

Notable Cases on the Law of Trusts

*Kye Joung Lee**

translated by JKL student editors

Manuscript received: May 20, 2018; review completed: June 4, 2018; accepted: June 4, 2018.

Korea, a civil-law jurisdiction, legislated the Trust Act in 1961 to adopt the trust originating from common law. However, there was criticism of the contemporary relevance of this Act because it did not correspond with the prevailing economic realities. The Trust Act, therefore, was thoroughly revised to meet international standards and to invigorate the trust system in Korea, and the revised Trust Act came into effect as of July 26, 2012. Consequently, unprecedented interest has been given to the trust and disputes revolving around them is on the increase. The cases introduced below are very meaningful and related to the essence of the trust, and therefore their implications remain valid under the revised Act even though the previous Act was applied to them.

I. Legal Characteristics of the Trustee's Ownership: Supreme Court Decision 2001Da47467 (Decided August 19, 2003)

1. Issues

In this case, the plaintiff was not registering transfer of ownership, although the acquisitive prescription period for Land A had elapsed.

* Professor, Seoul National University School of Law & Ph.D. in Civil Law

Meanwhile, ownership transfer registration was made from the owner of Land A to its trustee. The issue in this case was whether the plaintiff still could claim ownership transfer registration to the trustee.

In principle, when the requirements for prescriptive acquisition has been met but the ownership is not being registered by the possessor and the real estate is transferred to a third party so that a third party has registration, the possessor cannot claim acquisitive prescription against the third party. The issue is whether the same principle is applicable to a case in which ownership of the real estate obtainable by prescriptive acquisition is transferred to the trustee of a trust.

2. *Supreme Court Decision (2001Da47467 Decided August 19, 2003)*

The Supreme Court decided that:

A “trust” under Trust Act means that the settlor transfers a specific property or makes any other disposition to a trustee so that the trustee can manage or dispose of such property to fulfill the purpose of the trust. In real estate trust, when the transfer of its ownership to the trustee is registered in accordance with the settlor’s entrustment, ownership is completely transferred to the trustee both internally and externally; neither is it reserved to the settlor within their internal relationship. The trustee only bears an obligation to manage the trust property within the ambit of the trust purpose prescribed by the trust agreement. Thus a “trustee” under the Trust Act, for whom a settlor of a real estate has registered transfer of ownership after an acquisitive prescription period has elapsed, is a third party against whom the possessor cannot claim prescriptive acquisition.

Thus, the decision was that the plaintiff cannot claim ownership transfer registration to the trustee.

3. *Comment*

Trusts use two frameworks to manage property. One is to transfer

property directly to the trustee, and the other is to render the trust property separated from the settlor. It is designed to maintain management of the property independent of the settlor, even if there is a change of circumstances such as the death of the settlor and insolvency, by transferring the title to the trustee. There are property management systems which have similar functions to a trust; agency, mandate, administration of an estate. Transferring the title to the trustee is the fundamental difference between such property management systems and trust.

As the trustee owns the trust property for the profit of the beneficiary and not that of the trustee, it is inevitable that the right of the trustee has several restrictions. This means that it is controversial to explain the ownership of the trustee. The Supreme Court clarified the issue to the effect that the trustee has ownership internally and externally and his ownership is restricted only to managing the trust property within the scope of the purpose of the trust following the trust agreement. Article 31 of the Trust Act declares that:

A trustee shall, as the subject in whom the rights and duties concerning the trust property is vested, have the authority to perform the management, dispose of trust property and to engage in all conduct necessary to fulfill the purpose of the trust: Provided that such authority may be restricted by trust terms.

It can be said that this is a proper interpretation as regards the ownership of the trustee, however to interpret it more precisely, the trustee's property right is immanently restricted both by the right of the beneficiary, which is deemed to retain proprietary characteristics, and by fiduciary duty originated from the trust relationship.

II. Whether the Victim of the Tort Committed by the Trustee Can Claim His/Her Right against the Trust Asset: Supreme Court Decision 2005Da5843 (Decided June 1, 2007)

1. Issues

After the trustee had completed the ownership transfer registration of the land, the trustee constructed and leased condominiums to general consumers. The trustee committed a tort against the lessee through false or exaggerated advertisements. The issue was whether the victim of the tort committed by the trustee can claim his/her right against the trust asset.

2. Supreme Court Decision (2005Da5843 Decided June 1, 2007)

The Supreme Court decided that:

In contrast to general obligees of the trustee, the obligee who has a 'claim arisen in the course of the performance of trust affairs' may execute the compulsory execution against trust asset, and it is reasonable to say that a claim arisen in the course of the performance of trust affairs includes the tort claim that a third party has due to a tort committed against the third party by the trustee, who performs trust affairs such as management and disposition of trust property, in the process of performing his ordinary business affairs. The reason is that even if we consider the fact that the inherent purpose of Trust Act is to guarantee the separateness of trust property from the settlor or trustee's inherent property, the duties of trustee today goes beyond the traditional scope of simply managing property and involves robust external activities, and thus it is undeniable that there is need for protection measures for the injured party in accordance with this situations; in addition, a principal or employer assumes responsibility for the action of an agent or employee, and thus even though one cannot say that the settlor himself should assume responsibility for the action of the trustee within his general

authority, it is fair to say that the trust asset should assume responsibility for it.

The court thus decided that the victim of tort committed by the trust can claim his/her right against the trust asset.

3. *Comment*

The article 22 paragraph (1) of the Trust Act stipulates that in principle, neither compulsory execution nor auction based upon the security rights may be made against a trust property. This is a declaration of the separateness of the trust property, which means that trust property should be seen as separate from trustee's inherent property, since the nature of trusts is management of the property for another person(=beneficiary). However, by exception, compulsory execution can be made against trust property in relation to a right that arises in the course of the performance of trust affairs (proviso of article 22 paragraph (1) of the Trust Act), and such a claim is called a trust claim.

One issue regarding a trust claim is whether the injured party's tort claim constitutes a trust claim if the trustee committed a tort against a third party in the performance of trust affairs. The Supreme Court affirmed this, and UTC of the United States takes the same position.¹⁾

The principal reason that a trust property must be treated separately from the trustee's inherent property is to achieve the purpose of the trust. If the matter is irrelevant to the achievement of the trust's purpose, there is no reason for the trust property to assume responsibility. In contrast, it is logical that the trust property should assume responsibility for a tort that was committed while the trustee was performing business to achieve the purpose of trust. Thus, the Supreme Court's decision on this point is appropriate. It can be said to be an acceptable rationale in order to protect the injured party in the event that the trustee is insolvent.

1) UTC §1010(c).

III. Whether Insolvency Protection Can be Affirmed in Case of the Collateral Trust: Supreme Court Decision 2001Da9267 (Decided July 13, 2001)

1. Issues

A collateral trust refers to a trust which takes the following form: the settlor (who is an obligor) transfers the ownership of property to the trustee, the obligee being the beneficiary; in case of the obligor's default, the trustee disposes of the trust property and reimburses the beneficiary (the obligee) with the proceeds from the sale. The collateral trust functions, economically, as the collateral of the beneficiary's claim, as the settlor transfers the ownership of the trust property to the trustee and grants the beneficiary's right to the obligee for securing the discharge of obligation.

One issue regarding a collateral trust is whether it should be governed by the principle of collateral law, emphasizing its economic function as the collateral purpose, or by the law of trusts, emphasizing the form of the transfer of ownership. In particular, the issue is whether the trust property is affected if the settlor becomes insolvent, deeming the settlor as having provided the collateral for the obligee.

2. Supreme Court Decision (2001Da9267 Decided July 13, 2001)

The Supreme Court fully affirmed the insolvency protection of the collateral trust by deciding that the settlor's insolvency does not affect the beneficiary's right, since the beneficiary's right of the obligee is provided not by the settlor but by the trustee, and ownership of the trust property belongs to the trustee even in the case of the collateral trust. More recently, the Supreme Court also decided that a trust under the Trust Act means that the settlor render the trustee the authority to manage and dispose of a specific property for the purpose of trust through transfer of the ownership to the trustee, and the collateral trust is also explicable on the same theoretical basis.²⁾ Considering this, it is deemed that Supreme Court will

2) Supreme Court En Banc Decision 2012Du22485 Decided May 18, 2017.

also affirm the insolvency protection of the collateral trust under the current Trust Act.

3. *Comment*

In the case of a settlor's insolvency after the settlement of a collateral trust, if emphasis is placed on the form, which is the transfer of ownership of trust property to a trustee, the trust property is unaffected according to the principle of the separateness of trust property. However, if emphasis is placed on the substance that a settlor provided collateral for an obligee, the trust property is affected by the insolvency of settlor.

One of the advantages of collateral trust is that trustee can flexibly decide the means of disposing of the trust property. The reason the trustee has such authority is that the trustee is the property owner. Considering this point, the interpretation that respects the trustee's ownership is rational. Thus, the interpretation that regards the trustee's ownership merely as a security right is not valid and the interpretation that acknowledges the insolvency protection of the trust property is tenable.

However, one must note that acknowledging insolvency protection in a collateral trust may cause significant setbacks in the obligor's (=settlor's) rehabilitation, since the beneficiary right of the obligee can avoid restriction of the rehabilitation procedure.

IV. Trust and the Person who is liable for VAT Payment: Supreme Court Decision 2012Du22485 (Decided on May 18, 2017)

1. *Issues*

The issue concerns who is liable to pay VAT when the trust property is disposed of to a third party. As reviewed regarding the collateral trust above, the reasoning on this issue is applicable to collateral trust because collateral trust is not regarded differently from ordinary trust.

2. *Supreme Court Decision (2012Du22485 Decided May 18, 2017)*

The Supreme Court decided that “Korea’s VAT is a transaction tax which is levied on the appearance of transactions rather than an actual aspect, and therefore the issue of whether one is liable for VAT payment should, in principle, be decided based on the form of the supply of goods or services, not the actual attribution of profit or costs.” According to the Trust Act, the settlor of a trust is transferring a specific property or making some other disposal to the trustee so that the trustee may manage or dispose of the property right in accordance with the purpose of the trust.

Therefore, if the trustee provides goods in the course of managing or disposing of the property right transferred to him by the settlor, the trustee himself is managing the trust business. The trustee therefore is the contracting party, and the rights and duties attached to the trust party are attributable to him. Therefore, the trustee is liable for VAT payment because it is the trustee who transferred the right to goods to the other party through the juristic act of supplying goods. Therefore, the Supreme Court decided that when a trust property is disposed of, the trustee is liable for VAT payment.

3. *Comment*

In a trust relationship, the settlor’s property right is transferred to the trustee, who then disposes of it to a third party, delivering the proceeds to the beneficiary. One issue is whether the settlor is liable for VAT payment when he transfers the trust property to the trustee. However, the transfer of the trust property to the trustee is gratuitous and cannot be interpreted as a supply of goods, so the settlor is not liable.³⁾ However, when the trustee disposes of the transferred trust property to a third party, this can be seen as a supply of goods, and therefore a liability to pay VAT occurs.

It must be noted that Korea’s VAT law only sees the transaction of “supplying goods or services” as taxable and does not deem the income

3) See Supreme Court Decision 2012Du13393, Decided on June 15, 2017.

deriving from such a transaction as taxable. Therefore, in deciding who is liable for VAT payment, one must look at the form or semblance of the transaction, and on the issue of the disposal of trust property, the trustee is liable for VAT payment even though actual benefit deriving from supplying goods is supposed to vest in the beneficiary. The Supreme Court decision made this rule clear.

V. The Legal Characteristics of the Leasing Guarantee Trust: Supreme Court Decision 2014Du38149 (Decided June 8, 2017)

1. The Leasing Guarantee Trust and Issues

In Korea, the pre-leasing system allows the leasing of a condominium that has not yet been constructed and this is allowed under certain conditions. This system is advantageous for condominium buyers and sellers in that for the buyers it alleviates the burden of financing because they can pay according to the phase of construction, and the sellers can easily receive financing from the buyers so that they can proceed with construction without much financing of their own. However, it also has the drawback that it imposes on the buyer the burden of the various possible risks that may arise during the construction. For example, if there is an insolvency of the seller during construction, the risk of construction halting is imposed on the buyer.

The leasing guarantee trust has been developed to rectify such a problem. The leasing guarantee trust is a trust by which the leasing businessman transfers the construction site and the condominium to the trustee, and it involves a leasing guarantee. The leasing guarantee means that “when the business owner cannot perform the leasing contract for reasons such as insolvency, the trustee guarantees the performance of the leasing or refund of the purchase money. For example, a leasing businessman who plans to construct and to lease condominiums makes a leasing guarantee trust contract with the Korea Housing & Urban Guarantee Corporation(hereinafter “KUC”), and if the businessman cannot perform his obligation, then KUC either completes the construction and

transfers its ownership to the buyer (i.e., KUC guarantees the performance of leasing) or refunds the purchase money to the buyer (i.e., KUC guarantees the performance of refund). The leasing guarantee trust is a distinctive trust that has been developing in Korea.

In a leasing guarantee trust, the leasing businessman who plans to construct a condominium is a settlor and secondary beneficiary, and KUC is a trustee and priority beneficiary. Once a leasing guarantee trust is established, the businessman should transfer the ownership transfer registration to KUC based on the trust. When the trust contract has been terminated on the ground of complete performance by the businessman, KUC should transfer the ownership registration on the construction site to the businessman so that the businessman can successfully lease a newly constructed condominium to buyers, and finally transfer the trust principal and benefits to the businessman. Once the leasing contract is successfully performed, the businessman becomes the only beneficiary. However, when KUC performs the obligation of the leasing guarantee instead due to default of the businessman, the land and the condominium under construction become a collateral for the KUC's right to indemnity. In this case, KUC is given the ownership as a trustee not only of the land that has already been trusted but also of the condominiums under construction, and it can dispose of such trust assets in a reasonable way. As a priority beneficiary, it can use proceeds for the satisfaction of the indemnity claim.

In leasing guarantee trust cases, KUC often registers the ownership transfer of the trust property after the performance of refund to buyers on behalf of the businessman. In such cases, it is controversial whether acquisition of the trust property is a gratuitous acquisition or an acquisition for value. Since KUC often completes the registration without recording the cause of acquisition, i.e. leasing guarantee trust, it can be seen as an acquisition for value from the aspect of the registration form. This is an important practical issue, because depending on its conclusion, the amount of registration tax and local education tax differs.

2. Supreme Court Decision (2014Du38149 Decided June 9, 2017)

The Supreme Court clearly decided that:

...since the trustee does not pay any price for the transfer of the property ownership, if the trustee had completed the ownership transfer registration, it should be considered as a gratuitous acquisition. Whether an acquisition is gratuitous or for value should be decided based on the actual relationships of the parties regardless of apparent recording of registration.

It thereby decided that KUC's acquisition of the trust property is a gratuitous acquisition following the leasing guarantee trust.

3. *Comment*

In judging whether the trustee's ownership acquisition falls under the category of gratuitous acquisition, it is important to understand the legal characteristics of a leasing guarantee trust.

When considering its contents, the leasing guarantee trust can be interpreted as combining a management trust with collateral trust. In the leasing guarantee trust, KUC manages trust property- the construction site and the condominium - and when the trust contract is terminated because the businessman has performed the leasing contract, KUC is obligated to transfer the ownership of trust property and deliver the principal and revenue arising from the leasing business to the leasing businessman(= the settlor). This can be seen as management trust. On the other hand, KUC can take ownership of the construction site and the condominium as collateral for its right to indemnity. KUC can dispose of trust property in a reasonable way and use the proceeds for the satisfaction of the indemnity claim in case of the default of the leasing businessman. In this sense, a leasing guarantee trust falls under the category of a collateral trust.

Thus, when KUC completed ownership transfer registration of trust property after performance of refund, even when the recorded cause of transfer was not a trust, it is fair to say that KUC completed ownership transfer registration in order to manage and dispose of a trust property in its capacity as a trustee. Therefore, the acquisition of trust property by KUC is gratuitous regardless of the appearance of the registration.

www.kci.go.kr

www.kci.go.kr