the security interest through mortgage or pledge is given to a trustee, it is the debtor/settlor who owns the property and provides a security. Like Type (1), the creditors in this scheme shall experience reduction of the secured claim according to the rehabilitation plan.

To the contrary, Type (2), the Trust for Security Purpose can perfectly answer creditors' concern. Now that the ownership of the trust property is transferred to the trustee, the rights of beneficiaries on the trust property shall be regarded as unassociated with the rehabilitation process on the settlor. Under Sec. 2 of Art. 250, the lender, unaffected by the rehabilitation plan, can fully enforce his security right reflected as the beneficiary interest on the trustee property.³⁶

Thanks to the complete bankruptcy remoteness, the Trust for Security Purpose has become quite popular in the real estate security market. Lenders have strong motivation to secure their loan by Trust for Security Purpose if other devices like mortgage, self-interest trust, and security trust provide imperfect bankruptcy remoteness.

3. Analysis

The case law that provides complete bankruptcy remoteness often invites criticism from academia: (a) Despite its appearance, the economic substance and role of the Trust for Security Purpose is just the same as mortgage. No rationale is found that a trust scheme should be better treated than a mortgage scheme; (b) complete bankruptcy remoteness over the Trust for Security Purpose implies unequal treatment of creditors of debtor/settlor; and (c) as the Court pointed out, Sec. 2 of Art. 250 assumes a property provided by a third party and

³⁵ 2010Da28383, Jun. 14, 2012; 2005Da48482, Nov. 10, 2005 (the Supreme Court of Korea). The decisions were based upon Sec. 2 of Art. 240 of the previous Company Reorganization Act (revoked by the DRBA on Mar. 31, 2005), which has the same content as Sec. 2 of Art. 250 of the DRBA.

³⁶ 2001Da9267, Jul. 13, 2001; 2002Da49484, Dec. 26, 2002; 2003Da18685 May 30, 2003 (the Supreme Court of Korea).

therefore not associated with a debtor's financial capacity. However, it is difficult to say that a trust property stands totally independent from debtor/settlor's assets, especially in economic substance.

The Court, however, reiterated its jurisprudence over the Trust for Security Purpose. The criticisms, while persuasive in some points, overemphasize the economic substance. The Court's jurisprudence may result in inequality among settlor's creditors by favoring a creditor with beneficiary status at the Trust for Security Purpose. However, disfavored creditors may resort to other methods including canceling the trust under the fraudulent conveyance theory. Making drastic changes to a fixed case law shall cause confusion in business practices dealing with real estate transactions. We need not prohibit a scheme under which a creditor enjoys complete bankruptcy remoteness. The more important thing is to keep the jurisprudence well-known and consistent.

C. Tax Authority as a Creditor of the Settlor or the Trustee

The creation of a trust separates formal legal obligations and rights from economic substance: While the trustee has legal ownership of the trust property under the Korean civil law system, the beneficiary has the economic interest in the property. The tax regulation in Korea shows complicated jurisprudence over who will pay the tax concerning those properties that have been trusted.

As far as the income tax (in case of the beneficiary's being a corporation, the corporate tax) is concerned, a beneficiary is responsible. The statute on the income tax regards a trust as a conduit: Because the profit made during the operation of a trust property is supposed to go to the beneficiary, a beneficiary is expected to pay the income tax. By similar logic, a beneficiary is also responsible for the value-added tax arising from sale and purchase of the trust property.³⁷ On other hand, a trustee is liable for the registration tax from the transfer of property between the settlor to the beneficiary.³⁸³⁹

One of the most controversial issues is who will bear the burden of the property tax on the trust property.⁴⁰ The Korean government revised the Local Tax Act in 2013 so that a trustee should be responsible for the trust property as of Jan. 1, 2014. The implication of this revision needs to be clarified.

1. The Tax Regulation Before 2014: Settlor as a Property Tax Payment Obligor

Before the revision of the Local Tax Act in 2013, a settlor was responsible for the property tax under Sec 2 of Art. 107 of the Local Tax Act. The Supreme Court stated that while the ownership of a trust property is transferred to trustee on the title and the settlor may not argue his ownership to anyone, the courts could not impose the property tax on the trustee (or on the beneficiary) to the contrary of explicit provisions under the Local Tax Act.⁴¹ Combined with the provisions of the Trust Act, Sec. 2 of Art. 107 of the Local Tax Act offers strong protection to the management of the trust property, as shown below.

³⁷ 99Da59290, Apr. 25, 2003 (the Supreme Court of Korea).

³⁸ 2004Doo6761, Jun. 30, 2006 (the Supreme Court of Korea).

³⁹ The acquisition tax arising from the transfer in creating a trust, however, shall be exempt as shown by Table 5.

⁴⁰ The same logic shall be applied to the gross real estate tax because it adopted the same provision as the property tax. Please refer to Sec. 1 of Art. 7 and Sec. 1 of Art. 12 of the Gross Real Estate Tax Act.

⁴¹ 2001Doo26223, May 10, 2012, 2009Da969, Oct. 27, 2011 (the Supreme Court of Korea).

Sec. 1 of Art. 22 of the Trust Act prohibits an enforcement upon the trust property with limited exceptions: One of the major exceptions is where the right on which the enforcement is made has arisen in the course of the trust's operation. Can the tax authority's right over the property tax be said to be obtained concerning the trust's operation? A case was brought in over this issue: In the case, the settlor/beneficiary went bankrupt and the tax authority tried to satisfy its property tax claim by the enforcement against the trust property. The lower court stood by the tax authority.⁴²The right which has been obtained in the course of the trust's operation under Sec. 1 of Art. 22 includes, ① a right based upon the management and the sale of the trust property and ② a right which is originated from the trust property. The property tax, even though it is imposed after the creation of trust, can be fairly said to be originated from the trust property, the lower court stated. Thus the trust property shall be subject to the enforcement based upon a property tax claim. The Supreme Court, however, overruled the decision.⁴³ The Court focused upon the person who is subject to a property tax claim. As shown above, the settlor, not the trustee, is responsible for property tax. Because it should not be allowed to enforce upon the trust property arguing a claim against the "settlor," the tax authority may not exercise a property tax claim vis-à-vis the trust property. According to this logic, the tax authority may enforce its tax claim against trustee property only if the claim is owed by the trustee.

Criticisms have been raised against this ruling. The most important one is about the inequality. Generally speaking, the tax law gives privilege to the property tax claim in the process of enforcement: the property tax has priority to any secured as well as unsecured creditors.⁴⁴ The rationale is that the tax is closely associated with the property itself and the interested parties including secured creditors were able to expect the imposition and amount of the tax. The same logic should be applied to the secured and non-secured creditors on the trust property, the critics argued.

2. The Tax Regulation After 2014: Trustee as a Property Tax Payment Obligor

In 2013, the Local Tax Act was revised to identify the trustee as a person to be responsible for the property tax.⁴⁵ It is also notable that the property tax shall be imposed only upon the trust property, separated from the trustee's inherent assets, and thus the failure to pay such property tax shall not function to the disadvantage of the trustee.

While no case law was reported yet, the courts would naturally allow the enforcement against the trust property by the tax authority arguing a property tax claim. Now that the trustee is obliged to pay property tax, a trustee or a settlor cannot resort to the prohibition under Sec. 1 of Art. 22 of the Trust Act.

3. Analysis

The trustee companies in Korea strongly resisted the revision of 2013. They emphasized

⁴² 2010Na5172, Jul. 9, 2010 (the Suwon District Court).

⁴³ 2010Da67593, Jul. 12, 2012 (the Supreme Court of Korea).

⁴⁴ Sec. 1 of Art. 35 of the Framework Act on National Taxes and Art. 14-4 of the Enforcement Degree of the Local Tax Act.

⁴⁵ Sec. 1 of Art. 107 of the Local Tax Act.

that the trustee is not more than a nominal title-holder and the enforcement against trust property shall threaten the stable management of the trust property.

The revision of 2013, however, seems to be a step in the right direction. What is the purpose of Sec. 1 of Art. 22 of the Trust Act? The reason the provision allows an enforcement against the trust property as far as the right was caused in the course of trust's operation is that such imposition or enforcement looks fair: Because the cost is derived from the operation of the property itself, the property should be subject to the claim based upon the cost. A property tax can be safely regarded as an essential part of a cost related to the operation of a property. The revision of 2013, which enables the enforcement of tax authority, shall be viewed as filling a loophole.

What is the impact of the revision on the trust business? Under the old provision, the independence of the trust property was strongly protected: A settlor and trustee might create a trust dissociated with a property tax claim. This feature of trust was detrimental to both tax authority and other creditors of the settlor: The property tax authority was prohibited from the enforcement against the trust property; general creditors of the settlor should be subordinated to the property tax authority as a settlor's creditor. The new regime, on the contrary, shall be detrimental to creditors of the trust business, who shall be subordinated to the property tax authority.

IV. Inside the Trust: Reimbursement by the Trustee

A. Reimbursement against the Trust Property – In Case of a Transaction with the Trust Property

The Trust Act strictly regulates opportunistic behaviors by a trustee and imposes the duty to avoid conflicts of interest on trustees: Art. 33 of the Act declares the general principle of duty of loyalty by providing that a trustee should serve for the benefit of the beneficiary; Sec. 1 of Art. 34 of the Trust Act further stipulates specific transactions that are prohibited by the law, including (a) a transaction between the trust property and the trustee's inherent property, (b) a transaction among different trusts belonging to the same trustee, and (c) a transaction between the trust property and a third party who is represented by the trustee. Unless the trust instrument allows such transactions, the trustee may execute such transactions only under the approval by the beneficiaries or the court (Sec. 2 of Art. 34). What if a trustee ignores the rule and proceeds with the prohibited transaction? While the Act does not stipulate the validity of such transaction, the Korean courts and scholars opined that a transaction between the trust property and the trustee's inherent property shall be invalidated because no third-party protection is to be considered.

In Korean real estate trust practice, the application of Art. 34 of the Trust Act has become controversial. Real estate trustee companies for land development tend to serve as trustees for multiple development projects at the same time. Those companies have "inherent accounts (固有口座)" that manage their own assets. Undoubtedly, the inherent account shall be separated from each "trust account (信託口座)" that administers the trust property. Instead of financing necessary funds for each project when required and then supplying it to a trust account, many trustee companies raise money in advance based upon their credit and keep it in their inherent accounts. When a development project progresses and requires fresh funds, they transmit money from inherent accounts to the trust account as a loan. Is the loan valid under Sec. 1 of Art. 34, which prohibits a transaction between the inherent account and the

trust account? If not, what arguments can the trustee companies make for the loaned money and its interest? The Korean Supreme Court recently made a decision on those issues.⁴⁶ While the decision was made under the old Trust Act, the same logic shall apply unless the trust instrument or the beneficiaries' approval exists.

On the validity of the transaction between the inherent account and the trustee account, the Supreme Court regarded it void. A loan from a trustee's own asset to the trust property may be disadvantageous against trust property, and Sec. 1 of Art. 34 eliminates such risk. According to the court's decision, the trustee company could not ask for the payment of the principal and the interest promised in the loan agreement. The conclusion shall not be affected by the fact that the transaction turned out to be advantageous to the trust property.⁴⁷

Faced with the denial of the loan agreement, the trustee companies took a different approach based upon the reimbursement clause under Sec. 2 of Art. 46 of the Trust Act⁴⁸: Where a trustee has paid expenses incurred in relation to the performance of trust administration from the inherent property, he is entitled to reimbursement by the trust property for the expenses paid and the interest accrued from the date of payment. Under this clause a trustee may recover the principal paid to the trust property. But what about the interest borne by the loan agreement? For example, while the market interest rate is 4% a year, the trustee, based upon his reputation and higher credit rating, financed \$10m cheaply at 3%. Then he loaned to the trust property the \$1m along with \$5m from his own fund at the interest rate of 5%. Is the trustee entitled to the interest at 5%, arguing that his claim is not based upon the loan agreement but upon Sec. 2 of Art. 46? The court took a different stance according to the sources of the fund: funds from an outside source (\$10m in the example) and from an inside source (\$5m in the example). While both funds were managed by the trustee, the financing cost concerning the former can be easily traceable and provable, while the cost of latter is not.

For funds from outside sources, the trustee is entitled to reimbursement of the same interest as he has financed, the Court concluded. In the example, he is not allowed to claim market interest rate at 4% nor at 5% under the loan agreement but at 3% because this is the actual level of financing applied to him. That is, the Court denied any profit by the trustee from the transaction between the inherent property and the trustee property. The trustee counter-argued based upon unfair enrichment doctrine: The financing without the involvement of the trustee must be made at the market interest rate of 4%, and therefore the interest rate of 3% in the real deal benefitted the trust property without legitimate cause. The Court responded, however, that the reputation and higher credit rating is the reason that the settlor chose the trustee and thus the benefit enjoyed by the trust property was not an unfair enrichment.

More problematic was the issue of funds from an inside source. While the Court acknowledged the possibility of a trustee's proving the cost of financing, thereby claiming the interest, it largely denied any interest claim from such a fund. Overturning the Seoul Higher Court's decision that funds from an inside source should be treated equally as those from an outside source, the Supreme Court treated the former different from the latter. If the trustee is to be reimbursed on the interest from its own fund, he should prove the real payment of cost concerning the fund. An economic analysis including opportunity cost borne by the trustee was not sufficient. Actually, it seems almost implausible to claim the interest on the fund paid

⁴⁶ 2011Da18482, Jun. 10, 2011 (the Supreme Court of Korea).

⁴⁷ 2006da62461, Jan. 30, 2009 (the Supreme Court of Korea).

⁴⁸ For this case, Art. 42 of the old trust law, which has a similar provision as the current Art. 46 of the Trust Act, was applied. The trust instrument in this case also had a reimbursement clause based upon Art. 42 of the old trust law.

to the trust property if the fund is sourced by the trustee's own money.

The jurisprudences by the Supreme Court on the ① validity of transaction between the inherent account and the trust account and ② the scope of reimbursement where the trustee has received cheap financing make sense. Potentially harmful transactions need to be strictly regulated, and the duty of the trustee to serve the best benefit of beneficiaries should be respected. The logic applied to the imbursement from the inside-sourced fund, however, is subject to criticism, especially in the context of a commercial trust. As mentioned above, real estate trustee companies tend to operate multiple real estate development projects and to raise outside funds in advance. Such outside-sourced funds, together with trustees' own funds, shall be operated in trustees' inherent accounts. Following the Supreme Court decision, the trustee companies should specify the source of funds in an inherent account so that they can identify the nature of funds transferred to a trustee account. It's doubtful that the imposition of such a burden on trustee companies would lead to better protection of beneficiaries. Further, it seems absurd that a fund the source of which is a trustee company's own reserve is different from that from the outside source and shall not be entitled to the interest borne during the loan period. The beneficiaries for the real estate development projects are investors rather than seniors or minors requiring special protection, because the project is planned and executed on a commercial purpose. Just as the trustee companies should not gain improper benefits from the transaction with a trust property, so shall they be entitled to recover appropriate capital cost.

B. Reimbursement against Beneficiary – the Possibility of Waiving Beneficiary Rights

While the reimbursement of the legitimate expenses paid by the trustee against “trustee property” is allowed in most jurisdictions, the legislations differ on the reimbursement against “beneficiaries.” The new Korean Trust Act, like the old Act, acknowledges a trustee's reimbursement claim upon beneficiaries (Sec. 4 of Art. 46). The new Act, however, made some modifications to the old Act: ① Beneficiaries are responsible for the reimbursement to the extent of the benefit they have acquired (as compared to no limit under Sec. 2 of Art. 42 of the old Act); ② the reimbursement against beneficiaries is allowed where trust property is insufficient for indemnifying a trustee's payment (as compared to the old act, which did not have explicit priority provision between reimbursement against beneficiaries and the trust property).

The two modifications by the new Act were made to balance the interest of beneficiaries and trustees. The financial status of a real estate trust that has been quite strong in its initial stage may turn bad as its operation goes. In such surroundings it might be harsh to impose the cost and expenses for the management of the trust property only on a trustee even though the nature of trust is commercial. In order to protect the trustee, the new Act allows reimbursement against the beneficiary, an approach basically same as in the old Act. The new Act, however, also pursues the protection of beneficiaries by setting limits on reimbursement and placing the reimbursement claim against the beneficiary as a last resort. One might think a beneficiary who is also a settlor and has enjoyed the upside of the trust should be responsible for the downside, whatever the amount is. But a trustee is not just an agent of the settlor/beneficiary but a prudent person who can estimate the risk and cost from the real estate project. Even though the settlor/beneficiary has substantial residual interest in the trust

property, it is not always rational to impose on him all the cost and expense from the trust management where the trust is directed by the trustee. If the trustee believes that more liability should be put on the beneficiary/settlor, he should have negotiated for it in the trust instrument.

What if a beneficiary waives his beneficial interest? For example, a beneficiary who already reaped \$2m from the trust and spent all of it may try to waive his beneficial interest when faced with the reimbursement claim by the trustee. Under Sec. 4 of Art. 46 of the Trust Act, he should reimburse \$2m for the trustee because he is liable for the benefit he received. However, having waived his beneficial interest, he needs not reimburse anything because the waiver shall nullify the trust instrument retrospectively and, under the Korean unfair enrichment jurisprudence, he is obliged to return only what he currently has. While some legislations deal with the possibility of waiver according to the type of trust,⁴⁹ the Korean Trust Act generally allows the waiver no matter what the type of the trust: A beneficiary may waive his beneficial interest as far as the waiver shall not infringe upon any third party's right (Sec. 2 of Art. 57). There were some cases in Korea where a trustee made a reimbursement claim against beneficiaries even though they had declared the waiver of beneficial interests. While one lower court, based upon the abuse of right doctrine, limited beneficiary/settlor's right to waiver in a self-interest trust under the old Trust Act,⁵⁰ it is generally accepted that beneficiaries may waive their beneficial interest. The difficulty with the possibility of waiving beneficial interest comes with the range of third parties under Sec. 2 of Art. 57. As stated above, the waiver would be not allowed should it infringe upon a third party's right. A typical third party includes a person whose economic interest is extended from or based upon a beneficiary's beneficial interest, such as a pledgee of the beneficial interest. Is a trustee qualified as a third party? The issue is debated in academia, and no case law exists. In legal contexts, third party generally means someone who is not the party of the disputed arrangement and is under the risk of being negatively influenced by nullification of the arrangement. By waiving the beneficial interest, a beneficiary is intended to actually nullify the act of trust to which the trustee was a party. Therefore it is the trustee that is supposed to receive the notification of waiver by the beneficiary. Thus a trustee cannot be regarded as a third party in the literal interpretation of Sec. 2 of Art. 57. However, it seems unreasonable that, in the example above, the beneficiary is exempt from his obligation to reimburse \$2m thanks to a waiver. Further revision is required in terms of the harmonization of the benefit between beneficiary and trustee.

V. Concluding Remarks: Insights from the Korean Jurisprudences

The paper reviewed major jurisprudences developed in Korea from two perspectives: outside and inside of the trust. Outside the trust, focused upon here are legal disputes concerning settlor's creditors. If the economic substance of a trust is just a nominal transformation of settlor/beneficiary's property and trustee is designated to serve only the benefit of settlor/beneficiary, one may legitimately argue that trust properties, for the eyes of settlor's creditors, should be regarded as settlor/beneficiary's assets. From this reasoning, (1)

⁴⁹ According to Sec. 1 of Art. 99 of the Japanese Trust Act, "A beneficiary may make a manifestation of intention to waive a beneficial interest to the trustee; provided, however, that this shall not apply where the beneficiary is a party to the act of trust." Thus, in general, a beneficiary may waive his beneficial interest, but the waiver is not allowed for self-interest trusts.

⁵⁰ 2010Na84835, Feb. 2, 2012 (the Seoul Higher Court).

in deciding whether and to what extent a fraudulent trust is canceled and the trust property should be resumed, the trustee's good faith needs not be considered, because a trustee is just a custodian serving settlor/beneficiary's benefit; (2) in a rehabilitation process, a secured creditor by Trust for Security Purpose should have the same priority to a secured creditor by mortgage, because in two structures the nature of a property owner's behaviors, which is to provide security, is just the same; (3) the trust property should be subject to the enforcement based upon property tax because the owner of a property should pay the property tax and, whether a property is owned directly or indirectly by trust, the settlor/beneficiary actually owns the property.

What about the jurisprudences in Korea? First, even in a fraudulent trust, a good-faith trustee shall be protected under the Trust Act of 2011. The claim of restoration against a good-faith trustee shall be limited to the existing trust property as of the timing of the cancelation. Second, for a Trust for Security Purpose, the Court provided perfect bankruptcy remoteness as opposed to a mortgage. The Court pointed to the form made by the trust where the ownership of the trust property is transferred to the trustee. Third, while the old Local Tax Act did not allow the enforcement by tax authority against trust property based upon property tax, the revised Local Tax Act of 2014 made the enforcement possible.

The first and second jurisprudences above will strengthen the commercial advantage of trust structure and may benefit the trust industry: A good-faith trustee company may avoid worst scenario of a fraudulent trust; a Trust for Security Purpose may be advertised as reasonable alternative to mortgage. Regarding the issue of property tax, the old provision was quite advantageous to those investors who transacted with the trust business because they did not have to worry about their claim being subordinate to tax authority's property tax claims. Downsides of those jurisprudences are the sacrifice of settlor's creditors. By providing a trust with the structure of independence and separateness, the jurisprudences could be estimated as "commercial trust friendly" at the cost of settlor's creditors. From that perspective, the new provision on the property tax, which shall function to the detriment of the trust industry, seems to be a little trial for counterbalance.

The second major issue in this paper, inside the trust, explored the reimbursement by a trustee. Given the generally friendly jurisprudence on the issue of outside the trust, it may sound natural that trustees should be firmly protected in terms of reimbursement. The jurisprudences in Korea, however, showed a different approach here: The Supreme Court seemed reluctant to allow reimbursement based upon a loan from a trustee's inherent account to the trust account, and denied any profit by the trustee from the transaction between the inherent property and the trust property; while still debated in academia, a beneficiary is generally said to be able to waive beneficiary interest in a failed trust project, leaving the trustee vulnerable to loss from the project without any reimbursement right against beneficiaries.

What creates this difference between outside and inside the trust? As mentioned above, for a commercial trust to flourish, the conceptual and functional independence of a trust including complete bankruptcy remoteness is necessary. When it comes to the inside issue, however, the Korean jurisprudence seems to emphasize the role of the trustee as a fiduciary. The reimbursement against the trust property and beneficiaries was based upon his investment into the trust property or the project. In deciding such an investment, the trustee must have, and usually has, the ability and capacity to estimate the inherent risk and prepare the safeguard in advance. Thus it makes sense that the Korean jurisprudences applied a rather harsh standard to trustees who claim reimbursement, even in the case of commercial trust.