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A Giant Leap for Fairer Tax or Blind Compromise with Public Opinion? — A Review on the New Case Law on "Substance-over-Form" by the Supreme Court of Korea*

*Yoon, Ji-Hyun***

Abstract

This Article discusses recent developments pertaining to the substance-over-form principle in Korean tax law, which is sometimes regarded as a general anti-avoidance doctrine. In particular, this Article focuses on a recent judgment by the Supreme Court of Korea (the "SC").

After reviewing the relevant facts, the SC's holding, and its dissenting and supplementing opinions, this Article points out that this new case law is clearly a departure from the SC's old case law. This Article attempts to identify those theoretical factors and social incidents that influenced this radical change of direction. It is argued that this change in case law has to do with some real cases where sophisticated tax avoidance schemes were involved, but the tax authorities had difficulty in striking them down. Hostile public sentiment against these taxpayers led the legislature to enact statutory anti-avoidance rules of a general nature, and the administration to challenge the avoidance schemes employed by the taxpayers.

In brief, it is argued that the new case law should be understood in conjunction with all those social incidents and their aftermath. However, whether this change can also be supported from legal perspectives is yet a difficult question to answer, and should be subject to further discussions.

Key Words: Substance-over-form, Legality principle, General anti-avoidance rule (GAAR), Tax avoidance

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** Associate Professor of Tax Law, Seoul National University School of Law; dellacasa@snu.ac.kr

I. Introduction

This Article aims at reviewing, analyzing and evaluating from diverse perspectives a recent judgment[1)] rendered on the issue of "substance over form" by the Supreme Court of Korea ("SC"). In this case, Rodamco, a well-known investment fund specializing in real property, attempted to avoid the so-called Korean "deemed" acquisition tax by structuring the deal in a manner that the deeming provision should not be triggered. The Korean local tax authorities, i.e. the Seoul Metropolitan Government ("SMG"), did not agree and assessed the (deemed) acquisition tax at issue, and the taxpayers appealed. The SC, with its Plenary Chamber deciding on this case, established a new case law on the substance-over-form principle under Korean tax law, which this Article will discuss in the following order.

Section 2 will introduce and review this *Rodamco* Judgment itself, i.e. facts, issues and holdings (including the dissenting and supplementing opinions), taking into consideration the SC's former precedents, and the relevant international standards. This will include comparison with two selected jurisdictions, that is, Japan and India, partly to take account of the forum where this Article will be first presented in public.[2)] Having confirmed that the *Rodamco* Judgment is a sharp turning point from the old case law, Section 3 will be dedicated to identifying and analyzing what constitutes the social and political backgrounds thereof. Section 4 will wrap up discussions with some concluding remarks.

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1) This Article hereinafter will refer to this case or judgment as "*Rodamco* case" or "*Rodamco* Judgment" according to the former name of the plaintiff. The *Rodamco* Judgment was rendered on January 19, 2012, and its case identification number is 2008Du8499 (Supreme Court, 2008Du8499, Jan. 19, 2012).

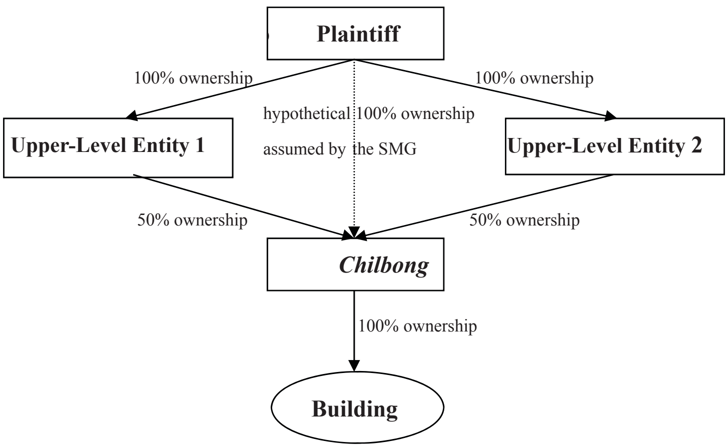
2) A draft of this Article was first presented in public at the 10th Asian Law Institute Conference, on May 24, 2013 in Bangalore, India.

II. The Supreme Court *Rodamco* Judgment

1. Facts

The plaintiff in this case is Ocmador Pacific B.V., former Rodamco Pacific B.V., a Dutch legal entity, which intended to acquire a building situated in Seoul in 2003. Rodamco let the plaintiff indirectly acquire the building in a manner that it is legally (or directly) owned by a Korean holding company, *Chilbong* Industry, and other upper-level entities in turn own the shares in *Chilbong* Industry ("*Chilbong* Shares"). The interesting feature of this structure is that the plaintiff, instead of acquiring directly the *Chilbong* shares, set up two 100% Dutch subsidiaries, and let each of the two subsidiaries acquire 50% of the *Chilbong* shares.[3)]

[Transaction Structure]



3) The plaintiff in this case indirectly acquired another building in Seoul in a similar manner. The difference is that, with respect to this other building, the plaintiff had owned 75% shares of the relevant Korean holding company (i.e. ING Property) prior to this case, and acquired additional 25% afterwards. It is this 25% additional acquisition that was at issue in this other case. It is not hard to imagine the plaintiff made sure that the subsidiary which owned the first 75% and that which acquired the latter 25% were not the same. Only for simplicity's sake, this Article will refer to the acquisition of the Chilbong shares, and refrain from discussing the case of ING Property, assuming of course this will not affect the analyses or discussions in this Article in any adverse way.

Under the *Jibangse-beop* or Local Tax Act ("LTA") of Korea, an acquisition of ownership in real property is subject to acquisition tax. The LTA also has a provision[4] that treats an acquisition of shares in a company in a similar way as that of real property owned by the same company. This is usually called the "deemed acquisition tax," and in order for this "deeming" provision to be triggered, the relevant taxpayer needs to have shares above a certain threshold level. As of 2003, it was set at 51% (that is, ownership of 51% or more shares is needed).

One should also bear in mind that shares owned by a group of related parties will be counted together in this context. The examples of such related parties are enumerated in the *Sihaengryung* or Enforcement Decree of the LTA,[5] and in particular, refer to, (i) a controlling shareholder (company or individual) who has 50% or more shares in the relevant taxpayer company, and, (ii) a subsidiary in which the taxpayer company has 50% or more shares. However, sister companies, i.e. subsidiaries that are owned by the same parent company, were not enumerated as such. This is obviously the reason why the plaintiff had each of its subsidiaries acquire not more than 50% *Chilbong* shares.

As for the two subsidiaries (or "upper-level entities" as referred to in the above diagram), the following facts were also noted in the *Rodamco* Judgment:

> (i) Their addresses, telephone numbers and representative directors are the same;
> (ii) No other employee was hired by either of the two companies;

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4) The deemed acquisition tax as referred to in this Article is based on art. 105, par. 6 of the LTA as of 2003. Currently, this deemed tax is based on art. 7, par. 5 of the same Act. As a matter of fact, the LTA and its enforcement decree were extensively amended in 2011, and accordingly, their provisions were completely renumbered or put in a newly enacted law, i.e. the *Jibangse-Kibon-Beop* or Framework Act on Local Taxes. This Article hereinafter will refer to the provisions of the LTA and its enforcement decree as numbered before the 2011 amendment, and their renumbered or re-placed articles and paragraphs will be cited only in parentheses.

5) Jibangse-Beop sihaengryung [Enforcement Decree of the LTA], Presidential Decree No. 22251, July. 6, 2010, art. 6, par. 1, *amended by* Presidential Decree No. 22395, Sep. 20, 2010. (Currently, Jibangse-Kibon-Beop sihaengryung [Enforcement Decree of the Framework Act on Local Taxes], Presidential Decree No. 24697, Aug. 27, 2013, art. 2-2, pars. 3 and 4.).

(iii) The agent who acted on behalf of the subsidiaries in their acquisition of the *Chilbong* shares was the same person;

(iv) At the 2004 annual shareholders' meeting of Chilbong Industry, there was only one person present, who was delegated by both of the subsidiaries; and,

(v) The subsidiaries paid the price for the Chilbong shares with money that came from the plaintiff, i.e. their common parent company.

2. Issue

Given that the plaintiff never directly acquired the *Chilbong* shares, it could be argued that there is no ground for levying the deemed acquisition tax thereon. In addition, because each of the two subsidiaries, which were not viewed as "related" for the LTA purposes, acquired only 50% of the *Chilbong* shares, it seemed that the deeming provision could not be triggered. This was exactly the position taken by the plaintiff in this case.

On the contrary, the SMG disregarded the two subsidiaries and viewed the *Chilbong* shares as directly owned by the plaintiff, based on the well-known substance-over-form principle. This re-characterization or recasting of the transaction enabled the SMG to apply the deeming provision to the plaintiff, and consequently, it issued a tax assessment.

Therefore, the only issue in this case was whether the substance-over-form principle can go as far as allowing such re-characterization of the transaction, i.e. regarding an acquisition of shares legally made by the subsidiaries as made by their parent company for acquisition tax purposes. The lower-level courts, i.e. the Seoul Administrative Court and the Seoul High Court both found the SMG's tax assessment illegal, stating that the substance-over-form principle could not be viewed as allowing the tax authorities to re-characterize the transaction (i.e. pierce the corporate veil, so to speak, in this particular case) and attribute ownership of the shares owned by a subsidiary to its parent, i.e. the plaintiff.

3. *Holdings*

1) Majority Opinion

In this Plenary Chamber judgment, all the incumbent Justices were involved in the process of delivering the SC's opinion. The majority opinion reversed the judgment of the Seoul High Court, which affirmed the initial judgment rendered by the Seoul Administrative Court in favor of the taxpayer, and remanded the case to the said High Court.

(1) General Principles

The SC first presented a number of principles that it will rely upon in deciding the case. These may be summarized as follows:

> (i) The substance-over-form principle[6] disregards legal forms or appearances that do not coincide with substance, and levy taxes according to the substance, where these legal forms or appearances are used by the taxpayers for tax avoidance motive;
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> (ii) This new doctrine is not contradictory to the constitutional doctrine of "taxation by statutory law" or simply "legality" ("Legality Principle"),[7] but they rather complement each other. The

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6) As this is a local tax case, the substance-over-form principle under art. 14, par. 1 of the *Kukse-Kibon-Beop* or Framework Act on National Taxes ("FANT") cannot apply directly, but art. 82 of the LTA dictated that provisions in the FANT generally apply *mutatis mutandis* to local tax. Since the extensive amendment in 2011, local tax law has had its own provision of the substance-over-form principle, which is art. 17 of the Framework Act on Local Taxes.

7) The translated title of this doctrine needs further clarification, because this doctrine is quite unique to Korea (and Japan), and somewhat hard to find its equivalent in other jurisdictions. This doctrine is said to be based on art. 59 of the *Daehanminkuk Heonbeop* or Constitution of Korea, which provides that "[t]ypes and rates of taxes shall be determined by statutory act." Although art. 59 does not seem to say much, many, including the SC and the Constitutional Court of Korea, believe that this article also dictates that wordings of tax law should be clear and concrete, and statutory tax acts, before mandating details to their enforcement decrees and regulations, should prescribe as much as taxpayers can reasonably predict what and how much is taxed only by looking at the wordings of the provisions of the statutory tax acts. Because this is a constitutional doctrine, if an act does not meet any of these requirements, it can be struck down by the Constitutional Court.

As will be discussed later in this Article, this doctrine has also wide support in Japan. It is substance-over-form principle permits teleological and flexible interpretation and application of tax law, but it functions only within the boundary of legal certainty and taxpayers' predictability. But for such interpretation and application, the Legality Principle would be deprived of its legal validity;

(iii) Therefore, if a taxpayer who legally owns the shares in question do not have the capacity of controlling or managing them, but in substance, someone else controls or manages the shares by making use of the legal shareholder, and this discrepancy results from the taxpayers' intention to avoid application of the deeming provision, such shares should be regarded as owned by the *in-substance* shareholder for acquisition tax purposes; and finally,

(iv) Whether all these requirements are met should be tested, taking all the relevant facts and circumstances into account.

(2) Application of the General Principles

The SC applied the foregoing principles to the facts of this case, and concluded as follows:

(i) The two subsidiaries showed substantially no business activities other than holding, and disposing of the *Chilbong* shares. Given that they had little human or material resources as a business entity, they do not seem to be able to make business decisions or carry out business activities of their own;

(ii) From these facts and circumstances, the SC can reasonably infer that the only motive behind the interposition of the two subsidiaries was to avoid the deemed acquisition tax, and the

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interesting to see that this doctrine is called in the Korean language, "*jose – bubryul – jueui*," and in Japanese, "*sosei – houritsu – tsui*." In either case, the first part means "tax," the second part "statutory law," and the last "doctrine." There seems to be no well-established English translation of this term. The "doctrine of taxation by statutory law" is one possibility, which can be found in at least one Korean treatise in tax law, but I found it too long to frequently use in this Article. Instead, I chose to call it the "Legality Principle," largely for convenience's sake, but partly also taking into account the German law term "Legalität," which is one component of the said Principle. For this point, *see* CHANG HEE LEE, SEIBUB-KANGEUI 20 (11th ed. 2013) (in Korean).

> plaintiff, which had complete control over the subsidiaries, had *in-substance* control over the *Chilbong* shares; and,
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> (iii) The Seoul High Court erred in having focused only on the legal form and appearance of the transaction, and not reviewed such issues as why the subsidiaries had been set up, how and why the subsidiaries had acquired the *Chilbong* shares, to whom the ownership of the *Chilbong* shares should be attributed in substance and so on. In brief, the High Court judgment is reversed and the case is remanded to the same High Court for further review.

2) Dissenting Opinion

In this *Rodamco* Judgment, two of the Justices filed a separate, dissenting opinion, and as is often the case in a Plenary Chamber judgment by the SC, the dissenting opinion is more detailed and lengthier. The following is a summary of the opinion:

> (i) If one permits the tax authorities to re-characterize a transaction solely based upon the substance-over-form principle, this may cause conflict with the Legality Principle, which functions as a safeguard against the government's discretionary power of taxation. The SC has been so far consistent on this point, thus respecting taxpayers' freedom to arrange their affairs so that they may minimize their tax burden, unless their planning activities are illegal or void under private law, or the tax law has prepared specific anti-avoidance rules ("SAAR"). Otherwise, legal certainty and taxpayers' predictability in the area of taxation would be severely damaged;
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> (ii) It could be argued that such re-characterization of the transaction is now allowed under art. 14, par. 3 of the FANT, which went into effect on January 1st, 2008. However, since the acquisition at issue in this case took place prior thereto, it is obvious that the said provision cannot apply to this case retroactively;
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> (iii) The majority opinion, in disregarding the subsidiaries for acquisition tax purposes, never presented any clear and objective criteria for taking such measures, other than the ever elusive concept of "economic substance." In brief, there is no sound logic in the

majority's reaching the conclusion;

(iv) If one supposes in this case that the plaintiff owned less than 100% shares of the subsidiaries, it is doubtful that the majority opinion could still maintain the same conclusion. If one assumes that it all depends on the facts and circumstances of each case, then one cannot but ask whether the Legality Principle would have any meaning; and,

(v) The taxing statute at issue in this case deems certain acquisition of shares as that of real property which is owned by the company that issued the shares. Given that this tax is already based on a legal fiction, its scope should be narrowly interpreted, strictly adhering to private law concept such as acquisition of shares, shareholders, etc.

3) "Supplementary" Opinion

One Justice who joined the majority opinion filed a separate, "supplementary" opinion, which contradicted the dissenting opinion. Although this opinion was joined by no other Justices, one could infer from this opinion more detailed arguments for the majority.

This opinion admits that the position taken by the majority opinion may sometimes lead to legal uncertainty, but emphasizes that this is inherent in the concept of "substance." The opinion goes on to say that, if one rejects application of the substance-over-form principle on the ground that it could result in legal uncertainty, then it will be tantamount to denying it altogether.

Then the opinion states that, as long as the new case law is applied only in cases where tax avoidance motive is present, the concern for abuse by the tax authorities is unfounded. The opinion finally observes that, since it is difficult to formulate the concept of "substance" in a more concrete manner or establish beforehand a legal test that enables to apply the concept more easily, it is up to courts to find what is the "substance" in each particular case, taking into consideration all the relevant "facts and circumstances."

4. Comparison with the SC's Precedents

1) Judgments that Constitute the SC's Old Case Law

Although this new Judgment did not expressly discard any previous judgment of the SC, it clearly departed from its precedents towards a new way of interpretation. Whether the tax authorities can re-characterize the legal form of the transaction based on its "economic substance" (whatever it means) had long been debated in the Korean tax community, and arguably, the SC used to be rather reluctant to disregard legal forms that are valid under private law, even if the relevant taxpayers clearly intended tax avoidance.

(1) The 1991 Leading Case[8)]

The earliest judgment of importance in this regard was rendered in 1991. In this case, where the taxpayers who had to transfer their pieces of land to a commercial bank first exchanged the pieces of land with each other, then made their respective transfer to the bank. This was done with the aim to avoid some unfavorable capital gains tax treatment that could happen when the taxpayers sold real property to legal persons rather than natural ones. The tax authorities re-characterized the transactions into a simple alternative of each taxpayer directly transferring his or her piece of land to the bank, based on the substance-over-form principle.

In this case, the SC stated that the Legality Principle is by far the most fundamental principle in Korean tax law, and pointed out that the lack of an applicable SAAR should result in favor of taxpayers, even if it could mean government's loss in tax revenue. The SC justified this loss by putting emphasis on legal certainty, and taxpayers' property rights and predictability.

(2) More Recent Cases

Even shortly before the *Rodamco* Judgment, the SC still seemed to maintain the old case law which was formulated in the foregoing 1991

8) Supreme Court, 90Nu3027, May 14, 1991.

judgment.

(a) The *Lone Star* Local Tax Case[9)]

One of these cases comprised some similarities to this *Rodamco* case. In this case, the Belgian *société en commandite par actions* (SCA), which was set up by Lone Star, a private equity fund, intended to acquire a building located in Seoul in 2001. However, it did not make a direct acquisition, but acquired shares in a Korean company first, then had the company acquire the building so that the company may function as a holding company.

The heart of this structure lies in that Lone Star did not establish a new company, but acquired a small-sized, "dormant" Korean company, so to speak, which would promptly have a new name and capital structure, newly elected board of directors and so on. This arrangement has to do with registration tax, which will be levied at a higher rate if one carries out certain activities subject to the said tax within certain metropolitan area near Seoul.[10)] These activities include establishment of a new company, and a newly established company's acquisition of real property, on condition that they are conducted within 5 years from the date of such establishment. This idiosyncratic provision was introduced to curtail concentration of people and capital in the foregoing area, which had long been considered as a major source of many social and economic problems in Korea. Clearly, the only purpose of acquiring a dormant company rather than setting up a new one was to avoid application of the said higher rate.

Because there happened to be a few separate tax assessments with respect to this registration tax on Lone Star, there were formally two separate cases that were reviewed at the lower-instance court level and the judgments of the two courts were split. One judgment focused on the "spirit" rather than "letters" of the provision. It also stated that, because in this case, the taxpayer deliberately abused the relevant provision, it was not in a proper position to claim such legal guarantees as legal certainty, taxpayer predictability, etc.. The other judgment on the other hand faithfully followed the old case law, and emphasized legal certainty in the area of taxation, which it observed could in the long run lead to inducing more foreign investment into Korea.

9) Supreme Court, 2007Du26629, Apr. 9, 2009.

10) Art. 138, par. 1 of the LTA (art. 28 par. 2 in the current Act).

The SC upheld the latter judgment in favor of the taxpayer, basically reiterating the old case law, i.e. referring to legal certainty, and taxpayers' predictability and property rights in light of the Legality Principle. It is also worthwhile to note that the SC in this judgment came up with a new, additional statement, saying that taxpayers have freedom to arrange their affairs in a manner that they should incur minimum tax burden, and the tax authorities, as a rule, are required to respect such taxpayer freedom.

(b) The "Yen-Swap Bank Deposit" Cases[11)]

These cases involve a series of financial transactions, which after all looks very similar to a simple bank deposit. However, the real structure was more complex than that, i.e. a combination of a time deposit in Japanese *yen*, and a forward contract under which the bank was obliged to buy the customer's money in *yen* at a specified exchange rate. Accordingly, the customer was expected to derive fixed-rate profits (in Korean *won*) from the transaction, but the profits consisted of not only interest *strict sensu*, but also gain from a foreign-currency forward contract, which was not taxable under the *Soduikse-Beop* or Income Tax Act at that time.[12)]

The banks which employed this structure withheld tax only from the interest portion, but the tax authorities, taking the position that the bank should have withheld tax from the entire profit out of the whole transaction, issued withholding tax assessments on the relevant banks. However, the SC quashed the tax assessments, basically repeating the former precedents, i.e. the need for SAARs to tackle such tax-avoiding schemes, and the taxpayer freedom to arrange his or her affairs in a tax-minimizing manner as long as the relevant legal form is valid for private law purposes.

2) New Case Law and New Logic

(1) Suddenness of Change

However, in this *Rodamco* case, the SC made a dramatic U-turn, and for

11) There are many commercial banks that were involved in this type of transactions, and accordingly the cases were also numerous. The judgment that was published in the official court report had been rendered on April 26, 2011, and its case identification number is 2010Du3961 (Supreme Court, 2010Du3961, Apr. 26, 2011).

12) It now seems that the Income Tax Act can tax such gain based on art. 16, par. 1, item 16, which was newly enacted in early 2012.

the first time in its history, stated explicitly that tax-avoiding schemes can be successfully struck down by the government even in the absence of SAARs, that is, based solely on the substance-over-form principle.[13] This is all the more surprising because there was not a hint of such change in the SC's judgments in either the *Lone Star* local tax case, or the "yen-swap bank deposit" case, although taxpayers in both cases clearly showed tax avoidance (or minimizing) motives.

(2) New Logic – Focus on Subjective Intent

It is often said that the substance-over-form principle applies when the economic substance of a transaction does not coincide with its legal form. In fact, this is what the expression "substance-over-form" says or at least, implies. In this sense, Korean commentators tended to presuppose that the substance-over-form principle involves an objective test.[14] In other words, whether a legal form involved reflects its economic substance can be ascertained in an objective manner, and taxpayers' subjective motive or purpose is of little, if any, relevance.

This line of reasoning leads to a couple of ramifications. The first is that the substance-over-form principle can be invoked by the taxpayer as well as the tax authorities. The second is the general reluctance broadly shared by courts and tax experts towards taking taxpayers' subjective intent into account in determining tax liabilities.

In this sense, one could identify in the new Judgment a certain degree of influence from the U.S. Supreme Court's well-known "business purpose" doctrine. As regards this court-made doctrine, it should be mentioned that

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13) Admittedly, this *Rodamco* Judgment did not explicitly discard any precedent judgments of the SC. However, since it appears clearly impossible to reconcile in any sensible way its majority opinion with its old precedents that emphasized the Legality Principle, I believe it perfectly reasonable to deduce from the *Rodamco* Judgment that the SC, in fact, radically changed its initial position. Otherwise, there would have been no need for the minority opinion to make such a passionate, full-pledged attack on the majority opinion.

14) This traditional view could be found, for example, in an article written in 1988 by a then prominent tax lawyer. *See* In-Ae Kang, *Josebeop-sangui-haeseok-gwa-siljilgwase-ui-wonchik* (*ha*) [*Interpretation of Tax Law and Principle of Substance-over-form (Part II)*], 23 PANRYE-WOLBO 23 (1988) (in Korean). This article refers to "ordinariness of the legal form employed by the taxpayer" as the relevant test for application of the substance-over-form principle, and on the other hand, firmly and plainly rejects taxpayer's motive of avoidance simply as irrelevant.

it is one of the legal weapons that the U.S. courts have used to tackle tax avoidance arrangements, and that it is sometimes understood as a variation of the substance-over-form principle.[15] It could be argued in this sense that the SC now views the substance-over-form principle more as a sort of general anti-avoidance measure that the tax authorities and courts can rely upon, than as a neutral means of interpreting and applying tax law.

That being said, this intent-focusing approach is arguably easier to apply than the aforementioned, purely objective test. The objective approach seems to presuppose that one can identify a legal form (or legal forms) that best reflect(s) the economic substance of the transaction. However, where there are a number of alternative legal forms that may ultimately achieve the same economic goal, it would be hard to discern which one(s) among them reflect(s) the economic substance and which other ones do not. In this sense, I believe that the SC's focus on taxpayers' subjective intent is justifiable, and this results in a test that is both simple and practicable.

(3) Origin of the New Case Law

As briefly implied above, the SC did not invent this new case law out of thin air. Rather, one can infer from the *Rodamco* Judgment some clear influence from certain other jurisdictions, including most of all the aforesaid "business purpose" doctrine, which is often associated with the US Supreme Court's opinion in the *Gregory v. Helvering*.[16] Considering that some commentators consider "business purpose" doctrine as a variation of the substance-over-form principle, this influence hardly seems to be out of place.

It should also be noted that some other countries which have incorporated general anti-avoidance rules ("GAAR"s) into their tax system, also designed their GAARs in a manner that taxpayer's intent should be considered. The subtle difference among these nations becomes apparent

15) James S. Eustice & Thomas Brantley, Federal Income Taxation of Corporations and Shareholders ¶12.03 (2013), *available at* 1999 WL 516620.

16) In this decision, the US Supreme Court held that the relevant "operation having no business or corporate purpose" was simply "outside the plain intent of the statute," and concluded that the relevant reorganization provision in the US Internal Revenue Code could not be applied. Gregory v. Helvering, 203 U.S. 465 (1935).

when the relevant taxpayer had some non-tax business reasons (along with tax avoidance motive) in implementing the transaction in question.[17] However, it is still undeniable that, with respect to all these GAARs, taxpayers' motive is highly relevant.

Finally, this trend was also confirmed in the so-called OECD Commentaries on its Model Convention, which stated that, improper use of tax treaties can be found "where a main purpose for entering into certain transactions or arrangements was to secure a more favo[u]rable tax position."[18] Given that the improper use of tax treaties is one example of tax avoidance, this statement implies that the OECD, too, admits that whether the relevant taxpayer had tax avoidance motive can serve as the thin line that divides legitimate tax planning and unacceptable tax avoidance.

3) What the SC did NOT Specify in the Rodamco *Decision*

The SC did not address in the *Rodamco* Judgment the question of what happens if the taxpayer had also non-tax reasons to enter into the particular step of the transaction (along with tax avoidance motive). The SC indeed seems to have taken care not to touch this subtle issue in this case, where the taxpayer could hardly be described to have any other non-tax reason to interpose the two subsidiaries. However, in considering that it is not totally inconceivable for tax planning purposes to put a certain degree of "substance" into the relevant legal entity, the question could soon arise in near future as to how to treat such non-tax business reasons.

Although it hardly seems to me that there can be such a thing as "the only right answer" to this question, I believe that it would be problematic if one assumes that any degree of non-tax business purpose would suffice to reject application of the substance-over-form principle. Accordingly, the

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17) There is an interesting article which refers to this issue, comparing the GAARs of a few selected jurisdictions. According to this article, which mainly discusses the now much-debated GAAR of India, "Australian GAAR uses the sole or dominant purpose test, while Canadian GAAR uses the primary purpose test," and the Indian GAAR adopts "one of main purposes" test. *See The GAAR is here, but the show must go on*, International Tax Review, Apr. 18, 2012.

18) *See* OECD, *Commentary on Article 1: Concerning the persons covered by the convention*, *in* Model Tax Convention on Income and on Capital 2010: Full Version para. 9.5 (2012).

right test would be whether the tax avoidance motive clearly outweighs the non-tax business purposes of the transaction, or whether one can reasonably establish that the taxpayer would have entered into the transaction even if there were no tax benefit obtainable from the transaction. Thus, if the tax authorities can establish that the non-tax reasons are relatively trivial compared with the tax benefits, it could be argued that the former should not hinder the SC from applying the substance-over-form principle or the new case law based thereupon.

Another issue that has yet to be cleared even after the *Rodamco* Judgment is whether taxpayers can raise the substance-over-form principle to their advantage.[19] This may occur when a taxpayer adopted a legal form that does not conform to the economic substance because of, for instance, some (non-tax) regulatory reasons. Before the *Rodamco* Judgment, the SC had never stated that the substance-over-form principle can be invoked only by the tax authorities. However, given that the Judgment emphasized the GAAR aspect of the substance-over-form principle, the SC could be viewed as implying that this principle now cannot be used in favor of taxpayers. On the other hand, since the SC never touched this issue anywhere in the Judgment, it is also arguable the SC may be of the opinion that the principle does not function exclusively as a GAAR. There is no clear answer to this question as of now, and one will just have to wait until the SC actually tackles this issue.

5. From Comparative Law Perspectives

1) Japan

As implied earlier, the majority of Korean tax lawyers (i.e. both academics and practitioners) in the 1990s tended to believe that the substance-over-form principle could not serve as a GAAR, which would

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19) Professor Chang Hee Lee briefly commented on this issue in his treatise, and denied taxpayers' possibility to claim that tax should be levied according to its economic substance rather than its form. *See* Chang Hee Lee, *supra* note 7, at 86 n.125. However, this view has never been expressly adopted in Korean case law. For instance, the SC in its judgment of May 26, 1998, 97Nu1723 (Supreme Court 97Nu1723, May 26, 1998), never explicitly rejected the argument that the relevant legal form should be disregarded in favor of the taxpayer, although the taxpayer did lose the case after all on some other ground.

allow the tax authorities and courts to re-characterize the relevant transaction based on its economic substance. At the heart of their belief lay the Legality Principle.

The Principle at first look seems to have just originated from the old saying, "no taxation without representation." Indeed, this Principle dictates that any tax should be based on statutes legislated by the National Assembly. However, this Principle in the current form goes much further than that, because it also requires that the taxing statutes should always use "clear and concrete" language. Any anti-avoidance rule of a general nature was once believed to have difficulty in meeting this "clear and concrete language" requirement imposed by the aforesaid Principle.

In fact, this belief, and the Principle as its background, reflect some strong influence from Japan. In Japan, Professor Emeritus Kaneko Hiroshi at the University of Tokyo is one of the early champions of this legal Principle.[20] His theory focusing on taxpayer rights and emphasizing legal certainty is said to have been imported into Korea in the late-1970s and throughout the 1980s, and made a deep impression on Korean lawyers interested in tax law. One of its basic ideas is that, as a rule, an SAAR is needed to disregard a legal form engaged for tax avoidance, but, if the relevant transaction is not valid even from the private law perspective, then the transaction cannot be recognized as such for tax purposes.[21]

It seems appropriate to make two comments at this stage, which might potentially conflict with each other to a certain extent. Firstly, it should be noted that the majority view among Japanese academics and practitioners are still faithful to the aforementioned idea. It is certainly admitted that the line between the two (i.e. tax avoidance activities in a narrow sense, and activities that are not valid even for private law purposes) is thin, and probably hard to discern in real life cases. Conceptually, however, the dichotomy firmly persists.[22] Secondly, as various tax-avoidance schemes

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20) *See* CHANG HEE LEE, *supra* note 7, at 19-20 on Prof. Kaneko's influence on Korean tax lawyers in this issue.

21) KANEKO HIROSHI, SOSEIHOU 120-122 (16th ed. 2011) (in Japanese).

This seems to be by far the most famous treatise in tax law in Japan.

22) *See* MIZUNO TADATSUNE, SOSEIHOU ([Theory of Tax Law in Japan]) 26-27 (5th ed. 2011) (in Japenese). *See also* Okamoto Tadamu, *Sosei-kaihi-koui-no Hiin*, 207 JURISTO 41 (2011) (in Japanese). The latter is a review on the Supreme Court's so-called *Resona Bank* judgment, and

have been more and more widely used, it seems that pressure has been building up in Japan as well as in Korea (or any other jurisdictions in the world). Although Japanese courts seem to be still insistent on the above traditional theory, there are some cases where, at the end of the day, courts did not respect as such the legal forms used by the taxpayer.

Japanese courts' insistence on the traditional theory is particularly evident in one case where the taxpayers took the legal form of two separate sales.[23] Under this scenario, the taxpayers sold their real property for approximately 0.7 billion *yen*, and acquired other real property for approximately 0.4 billion *yen*. The difference of 0.3 billion *yen* was paid to the taxpayers in cash. However, the tax authorities viewed this transaction as a single transaction of exchange with payment of a boot. Under this scenario, as the real property acquired by the taxpayers was evaluated at 0.7 billion *yen*, the tax authorities viewed that the taxpayers transferred their real property for a consideration of 1 billion *yen*.

However, the Tokyo High Court rejected the tax authorities' re-characterization of the transaction, and decided in favor of the taxpayers. According to this judgment, even if an exchange with a boot better conforms to the substance of transaction, the taxpayers still have freedom to choose another legal form. It also stated that the tax authorities, under the Legality Principle, had no right to re-characterize this legal form in the absence of an SAAR. This judgment became final, as the appeal to the Supreme Court was denied.

On the other hand, the best-known case in the direction of the above second comment appears to be the so-called *Resona Bank* case,[24] decided by the Supreme Court in 2006. In this case, the taxpayer, a Japanese bank, was

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its title can be literally translated as "Negation of Tax Avoidance." In Japanese tax literature, the word, "*hiin*," or "negation" in this context means tax authorities' re-characterizing the relevant transaction so the taxpayer is denied his or her intended reduction in, or exemption from the relevant tax liabilities.

23) Tōkyō Kōtō Saibansho [Tōkyō High Ct.] June 21, 1999, Heisei 11 (gyō ko) no.108, 52 KŌTŌ SAIBANSHO HANREISHŪ [SAIBANREI JŌHŌ], no. 0, at 26 (Japan), *available at* http://www.courts.go.jp/search/jhsp0030?hanreiid=20144&hanreiKbn=03 (in Japanese).

24) Saikō Saibansho [Sup. Ct.] Dec. 19, 2005, Heisei 15(gyō hi) no. 215, 59 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] no. 10, at 2964 (Japan), *available at* http://www.courts.go.jp/search/jhsp0030?hanreiid=52394&hanreiKbn=02 (in Japanese).

involved in a back-to-back loan structure, where it paid more interest to a Cook Islands company than it received from another Cook Islands company. This deficit was intended to be recovered by the Japanese foreign tax credit, which the Supreme Court denied the taxpayer. The ground for this judgment was that the taxpayer had attempted to abuse the relevant provisions of tax law, and thus grant of foreign tax credit in this case would impair "tax equality" to a considerable extent. It is interesting that this judgment never labeled the relevant transaction as tax avoidance, or even referred to the substance-over-form principle which had always been at the core of discussions on tax avoidance.[25)]

In brief, it is hard to discern from this judgment by the Japanese Supreme Court any radical movement opposed to the traditional view, and there also have been diverse attempts to reconcile this judgment with the Legality Principle. Most notable is Professor Kaneko's own explanation that, even under the said traditional theory, courts are allowed to limit application of a statutory provision that mitigates or exempts tax burden, when deciding otherwise would conflict with the spirit of the relevant provision.[26)] This explanation seems to presuppose a distinction between taxing statutes and tax-mitigating or –exempting statutes, which distinction may not always be as clear-cut as one might think.

In any case, this Article does not aim at giving a full-length analysis of the current status of Japanese law on the Legality Principle, but is content with only contrasting the mainstream case laws of Japan and Korea, whose legal systems have thus far shared many things in common. From this perspective, it is all the more obvious that the Supreme Court of Korea in its *Rodamco* Judgment, took a fundamental departure from the traditional view on tax avoidance (or the Legality Principle). The SC was also clearly aware of the tension between its new case law, and the old one based on the Legality Principle, and tried, in a way, to harmonize the conflict. However, when the SC saw it necessary to recognize that the substance-over-form

25) The Japanese tax authorities, along with arguing for this narrow interpretation of foreign tax credit provisions, characterized the back-to-back loan as a sort of sham transaction and asserted it to be void for private law purposes, which arguments was accepted neither by the lower-level courts nor the Supreme Court. *See* Okamoto, *supra* note 22, at 40.

26) Kaneko, *supra* note 21, at 122.

principle can function as a GAAR so as to "maintain the validity of the Legality Principle," although it never explicitly admitted, what it actually meant was that the old case law based on the said Principle could no longer survive, at least not in the traditional form.

On the contrary, the majority view in Japan still seems to follow the traditional view mainly originating from the Legality Principle. Although the dividing line is admittedly thin, the distinction between "the *negation* based on substance-over-form" and "the *negation* based on private law" is still considered useful and practicable. The few judgments that did strike down tax-avoiding schemes without sound business purpose, with the *Resona Bank* case as its best-known example, were somehow viewed as not infringing the validity of the old Legality Principle.

It is not easy to explain why tax case laws of the two countries went into directions that are now so different from each other (at least from theoretical perspective, because the end-results might not be as different as they look). However, one certain thing is that, from the Korean *Rodamco* case, one can infer some clear non-legal influence, i.e. the voices from ordinary people and politicians, which the judges must have believed it hard not to conform to. This influence will be discussed in more detail in 3. below.

2) India

India is known to be a country where the tax authorities recently took a very aggressive stance towards tax avoidance, particularly in the area of international tax. However, the Indian court has not always supported the tax authorities in this respect, and the most recent example of such tendency that is well known even outside India is the so-called *Vodafone* case.

In this case, which deals with a transaction where the taxpayer transferred shares in an offshore holding company rather than implementing direct transfer of shares in the Indian company, the issue is essentially how far the substance-over-form principle can reach.[27] For the purposes of this Article, this case is all the more interesting for its apparent

27) For details of the *Vodafone* case, *see* D. P. Sengupta, *India: Vodafone*, *in* Tax Treaty Case Law around the Globe 2011, at 265-278 (Michael Lang et al. eds., 2012).

similarities of the fact pattern to the Korean *Rodamco* case. In *Vodafone*, an "indirect" transfer of shares in an Indian company was at stake, whereas in *Rodamco*, it was an "indirect" acquisition of shares in a Korean company.

In any case, the issue in *Vodafone* case was whether the tax authorities can re-characterize the "indirect" transfer or acquisition into a "direct" one, or (sort of) "pierce the corporate veil." Technically, the Indian tax authorities viewed the transaction as economically equivalent to transferring directly the shares in the Indian company, whereas the Korean tax authorities regarded the transaction as, in economic substance, the same as the offshore investor directly acquiring the shares in the Korean company. The difference lies in that, in *Vodafone*, the corporate veil was used to cover the object of the transaction, while in *Rodamco*, the same was used to protect the acquirer.

If one focuses on these similarities of the two cases, the different outcomes from the Supreme Courts of the two countries show how hard it is to apply the substance-over-form principle in a real life cases in a consistent manner, or to pursue a common understanding of the principle that can be accepted by everyone across the world. It should also be noted that the *Vodafone* judgment seems to be in line with the Indian courts' mainstream precedents,[28)] while the *Rodamco* Judgment is a clear departure from the SC's older case law. As will be discussed in more detail in below 3., the Korean tax authorities' overall hard position towards tax avoidance with a favorable public opinion was behind the *Rodamco* Judgment. On the other hand, the Indian tax authorities do not seem to be satisfied with the *Vodafone* judgment, and are apparently working hard to curb its potential influence.[29)]

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28) Daljit Kaur & Kamesh Susarla, *Anti-Avoidance Developments in Selected Asian Jurisdictions*, Asia-Pacific Tax Bulletin, July & Aug. 2011, at 264 briefly summarized Indian "case law principles" on this issue. According to them, "[t]he Indian Judiciary has often upheld the taxpayer's right to legitimate tax planning by the use of tax treaties," and the *Azadi Bachao Andolan* case and *E*Trade* case were cited in this sense.

29) The Indian government has been in the process of introducing a GAAR into the Indian Direct Tax Code. The most controversial feature of this GAAR is arguably the possibility of its retroactive application, in that it would allow the tax authorities to tax past transactions involving assets in India. This seems to have aroused some unfavorable reactions from the community of foreign investors. *See India's Lower House Passes Finance Bill, Defers GAAR*, Tax Notes International, May 14, 2012, at 591. This is also understood as having

In the end, the tax systems of both countries appear to move towards the direction of having an anti-avoidance measure of a general nature. Considering that many common law jurisdictions such as Australia, Canada, New Zealand, South Africa have enacted their own GAARs, as well as civil law jurisdictions such as Germany, and more countries are headed for this direction, with UK as the most notable example, this movement is hardly surprising.[30)] Now that public hostility and resentment against tax avoidance from business sector has risen to a level higher than ever in many jurisdictions, it is expected that the current trend would continue, at least for some time.

Maybe now is the time to discuss what an ideal GAAR should be like if one wants it to be flexible enough to strike down any conceivable tax avoidance schemes in an efficient manner, but without losing too much legal certainty, rather than debating over whether or not a GAAR is needed or constitutional. In Korea, the *Rodamco* Judgment will certainly serve as a starting point in this regard.[31)]

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opened door for the tax authorities to reverse the Supreme Court's *Vodafone* decision. *See India's Response to Vodafone Draws Global Scrutiny*, Tax Notes International, Apr. 30, 2012, at 403. Meanwhile, it had initially been announced that the GAAR would go into effect in April, 2012, but it has yet to come into force. The most recent news is that its implementation would be again postponed until April, 2016, as announced by the Indian Finance Minister. *See Government Delays GAAR Implementation*, Tax Notes International, Jan. 21, 2013, at 242.

30) According to the Panel of a seminar (the Seminar H: Recent Developments in International Taxation) in the IFA 2013 Copenhagen General Congress (chaired by Philip Baker), introduction of GAAR is the "[f]ashion of the day" and "most of the developing countries are adopting the concept of GAAR in their domestic law."

31) Although not fully relevant, considering the main theme of this Article, it is worth recalling at this stage an insightful and intriguing remark from Prof. Chang Hee Lee pertaining to this point, i.e. whether the substance-over-form principle can serve as a GAAR or allow the tax authorities to re-characterize the facts before applying the applicable tax law. Put in another way, according to Prof. Lee, this is the same as asking to which branch to give the responsibility to cope with the phenomenon of tax avoidance. If we deny the possibility of re-characterization based on the substance-over-form principle, and require that there should be an SAAR to strike down the transaction structure in question (as used to be the position taken by the SC), he said, it is tantamount to vesting the legislature with the exclusive authority and responsibility to cope with tax avoidance. Under this scenario, it is up to the National Assembly to identify (hopefully beforehand) every possible tax avoidance scheme, and take pre-emptive measures, i.e. provide an adequate statutory SAAR in tax law. On the other hand, if we recognize the possibility of such re-characterization, it is equivalent to granting wide range of discretion in interpreting and applying tax law to the administration

III. Background of the *Rodamco* Judgment

1. *Inheritance and Inter-Vivos Gift within* Chaebol *Families*

1) *Controversial Incidents*

Along with the rapid economic growth in Korea, a number of Korean conglomerates, sometimes called *Chaebol*, rapidly gained and accumulated both corporate and personal wealth. These groups of companies are often managed by family members who are both controlling shareholders and top management staff. In other words, ownership and management functions are both concentrated in a small group of people who are typically family members or close relatives. Initially, these companies were in many ways supported by the government which was determined to promote quick economic growth of the nation, but more and more, government and politicians realized that social and economic power of these *Chaebol* companies or families became so strong that it sometimes seemed to go beyond their control.

As time went by, some of these *Chaebol* companies had to go through changes of ownership or leadership from one generation to another. Sometimes the head of the *Chaebol* family had to divide the group of companies among his many sons or daughters. This could be done either by waiting for the controlling shareholder to die so the controlling block of shares may be passed over to the heir(s) or heiress(es) by way of inheritance, or transferring them beforehand for no consideration (i.e. gift). Either of these simple methods, however, might be costly because of inheritance or gift tax, the maximum rate of which goes in Korea as high as 50%.[32)]

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so that it can effectively combat tax avoidance, which will nevertheless be subject to ultimate control by the judiciary, he said. *See* Chang Hee Lee, *supra* note 7, at 97. In this regard, the statement in the supplementary opinion of the *Rodamco* Judgment that "it is up to courts to find what is the [substance] in each case, taking into consideration all the relevant [facts and circumstances,]" is all the more interesting, because it could arguably be read as a solemn declaration by the SC that courts will now assume the full responsibility to adequately deal with tax avoidance problem.

32) *See* art. 26 of the *Sangsokse-Mit-Juingyeose-Beop* or Inheritance Tax and Gift Tax Act

Hyundai Group first experienced this problem in the late-1980s, while Samsung Group had to solve a similar sort of questions in the late-1990s, and there are also other examples in other smaller corporate groups. Because they could not rely on simple gift of shares or cash, they had to invent various methods that were not simple gift, but could attain similar end-results without incurring too heavy tax liabilities. For example,[33] Hyundai Group and its founder, Mr. Ju-yung Chung had his eldest son Mong-Koo acquire shares in a group affiliate at a nominal price, and this affiliate company merge into another affiliate at terms that were highly favorable to the former affiliate and its shareholders including his son. Although this transaction resulted in a huge gain of Mr. Mong-Koo Chung's, there was no statute which could tax this gain. The National Assembly subsequently enacted a new provision into the former *Sangsokse-Beop* or Inheritance Tax Act,[34] but given that this new provision could not have retroactive effect, it could not lead Mr. M.-K. Chung to pay tax on the foregoing transaction.

Samsung Group also began to implement tax planning of similar sorts in the 1990s. The best-known example of such tax planning was carried out in the following manner.[35] First, cash was given to Mr. Jae-yong Lee, who is the only son of Mr. Kun-hee Lee, the president of the entire group. The former duly paid gift tax, and then with the remaining cash, bought shares in a group affiliate, which then was a non-listed company, but expected to go through its initial public offering (IPO) shortly. The price of these shares skyrocketed soon after the IPO, and Mr. J.-y. Lee swiftly disposed of his shares at stock market to realize a large amount of capital gains. This fund enabled him to acquire shares in other Samsung Group companies, which would eventually secure him a position where he could gain control over the entire Group, again, without incurring much tax liability. This was

("IGTA").

33) This example is included in an article published in 2003. *See* Nak-In Sung, Jeong-Hoon Park & Chang Hee Lee, *Sangsokse-mit-juingyeose-ui Wanjeonpogwaljuui Doipe Kwanhan Yeonku* [*Enactment of Comprehensive Taxation of Gift*], 44 SEOUL-DAEHAKGYO-BEOPHAK [SEOUL LAW JOURNAL], no. 4, 2003 at 188, 209-210.

34) Now the name of this Act has been changed into the Inheritance Tax and Gift Tax Act ("IGTA"). This provision is now art. 38 of the IGTA.

35) This Example is also included in Nak-In Sung et al., *supra* note 33, at 191.

possible because capital gain arising from disposition of shares in a listed company was never taxable at that time. The legislature, again, made a new law[36] that enabled the tax authorities to tax certain controlling shareholders on their disposition of shares in listed companies, but this was also too late to tax the younger Mr. Lee on the forgoing transaction.

In the 2000s, Mr. Mong-Koo Chung, who was the beneficiary of the first-mentioned wealth-transferring transaction, attempted to transfer some of his control over Hyundai Motors to his son Eui-sun Chung. In this instance,[37] their plan was to let the latter acquire the shares in a non-listed affiliate company at a nominal cost, and afterwards, merge the non-listed company into a listed company, which was acting in a sense like a holding company of the entire Hyundai Motors group. It is remarkable that the second step of this transaction has not occurred at the end of the day, because of the vehement reaction from the public opinion and more importantly, the negative effect on the stock price of the said listed company. However, the government still had to amend the IGTA to insert a complex provision[38] that could tax this type of transaction.

2) Reaction from Government and NGOs

These experiences repeated over the years prompted diverse reactions from different sectors of the nation. NGOs interested in social and economic equality and fairness began campaigning against those *Chaebol* families and urged that the government tax the controversial transactions although the government was sometimes cautious in doing so without a statutory provision that was clearly designed to tax such ingenious transactions.

Some lawyers believed that at the heart of this difficult situation lay that the SC's insistence on their narrow interpretation of the term "gift," as is prescribed as the basic taxable event of gift tax under the IGTA.[39] A "gift"

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36) Art. 94, para. 1, subpara. 3 of the Income Tax Act. The National Assembly also enacted a provision that could tax the person who acquired non-listed shares that are expected to go through an IPO. Accordingly, the overall gain derived by such a person could be taxed as either gift tax or income tax (capital gains tax).

37) This Example is also included in Nak-In Sung et al., *supra* note 33, at 212.

38) Art. 41-5 of the IGTA.

39) This situation is described in details in CHANG HEE LEE, *supra* note 7, at 1089-1092.

under private law may be defined as a contract that transfers ownership or other property rights from one party to another for no consideration.[40] Because there was no other definition of the term "gift" in the IGTA before 2004, courts usually adhered to this private-law definition and maintained the position that such transactions as described in 3.1.1 above could not qualify as "gift" for gift tax purposes unless there was a statutory provision specially designed to cover the relevant transaction. One can now easily imagine that the rigid Legality Principle is right behind this position.[41] The then Ministry of Finance and Economy (now called the Ministry of Strategy and Finance) worked hard to come up with new draft law that might enable the National Assembly to enact new IGTA provisions. However, given that the Constitution would generally bar retroactive taxation, this was not of much help to improve the overall situation.

On the other hand, some NGOs kept tenaciously on criticizing both the *Chaebol* families for not paying their fair share of tax in transferring their stock to the next generation along with their economic and social power, and the government for not taking active measures to tax them. In the end, they made success in some cases to a certain extent. For instance, they indeed contributed to preventing the Chung family of Hyundai Motors from implementing the second step of the aforesaid *merger-with-non-listed-company* structure.

Another example of their significant victories is that they led the tax authorities to tax the Lee family of Samsung Group on a transaction that took place in 1999 and resulted in, again, Mr. Kun-hee Lee's son and daughters acquiring shares in a non-listed group company at a price that was lower than the fair market value.[42] It is said that the tax authorities were initially not certain whether this transaction was taxable, but under pressure from some NGOs and politicians, the NTS in 2001 finally issued

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40) Minbeop [Civil Act], art. 554 (S.Kor).

41) This thought was indeed confirmed in a decision by the Constitutional Court that struck down an IGTA article for its language not being sufficiently "clear and concrete." *See* Constitutional Court, 95Hun-Ba55, Apr. 30, 1998.

42) A news article that includes an overview of this case can be found at Jong-chul Kim, *Samsung faces tax violation charges after evading fair trade regulations*, OhmyNews, Nov. 25, 2004, http://news.naver.com/main/read.nhn?mode=LSD&mid=sec&sid1=101&oid=047&aid=0000053899 (in Korean).

tax assessments, which were ultimately upheld by the Seoul Administrative Court in 2004.[43] Those incidents happened in the early- and mid-2000s, and clearly showed the wind was somehow changing.

3) Enactment of New Law and its Current Status

Neither inheritance nor gift tax has ever been an important source of revenue in Korea in terms of the amount collected.[44] However, because it is mostly the wealthy and well-off that pay these taxes, whether they are duly enforced have always been of huge interest to ordinary people. In this respect, some politicians focused on finding a legal solution through which all those gift-tax-avoiding schemes are guaranteed to be taxed. Because it was often said that the problem arose from the SC's narrow interpretation of the term "gift," those politicians believed that a new statutory definition of "gift" should be inserted into the IGTA, so that the term may embrace every attempt to transfer wealth to another person for no or little consideration. This idea somehow began to be called the doctrine of "comprehensive taxation," and Mr. Roh Moo-hyun, the 9th president, presented it as one of his campaign promises. The law was indeed amended accordingly after his election, mainly with enactment of the two new provisions in art. 2 of the IGTA.[45]

It should be noted that, before the law was actually enacted, there had been discussions on whether the so-called "comprehensive taxation" is constitutional under the Legality Principle.[46] However, now that ten years

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43) Seoul Administrative Court, 2003Gu-Hap15591, Nov. 25, 2004. The taxpayers in this case appealed to the Seoul High Court, but in February 2006, withdrew their petition.

44) According to the official statistics of the National Tax Service, the amounts of inheritance tax and gift tax collected for the fiscal year 2011 are respectively, 1,258,637 million and 2,074,062 million Korean *won*, while the overall internal tax revenue for the same year is 180,153,173 million Korean *won* (i.e. about 1.84%). Thus it could be said inheritance tax and gift tax altogether make up only less than 2% of the whole national tax revenue.

45) Par. 3 is a new, broad definition of the term "gift," which is now independent from its private-law meaning. Par. 4 is a GAAR, in the sense that it provides any attempts to circumvent gift tax by "using intermediaries or other indirect methods" should be disregarded. As will be seen later in this Article, this par. 4, which is now renumbered as article 4-3 of the same Act, was also going to be used in other contexts.

46) Mr. Roh, then as the president-elect, delivered a speech on this point at the year-end meeting of journalists in late 2002, observing that he was aware there was controversy on constitutionality of the "comprehensive taxation," but he did not believe it unconstitutional.

have passed, it seems only few commentators actually believe this provision should be struck down altogether for its unconstitutional vagueness, although there are diverse discussions on limiting its scope of application for enhancement of legal certainty.47) This is a good example of how people's idea on fairness of the tax system can vary as time goes by, and how this change can eventually affect the tax law and lawyers' thought on it. There are some pending cases at lower-instance courts, where the tax authorities indeed relied on those new provisions,48) and it will be of much interest to see whether, eventually, the SC follows in the same direction as the *Rodamco* Judgment, or for this issue, make some detour.

2. Short-Term Foreign Investors' Profit

1) Tax Avoidance by Foreign Investors and Public Reaction

Another issue that drew public attention on the question of tax fairness is whether some of the foreign investment funds which invested in Korea

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See 'Comprehensive taxation', OHMYNEWS, Jan. 7, 2003, http://news.naver.com/main/read.nhn?mode=LSD&mid=sec&sid1=101&oid=047&aid=0000021160 (in Korean).

47) As an example of such discussion, *see* Jeong-Woo Park & Kyoung-Hee Go, *Wanjeonpogwaljuui Kwasejedoe Ttaruin Juingyeose Doipe Ttaruin Kwasebangan* [*A Study on a Reasonable Gift Tax System under the Comprehensive Taxation Principle*] 35 KONGBUP-YEONKU [KOREAN PUBLIC LAW ASSOCIATION], no. 2, 2006 at 390-391. Recently, Professor Hoon Park also showed similar understanding at a joint seminar of the *Hankook-Sebub-Hakhoe* [Tax Law Association and the Tax Community of Judges] held on May 25, 2012. *See* Hoon Park, *Jose Bulbok Sarye-e Natanan Sangsokse-mit-Juingyeose-Beop Je-2-Jo Je-3-Hang-eui Euimi* [*The Meaning of Clause 3, Article 2 of Inheritance Tax and Gift Tax Act in the Tax Cases of Appeal or Litigation*], 18 JOSEBEOP-YEONKU [SEOUL TAX LAW REVIEW], no. 2, 2012 at 341-342.

48) Art. 41, par. 1 of the IGTA provides that, if a person transfers assets for no consideration to a corporation whose shares are owned by the person's related parties, and this corporation has net operating losses (NOL) to be carried forward, the tax authorities can levy gift tax on these related-party-shareholders. The problem is whether gift tax can be levied even if the relevant corporation has no NOL, and thus the corporation is liable for corporate income tax on this transfer of assets. The IGTA is silent on this issue, and there are split decisions by the Seoul Administrative Court. These cases are still pending at High Court level, and for a news article reporting on them, *see Seoul Administrative Court decided to levy tax when transferring assets to a corporation,* SEOUL ECONOMY, Aug. 05, 2012, http://economy.hankooki.com/lpage/society/201208/e2012080511375993800.htm. Although no new report has been released, there are other cases where other judges of the same Court decided otherwise, and one of such judgments is dated August 17, 2012 with the case identification number 2012Gu-Hap8373 (Seoul Administrative Court, 2012Gu-Hap8373, Aug. 17, 2012).

during its financial crisis in the late-1990s should be taxed upon their profits. Because those investment funds often utilized sophisticated tax planning schemes, including use of intermediary companies set up in a state which entered into a favorable tax treaty with Korea, the investors initially believed that their profits would not be subject to Korean tax. Lone Star, which acquired the Star Tower Building, and the Korea Exchange Bank, used a structure the key of which was channeling the investment through such countries as Belgium and Luxemburg. Meanwhile, the case of Newbridge Capital, another investment fund which acquired the Korea First Bank using an entity established in Labuan, Malaysia, was also a well-known example to Korean public. Income tax is not the only tax they paid attention to, and the local tax authorities were equally prepared to strike down, based upon the substance-over-form principle, the elaborate tax-minimizing structures used by those investment funds. The *Rodamco* case discussed in this Article was surely the best-known of such cases.

As Korean economy recovered quickly from the crisis, their investments indeed proved to be profitable. When people learned that these foreign investors would probably not be required to pay much Korean tax, this result was widely believed to be unfair. Journalists and politicians often supported this public sentiment, which, again, resulted in the NTS taking a very aggressive stance towards these investment funds.

The term, "tax avoidance" connotes such a tax planning as makes full use of taxpayer freedom to arrange their affairs as they like. Accordingly, the tax authorities might still have difficulty in taxing these taxpayers even if their tax avoidance motive is clear to them. However, since the NTS is usually regarded as one of the most powerful government bodies in Korea, not many Koreans would dare take such bold stance against the NTS and test their luck. It should also be taken into account that, traditionally, the compliance level in this area has not been very high, which means the NTS probably never lacked in issues to raise once they went into audits. This partly explains why there had been thus far only very few cases involving the issue of re-characterization based on the substance-over-form principle.

However, those foreign investors who made their investments in Korea during the late-1990s, where Korea was going through hard time, were ready to stand against the Korean tax authorities with their elaborate, and often complicated tax-minimizing schemes, if necessary. The Korean national and local tax authorities then began challenging some of their transaction structures, and this led to many tax controversy cases, many of which were decided by the SC subsequently to this *Rodamco* Judgment.

In these cases, the NTS basically disregarded the funds' tax-minimizing schemes based on the substance-over-form principle, and looked through the intermediaries that were established for mainly tax-driven reasons. This allowed the NTS to attribute the relevant income or gains to the other entities that directly or indirectly owned those intermediaries. The result is that the taxpayers could not benefit from the favorable income tax treaties that they had intended to take advantage of.

2) Direct Application of the Rodamco *Decision*

Not surprisingly, the issue of whether the tax authorities could re-characterize the relevant transaction according to its economic substance was almost invariably debated in those cases. The new case law in the *Rodamco* Judgment indeed played an important role, that is, the SC disregarded the Belgian or Labuan entities which the taxpayers interposed with the intention of obtaining benefits under the relevant tax treaties Korea had entered into. One could imagine that the SC, which has already disregarded the two subsidiaries to attribute the ownership of the *Chilbong* shares to the Dutch Rodamco entity (i.e. the plaintiff in this case), was much more at ease to disregard based on the substance-over-form principle the Belgian or Labuan entities in the subsequent cases. In addition, the SC went on to state that the substance-over-form principle does not lose its full force even in applying the provisions of tax treaties,[49] which is an issue that had already been heavily discussed in international tax communities.[50]

It is more than probable that the SC reviewed and judged the *Rodamco*

49) On these cases, *see* Ji-Hyun Yoon, *An End of a Journey or a New Beginning? - The 2012 Trilogy of Supreme Court Decisions on International Tax*, ASIA-PACIFIC TAX BULLETIN, May & Jun. 2013, at 193-194.

50) This discussion was prompted by the 2003 amendment to the Commentaries on the OECD Model Convention, which states that such rules as the substance-over-form principle "are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability [which] are not addressed in tax treaties and are therefore not affected by them."

See OECD, *Commentary on Article 1: Concerning the persons covered by the convention*, *in* MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 2010: FULL VERSION para. 22.1 (2012).

case with all those international tax cases in their mind. Indeed, since the taxpayers in those cases had filed petition to the SC long before the issuance of the *Rodamco* Judgment[51] and their issues were already widely known, it would be naïve to assume otherwise. In this sense, it could be argued that the Justices of the SC in this *Rodamco* case, reviewed and judged not only the *Rodamco* case itself, but the substance-over-form issue in general, which is in the kernel of the controversy in many other cases to be reviewed and judged in near future.

3) Reaction from the Legislature

Apart from issuing tax assessments on the investment profits that had already arisen, the government wanted to have a guarantee that no more controversy would arise in future cases as to whether such re-characterization would be legally acceptable at all. This resulted in the 2006 enactment of art. 2-2 of the Law for Coordination of International Tax Affairs ("LCITA"), which explicitly provided that the substance-over-form principle is also applicable to cross-border transactions. The first two paragraphs of this art. 2-2 are identical to those of art. 14 of the FANT, and since there is no reason to believe that this FANT is inapplicable to cross-border transactions, it could be said that those two paragraphs were merely redundant. However, the third paragraph of art. 2-2 was something new at that time, of which there was no equivalent in the FANT.[52] It is also worth mentioning that the wording of this third paragraph came largely from that in art. 4-2 of the IGTA, which was one of the two children of the doctrine of "comprehensive taxation." Given that this "comprehensive taxation" was intended to function as a sort of GAAR in the area of gift tax, it is submitted that this par. 3 should also be viewed as having a similar function in the area of international tax. It is obvious that this is at least what the government intended when they presented the draft law to the legislature, which in turn transformed the draft into the law without much discussion.

In sum, re-characterizing transactions based on their economic

51) For example, the *Lone Star* cases, the *LaSalle* case and the *WiniaMando* case, all of which were discussed in the article cited in footnote 49, and comprised the issue of the substance-over-form principle, were appealed in 2010.

52) Its equivalent, par. 3 of art. 14 was introduced no sooner than 2008.

substance was made generally possible with respect to cross-border transactions with the enactment of the third paragraph of art. 2-2 of the LCITA. This had been preceded by the introduction of the so-called doctrine of "comprehensive taxation" in the area of gift tax, but still came prior to art. 14, par. 3 of the FANT (as amended in 2008), which could also apply to the areas of taxation that had not been covered by either the IGTA or the LCITA. This also shows why and how the Korean tax system as a whole moved gradually towards a direction that puts more weight on fairness than legal certainty.

4) NTS Position Strengthened by Outside Influence – Seoul Declaration 2006

The NTS's enthusiasm in tackling the issue of tax avoidance has been in line with the general OECD position on tax avoidance during the 2000s. The OECD is known to have taken somewhat aggressive positions on the same issue, in particular those cross-border tax-avoiding schemes extensively used by many large-scale multinationals.[53)] The 2003 amendment to the Commentaries on the Model Convention,[54)] was one of these movements, which helped the NTS tax such foreign investment funds as Lone Star, Newbridge Capital, Rodamco, etc. in a conveniently timely manner. Indeed, one could imagine that, but for the theoretical support provided by the Commentaries, it would have been much harder for both the NTS and the SC to disregard the legal forms elaborately devised by those foreign investors against the firm tradition of the Legality Principle.

Another event that is worth mentioning in this respect is that the OECD's Forum of Tax Administrations held in March 2006 in Seoul. The Seoul Declaration was unanimously adopted at the end of the meeting.[55)] After recognizing that "some multinational enterprises (including financial institutions) have used more sophisticated cross-border schemes and/or investment structures involving the misuse of tax treaties … which go[es]

53) It may be said that the BEPS (Base Erosion and Profit Shifting) Action Plan announced by the OECD in July 2013 is the culmination of such continuous works. This Action Plan is *available at* http://www.oecd.org/ctp/BEPSActionPlan.pdf.

54) *See supra* note 50.

55) This Declaration is *available at* http://www.oecd.org/tax/administration/37415572.pdf.

beyond legitimate tax minimization arrangements[,]" and referring to "the increased flows of capital into private equity funds and the potential issues this may raise for revenue bodies[,]" the Declaration clearly stated that "[n]ational revenue bodies need to respond in diverse ways taking into account their legal, political and economic environment." For such "responses," the Declaration first of all suggested "[e]mploying effective risk management techniques at the organizational and operational levels and sharing [the tax authorities'] assessments of risk with taxpayers." Although this statement does not explicitly recommend adopting a GAAR or similar interpretative measures, there is no doubt they can play such a role as suggested in the Declaration.[56)]

It seems that the NTS had been more than interested in taking full advantage of this international event as an outside stimulus for their efforts in tackling tax avoidance and collecting more tax revenue. This is evidenced by the NTS officials' comments issued shortly before the meeting, one of which observed that this Forum was expected to help Korea to maintain its "tax sovereignty" in the area of international taxation.[57)] Another official earlier made some more direct comments that he was hoping that this meeting would contribute to enhancing Korean "taxing power" in international tax controversies.[58)] The then-incumbent President Roh, who, ironically, had been a well-known tax litigator before entering the political arena, also delivered a message which was announced during the opening ceremony, remarking that there were examples of tax avoidance which took unfair advantage of differences in tax systems of various jurisdictions, and in this regard, the meeting should contribute to enhancing effectiveness in tax administration.[59)]

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56) The United Kingdom is one country which is in process of newly introducing a GAAR into its tax system, and its tax authorities refer to GAAR as "one part of the Government's approach to managing the risk of tax avoidance." See http://www.hmrc.gov.uk/avoidance/gaar.htm.

57) *See Tax administration heads from more than 30 countries meet in Seoul under the auspices of the OECD's Forum on Tax Administration,* Yonhap News, Sept.13, 2006, http://news.naver.com/main/read.nhn?mode=LSD&mid=sec&sid1=101&oid=001&aid=0001410360.

58) *See The Forum on Tax Administration (FTA) - Tax Commissioners from 45 Countries - meets in Seoul on 14-15 Sept. 2006,* Maeil Business Newspaper, June 15, 2005, http://news.naver.com/main/read.nhn?mode=LSD&mid=sec&sid1=101&oid=009&aid=0000445101.

59) *See The 3rd meeting of the OECD Forum on Tax Administration in Seoul: a unique means of*

It is not hard to imagine that the NTS, already helped by the timely 2003 amendment to the OECD Commentaries to a considerable extent, needed some further support for them to be sure that they were acting in line with the global standards in this area. The NTS, as a governmental body which hosted the event, took initiatives in preparing the agenda of the meeting, and received what they needed, i.e. justification for greater aggressiveness towards sophisticated international investors including "private equity funds" to which a direct reference was made in the Declaration, and against which the NTS had been fiercely fighting. It should be noted that this trend still continues all over the world, and I believe that the *Rodamco* Judgment and the later SC judgments which dealt with the issue of treaty abuse should also be seen in light of this trend.

5) Problem of "Fair Share" in International Tax

International tax is a relatively new area of law, and this is also where interests of different countries conflict with each other. Legal principles that are stable and certain, and that can efficiently reconcile conflicting interests of the relevant countries are yet to come into existence in this field of tax law. The existing legal principles, although they are works of many insightful and experienced minds, are often expressed in terms broader and vaguer than those employed in domestic law. The rules and principles that have been clarified in more concrete terms in the OECD Commentaries, for example, are still in many cases more descriptions than definitions (or veritable legal tests).

Accordingly, the ultimate question often becomes "what is the fair share of our country,"[60] rather than "how to correctly apply the established legal principles." This aspect of international tax law certainly contributed to the

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co-operation between tax administrations at Commissioner-level, YONHAP NEWS, Sept. 14, 2006, http://news.naver.com/main/read.nhn?mode=LSD&mid=sec&sid1=101&oid=001&aid=0001410960.

60) The British Prime Minister David Cameron has been often quoted to use the "fair share" expression in this context. For instance, he is reported to have said that he will "make 'damn sure' that Starbucks and other foreign multinationals found to be legally avoiding paying corporation tax in Britain pay their fair share in the future." *See* Rupert Neate, *David Cameron: We'll ensure foreign firms pay their fair share of tax*, THE GUARDIAN, Jan. 4, 2013, http://www.theguardian.com/business/2013/jan/04/cameron-ensures-multinationals-pay-full-taxes.

NTS and the SC more easily embracing the hostile public opinion against the foreign investment funds which made huge profits (at the loss of the initial Korean asset-owners) on their short-term investments. It is interesting that the international trend of taking aggressive stance against tax avoidance might result in each country's claiming what it believes to be its "fair share" even if it might sometimes have difficulty in reconciling the desired end-result (i.e. "fair share") with established domestic or international legal principles. The *Rodamco* Judgment and the other SC judgments on international tax issues are arguably examples of such phenomenon, which resulted in a radical change of case law.

IV. Conclusion

To sum up, the *Rodamco* Judgment should be seen in line with development of all those facts and circumstances that this Article has so far referred to and discussed, amongst which this Article identified two incidents as most highly relevant, i.e. some *Chaebol* families' inter-generation, tax-free transfer of wealth and control over the relevant group companies, and certain international investment funds' earning of Korean-sourced income without incurring much Korean tax liabilities. These factors came to draw public attention in the 1990s and the 2000s, and led to Korean people's growing concern for the overall fairness of their tax system. People began to seriously consider that tax liabilities should not be avoided by some ingenious and elaborate schemes, and apparently became more indifferent to finding broader and vaguer wording in taxing statutes as long as they can serve the purpose of enhancing tax fairness.

It is clear that the tax authorities pursued this line of thinking throughout the 2000s, and the national lawmakers backed it up with their legislative power. The SC should be seen as having taken this series of events into account, and succumbed to the social and political pressure in making a sharp turn from its old precedents towards a new direction. The *Rodamco* Judgment was clearly the most important turning point, as many subsequent SC judgments, which struck down taxpayers' tax-minimizing schemes based on the substance-over-form principle, have already expressly cited it.

The question still remains as to whether the world after all became better-off by this change. Positively speaking, this is a good example of a democratic process, where ordinary people's belief or public opinion first influenced the practice of the tax authorities, and finally reached courts' case law. The presidential election of 2002 is a wonderful example, where people chose a candidate who specifically promised to introduce a new tax law, and indeed, made it happen after his victory at the election. Coincidentally, this new line of ideas was backed up by the new international trend, which undeniably helped the tax authorities and the SC to become more certain that they were doing the right thing.

However, there is still some voice, albeit few in number, against this seemingly impeccable position (i.e. how could one blame a legal theory that satisfies both international standards and domestic public opinion?). This minority position is still faithful to the essence of the Legality Principle, which is none other than legal certainty, taxpayer predictability and so on. Apart from the fact that this is a classic moment where the virtues of liberty and equality conflict with each other, this seems to pose interesting questions to lawyers. When majority of people believe that legal certainty can be sacrificed to enhance the overall fairness of the tax system, could it be said that it is still lawyers' responsibility to stand as the *happy few* and say "no" to the majority if he or she believes that legal certainty should be valued over fairness? Or, in spite of his or her personal belief, do lawyers have to interpret the law in a manner that ordinary people find it more persuasive? Although this is no place for such a discussion on methodology of legal interpretation, one should be aware that the issue is not so simple and requires much further and deeper consideration on fundamental issues of legal methodology from both legal academics and practitioners. In this respect, even after the *Rodamco* Judgment, the issue of tax avoidance is still a live one in Korea, on which one will certainly hear a lot more in near future.